Calculation of majorities for acceptance of compositions with creditors after Spanish Royal Decree-Act[1] 11/2014

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1. RDA (RDL, its Spanish acronym) 11/2014, of 5 September, on urgent measures in insolvency matters, amends, inter alia, the rules on majorities required for the acceptance of settlement proposals.

The new rules can be found in art. 124(1) of the Spanish Insolvency Act (*Ley Concursal*), which now reads as follows:

1. *In order for a proposed composition to be deemed accepted by the meeting of shareholders, the following majorities are required:*

   a) *If creditors whose claims amount to at least 50 per cent of the unsecured liabilities have voted for such composition, they shall be subject to haircuts (forgiveness/write-offs) equal to or less than half the value of the claims; to deferrals in the payment of principal, interest or any other outstanding amount, for a period not exceeding five years; or, in the case of creditors other than those related to the public administration or employment matters, to the conversion of debt into profit sharing loans over the same period.*

   Notwithstanding the above, a vote for by creditors representing a portion of the unsecured liabilities that is greater than the vote against will suffice when the proposal consists of (i) full payment of unsecured claims within a period not exceeding three years or (ii) immediate repayment of outstanding unsecured claims applying a haircut of less than twenty per cent. To that effect, in the case of a proposal for an early composition whose agreement is sought by a written procedure, creditors must, where appropriate, express their vote against subject to the same requirements as those applicable to assents under art. 103 and within the time limits, as appropriate, provided in arts. 108 and 115 bis.

   b) *If the creditors whose claims amount to 65 per cent of the unsecured liabilities vote for the same, they shall be subject to deferrals of more than five years, but in no case more than ten; to haircuts in excess of half of the value of claims; and, in the case of creditors other than those related to the public administration or employment matters, to the conversion of debt into profit sharing loans over the same period and subject to remaining measures provided in art. 100.*

2. This legislative amendment can be linked to the relaxation effected in the content of compositions. In this regard, the overall limit on haircuts (which under the previous legal regime

[1] Translator's note: A "Real Decreto-ley" is primary executive legislation subject to subsequent legislative approval.

could not exceed half the value of unsecured claims) and deferrals (which could not exceed five years from conclusiveness of the court ruling approving the composition) has been removed from art. 100 IA. However, to overcome these limits (i.e., to accept compositions involving deferrals in excess of five years – but never in excess of ten – and/or haircuts in excess of half of the value of claims) it will now be necessary that creditors representing at least 65 per cent of the unsecured liabilities vote for the proposal. This enhanced majority (supermajority) will be necessary for acceptance of a proposal providing for the conversion of debt into profit sharing loans over this period greater than five years, debt for equity swaps, convertible bonds or, in general, remaining measures provided in art. 100 IA (which shall only be possible in respect of non-public administration/ employment claims).

In remaining cases (haircuts and "moderate" deferrals and conversion of debt into profit sharing loans for a period under five years) the support of creditors whose claims amount to 50 % of the unsecured liabilities shall suffice to consider the proposed composition accepted (although this percentage does not allow the conversion into profit sharing loans to be imposed on public administration or employment creditors). Excluded, as before, proposals consisting of (i) full payment of unsecured claims within a period not exceeding three years or (ii) immediate repayment of outstanding unsecured claims applying a haircut of less than twenty per cent, where a vote for by creditors representing a portion of the unsecured liabilities that is greater than the vote against will suffice.

3. The new wording of art. 124(1) IA seems destined to raise some uncertainties from the point of view of its "*management*", that is, how it is to be applied to determine whether a given proposal has been accepted or not. In this paper we will focus on problems in connection with counting the vote of preferential creditors[2] (4, *infra*), proposals that have an alternative content (5, *infra*) or include a unique treatment (6, *infra*) and the binding of preferential creditors (7, *infra*).

4. First off, the rule which provided that, for the purposes of calculating majorities, preferential creditors voting for the proposal should be considered included in the unsecured claims against the asset pool, has been removed from art. 124(1) IA.

It is unclear to what extent the abolition of this rule is a conscious decision or the result of a misunderstanding of the scope of the reform. Indeed, it appears that, by introducing the possibility that the agreement extends to preferential creditors without their individual consent (art. 134(3) LC), the draftsman of RDA 11/2014 has understood that keeping such rule was no longer necessary. In other words, it seems that as specific calculations should be made to determine whether the preferential creditors - from each class - are subject to the composition, it was thought that consideration of their votes with regards to the acceptance of the proposed composition is no longer appropriate. However, these are two very different issues. The possible extension of the composition to dissenting preferential creditors (which requires making a count of votes per class) is totally unrelated to the possible contribution to the acceptance of the same by the votes of preferential creditors who have decided to vote in favour.

Be it as it may, the removal of a rule that, for the purposes of calculating majorities, explicitly considered secured claims, whose holders have voted for an accepted proposal, included in the unsecured liabilities, leads one to conclude that such consideration is no longer possible (regardless of the assessment such outcome may deserve). Thus, holders of secured claims voting for the composition will be individually bound by its content (art. 134(2) IA), but will not be taken into account in determining if the 50 (or, as the case may be, 65) per cent of the unsecured liabilities has been reached. Admitting this interpretation, the rule is obviously not conducive to reaching solutions on insolvency.

5. The new art. 124(1) IA also casts some doubts regarding the handling of proposals with alternative content.

[2] Translator's note: Preferential creditors ("acreedores privilegiados") comprises not only first-priority secured creditors("acreedores con privilegio especial"), but also a defined set of unsecured creditors ("acreedores con privilegio general")ranking senior to ordinary unsecured creditors ("acreedores ordinarios").

5.1. In particular, questions arise in relation to debt for equity swap offers. The interpretation usually given to art. 100(2) IA (before RDA 11/2014 was published) had led to the conclusion that these capitalization transactions could only be included in the composition as part of an alternative proposal, so that the creditors affected by the composition could always opt for a different solution (capitalization could not be imposed, therefore, on those who chose any of the alternative proposals on offer). Thus, the majority view was that the conversion of debt into equity or profit sharing loans could not form part of the content of a single proposal or of all those alternatively offered (Order of the *Audiencia Provincial* of Madrid (Twenty-eighth Chamber) of 12 March 2010).

Should something change in this construction of the legal system in the light of RDL 11/2014? The very debatable question arises because the wording used for art. 124(1)(b) IA could lead one to think that, with the support of creditors who claims amount to 65 per cent of the unsecured liabilities it would be possible to impose on all ordinary and subordinated creditors a debt for equity swap. Indeed: pt. [b] of art. 124(1) IA provides that when the composition has certain content (including debt for equity swaps) it must be accepted by a majority of creditors whose claims amount to 65 per cent of the unsecured liabilities. And requiring this enhanced majority only seems to make sense to the extent that particularly "burdensome" measures (in relative terms, when the measures are "minor", the support of creditors whose claims amount to 50% of such liabilities shall suffice) will also be imposed on ordinary and subordinated creditors. On these lines, it could also be argued that, precisely because it is assumed that such imposition is possible, public administration or employment creditors are excluded from this extension (if the swap were always an alternative - always requiring the creditor's consent - there would be no need to except certain types of claims).

Other considerations would come into play in the opposite direction: for example, one might consider that the possibility of converting the creditor into a shareholder without his consent must be derived from a strict legal provision (recall in this regard the strength of art. 1166 of the Spanish Civil Code) which is missing in this case because the changes in the wording of art. 100(2) IA are inconclusive (and because art. 134(1) IA remains unaltered). Similarly, note that in court-approved (sanctioned) refinancing agreements, a debt for equity swap is not imposed on the creditor, who is rather is given the right to opt for a haircut (additional provision 4 IA).

In view of the legislative papers, and in the absence of practical experience and established judicial criteria, absolute assurance cannot be given at this time regarding the interpretation that will ultimately prevail in this matter.

5.2. All the same, some comments should be made on how to calculate majorities in the event of alternative proposals (regardless of their content).

We must start from the premise that the acceptance of a composition with alternative proposals constitutes acceptance of the composition as a whole, so that it will be the bound creditors who will have the right to opt for one or the other (i.e., voting is not carried out to choose between one or other alternative on offer, but to accept a composition in which creditors may choose between them: Judgment of the Supreme Court of 25 October 2011). Now, in these conditions, and assuming that the alternative is offered to *all* creditors, one could venture a guess that if one of the alternative proposals includes a haircut or deferral under art. 124(1)(a) IA, the majorities designated in that sub-article will suffice for acceptance of the composition. Note that in this case the creditors could always opt for this less "burdensome" alternative which could be imposed without alternative by the creditors whose claims amount to 50 per cent of the unsecured liabilities (or by simple majority vote, as appropriate); thus, in this case it makes no sense to require 65 per cent. However, if this

alternative is not offered to all creditors, but only to some of them, then it will be necessary to reach 65 per cent of the unsecured liabilities. The same will happen obviously if all alternatives offered have as content the measures provided in art. 124(1)(b) IA.

6. RDA 11/2014 has not altered art. 125 IA, which contains special rules applicable where the proposed composition confers a unique treatment to certain creditors. Therefore, if this were the case, as well as the appropriate majority in accordance with art. 124(1) IA (simple majority, absolute majority or enhanced majority of the unsecured liabilities), the affirmative vote (in the same proportions) of the liabilities not affected by the unique treatment will be necessary.

Here it must be noted that amongst the liabilities unaffected by the unique treatment we must include (as before) preferential creditors who voted for the proposal and also, now, those who have not voted for the same but have eventually become subject to the composition under art. 134(3) IA.

7. One of the most remarkable changes introduced by RDA 11/2014 (reflected positively in the new art. 134(3) IA) is the provision that preferential creditors who have not voted for the finally accepted proposal can be bound by the composition.

To that effect, preferential creditors are classified into four classes (employment, public administration, financial and "other"). Hence, in those classes in which certain percentages of support for the proposal are reached (60 or 75 per cent, depending on whether the content of the accepted composition is covered by pt. (a) or (b) of art. 124(1) IA, respectively), all creditors (also dissenting creditors or simply those who have not expressed an opinion) shall be subject to the composition. This means that up to 8 different calculations may have to be made in relation to preferential creditors (because each class actually comprises two "sub-classes", depending on whether the preference is unsecured [general] or secured [special]).

The fact that necessary majorities were not met within the classes that have been formed to "drag" preferential claims into the composition, does not prevent preferential creditors who voted in favour to be subject to the same. No vote would be permissible subject to the condition that the composition should extend to the other creditors of the class (expressly for assents, arts. 103(2) and 115 bis IA).

Otherwise, in connection with the above, note that in the event of survival of syndication agreements, all liabilities represented by the syndicate will be deemed to have voted for the composition if 75 per cent of the same does so (art. 121(4) IA). The point is that if the syndicate claim or loan is preferential (or to the extent that it is), the strict application of the rule assumes that - regardless of reaching the necessary percentages to extend the composition to all creditors of the appropriate class - syndicate creditors dissenting with the syndicate's decision will be bound by the composition as they are deemed to have voted for it (provided the composition is finally accepted).