Debt capitalisation in court-approved refinancing agreements and in the composition with creditors: the availability of cramdown

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1. Debt capitalisation in court-approved refinancing agreements

The 4th additional provision (4th a.p.) of the Spanish Insolvency Act (IA) provides that certain effects under a court-sanctioned refinancing agreement may extend to financial creditors that either have not signed the agreement or have expressed disagreement with it (dissenting creditors). This applies, for instance, to agreed debt forgiveness and payment deferrals, the conversion of debt into profit sharing loans, the transfer of property or rights to creditors in payment of all or part of the debt...

Debt for equity swaps are also envisaged by said 4th a.p. as possible content of refinancing agreements. However, unlike what happens with the other measures envisaged by the IA, strictly speaking they cannot be said to have an effect that can be "extended" regardless of consent to dissenting financial creditors (cramdown effect). Indeed, the IA clarifies that this type of creditors that have not signed the refinancing agreement or have expressed disagreement with the same may "*choose between a debt for equity swap or a forgiveness of debt equal to the sum of the nominal value of shares that they would subscribe to or take up and, where appropriate, of the share premium.*" To which is added that debt forgiveness will be deemed chosen in the absence of explicit indication from the creditor.

It is worth drawing attention to the fact that a similar alternative is not provided in the event of the court-approved refinancing agreement setting out measures such as the conversion of debt into profit sharing loans. Nor when the conversion is into convertible bonds (and this is striking because it can mean a "deferred increase" of share capital when the conversion is set, under the terms of the issue, as a power of the issuing company or as necessarily linked to the fulfilment of certain objective conditions). And finally, it should be noted that the IA does not grant dissenting financial creditors the possibility of choosing another measure if the court-approved refinancing agreement provides for the transfer of property or rights to creditors as payment of debt.

Leaving aside the fact that the haircut (debt forgiveness) may be of such magnitude that, in practical terms, it does not give the creditor room for any reasonable alternative (unless such creditor has strong personal guarantees), the truth is that the legislator has chosen not to impose the conversion of a creditor into a shareholder without said creditor's consent. So much so that silence shall not be construed as consent to the conversion, but rather as denial of the same and, consequently, as opting for debt forgiveness.

Note that if the court-approved refinancing agreement is backed by creditors whose claims amount to less than 75% of the financial liability (but always more than 51%), the debt for equity swap shall not affect dissenting financial creditors. Therefore, in order for the creditor to be in the position of having to make such a choice where not signing the agreement or expressing disagreement with the same, the agreement must be backed by the former percentage.

2. Debt capitalisation in the composition with creditors

The amendment made to the composition with creditors' regime by RDA (*Real Decreto-ley*) 11/2014 envisages debt for equity swaps as possible content of the composition with creditors (already the case in the IA since its initial version).

Unfortunately, the truth is that the extent of the changes made to the composition with creditors' regime is unclear, especially, as to what matters here, in respect of the conditions under which the different measures that may be included in a proposed composition can be crammed down on dissenting creditors.

So it is still possible nowadays to hold the view, as was held by most before the last amendment, that debt-equity swaps may 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). Hence – it was said – capitalisation could not be imposed on creditors opting for any alternative proposals offered. This was also backed, among other things, by art. 100 IA maintaining the same structure as before RDA 11/2014, by art. 134(1) IA not changing and by the possibility of converting the creditor into a shareholder regardless of consent having to be derived from a strict legal provision (recall in this respect the power of art. 1166 of the Spanish Civil Code) which in this case would not exist.

But it is also perfectly possible to argue, in light of the new discipline and philosophy that seems to inspire it, as well as – on the positive side – in light of the new wording of art. 124 IA, that debt for equity swaps may be crammed down on 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 to require the creditor's consent, there would be no need to except certain types of claims).

Based solely on legislative papers, one is at pains to offer a fully convincing answer. It is thus likely that the debate on this issue will not be put to rest until a there is a new legislative amendment or a clear line of interpretation is established in the court rooms. For now, we may note the following:

(i) Let us assume, as a first hypothesis, that the capitalisation of debt can only form part of alternative composition proposals and, therefore, the creditors affected by such have the possibility to opt for other measures not involving a conversion into shareholders (a haircut, a deferral or both). In this case, the situation would bear some resemblance to that just outlined in relation to court-approved refinancing agreements to the extent that, in the absence of consent, the creditor will not become a shareholder (for instance, disregarding the differences that are not of essence, the composition always affects ordinary and subordinated unsecured creditors, whether or not financial – although the conversion shall not extend to public administration and employment creditors; the alternative option must be the subject matter of a proposal of this nature and not necessarily a haircut with a predetermined scope...).

(ii) Conversely, let us start now from the premise that after RDA 11/2014, it is possible – with a supermajority of creditors whose claims amount to 65% of unsecured liabilities – to impose on ordinary and subordinated creditors bound by the composition – with the exception of public administration and employment creditors – the conversion of their claims into shares (regardless of consent, therefore). In addition, assuming the conditions of the new art. 134(3) IA are met, it follows that such measure could be crammed down on preferential creditors (within each class). If this turns out to be the correct interpretation, the difference with court-approved refinancing agreements will be significant.