IBERIAN LAWYER

Restructuring and Insolvency Report 2011: Unlocking business finance

MONDAY, 14 NOVEMBER 2011 09:10

Locked bank vaults and a lack of access to working capital is the biggest threat facing Iberian businesses, say Spanish and Portuguese restructuring and insolvency lawyers. Liquidity, or the lack of it in the real economy is a growing concern and driving many otherwise viable companies towards insolvency proceedings.

La falta de liquidez es la principal preocupación de las empresas en España y Portugal, y está llevando a muchas de ellas a situaciones de concurso. Cada vez es más difícil llegar a acuerdos de financiación y refinanciación debido a las inquietudes de los bancos sobre la suficiencia de capital. Para los abogados, las herramientas legales son adecuadas para situaciones de insolvencia pero, a pesar de las reformas, hay que hacer un esfuerzo para fomentar los convenios preconcursales y la protección para los nuevos inversores.

"The banks are simply too worried about their own financial situations to free up funds for financing. Increasingly we see companies with otherwise strong order books face the prospect of insolvency simply because there is no way to raise new finance," says Antonio Fernández, Head of Restructuring & Insolvency at Garrigues in Spain.

Spain's financial sector has seen a wave of restructurings and mergers, notably among its savings banks (cajas), as they have sought to recover from the real estate crash in 2008, which left many with large liabilities, and to strengthen their own capital structures.

In Portugal the issue is perhaps even more acute. The €78bn financial assistance package agreed with the European Union (EU), European Central Bank (ECB) and International Monetary Fund (IMF) includes a provision for €12bn to help capitalise the country's banks, but this is a fraction of what is needed across the finance sector as a whole, say lawyers there.

"The banks are extremely limited in their ability to raise new finance, they face stricter capital adequacy requirements and closer outside scrutiny of their books. This is inevitably reflected in the way they are managing their loan portfolios, with a clear lack of appetite for any form of new risk or leveraged financing," says Frederico Gonçalves Pereira, Head of Restructuring and Insolvency at Vieira de Almeida (VdA) in Lisbon.

The Portuguese and Spanish business markets are ultimately hostage to two different but inter-connected factors, say some: the economic uncertainty that surrounds Europe, and particularly the sovereign debt of the eurozone countries, and second, the pains associated with de-leveraging their debt-burdened economies.

No change

Three years into the crisis in Spain, and few are of the opinion that the issues presented today are significantly different to those experienced previously.

"The initial reaction by the banks to the crisis was, don't worry, we'll refinance, which they did based on business plans that predicted an upturn in economic activity. Now however, many of

these loans are up for renewal and there has been no economic growth," says Sharon Izaguirre, Partner with Deloitte Abogados.
Some suggest however, that the persistence of the situation is though forcing banks to be flexible once again. "Due to the fact that the vast majority of insolvency proceedings end up with liquidation – over 90 percent of those judicially declared insolvent in 2010 – many are becoming more open to discussing restructuring deals than in preceding years," says Alvaro Gasull Tort, a restructuring and insolvency Partner with Roca Junyent in Barcelona.
There is however expectation that new areas of the economy are beginning to suffer, notably retail and export.
"At the national level, there is also no hope that one of the major debtors – the public administration – will improve its payment practice and comply with the payment deadlines set out in the recently amended Law on late payments (30 days from the certificate of performance)," notes Michael Fries, Partner with Monereo Meyer Marinel-lo Abogados.
A new wave of insolvencies will likely therefore begin to emerge, believes Roca Junyent Partner Joan Albert Salas Roig. "Some of the agreements signed in 2009 and 2010 to restructure and finance existing debts have not been honoured, bringing the affected companies again to insolvency."
Jose Luis Vázquez, Partner at Hogan Lovells agrees: "Most of the debt restructuring work completed early in the downturn assumed a two year crisis and a progressive reactivation of the economy and the financial markets."

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Extend and pray no more

Others say that a significant turnaround has been the ending of banks' early willingness to "extend and pray" as regards refinancing businesses. Financial institutions are more than ever concerned about recording losses on their own accounts and are no longer throwing good money after bad.
Some state therefore that those companies that have already refinanced, and restructured, may have enjoyed the best of the bad times. "Those industrial and real estate groups that did manage to reach significant deals with the creditors over the past 12-24 months are undoubtedly in a more secure position, at least in the medium term," says Iñaki Gabilondo, Managing Partner of Freshfields in Madrid. "Among many of the major banks, there is increasingly little appetite to follow through with second or even third rounds of refinancing for non-premium businesses."
If the banks aren't lending then where will the new money come from, question others "We sense that there is growing interest in distressed debt opportunities – the proposed changes to Spanish insolvency law, may even encourage it – and that there are more international funds with an interest in the market. But the prices are still not yet right for most buyers," says Jesús Almoguera, Partner at Ashurst in Madrid.
Likewise, the trend of debt-for-equity swaps has also now stopped. "Most banks do not wish, or simply cannot afford to take on any more assets. They are instead looking to clean their balance sheets and that means looking to dispose of large portfolios," says Iñigo Villoria, a litigation and insolvency Partner with Clifford Chance in Madrid.
The refinancing challenges in Portugal are comparable but the options fewer, say lawyers there. "There is still a high degree of business uncertainty and the main issue being presented by clients is concern with costs and risks reduction. We have though seen a general increase in insolvencies rather than restructurings," says Jose Carlos Soares Machado, Partner with SRS Advogados in Lisbon.
"The banks are delaying a response to clients' credit applications but this is in hope of being able to respond positively in due course, rather than having to reject inmediately which is what they would have to otherwise," says Alexandra Almeida Mota of F. Castelo Branco & Associados.
Proceedings are also now much more complex, say others. "Instead of dealing with a single bank that would assume leadership of a restructuring plan, we have to deal with all the banks involved and each one has its own position thus pushing the duration of each operation

forward," says Jose Carvalhosa, Partner with Raposo Bernardo in Lisbon.
But matters in Portugal are being compounded also by a shrinking finance sector, say some. "The domestic Portuguese banks are facing tremendous issues. There is no interbank lending and there are recurring concerns around their ability to continue to borrow money from the ECB, even with the support of the troika," says Pedro Siza Vieira, Managing Partner of Linklaters in Lisbon.
Companies have therefore to now find new and alternative solutions to their refinancing needs. "The challenge remains that many businesses cannot restructure outside of a formal insolvency process, that private equity funds cannot exit their investments, and the banks themselves need to recapitalise or to merge," says Miguel Pena Machete, Partner with Serra Lopes Cortes Martins in Lisbon.

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Legal toolkits

When it comes to the tools lawyers have to help turnaround or rescue businesses in financial difficulty, there remains a mixed perspective. Among the Iberian business community a very negative perception of insolvency remains, the belief persists that this is still very much a terminal option.
"Letting businesses fail clearly impacts on the ability of the economy to recover, while the inability to find out of court solutions to financial restructuring will lead more companies to insolvency. It is a downward spiral," says Siza Vieira of Linklaters in Lisbon.
Likewise many say that a degree of inflexibility does still remain among many, and in refinancing negotiations there is always the danger of a creditor filing for insolvency in order to protect their own position relative to others, say lawyers
"There is often no collective sense or will to turn companies around. The danger of one creditor filing for insolvency is always there and a major challenge we have is trying to manage expectations. For many businesses, however, arguably among the most inflexible parties they have to deal with are the state's own tax and social security authorities," says Nuno Líbano Monteiro, Head of Litigation and Restructuring at PLMJ.
More emphasis and legal weight needs therefore to be placed on out of court restructuring arrangements, say lawyers. In neither the Spanish or Portuguese insolvency legislation, is there any standstill mechanism similar to the US Chapter 11 procedure in which an insolvent company may gain protection from its creditors in order to agree a new financing structure.
"In Portugal it is very difficult to impose a scheme on creditors and even more so outside of the courts. But without the ability to restructure companies' debt, and to protect new money required to turn a company around, the most likely outcome is liquidation," says Gonçalves Pereira at VdA.

Caught in the middle

On both sides of the border a recurring issue is also the actual implementation of insolvency laws and the ability of the Commercial Courts to manage the overwhelming workload they now face, say lawyers.
"Portuguese courts are very slow and insolvency proceedings can be very adversely affected especially when restructuring is still a possibility," says Francisco Patricio, Partner of Abreu Advogados.
The courts in the main commercial centres are jammed, say some. "Portugal's bankruptcy legislation was designed to manage individual company insolvencies and not for the type of systemic failure we are now seeing," says Francisco Proença de Carvalho of Uría Menéndez - Proença de Carvalho in Lisbon.
There are even now instances in which companies have re-registered their domicile in order to subject their proposed insolvency to the jurisdiction of a different – less busy – court. "In Lisbon and Portugal in general the judges simply have too many cases. To this extent we are now seeing a degree of forum shopping in insolvency cases, in order to try and make proceedings move more quickly," says Filipa Cotta, an insolvency lawyer at PLMJ.
In Spain too, the Madrid and Barcelona Commercial Courts are overwhelmed, say lawyers. One

consequence of which is the excessive time it takes even to ascertain the extent of a company's liabilities. "Our advise is in fact to use this time to talk with the banks, creditors and employees," says Pablo Albert of BDO Abogados.
The issue is also related to Receivers' ability to manage proceedings in a competent way, say others. The quality of Court appointed Administrators is also an issue raised in Portugal. The size of the market and the revenues generated are not enough to attract the best players.
"In Portugal, the Administrator is not the owner of the process, and it would require a significant shift in mentality for this to become the case," says Helena Soares de Moura, a Restructuring and Insolvency specialist at Morais Leitão in Lisbon. "What we often drastically require is an increase in the professionalism of many of those involved in the liquidation and restructuring (insolvency) process. We often see a drastic difference between international and domestic insolvency cases."

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Nuno Líbano Monteiro, PLMJ

Reform

In response to the questions that surround the efficiency of Receivers, as well as other concerns, a reform of Spain's Insolvency Law was launched in December 2010. The proposed amendments are now before the Spanish Parliament.
"The new law opens up the possibility of reaching new forms of financing arrangements with creditors both in and outside of the court, and potentially of bringing in fresh money. There is also, for the first time, the creation of a Spanish style Scheme of Arrangement," notes Almoguera at Ashurst.
But gaps will still remain in the new Law's practical application, say some. There are many small, useful, changes but most are procedural. There is no big change of thinking as regards utilising the insolvency process to 'turnaround' businesses," says Gabilondo.
The current regime has clearly proved insufficient for the needs of some – UK Schemes of Arrangement have been utilised by companies such as La Seda and Metrovacesa – and the proposed reform is still far from the pre-insolvency mechanisms found in the UK, France or Italy, adds Francisco Málaga, Head of Disputes at Linklaters in Madrid.
"On the other hand, this should be just the first step in the introduction of a richer pre-insolvency regime that can help companies avoid the burden of insolvency proceedings in cases were the main problem lies in an inadequate financing structure rather than in commercial problems," he suggests.
Others take the view that the amendments were never intended to introduce wholesale change, but instead to focus on the most important weaknesses within the current legislation. "Perfection does not exist. The recurring issue for those entering insolvency is the speed of the process – in order to be useful it has to help preserve the value of the company, and this means that they must exit proceedings as quickly as possible," says Ángel Alonso Hernández, Partner with Uría Menéndez in Madrid.
Nonetheless the implementation date of the new law is not yet set, note lawyers. "It has been rumoured that it will be passed by the time the elections take place, in November, but this still needs to be confirmed," says Fernando Quicios, Partner with Pérez-Llorca in Madrid.
Portugal too is seeing amendments to its insolvency and restructuring regulation, note lawyes. Under the terms of its bailout package, new general principles on voluntary out of court restructuring have been issued, likewise intended to make restructuring a more viable option for businesses.
"The Portuguese insolvency procedure remains bureaucratic and inefficient. We need swifter courts and better prepared judges, with a pragmatic view of insolvency/economic issues, and transparent rules, as found in the US' Chapter 11 rules," says Tiago Caiado Guerreiro, Partner of Lisbon's Franco Caiado Guerreiro & Associados.
Lawyers in both Spain and Portugal continue to believe however, that despite the continued lack of flexibility in pre-insolvency situations, that the legislation as it stands provides them with good tools.
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to handle the dissolution of a bankrupt company", say PLMJ Partner Monteiro.
Nonetheless, changes are proposed to provide new guarantees for certain funds over unsecured creditors, as well as to make restructuring a faster and more effective procedure, including through fast track court approval procedures for restructuring plans.

Changing mindsets

The sentiment remains therefore, that both Spain and Portugal will see a continuing flow of insolvencies over the coming year, and that while this is particularly acute among small and medium-sized businesses, the lack of market liquidity is also now affecting larger companies.
"In markets like Spain and Portugal where the vast majority of the economy is driven by small and medium-sized businesses, the ability of the banks to lend is crucial," says Fernández at Garrigues. "There is though a need for greater flexibility in the insolvency laws and for more dedicated expertise, but we also need to change the mindset of many of those in the best position to help, notably within the banks."
Legislation can only ever be guidance in this respect, say some. "We should not talk about a finished reform but another step (giant in my opinion) towards its improvement," says Santiago Hurtado Iglesias, who helped oversee the development of the reforms whilst with the Ministry of Justice, and now Head of Insolvency at Broseta in Madrid. "The proximity of the bankruptcy law to the real economy demands ongoing changes to ensure it is up-to-date."
Important issues do indeed still need to be addressed, note some. "One big problem is that there are not enough guarantees for post-insolvency financial help, and this will continue to impede new money coming into bankrupt companies," says Javier Díaz-Gálvez, Partner with DLA Piper in Madrid.
The hope in Spain is that the new law will make both refinancing and insolvency more efficient and reduce the number of businesses that need to be wound down. Likewise the proposed reforms in Portugal promote more pre-insolvency mechanisms.
"The new law acknowledges the importance of helping to reduce the burden of proceedings, delay can certainly damage the value of a business, which to date has been by far and away the most usual outcome," says Alonso Hernández with Uría Menéndez.
There appears therefore to be no let up to the boom in restructuring and insolvencies lawyers have been experiencing.
"Taking into consideration the uncertainties still affecting the Spanish and global economies as a whole, we still see a significant stream of work," says Rafael Molina, Partner with Linklaters in Madrid.
Yet no matter how busy are firms' departments, the desire remains for a more healthy economy, and that means prising open the money vaults.
"As the economy hopefully recovers, work will obviously decrease but I don't see this causing any problems for law firms. Restructuring and insolvency work is inter-disciplinary and it will be easy to reallocate the lawyers involved to other departments, especially if there is an upturn in corporate work," says José María Álvarez, Partner with Gómez-Acebo & Pombo in Madrid.