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Take-over lender-led non-consensual restructuring plan

Case note – Commentary on the judgment of September 4, 2023, by the Commercial Court No. 2 of Barcelona (Celsa Case)

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Abstract

Court approval of a lender-led non-consensual restructuring plan filed by financial creditors without the debtor's support and challenged by all the shareholders. The plan allows creditors to take control of the equity post-restructuring and to wipe out pre-existing shareholders. The Court found that the necessary requirements were met due to the existence of imminent insolvency and the shareholders being "out of the money". This is a landmark case in Spain regarding the new fairness test, based on an agreement between the affected classes or, in its absence, on the enterprise value and its distribution amongst the insolvency ranks following the absolute priority rule.

Keywords: Directive (EU) 2019/1023, restructuring plan, cramdown, transposition, imminent insolvency, legal standing, accordion operation, Spain

1. The Directive (EU) 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt, was transposed in Spain through Law 16/2022 of September 5, which came into force on September 26, 2022. On the same day, a request for the appointment of a restructuring expert was submitted, initiating a complex procedure (known as the "Celsa Case").

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2. Celsa Group was founded in 1967 by the Rubiralta family and in the last decades the group was consolidating its position in the sector until it became a leading company in the steel sector at a European level. In 2019, the Group's annual revenue amounted to 2.5 billion euros. However, the Covid-19 pandemic caused its income to decrease considerably, being reduced by 514 million euros in 2020.

   As a consequence of the above, in 2020 the Group proposed a debt restructuring to its creditors, which was not successful to the extent that the Rubiralta family refused to transfer shares to creditors, at the same time that it demanded a high write-off arguing that the majority of creditors had acquired the bank's debt at a high discount. In 2021, the group requested pre-bankruptcy ("*comunicación de apertura de negociaciones con acreedores*[2]") to obtain temporary legal protection and continued negotiations with creditors. However, no agreement was reached either.

   Finally in 2022, having negotiation attempts failed, a group of creditors led by Deutsche Bank and among which were investment firms such as Cross Ocean, Sculptor, Trinity, and Golden Tree filed for their own restructuring plan ("*plan de reestructuración*") for Celsa Group, taking advantage of the inclusion of this new tool in Spain[3].

3. The Celsa case culminated in the judgment of September 4, 2023[4], which approved an unprecedented non-consensual restructuring plan ("*plan de reestructuración no consensual*").

   That plan, presented by creditors with the support of a majority of classes against the strong opposition of the shareholders (Rubiralta family) and the debtor's board of directors, allowed the creditors to access the equity and expel the pre-existing shareholders through an accordion operation (capital reduction to offset losses and simultaneous capital increase via debt capitalization), thus taking full control of the holding company of the group.

4. During the preliminary analyses before the entry into force of the regulation, this legal possibility had been considered improbable and residual by certain operators. Nonetheless, it did materialize: through a restructuring plan, creditors can take control of the company against the will of the company's management body or its shareholders.

2 Vid. articles 585 et seq. of the Spanish Insolvency Law ("TRLC")

3 Vid. articles 614 et seq. TRLC.

4 The decision can be consulted at the following link: https://www.poderjudicial.es/search/AN/openDocument/b5a5f17002b683d4a0a8778d75e36f0d/20230912

The realization of this possibility of forced eviction of the equity has aligned the legal conception of private property in Spain with the prevailing international conception of capital structure in the world of corporate finance. The Celsa Case is already seen as a warning that has, in turn, highlighted the advantages and opportunities of restructuring plans that, although perfectly foreseeable, had until then gone unnoticed by many operators. We will later analyze some of them, although it should be noted that the path has not been easy, as evidenced by the duration of the procedure, the numerous intermediate resolutions, and an unusually extensive final judgment.

5. It is not the purpose of this article to conduct an exhaustive legal analysis of the judgment of September 4, 2023, which approves the non-consensual restructuring plan presented by the creditors, although we would like to highlight various aspects of it.
   The regulation requires the fulfilment of certain requirements, including: (i) that the debtor is in a situation of insolvency according to a cash-flow test, whether such insolvency is current or imminent (i.e., that debtor foresees that it cannot meet its due obligations in the next three months); and (ii) that the shareholders are out-of-the-money (the absence of this element being a reason for challenging or opposing the plan due to the non-compliance with the corollary of the absolute priority rule, and not strictly as a requirement for approval). Additionally, creditors must be able to put together a restructuring plan proposal, although in many cases their access to relevant information is limited, and they may therefore require judicial assistance.

6. Spanish insolvency law only allows creditors to present a restructuring plan that affects the equity and has not been approved by the shareholders' meeting if the debtor is in a situation of actual or imminent insolvency and shareholders are out-of-the-money[5]. As can be easily understood, the knowledge and evidence of these two requirements will sometimes be difficult for creditors (outsiders) to obtain; even for financial creditors who have information covenants in their favor (especially when the debtor has already incurred in other breaches). This limitation will, in most cases, be a strong disincentive for creditors to present their own plan if they do not have the support of the debtor and its shareholders, and it could de facto empty their formal legal standing.

5 Vid. articles 631.4 and 640.2 TRLC.

However, to circumvent this limitation and avoid such emptying, in the present case, the judge, the Hon. Álvaro Lobato, opened a disclosure procedure where he required the debtor to provide all the necessary financial documentation to analyze the mentioned requirement and know the debtor's real situation. This disclosure was not expressly provided for in the insolvency regulation, although the judge applied general procedural legislation supplementarily. As expected, the analysis of the provided documentation and the concurrence of the insolvency situation was the subject of extensive expert evidence by all parties, reaching conclusions very far apart, which forced the judge to make a deep technical assessment of each of the presented expert reports.

7. The transposed regulation on restructuring plans expressly excludes the pre-emptive right of shareholders in case the plan provides for an accordion operation of the debtor in a situation of imminent insolvency. Therefore, pre-existing shareholders are excluded from the new shareholding if they are out of money and the enterprise value breaks in a creditors' class without reaching the pre-existing shareholders. In this case, the latter are disenfranchised and not allocated new shares.
 This was precisely the assumption of the creditors in their plan to justify the exclusion of pre-restructuring shareholders from the new shareholding, supporting it with elaborate expert reports on the debtor´s enterprise value. These reports were, in turn, subject to counter-reports by the shareholders. The enterprise value according to creditors was 2.4 billion euros and 6.6 billion euros according to the shareholders.
 The critical analysis carried out in this matter by the judge is remarkable. The judge, to form his opinion, not only deeply analyzed the financial and accounting arguments used by the parties' experts (such as the use and adequacy of the discounted cash flow method as an enterprise valuation method) but also considered the debtor's historical behavior. In this regard, the resolution highlights the importance of the coherence and consistency of a debtor's behavior over time and with different operators. This was not the case for the debtor, Celsa, who, a few months before the procedure, had requested State aid due to its poor financial situation, maintaining before the Administration an implicit liquidity and valuation that contradicted the position that the shareholders were now trying to defend when opposing the creditors' plan. The debtor's historical inaccuracy in successive growth forecasts (with a tendency towards excessive optimism rather than prudence) also did not help. These forecasts were a relevant reason for the divergence in the enterprise valuation performed by the different expert reports.

8. It is also worth highlighting certain procedural peculiarities that occurred throughout the procedure:
   a. Admission of the creditors' request to appoint a restructuring expert ("*experto en la reestructuración*")[6], the entity Lexaudit. This appointment took place by resolution of September 29, 2022, being challenged by the debtor but finally confirmed by the Appellate Court of Barcelona on June 26, 2023.
      The plan in the Celsa Case was presented for approval based on the support of a majority of classes (as opposed to the legitimacy derived from a class of creditors within the money according to the expert's enterprise valuation). However, even so, the appointed expert carried out an enterprise valuation that was subsequently taken into consideration by the judge along with those of the parties' experts.
   b. Processing of the plan approval with *ex-ante* opposition[7] instead of *ex-post* challenge, as proposed by the filing creditors in their request of April 26, 2023, according to the options offered under Spanish law[8]. Therefore, the shareholders and remaining creditors were notified of the approval request, leading to the submission of various opposition writings and the subsequent holding of a trial (from July 3 to 11, 2023).
      Consequently, the judgment issued by the Commercial Court after hearing the parties and holding the trial became immediately final as the Spanish regime, in the interest of the usual urgency of restructuring situations, does not allow further appeals or challenges in case of *ex ante* opposition.
   c. Admission of the creditors' legal standing to file a plan without the debtor´s or its shareholders' consent in accordance with the new wording[9] of the Spanish insolvency regulation after the transposition of Directive (EU) 2019/1023, in the cases and with the requisites already mentioned.
   d. Judicial confirmation of classes ("*confirmación judicial de clases*")[10]. On October 3, 2022, the proposing creditors requested prior judicial confirmation of class formation, which was confirmed by the Court by judgment of December 2, 2022.

6 Vid. article 672.1 TRLC.

7 Vid. articles 662 and 663 TRLC.

8 For a detailed description of the Spanish restructuring framework, see Garcimartin, F. (2023). The Spanish Approach to Corporate Restructuring: A "Pre-packaged Chapter 11". European Insolvency and Restructuring Journal. https://eirjournal.com/article/view/14827

9 Vid. articles 625, 640.2 and 643 TRLC.

10 Vid. articles 622 et seq TRLC.

It should be noted that, as allowed by Directive (EU) 2019/1023, Spanish law allows the plan proponent to define the affected debt perimeter, without the need to affect the universality of the liabilities or contracts with pending obligations by both parties (executory contracts, which can be requested to be resolved in the interest of the insolvency, with the compensation in favor of the party *in bonis* being an ordinary unsecured credit that may be affected by the plan itself). In the Celsa Case, the proposing financial creditors decided to only affect the shareholders and long-term financial debt, without affecting executory contracts of operational or working capital suppliers. This allowed avoiding the stigma associated with such situations, as well as maintaining operational stability.
By initially validating the class formation, the Court did not rule on the fairness of the affected perimeter, but only on the correctness of the classes into which the affected debt was divided. The class formation was mainly based on the waterfall of claims according to the existence or non-existence of real guarantees, as well as their rank according to inter-creditor contracts (or relative subordination agreements). Inter-creditor agreements deserve in Spain bankruptcy (and thus restructuring) recognition as long as they do not prejudice third parties. No such prejudice was deemed to exist in the Celsa Case as the parties affected by the plan coincided with the parties to the relevant inter-creditor agreements.

9. Considering all this, the Celsa case has highlighted that the substantive discussion in the pre-insolvency field has shifted with the transposition of Directive (EU) 2019/1023 from a fairness concept based on majorities to one focused on enterprise valuation. This should undoubtedly help rationalize the actions of the various operators in a pre-insolvency situation and the decisions made accordingly.

10. In the future, the behavior of debtors, their management, and their shareholders should become more cautious in situations close to insolvency. They shall aim to adopt early solutions, knowing existing risks if they were to become insolvent: lender-led plans that may wipe out preexisting shareholders.

11. From the perspective of creditors, there is now a path to remove shareholders and/or managers who have lost credit, as well as to take control of the debtor without the need for a fully-fledged bankruptcy procedure, which in certain cases may impair the restructuring surplus if there is one. Such a path has also an indirect benefit: the dynamization of the distressed debt market and the optimization of bank recovery thanks to the secondary market.

Secondary trades are mentioned by the judge who, far from showing the traditional negative bias towards debt buyers, expressly reflects in the resolution full respect for the derivative acquisition of credits, which will undoubtedly provide greater comfort to such buyers in the future.

12. The new legal framework, of which the Celsa case is a good example, will also help to reach balanced consensual restructurings. Indeed, there is greater symmetry between the rights of creditors and shareholders based on whether they have the economic support of the enterprise valuation. By eliminating the bilateral monopoly situation that previously existed between creditors and shareholders, it facilitates the fruition of negotiations by the various operators. When parties are aware of the risk and the leverage the counterparty has, greater rationality emerges. The stakeholder who has more bargaining leverage is not anymore the one who has the least to lose, but the one who is more confident in his view on the enterprise valuation.

13. Shareholders and directors now know that the risk of losing their position is real if they do not reach an agreement with the creditors. For their part, creditors are aware that, in certain circumstances, they might take control of the equity, although with the uncertainty derived from possible litigation – which could be settled through a consensual plan.

14. Therefore, even though it may seem counterintuitive, the eviction of pre-existing shareholders from the capital in the Celsa Case may help many other shareholders of future distressed companies to maintain their equity in the future. They will prefer to lower their expectations rather than lose everything. Thus, the balance at the negotiating table is leveled. Paradoxically, the introduction of the new regime on non-consensual plans casts a shadow upstream in the restructuring negotiation that fosters the achievement of consensual plans, which was the purpose of the European and Spanish legislators in the first place.