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Company in Crisis: Refinancing and Insolvency Proceedings (A)

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It is unfortunately common for a company, at one point or another, to enter into a financial crisis situation, which is seen immediately in its inability to settle its payment obligations in the ordinary course of business.

Should the financial crisis not be resolved in a reasonable way and time period, the company will face operational paralysis and total collapse, marking the end of its existence.

To prevent their demise and fight for their survival, companies in financial crisis seek fresh funding (whether through capital increases or new loans of various types). The other option is to renegotiate financial obligations by modifying repayment terms and conditions and, ultimately, restructuring total debt to a level that is feasible for the business.

In many cases, recapitalization is made impossible due to the shareholders' disagreement, lack of funds or refusal to pay additional dividends.

This is where the financial creditors come into play. If there is no possibility of new funding in the form of capital, financial creditors are in a position to either let the company fall and recognize its obligations as bad debt or commit to it by granting debt maturity extensions and/or modifying the amounts owed in accordance with a realistic repayment plan and/or by issuing new credit to finance the operations.

In this respect, when a company enters a financial crisis, it is crucial to determine realistically whether the situation is temporary and surmountable or whether the degree of the loss of competitiveness is already severe and irrecoverable. A company that is sick but with a pulse may require special attention or even emergency care. It is important to identify the causes of the crisis, apply shock therapy and perform the appropriate transfusion (that is, credit provision). But a company without a pulse or other vital signs should be given a timely burial. In opting for a timely burial, we are betting that any existing assets will not end up devalued and that their liquidation will help compensate the creditors, at least in part. And we are also betting against

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the emergence of new liabilities (against the estate) that end up compromised when the period of assisted breathing is over.

Ultimately and in certain circumstances, liquidation may end through the sale of the productive unit, providing continuity free of liabilities and the retention of part of the workforce.

Refinancing and Insolvency Proceedings: From "Preinsolvency" to Out-of-Court Refinancing Agreements

A company in acute financial crisis may pursue out-of-court settlement through a negotiated agreement with its creditors or it may pursue judicial proceedings. Opting for protection under the Insolvency Act 22/2003 of July 9 [Ley Concursal – LC] is usually the most advisable choice in situations of imminent insolvency, since it shields the company from possible enforcement actions by the creditors and satisfies the requirements for protecting its directors from liability. At the same time, the creditor financial institutions that enter into the agreement on new conditions will have their positions legally reinforced in the event of a subsequent arrangement phase.

Figure 1 seeks to provide an overview of the alternatives and paths available to companies facing imminent financial crisis. There are three realistic alternatives: renegotiation of terms with the creditors (ordinary refinancing); renegotiation of the continuity of the company under the purview of the Insolvency Act;[1] or, if maintaining the business's continuity is clearly impossible, a direct request to commence liquidation proceedings, also under the Insolvency Act.

There are two paths for renegotiating the business's continuity under the Insolvency Act: preinsolvency negotiation or a formal arrangement with creditors. If preinsolvency negotiations are pursued and do not come to fruition, voluntary insolvency proceedings are instituted. On the other hand, once the arrangement with creditors phase begins, there are two possible outcomes for the business: its continuity under a debt repayment agreement with creditors or its liquidation through the monetization of its assets to settle the outstanding debts to the extent possible.

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[1] See José Antonio Segarra and Jordi Carrillo, "Crisis de empresa: la Ley Concursal y sus reformas" [Company in Crisis: The Insolvency Act and Its Reforms], JN-26, February 2012. (Disponible en IESEP) [in Spanish].

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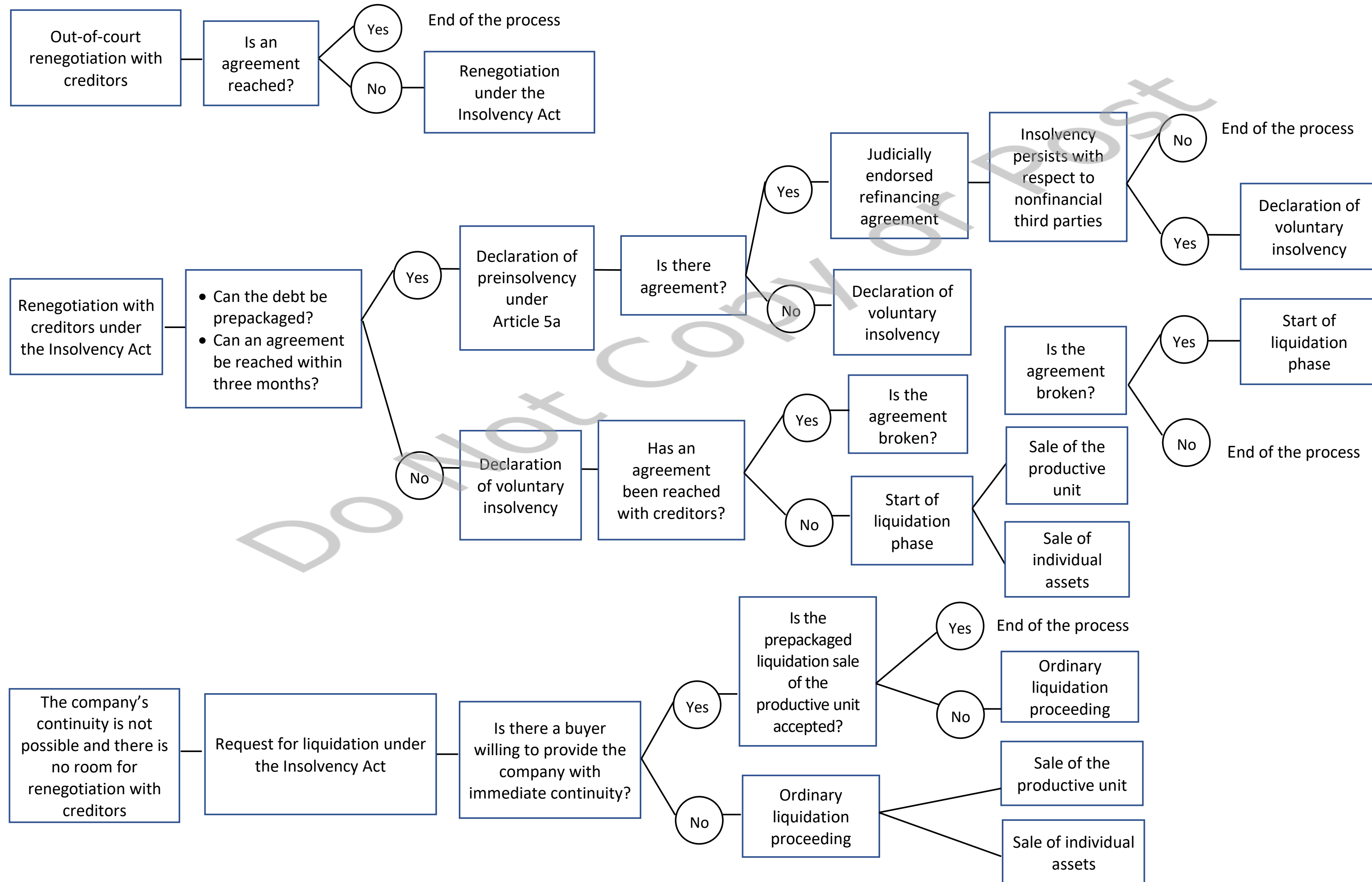
Figure 1

Paths for Commercial Enterprises Facing Immediate Insolvency



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