La Seda de Barcelona SA

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1. Synopsis

La Seda de Barcelona SA is a leading manufacturer of food and beverage packaging and plastics, with operations across Europe and over 2,000 employees. In May 2010 it became the first Spanish company to use an English scheme of arrangement to restructure its syndicated debt. The scheme, combined with the injection of significant additional capital through a successful rights issue, a debt-for-equity swap and the careful rescheduling of the company's trade debts (all undertaken under considerable time pressure), saved a business that was perilously close to insolvency.

For the wider European restructuring market, the most significant aspect was that a non-English company restructured using an English scheme and, crucially, did so without moving its centre of main interests from Spain to England. Instead, the company relied on having a sufficient connection with England and an English establishment to use an English scheme to restructure its English law-governed debt. At the time, the effectiveness of such a strategy was doubted due to uncertainties as to the recognition in Germany of the Equitable Life English scheme. While the issue there concerned German law obligations being restructured by an English scheme, for some in the market those concerns also tainted the use of an English scheme to restructure English debt borrowed by non-English companies.

La Seda was seen as a watershed. It has since been followed by the restructurings of German companies Telecolumbus, Rodenstock and Primacom and a second Spanish company, Metrovacesa – none of which moved their centres of main interests to England or, going one step further, had an English establishment. In other words, they relied solely on a sufficient connection with England.

With so many European companies borrowing under English law loan agreements, the issue is particularly important for the European restructuring market. Accordingly, the restructuring of the company has become a template for the use of an English scheme to restructure non-English companies with English law debt obligations. The advisers on the restructuring were Gila & Co, Bryan, Mansell & Tilley LLP and Freshfields Bruckhaus Deringer LLP.

2. Background

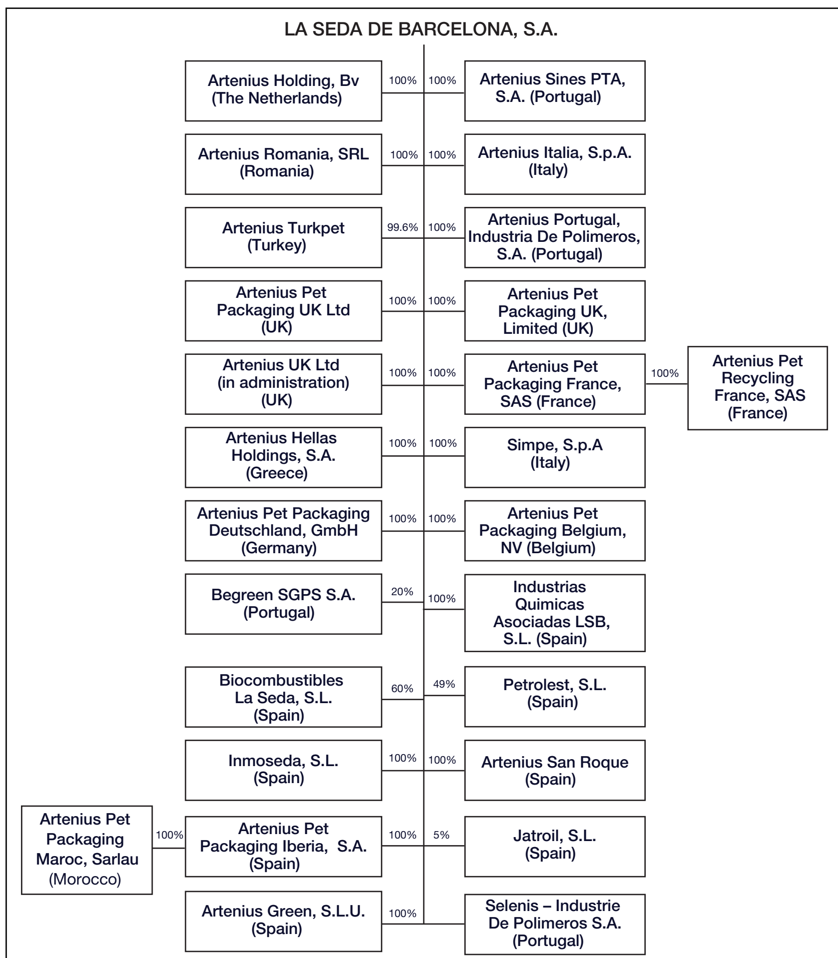
La Seda, and the group which it heads, is one of the leading manufacturers of purified terephthalic acid (PTA), polyethylene terephthalate (PET), packaging materials, PET recycling products, resins and polyester fibres. These materials and products are used primarily in the production of food and beverage packaging. At the

time of the restructuring, the company had 22 production sites and more than 2,000 employees. The group also had operations and subsidiaries in a number of other countries, including Portugal, Greece, Italy, Turkey, Romania, the United Kingdom, Belgium, Germany and France.

From 2005 the group grew significantly through a series of acquisitions within the European PTA, PET and PET packaging sectors. These acquisitions were intended to transform the group from a fibre producer to one of the largest integrated PTA, PET and PET packaging groups in Europe. The goal of this growth strategy was to achieve scale and become the leader in the PET production and PET packaging markets in Western Europe.

3. Pre-restructuring corporate structure

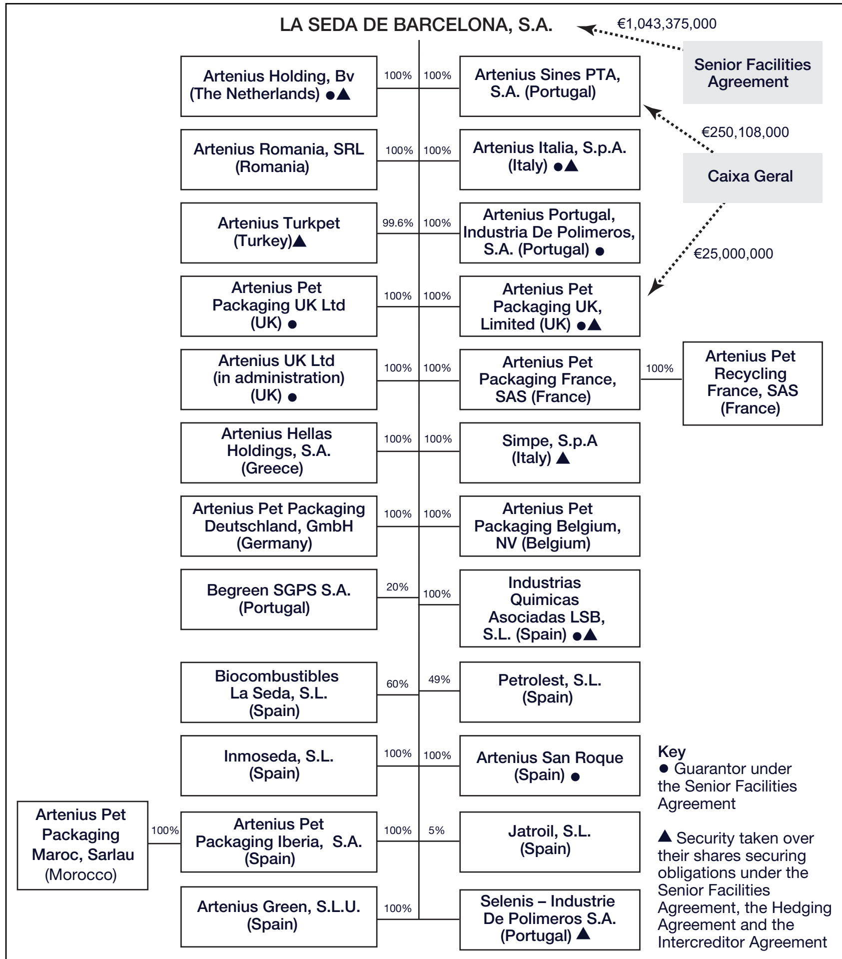
Figure 1 sets out a simplified corporate structure chart for the group before the restructuring.



At the time of the restructuring, the La Seda board was made up of six directors. Three of the directors were the companies – or were directly related to the companies – that ultimately made the new capital investment into the company as part of the restructuring. Of the three remaining directors, two were company executives and the third, Mr Carlos Gila, was appointed to assist with the restructuring.

4. Pre-restructuring capital structure

Figure 2 sets out a simplified diagram of the group's capital structure before the restructuring.



In summary, by a senior multi-currency term and revolving facilities agreement of June 8 2006 between the company and Deutsche Bank AG (acting as arranger, agent and security trustee), the lending institutions under the facilities provided the company with the following facilities of up to €603.3 million. (of which €578.6

million. had been drawn when the scheme was launched):

- Facility A – a term loan of up to €163.3 million, which amortised every six months commencing on December 31 2007 and matured on June 30 2013. At the time of the restructuring, the principal amount outstanding under Facility A was approximately €145.8 million.
- Facility B – a term loan of up to €265 million, which matured with a bullet repayment on June 30 2014. At the time of the restructuring, the principal amount outstanding under Facility B was approximately €257.8 million.
- Facility C – a term loan of up to €100 million, which amortised every six months commencing on December 31 2010 and matured on June 30 2013. At the time of the restructuring, the principal amount outstanding under Facility C was approximately €100 million.
- Revolving facility – a revolving credit facility of up to €75 million. At the time of the restructuring, the principal amount outstanding under the Revolving Facility was approximately €75 million.

The senior facilities agreement was governed by English law.

In addition, the following documents were entered into in relation to the senior facilities agreement:

- a hedging agreement between the company and the hedge counterparty, under which those parties entered into a number of interest rate swap agreements to hedge part of the interest rate liabilities under the senior facilities agreement; and
- an intercreditor deed, under which, among other matters, it was agreed that the liabilities that were owed under the senior facilities agreement and the hedging agreement would rank equally.

Additionally the obligations under the senior facilities agreement (together with any obligations under the hedging agreement and intercreditor agreement) were secured by the company granting security over the shares of a number of its subsidiaries (see Figure 2).

The obligations under the senior facilities agreement were guaranteed by a number of the company's subsidiaries (see Figure 2). There were also share pledges over key subsidiaries; however, no asset level security was given by those subsidiaries.

In addition to the senior facilities agreement, the following main bilateral facilities were granted by the Portuguese state bank Caixa Geral de Depósitos, SA to:

- Artenius Sines PTA, SA and the company as guarantor, in respect of a number of bridging loans relating to the construction of a petro-chemical industrial plant in Sines, Portugal – at the time of the restructuring, €250,108,000 had been drawn under these facilities; and
- two UK subsidiaries to provide working capital – at the time of the restructuring, €25 million had been advanced under this facility for short-term liquidity purposes, as the group was running out of cash.

5. Restructuring triggers

In 2008 the company experienced severe trading difficulties as demand for its finished products weakened, oil price-related raw material costs rose and low-cost competition from the Far and Middle East significantly eroded its margins. These factors had a serious negative impact on the group's operations, causing it to suffer a severe lack of liquidity.

By the fourth quarter of 2008, these difficulties resulted in the company breaching a number of its financial covenants under the senior facilities agreement. Further breaches occurred during the course of the following year and the debt ceased to be serviced, resulting in payment defaults.

In April 2009 the audit revealed significant past accounting malpractice and, as a result, the preliminary 2008 results were significantly downgraded from an operating loss of €153 million to €561 million. A KPMG report uncovered questionable trades and other irregularities which became the subject of investigations by the authorities. The chairman and the chief operating officer resigned and a new chairman and Mr. Carlos Gila were appointed to lead the Company s turnaround efforts . At the same time, Bryan, Mansell & Tilley LLP was appointed as restructuring and turnaround adviser to the group.

Difficulties for the group continued to increase throughout 2009. For instance:

- in July 2009 one of the group's UK subsidiaries, Artenius UK Limited, (AUK) was placed into administration in the United Kingdom – this was prompted by a winding-up petition that was issued against AUK by a creditor;
- two of the group's largest production plants in Spain were temporarily closed due to liquidity problems;
- the large-scale Sines project in Portugal was halted, with the contractors leaving the site and the construction project management company threatening legal action; and
- the claims against the group by overdue trade creditors had reached approximately €130 million.

In June 2009 the company agreed to a standstill agreement with the senior lenders. This standstill was extended a number of times. With the protection of the standstill, the company focused on maintaining liquidity while identifying the group's viable core business and preparing a business plan and restructuring programme with the aim of attracting new capital.

6. Composition of lending syndicate and syndicate dynamic

The syndicate consisted of a mixture of funds and banks, many of which were Iberian. There was secondary trading and some special situations and distressed debt investors bought into the debt. However, no secondary fund built a significant stake and the majority of the debt remained with the primary par lenders.

A steering group of senior lenders with a significant proportion of the debt under the senior facilities agreement was constituted to handle preliminary negotiations. This included agent bank Deutsche Bank, HSBC Madrid and Caixa Geral, plus other Spanish and London-based banks. The significance of the steering role varied

throughout the process and many of the fees were paid only at the end of the restructuring.

7. Restructuring negotiation process

The key aim of the restructuring was to secure a stable and sustainable platform to allow new money to be invested into the group.

Midway through 2009, negotiations took place to identify potential parties to inject new investment into the group. Caixa Geral, which was a significant shareholder in the company as well as a lender to it, introduced BA Vidros SA, a Portuguese glass packaging manufacturer, as a potential new investor. BA Vidros SA, along with Liquidambar Inversiones Financieras SL and Caixa Geral, indicated that together they were prepared to invest €100 million into the company. However, before they made such an investment, these new equity investors required the company, among other matters, to restructure its financial debt, address some of the ongoing problems at its subsidiaries (AUK in particular) and enter into reasonable agreements with its unpaid trade creditors.

In relation to the restructuring of the financial debt, being primarily the amounts owed under the senior facilities agreement, meetings between the company, the equity investors and representatives of the senior lenders took place from September to November 2009 in Madrid, Lisbon and London. In addition, a number of all-party senior lender conference calls were held over the same period. These meetings and calls resulted by mid-November in a preliminary agreement for a rescheduling of part of the sums owed under the senior facilities agreement, together with a proposed debt-for-equity swap.

7.1 The restructuring

The proposed restructuring comprised the following components:

- group operational changes, which included:
  - a refocusing of the business on PET applications;
  - divestment of the raw materials part of the business;
  - a major cost-cutting programme; and
  - a wholesale change of senior management;
- new investment into the company of at least €150 million; and
- the restructuring of the company's debt under the senior facilities agreement.

7.2 New equity investment

The equity investors stated that, subject to the fulfilment of certain conditions, they would invest a total of €100 million in the company. To facilitate these investments, the company proposed to increase its share capital. However, the company additionally sought money from other sources in order to obtain a further €50 million investment.

In summary, it was proposed that there be an equal distribution of equity between the new equity investment of €150 million (which would in part comprise the €100 million investment proposed by the equity investors) and the senior lenders. Thus, it was proposed that €150 million of the debt under the senior

facilities agreement be converted into equity in the company. This would mean that both the senior lenders and the new equity investment would each own 41.4% of the company's equity, which left existing shareholders with 17.2% of the company. Such a high amount was unpopular with some of the senior lenders, which felt that 5% was more in line with similar recent restructurings. This issue contributed to delays and the subsequent failure to achieve unanimity of senior lender support.

At an extraordinary general meeting (EGM) in December 2009, it was put to the shareholders that, among other matters, the share capital of the company be increased by €300 million through the issue of new shares. These new shares would have the same financial and voting rights as the shares already issued by the company. KPMG was commissioned by the company to prepare a fairness report that supported the equity dilution. This was presented to the shareholders at the EGM and, after protracted debate, the proposed equity issuance was accepted by shareholders.

7.3 The financial restructuring

In broad summary, it was proposed that the claims of each senior lender against the company under the senior facilities agreement be settled by:

- the allotment and issuance of shares pursuant to the debt-for-equity swap;
- an allocation of debt under Facility A;
- an allocation of debt under a new payment-in-kind (PIK) facility; and
- cancellation of Facility B, Facility C and the revolving facility.

7.4 Other challenges

Throughout the period in which the restructuring was negotiated, talks continued to reschedule the €130 million that was overdue to trade creditors. This involved a number of separate but linked initiatives, including:

- putting in place much stricter cash-flow discipline for all members of the group;
- contacting critical vendors and stopping hostage payments;
- managing cash prioritisation centrally to ensure that critical suppliers were paid and maintained their supply;
- negotiating repayment programmes that were consistent with the restructuring, many of which were signed to become effective when the capital increase was completed; and
- avoiding litigation through negotiation, despite missed deadlines and extended timelines caused by delays in the implementation of the restructuring.

The most pressing challenge during the negotiation period was presented by AUK in England. As previously noted, it had been placed into administration in July 2009. According to the company's records, AUK was owed over €30 million by the company and various members of the group. The administrators also had potential claims against the company and members of the group in respect of a further possible €50 million of multilateral group netting transactions which had relatively

recently pre-dated the administrators' appointment, making an aggregate of over €80 million of potential claims by AUK. On the other hand, AUK owed a substantial amount to the company and members of the group, some of which had the potential to be offset, although it would have necessitated a complex analysis of where set-off would have been permissible. Netting these amounts would benefit both AUK and the company by avoiding a claim by AUK against various group companies, which would have resulted in their insolvency – which itself could have triggered an insolvency of the company at group level.

Pursuant to a settlement agreement of March 25 2010, it was agreed that AUK would release virtually all debts that were owed to it by the company and the group, and that the administrators would not pursue legal claims against the company or its subsidiaries in respect of the netting transactions. Essentially, it was a 'drop hands' between AUK and the group on agreed terms. Without reaching an agreement, it is likely that the company would have had to file for Spanish insolvency. This would have in turn led the senior lenders to claim against AUK as a guarantor under the senior facilities agreement, which would have caused the return to AUK's other unsecured creditors to be reduced significantly. The settlement was made subject to completion of the restructuring.

In June 2009 it had been forecast that €20 million of bridging finance would be required to fund the group through the restructuring, assuming a January 2010 completion. This was obtained in two tranches: the first from Caixa Geral (€5 million in October 2009) and the second from the Catalan State Funding Agency, the ICF (€15 million in February 2010).

7.5 Options for the group's business

The company believed that, in the absence of a successful restructuring, part or all of the group was likely to enter into insolvency proceedings. If that occurred, the board believed that it was likely that the proceeds available to the group's and the company's respective creditors (including the senior lenders) would be reduced to a level that was considerably lower than if the restructuring, of which the proposed scheme formed a part, were implemented.

This view was supported by a draft report that the company obtained in October 2009 from PricewaterhouseCoopers which, among other matters, estimated the recovery for scheme creditors if the company were placed into an insolvency procedure in Spain. This report was provided in draft form at that time and was not finalised because of issues surrounding the settlement of fees. In summary, the report concluded that on an insolvency of the company, the senior lenders would recover approximately €212.5 million. This equated to a recovery of less than 40% of the sums owed to them under the senior facility agreement (as of June 2009). Moreover, the report concluded that such recovery was likely to take a minimum of two to three years and estimated that if the restructuring were implemented, the percentage of recovery for senior lenders was likely to be between 69% and 94% by December 2014.

8. Implementation of the restructuring

8.1 Lock-up agreement

In early 2010 the company entered into a lock-up agreement with some of the scheme creditors. Appended to the lock-up agreement was a debt term sheet that set out the agreed restructuring of the company's indebtedness under the senior facilities agreement. The lock-up creditors agreed, subject to certain conditions, to support the restructuring on the terms set out in that debt term sheet. By the time that the scheme was proposed, over 75% of the scheme creditors had signed the lock-up agreement.

However, not all of the conditions precedent to the lock-up agreement had been achieved by the time that the scheme was proposed. Furthermore, the terms of the debt term sheet appended to the lock-up agreement differed from the terms appended to the scheme following continuing negotiations between certain senior lenders, the company and the equity investors.

For the above reasons, the lock-up agreement was not binding on the senior lenders at the time of the scheme meeting.

8.2 Implementing the financial restructuring

There was not unanimous senior lender support for the restructuring. As a result, the financial restructuring was implemented pursuant to a scheme of arrangement under Part 26 of the Companies Act 2006. The main advantage of such a scheme – which allows for a court-enforced compromise between a company and its creditors – is that, in very basic terms, it permits a minority of dissenting creditors to be dragged along with a proposal provided that a sufficient majority of creditors support it. Under Spanish law, such a 'cram-down' procedure is not available to companies outside a formal insolvency process.

In an innovative move, it was suggested that the company, despite being incorporated in Spain, could implement a scheme in England that bound its creditors where they were located. The group benefited from having a UK subsidiary which was a substantial operating business with significant employees in the United Kingdom. Further, one of the company's employees was based in the United Kingdom. Consideration was given to whether the company's centre of main interests could be moved to England. However, as a listed Spanish company with Spanish tax residency, this was impossible. Accordingly, a plan was developed to use an English scheme, based on the company having a sufficient connection with England and an English establishment. Some parties questioned this in light of issues in Germany, where the effectiveness of the Equitable Life English scheme to bind German creditors was being challenged. However, the company believed that its situation was different, with English law obligations being subject to the scheme rather than non-English law obligations (in Equitable Life, the challenge in Germany related to German law-governed obligations).

After discussions with the interested parties, the company proceeded with the English scheme and became the first Spanish company to implement such a scheme.

The scheme set out the restructuring proposals for the company's debt under the

senior facilities agreement. It proposed that, provided certain conditions were met (the most important being that the company obtain at least €150 million of new investment), the restructuring of the debt under the senior facilities agreement would take place as follows:

- The company would issue and allot new shares with a total value of €150 million to the senior lenders in return for the partial settlement of the claims of the senior lenders against the company with respect to their participation in the debt under the senior facilities debt.

If, during the rights issue, more than 150 million new shares were subscribed for by the existing shareholders of the company, the equity investors or any third party, then the scheme lenders' entitlement to receive the new shares as part of the debt-for-equity swap would be reduced on a pro rata basis. Instead, scheme lenders would receive a cash sum equal to the value of the new shares that they would have otherwise received.

- Amounts due under Facility B, Facility C and the revolving credit facility would be automatically converted into either new Facility A loans (with the principal amount of the new Facility A increased to €235,730,000) or into sums due under a new PIK facility.
- The terms and conditions of Facility A would be amended.
- The scheme lenders would release various members of the group (see Figure 3).
- All security interests securing any obligation of the company or the group in the company would be released.
- A number of additional members of the group would accede to become guarantors of the company's performance of the senior facilities agreement (see Figure 3).
- Facility B, Facility C and the revolving facility would be automatically cancelled.

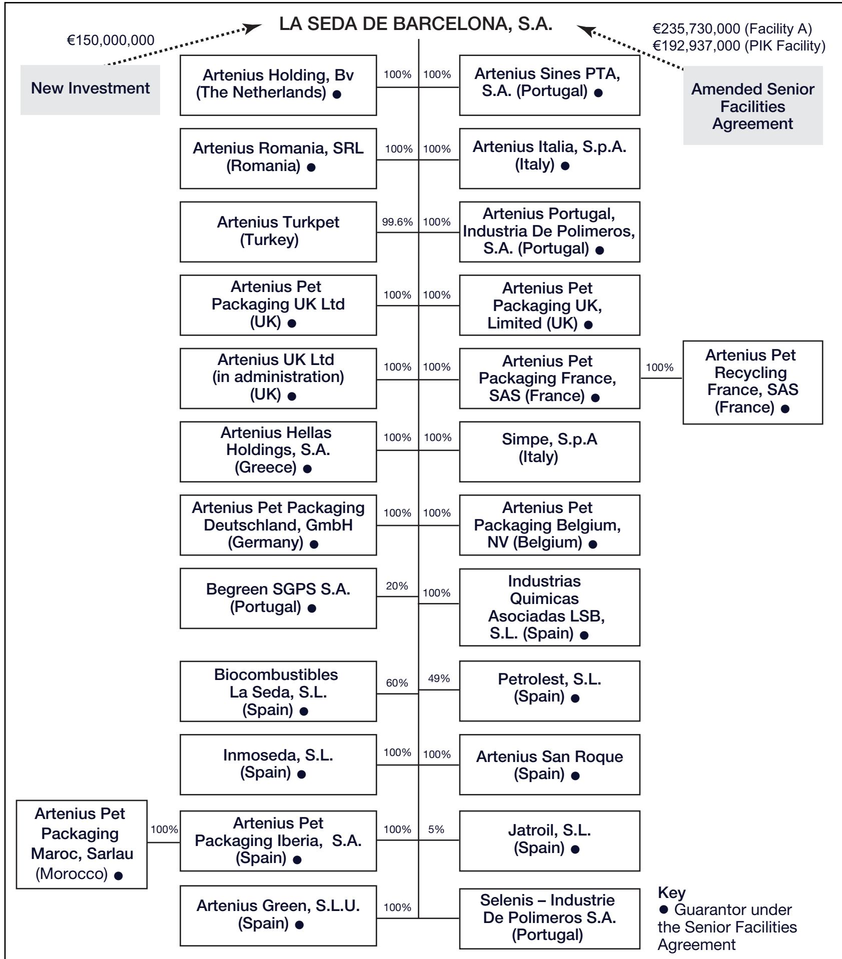
If all the preconditions to the restructuring were not satisfied or waived by October 31 2010, the scheme provided that the restructuring would not take place and the scheme would cease to have effect.

8.3 Implementation of the scheme

At a hearing on April 30 2010, the English court gave the company permission to convene a meeting of the senior lenders to vote on the scheme.

The scheme meeting was held on May 21 2010. The notice period for the meeting was truncated due to severe liquidity issues and on the basis that the senior lenders had been aware of the broad commercial terms and proposed scheme for several months. Forty-one of the senior lenders voted at the meeting, representing 76% of the syndicate by value. Of those 41 senior lenders, 37 voted in favour of the scheme and four voted against it. Of those that voted, 95.54% of the senior lenders (by value) voted in favour of the scheme and 4.46% voted against it.

Under the Companies Act 2006, for a scheme of arrangement to be passed at a



scheme meeting, a majority in number representing 75% by value of those creditors attending and voting at the meeting must vote in favour of the scheme.

Accordingly, on the basis of the above voting figures, the scheme achieved these statutory majorities and was successfully approved.

The sanction hearing of the scheme was held on May 26 2011. No senior lenders appeared at the hearing to object to the scheme and the scheme was sanctioned by the court at the hearing.

8.4 Issuance of new shares

In order to issue the new shares, the company had to follow the Spanish procedure for a share capital increase. In accordance with what was agreed at the EGM, there was an initial 15-day pre-emption period to allow existing shareholders in the company to subscribe for new shares. This pre-emption process raised €83,2 million, exceeding the target by €33.2 million. Under the terms of the scheme, this meant

that the senior lenders received €33.2 million in cash, thereby reducing their entitlement to equity by the same amount.

Once the allocation of new shares under the pre-emption process was completed, the company was permitted to allow the remaining shares to be subscribed for by new investors for cash (eg, the equity investors) or by way of set-off of debt.

Once all conditions under the scheme had been achieved, the company allotted and issued each scheme creditor with its share of the new shares in accordance with the provisions of the scheme and paid cash in place of such shares to the extent necessary.

On August 10 2010 it was confirmed that at least €150 million of the company's shares had been subscribed for in the share issues. The following day it was confirmed that all conditions to the restructuring becoming effective had been fulfilled. The restructuring, in accordance with the terms of the scheme, became effective on that date.

9. Final closing structure

The group structure, including the new debt structure, is set out in Figure 3.

10. Comment

As mentioned, the company was the first company incorporated in Spain to use an English scheme of arrangement to restructure its English debt obligations. It was subsequently followed by the Spanish company restructuring of Metrovacesa, with many billions' worth of debt, using an English scheme.

The impact has stretched further across Europe, as seen by the use of English schemes to restructure the English law debt obligations of German companies Telecolumbus, Rodenstock and Primacom. Furthermore, the use of English schemes by non-UK companies has prompted other European countries to review their insolvency regimes to consider implementing similar restructuring mechanisms in their own jurisdictions.

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