The Mergers & Acquisitions Review

Sixth Edition

Editor
Simon Robinson

Law Business Research

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SIXTH EDITION

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EDITOR'S PREFACE

Deal-making has remained on the agenda in the past year, although the first half of 2011 showed a stronger performance than the second half, which saw a significant fall in transactional activity. In the wake of continuing economic uncertainty, opportunities for acquisitions remain limited to companies and institutions on a stable financial footing. At the same time, corporates are beginning to focus on their core business and looking for ways to return value. Valuations remain favourably low for purchasers, and the prospect of striking a bargain makes cross-border M&A attractive for those who can afford it. While access to the loan market has remained difficult, cash-rich corporations have begun to swing the balance in their favour. Shareholder participation and a desire for control and accountability are on the rise, and an atmosphere of increased regulation, reform and austerity is building. We remain in a state of geopolitical flux, and these factors continue to complicate the global economic scenario. The period of widespread unrest in the Middle East and North Africa seems to be reaching a settled conclusion, although the situation in Syria (and possibly Mali and Sudan) is still volatile. A number of countries have seen fresh elections and a transition of leadership, including France and Russia, and a change of leadership in China is expected following the 18th National People's Congress this autumn, when the US presidential elections will also take place. The sovereign debt crisis and the ongoing uncertainty over the fate of the eurozone are further contributing to the lack of confidence in the markets.

All is not doom and gloom, however, and whereas the global picture remains difficult, there are signs of hope. The emerging markets have shown a persistent growth in outbound investment, spurred on by a desire to build a more prominent global presence and for the purpose of accessing new markets. European targets remain of interest to both US and Middle and Far-Eastern buyers. Inbound investment from the emerging markets into both Africa and Australia is on the rise, and this has strengthened activity in the energy, mining and utilities sector. The technology, media and telecoms sector has also shown signs of promise with some high-profile deals, and must be watched with interest in the coming year. There is hope that, as political and economic factors

stabilise, M&A activity will once more gather pace and momentum, and enter a new era of resurgence. We shall see.

Once again, I would like to thank the contributors for their continued support in producing this book. As you read the following chapters, one hopes the spectre of the years past will provide a basis for understanding, and the prospect of years to come will bring hope and optimism.

Simon Robinson
Slaughter and May
London
August 2012

Chapter 55

SPAIN

Christian Hoedl and Javier Ruiz-Cámara[1]

I OVERVIEW OF M&A ACTIVITY

During 2011, the financial crisis escalated to unprecedented levels. The bursting of the real estate bubble of 2007 and 2008 was followed by a deep banking crisis, which subsequently affected the real economy and has recently generated doubts about the solvency of the Spanish banks and even Spain's capacity to repay its sovereign debt, with the spread between Spanish and Germany bonds reaching records.

At the end of November 2011, a new government was elected by absolute majority, and immediately started to implement deep reforms in a concerted effort to tackle some of the structural problems of the Spanish economy (e.g., lack of competitiveness, a very rigid labour market, over-development of the real estate industry, public deficit, and slowdown in tourism). In particular, the new government has built its programme of reforms on three pillars: reform of the financial institutions, reduction of the budget deficit and sovereign debt, and labour market reforms. The reforms appear to be steering Spain in the right direction on the road to recovery and are helping to restore the confidence of domestic and foreign investors.

In spite of the turbulent general situation, there have been a significant number of mergers and acquisitions in 2011 although, at the end of the year, a number of transactions were aborted due to market uncertainties. In this difficult environment, valuations have decreased and there has been more interest on the buy-side, particularly from foreign corporations and investors from emerging countries, mainly China and Brazil.

Going forward, we expect a recovery of M&A activity in 2013 once confidence in Spain and its economy is restored. Spanish banks and top multinational corporations are looking to divest non-strategic assets, focus on their core businesses, strengthen their margins and rebuild their balance sheets, creating a range of M&A investment opportunities. On the other hand, the Ministry of Economy and Competitiveness has

1 Christian Hoedl is a partner and Javier Ruiz-Cámara is a counsel at Uría Menéndez.

announced an ambitious large-scale privatisation plan of up to €30 billion that will be approved before August to cut deficit and repay public debt, which will certainly give rise to activity. Spain's energy industry is also due to be reformed, which might lead to a consolidation of market players. Finally, due to the liquidity shortfall and the turmoil of the Spanish stock markets, the market capitalisation of listed Spanish companies has decreased very significantly, converting those corporations in very attractive targets for private equities and cash-rich investors. Particularly taking into account that the turnover of many of the undercapitalised banks and corporations is generated outside of Spain (notably, in Latin America) and therefore exposure to the situation of Spain and the rest of Europe is limited.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

i Corporate law

The basic Spanish legal framework for corporate acquisitions, mergers and other types of corporate reorganisation includes both contract and corporate law. Spanish contract law is mainly contained in the Civil and Commercial Codes.

The Companies Law ('Companies Law') governs, *inter alia*, the corporate aspects of the acquisition of corporations and limited liability companies, the most common type in Spain. It also includes the basic legal framework for listed companies. The Companies Law has recently been amended, as detailed in Section III, *infra*.

Law 3/2009 on Corporate Reorganisations ('the Law on Corporate Reorganisations') contains the regulation of corporate reorganisations, such as mergers, spin-offs, conversions or *en bloc* transfers of assets and liabilities of all forms of commercial companies. The Law on Corporate Reorganisations specifically regulates leveraged buyout ('LBO') mergers (i.e., mergers between two or more companies where one has incurred debt during the immediately preceding three years in order to acquire control or the essential assets of the other company participating in the merger). The law requires, *inter alia*, that an independent expert determines whether the LBO merger constitutes financial assistance. The provisions nevertheless fail to establish the effects of the declaration of the existence of financial assistance; circumstances that create uncertainty in LBO mergers (particularly due to the interpretation of the law by various companies' registries of Spain, which has not been as consistent as would have been desirable).

The 1988 Stock Market Law regulates public offerings, official listings of securities, transactions related to listed securities and takeovers, whereas the legal framework for listed companies is now contained in the Companies Law. The law is implemented and developed by a number of additional regulations.[2]

ii Insolvency law

The general legal framework on insolvency is primarily contained in Law 22/2003 on Insolvency Proceedings ('the Insolvency Law').

2 All of these are available for consultation at www.cnmv.es.

The Insolvency Law created a single insolvency proceeding applicable to any insolvent debtor (i.e., a debtor that is unable to, or will imminently be unable to, regularly comply in a timely manner with its payment obligations). The single procedure has a joint phase and two different solutions: (1) the creditors' agreement (the purpose of which is for the debtor and the creditors to reach an agreement on the payment of the outstanding claims in order to enable the debtor to restructure its business); or (2) the liquidation of the assets of the debtor in order to satisfy its debts. The Insolvency Law has also helped to clarify the risks associated with the clawback (rescission) of acts considered detrimental to the estate of the debtor, which were carried out within the two years preceding the declaration of insolvency.

The Insolvency Law is generally seen as a positive development as it replaced the outdated insolvency regulations of the 19th-century Commercial Code. Nevertheless, it must be kept in mind that the law was passed in a more favourable economic climate in which few insolvency proceedings were initiated. Indeed, the application of the Insolvency Law only started to be tested in practice during the turbulence experienced in recent years, during which time the number of insolvency proceedings has increased dramatically. As a consequence, the Insolvency Law was recently amended by Law 38/2011 of 10 October. The reform aims to bring the Insolvency Law in line with current practice and improve certain technical aspects that have been criticised by judges, scholars and lawyers alike. The main developments of the reform are as follows:

a Clarification of the rules to apply for a grace period to file for insolvency (related to the negotiation of a creditors' agreement or a pre-insolvency refinancing agreement).

b Immunity of pre-insolvency refinancing agreements provided that they meet certain legal requirements.

c Out-of court cram-down mechanism, meaning a refinancing agreement with the legal requirements mentioned in item two entered into by financial creditors representing at least 75 per cent of the debtor's financial liabilities, which may impose extensions (on deferrals of principal or interest) on the dissenting unsecured financial lenders, provided that:

- the agreement has been validated by the court at the debtor's request; and
- the court considers that the agreement does not impose a 'disproportionate sacrifice' on the creditors of the same class that have not entered into the refinancing agreement or do not support it.

d Privileges for fresh money and for other credits. Law 38/2011 has recognised certain privileges to the credit rights of creditors who participate in a refinancing agreement (with the conditions mentioned in Section 2) and provide fresh money to the debtor.

e Distressed debt acquisitions. As a general rule under Spanish law, investors who acquire credit rights against the insolvent debtor after the declaration of insolvency are not entitled to vote in the creditors' agreement of the debtor. The reform introduced an exception to that rule: if the acquirer of the distressed credit rights is an entity subject to financial supervision, the acquirer will not be deprived of its voting rights in the composition agreement. The fact that only entities subject to financial supervision will preserve their voting rights reflects the distrust of the Spanish legislature in some distressed funds. In spite of these unfriendly rules,

the market for non-performing loan portfolios and other distressed asset has significantly grown in Spain over the past 12 months.

iii Other regulations

Other matters relating to tax, employment, antitrust, unfair competition, administrative and regulatory issues, alternative dispute resolution and other laws and regulations also form part of the M&A legal framework (see below).

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Structural reforms: credit entities and public administration

Several regulations enacted in 2011 and 2012, and others currently being enacted, will directly or indirectly affect M&A transactions involving Spanish companies. Particularly, the new government that entered into office in November 2011 has proven its determination to cure what ails the Spanish real and financial economy and public administrations and has launched a programme of structural reforms that may make a difference to M&A prospects.

The Spanish government recently approved two pieces of legislation aimed at strengthening the balance sheets of Spanish credit entities, which are highly exposed to real estate assets as a result of the housing bubble: Royal Decree-Law 2/2012 of 3 February on the banking industry reform and Royal Decree-Law 18/2012 of 11 May on the write-down and sale of real estate assets of the banking industry. The reform also aims to encourage the concentration of the banking industry and increase the credit flow from international capital markets into Spanish banking institutions and, eventually, the real economy.

On the other hand, the severe international economic crisis has elicited a strong decline in the economic activity in Spain in recent years causing deterioration in the budgets of the Spanish regional public administrations. Some regional public administrations have even been unable to settle their debts on a timely basis, with some obligations outstanding for several months, and sometimes years. To address the situation, the Spanish government recently approved legislation aimed at facilitating the settlement of debts owed before 31 December 2011 by the Spanish regional public administrations (municipalities and autonomous regions, and entities that answer to them) to their suppliers: Royal Decree-Law 4/2012 of 24 February on the information obligations of municipalities and on the proceedings required to design a financing mechanism for payments to suppliers of municipalities; and Royal Decree-Law 7/2012 of 9 March, by which the government creates a fund for financing payments to suppliers. The total debt subject to the new repayment mechanism is estimated to be €35 billion, constituting the largest financing ever granted in Spain.

ii Corporate law

Law 25/2011 of 1 August ('Law 25/2011'), Royal Decree-Law 9/2012 of 16 March ('Royal Decree-Law 9/2012') and Law 1/2012 of 23 June ('Law 1/2012) introduce important amendments to the Companies Law.

Among other matters, Law 25/2011 introduced a significant novelty: the right of (minority) shareholders to request that the company acquire their equity stake in the event that, *inter alia*, following the request of the shareholder, the company does not distribute at least one-third of the previous year's profits (which are related to the company's activity and may be distributed according to Spanish law). The rule does not apply to listed companies or startups (as it only applies for the five years following the registration of the incorporation of the company in the commercial registry). In view of the potentially negative financial effects of this 'withdrawal right' the rule was recently suspended until 31 December 2014.

Law 25/2011 also aims to simplify some of the formalistic provisions (especially the publication of announcements in the media) and to reduce costs and administrative burdens of capital companies.

Royal Decree-Law 9/2012 and Law 1/2012 further simplify some of the formalistic provisions of Spain's corporate law and reduces the costs and administrative burdens of capital companies and, in particular, among other provisions:

a develops the framework on corporate web pages (compulsory for listed companies and voluntary for others), allowing capital companies to address specific communication to their shareholders and debtors directly through the corporate web page rather than by announcements in official journals;

b allows the possibility of delivering notifications to shareholders through electronic means if shareholders have accepted the procedure; and

c establishes additional exceptions to the requirement of appointing financial experts for the valuation of in-kind contributions to corporations (*sociedades anónimas*) in specific mergers and capital increases.

iii Mergers and other corporate restructurings

Royal Decree-Law 9/2012 and Law 1/2012 also introduce relevant changes to the Law on Corporate Reorganisations:

a Capital companies undergoing a merger may publish the merger project on the companies' web pages (instead of filing it with the commercial registry).

b For mergers involving corporations or limited partnerships, all implicated companies must request from the commercial registry the appointment of one or several independent experts to issue a report on the common merger project.

c The directors of the companies must make the information on the merger (e.g. the independent expert's valuation, the annual accounts, the merger balance sheet, the common merger project) available on the companies' web pages before the announcement or notification of the general shareholders' meeting at which it will be decided whether or not to approve the merger.

d The reform simplifies merger documentation requirements if the merger is unanimously approved by all shareholders of the companies involved.

e In contrast to the previous framework, registration of the merger will be permitted even if creditors have opposed the merger (which result facilitates merger processes that could otherwise be potentially blocked by unsecured creditors), without prejudice to the creditors' right to bring legal actions against the company in court.

iv Takeover regulations

Finally, due to the severe undercapitalisation of Spanish companies and the expropriation by YPF by the government of Argentina and Red Eléctrica de España's Bolivian subsidiary by the government of Bolivia, Law 1/2012 has introduced two amendments to the Company Law for listed corporations, seeking to instate, as in other European Union jurisdictions, protective legislation against opportunistic tender-offers:

First, listed corporation may reinstate clauses in their by-laws that establish a maximum number of votes that a shareholder or the same group of companies or any concerted party can issue at the general shareholders' meeting. These clauses, which were prohibited in 2010, entailed a limitation on shareholders' voting rights (typically 10 per cent per shareholder) and were one of the most common kind of poison pill used by Spanish listed companies before their prohibition. The limitation on voting rights is, however, lifted following a tender offer in which the offeror acquires 70 per cent or more of the target voting rights (unless the offeror is not subject to a similar exception to the limitation).

Second, the minimum price of tender offers for companies that underwent an expropriation, other extraordinary circumstances (e.g., natural diseases, wars, force majeure), or reasonable evidence of market manipulation, would be the higher amount of either the 'equitable price' (which is a threshold currently only applicable to mandatory tender offers) or the price determined by an independent expert pursuant to the Stock Market Law.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

i Cross-border transactions by strategic investors

In the past 12 months Spain has witnessed an increase in cross-border deals. Inbound deals exceeded outbound deals over the period.

German, French and American companies have taken advantage of the macroeconomic conditions in Spain, acquiring new technologies and market share at attractive valuations. Brazilian, Mexican and Chinese corporations and SOEs have also been active on inbound cross-border M&A transactions. The following cross-border deals are some of the most relevant in the second half of 2011 and the first half of 2012:

a In August 2011, Pemex, a Mexican state-owned oil company that held a 4.87 per cent stake in Repsol, reached a syndication agreement on its stake in Repsol with Sacyr Vallehermoso, the Spanish infrastructure and real estate holding company, which in turn held a 20.01 per cent stake in Repsol. Under the syndication agreement, Pemex raised its stake to 9.49 per cent. The syndication agreement over the 29.5 per cent stake (slightly short of the 30 per cent threshold for compulsory tenders) was not welcomed by Repsol and was cancelled in December 2011 through the sale of a 10 per cent stake in Repsol owned by Sacyr Vallehermoso to Repsol for €2.5 billion, and the execution by Repsol and Pemex of a strategic 10 year joint-venture agreement. In January 2012, Repsol sold half of the stake acquired from Sacyr Vallehermoso to institutional investors for €1.3 billion.

b In September 2011, Schneider Electric SA closed a €1 billion tender offer to acquire 100 per cent of the shares of Telvent, a Madrid-based company listed on the NASDAQ and leader in software and IT solutions of smart infrastructures.

c In January 2012, the Brazilian Companhia Siderurgica Nacional, a worldwide leader in steel and mining, listed in Sao Paulo and New York, acquired multiple assets and a steel plant in Germany from Spanish Grupo Gallardo (€485 million);

d In April 2012, the Bolton Group acquired a 40 per cent stake in the Spanish company Grupo Calvo, a leading player in canned seafood, for €106 million.

The number of Spanish companies investing overseas also grew over 2011. Companies like CIE Automotive (car parts manufacturer), or Ebro Foods (a world leader in the rice industry) have all been highly acquisitive to expand their overseas operations, possibly to mitigate the effects of challenging domestic conditions. However, divestments by Spanish companies have by far exceeded new investments in the second half of 2011 and the first half of 2012:

a In the last months of 2011, Banco Santander, whose moves often anticipate market trends, sold its businesses in Colombia to the Chilean bank Corpbanca for €910 million and a 7.8 per cent stake in its Chilean subsidiary though a €710 million IPO. Banco Santander is also reportedly in the process of selling a 8 per cent stake of its Brazilian subsidiary.

b In January 2012, Iberdrola offered €1.4 billion to increase its stake in the Brazilian energy company Neoenergia from 39 to 75 per cent and, as the transaction did not go though, is currently in the process of selling its 39 per cent participation in Neoenergia to Brazilian energy companies.

c In January 2012, Abertis sold its 12.6 per cent stake valued at €1 billion in the French satellite operator Eutelsat to institutional investors.

d In April 2012, Ferrovial sold (through its subsidiary BAA) Edinburgh Airport to the investment fund Global Infrastructure Partners for €988 million.

e In May 2012, ACS announced the sale of energy distribution assets in Brazil worth an aggregate €750 million.

ii Private equity transactions

The 2011 investment volume by private equity funds doubled that of 2009 and was over €3.2 billion according to ASCRI. International funds were the big players in the market. Special situation funds are particularly active in acquiring NPL portfolios and other distressed or non-core assets from Spanish banks and corporations.

Private equity funds investment volumes in 2012 are expected to be slightly lower than those in 2011. Distressed M&A by special situations funds should continue to grow and 'public-to-privates' by traditional buyout funds may not be ruled in view of the sharp decrease in the market capitalisation of a number of Spanish listed corporations.

Spanish private equity firms may evaluate to expand in Latin America or other emerging markets. Mercapital was the first Spanish private equity house to recently venture overseas by establishing a presence in Miami, and in Brazil and Colombia.

By way of example, some of the more significant private equity deals in 2011–2012 include:

a Blackstone's purchase (in alliance with N+1) of Mivisa, the leading Spanish manufacturer of metal food containers, at a value between €850 million and €950 million;

b PAI Partners' acquisition of Swissport International (a handling company) from Ferrovial, for a price of €654 million;

c CVC's acquisition of Capio Sanidad, the Spanish subsidiary of the Swedish hospital management group, for €900 million;

d Carlyle's €400 million acquisition of Telecable, a Spanish-based TV, telephony and broadband provider;

e First Reserve's €300 million investment in Abengoa, a Spanish technology group.

f KKR's acquisition of a 12.5 per cent stake in Saba Infraestructuras SA, the Spanish car park owner and manager that was spun-off from Abertis, for €112 million (including debt); and

g Advent International's acquisition of a 49.9 per cent stake in the Spanish company Maxam, a leading manufacturer of explosives, from Portobello, Vista Capital and specific Maxam managers, advisers and employees for an undisclosed amount.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

Over the period, M&A has been largely driven by the ongoing restructuring of the Spanish financial institutions (in particular, the former savings banks or *cajas*) and the need of these institutions and many corporations to deleverage, shrinking their balance sheet through the disposal of non-core assets, NPL portfolio and other assets. The Spanish government has announced a wide-ranging privatisation programme. And energy and private equity should also (continue to) be a source of M&A transactions.

i. M&A related to financial institutions

As in 2010 and the first half of 2011, the ongoing restructuring process of the Spanish financial industry will continue to fuel the Spanish M&A market over the following months on two fronts: Bank consolidation and the sale of non-core assets.

During 2012, the Spanish banking industry will continue to be subject to a restructuring, merger and concentration process. Small Spanish banks are likely to face downward rating pressure in 2012 as the potential for losses grows, prompting them to merge. The rating agency predicts smaller banks, particularly those with capital injections from the state's Fund for Orderly Banking Restructuring ('the FROB'), the Spanish banking restructuring and rescue fund controlled by the Bank of Spain, will face difficulties in complying with requirements in just one year. By way of example, the mid-sized Banco Pastor was taken over by Banco Popular in December 2011. The FROB will also play a significant role in M&A: in 2011, it bailed out and acquired control of Caja de Ahorros del Mediterráneo, Catalunya Banc, NovaCaixa Galicia Banco, Unnim and Banco de Valencia. In May 2012, Bankia (a financial institution singled out by the International Monetary Fund as a systemic risk for the Spanish banking industry for its real estate exposure) requested a €19 billion bailout from the FROB (in addition to a previous €4.4 billion loan, which is in the process to be converted into equity). The entities taken-over by the FROB will eventually be sold or liquidated.

The financial institutions also pursue an aggressive programme for the divestment of non-core assets. As indicated above, Banco Santander sold its business in Colombia

and a 7.8 per cent stake in its Chilean subsidiary though an initial public offerings and is reportedly in the process of selling a 8 per cent stake in its Brazilian subsidiary. Financial entities bailed out by the FROB tend to hold important stakes in public 'big caps' and 'mid caps' and in private companies that will most likely be sold, sooner rather than later, to repay the funds granted by the FROB. For instance, for historical reasons, Bankia holds stakes in a wide array of listed companies such as Iberdrola (an energy company), IAG (an airline), Mapfre (an insurer), BME (the operator of all Spanish stock markets), Indra (an engineering company), Realia (a construction company) and Deoleo (a food company) and relevant stakes in private enterprises such as Glovalvía, an infrastructure operator, and Mecalux, a storage company. Additionally, bailed-out financial institutions acquired by the FROB will be recapitalised and eventually sold, possibly subject to a form of public protection arrangement (for instance, following a beauty contest, CAM was sold to the Spanish Banco Sabadell under an asset-protection scheme and Catalunya Banc is currently being auctioned).

This ongoing restructuring and divestment process should be seen as an opportunity for foreign investors interested in acquiring strategic interests in Spain.

ii Divestments by Spanish corporations

In addition to banks, many Spanish corporations are looking to divest non-essential assets, focus on their core businesses, strengthen margins and rebuild balance sheets. These divestments will continue to create a range of M&A opportunities. A good example of this trend is Telefónica, a global player in the telecommunications industry, as well as ACS, a construction and energy holding company.

In contrast to 2010, when Telefónica, acquired Portugal Telecom's 50 per cent stake in Brasilcel (which in turn controlled the Brazilian operator Vivo) for €6.5 billion, Telefonica has recently announced an ambitious programme of selling non-core asset estimated at €1.5 billion, including the sale of Atento, its call centre, its participation in Rumbo, an online travel agency, and its participation in Portugal Telecom, a listed Portuguese operator company. It has also announced the IPO of its German subsidiary (on a standalone basis or through a merger with Dutch operator, KPN) and is evaluating the IPO of its Latin American subsidiaries. The IPOs are estimated to amount to €4 billion. Furthermore, Telefonica restructured its Colombian subsidiary, sold its 13 per cent stake in Hispasat (a Spanish satellite operator) to Abertis, its telecommunications towers and its 4.92 per cent participation in the listed Portuguese telecoms company. These transactions amounted to approximately €1.6 billion. In addition to these divestment's and listing's programmes, in June 2012 Telefónica also announced the sale of a 4.56 per cent participation in China Unicom, China's second-largest telecommunications company, for €1.1 billion.

In turn, ACS is also carrying out an ambitious €3 billion divestment programme which includes the March 2012 sale of its 23.5 per cent stake in Clece, its cleaning services affiliate, to Mercapital, a Spanish private equity fund, for €80 million, the April 2012 sale of a 3.7 per cent stake in Iberdrola for €800 million, the April 2012 sale of a 10 per cent stake in Abertis to OHL, a construction company and concessionaire, and Abertis for €875 million and announced in May 2012 the sale of energy distribution

assets in Brazil worth an aggregate €750 million. ACS is also reportedly attempting to sell Urbaser, its waste management business.

iii Privatisations

The Spanish government also intends to reduce its budget deficit and sovereign debts, *inter alia*, through privatisations. The Ministry of Economy has announced an ambitious large scale privatisation plan of up to €30 billion. The plan will be approved during the summer. It is expected to include the total or partial sale of Spanish stakes in some of the most important state-owned enterprises such as Renfe (the Spanish train operator), Aena (the Spanish owner and manager of Spanish airports), Paradores (a hotel chain) and LAE (the Spanish lottery operator). The Ministry also intends to dispose of the shareholdings in listed companies such as International Airports Group (the company resulting from the merger of Iberia and British Airways), Ebro Foods (the world's largest seller of rice and the second-largest producer of pasta) and Red Eléctrica de España (which operates the national power transmission system and electricity grid in Spain). The plan may also provide for the privatisation of Canal de Isabel II, the entity that manages public water services in the autonomous region of Madrid, Canal de Isabel II, which was approved in 2008, but which has nevertheless faced political and popular opposition since that time.

iv Construction and energy-related M&A

In the Spanish construction industry, a key one until the economic downturn, it is expected that 2012 will be a year of post-merger integration, stabilisation and downsizing, with companies focusing on synergies from previous acquisitions and restructuring activities. Spanish construction companies diversified in the past into numerous activities to complement the construction business; however, in recent years, some of them sold non-core activities to reduce leverage to more acceptable levels. The divestment process will continue in 2012 if financial conditions for potential buyers become less adverse. M&A among the relevant industry players is also expected to increase as the industry downsizes.

On the contrary, the energy industry is expecting a significant regulatory change which might lead to a market consolidation. Companies in the renewable energy industry (in particular wind parks) have witnessed a significant number of (mid-market) M&A transactions. The large Spanish energy groups (Repsol, Iberdrola, Endesa and Gas Natural-Fenosa) should also continue to be active as acquirers and potential targets for foreign strategic investors.

v Private equity

Private equity should also continue to be active in 2012–2013 both on the sell-side and as buyers. Indeed, private equity funds face increasing pressure to exit their portfolio companies and to distribute capital to investors as they approach the end of the life of their funds. Private equity sponsors may also wish to divest from highly leveraged acquisitions completed in the boom years of 2006 and 2007.

On the other hand, private equity firms can be relevant players in Spain in 2012, as some are coming under increasing pressure to invest funds raised in recent years and

Spanish listed companies are becoming extremely undercapitalised and thus attractive for 'public-to-private' transactions.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

i New acquisition financings

Although the number of acquisition finance transactions increased in 2011 compared with 2010, the trend experienced a slowdown in the last quarter of 2011 and the first quarter of 2012, mainly due to the intensification of the economic world crisis, which has had a significant impact on Spain and its sovereign debt.

As in recent years, the terms and conditions offered to borrowers continue to be challenging. Despite the environment, some large transactions have been closed recently, such as the €120 million credit facility granted to CSN to partially finance the acquisition of certain German companies of the Gallardo Group, a steel producer; other interesting M&A transactions, however, ultimately fail to close due to the lack of financing derived from the strict conditions imposed on banks.

The availability of funds from Spanish financing entities has clearly decreased due to the stronger needs for tier 1 capital and 'principal capital' for Spanish financing entities, which have become even more constraining due to the recommendation of the European Bank Association of 8 December 2011; the reorganisation of the Spanish banking industry, still underway; and the latest legislative reforms made by the new government, which require Spanish financial entities to increase, before 31 December 2012, the currently required accounting provisions associated with real estate financing transactions from 7 per cent up to a maximum of 52 per cent, for both land financing and unsecured financings, or 29 per cent or 14 per cent for financings granted to ongoing or completed constructions, respectively (all of which applies regardless of whether or not the asset is considered to be distressed).

In addition to the strict conditions imposed on banks, borrowers must also cope with the limitation on the tax deductibility of financial expenses that has been recently introduced (see Section VIII, *infra*). This limitation is likely to have an adverse effect on the shareholders' returns as well as the fulfilment of business plans that were agreed with the banks during 2008, 2009 and 2010.

High-yield and other debt issuances continue to be rare in Spain since they face both the drought in the capital markets (which intensified last year) and Spain's strict legal limits (limited liability companies, the most commonly used vehicles for such transactions, may not issue or guarantee debt instruments and the maximum amount of the issuance is limited by the issuing company's equity).

ii Financing conditions

Apart from these general trends, the following are the main features of acquisition financings during 2011 and 2012:

a The range of financing products available to the borrowers remains limited: second-lien facilities, ancillary facilities, bridge-to-equity facilities and equity-like facilities have almost entirely disappeared and the amount of mezzanine and payment-in-kind ('PIK') facilities has decreased (except in specific restructurings

when borrowers do not generate sufficient cash to serve all the debt and part of the term loan facilities are converted into partial PIK facilities). In contrast, vendor loans are being used increasingly to finance acquisitions.

b Banks generally reject debt-to-asset transactions. In certain extreme circumstances they may ultimately capitalise their loans to ensure the borrower's solvency; however, banks analyse the capitalisation of debt on a case-by-case basis.

c As a consequence of the intensification of the economic crisis and its specific impact on financial markets, banks still refrain from agreeing to the 'certainty of funds' provision in commitment letters, whereas the inclusion of material adverse change clauses and 'diligence out' provisions are currently essential. Limits to changes in pricing that can be arranged without the borrower's consent have been widened under the 'market flex' provisions, and 'reverse flex' provisions have disappeared. Facility agreements always include widely drafted 'market disruption' clauses. In contrast, LMA provisions concerning defaulting lenders are uncommon in the Spanish market.

d As in recent years, the economic terms of acquisition finance transactions currently contemplate a reduction in the terms and an increase in margins and fees, especially agency fees, compared with previous years, mainly intended to make the ratio between risk and returns more appealing to banks. Leverage ratios have been reduced and banks tend to include amortising term loans rather than bullet loans (which approach, to a certain extent, commits banks to the future refinancing of the bullet loan). Forward start loans have also been used recently as a refinancing method.

e Banks continue to reject specific provisions which were common in a more favourable economic environment. Banks are currently focused on anticipating insolvency given that agreements can only be terminated due to breaches that occurred after the declaration of insolvency (and not as a result of the borrower being insolvent).

f Security packages requested in acquisition finance continue to be robust in Spain as a consequence of financial assistance restrictions, among other factors.

g We continue to see that some of the target companies acquired by private equity companies in leveraged buyouts which closed at high prices between 2005 and 2007 are facing financing difficulties, as the 'wall of debt' approaches (leveraged loans due to mature between 2012 and 2014). Similar difficulties have arisen for other companies, which during the same period financed ambitious recaps out of new subordinated bank facilities. The base cases, which assumed constant growth, have been breached due to the crisis, and companies are unable to service their debt. We have even witnessed large and medium-size private equity firms fail to support their vehicles, leaving the financing banks with the dilemma of whether to seek out a new purchaser, acquiring the shares of the vehicle in exchange for their debt, or request the declaration of the vehicle's insolvency. Private equity firms have taken advantage of this opportunity to buy back their vehicles' debt.

iii Refinancings

Unlike in the first half of 2011, the volume of large refinancings and restructurings slightly increased during the second half of 2011 and the first quarter of 2012. Most of these refinancings and restructurings are second or third-round refinancings and restructurings of those made during 2008, 2009 and 2010 that failed to meet their business plans as a consequence of the intensification of the economic crisis. Private equity also faces the need for significant refinancing as the 'wall of debt' of their portfolio companies approaches fast.

VII EMPLOYMENT LAW

Royal Decree-law 3/2012 of 10 February significantly modified the framework of Spanish labour relations with a significant impact on pre or post-M&A labour reorganisations. The new regulations are based on two main axes: promoting 'internal flexibility' and amending regulations concerning terminations of employment based on business grounds (redundancies).

Amendments have been approved in the following areas to promote 'internal flexibility' within companies, as an alternative to terminating employment contracts:

a geographical and functional mobility;

b substantial changes to employment conditions;

c suspension of contracts or reduction of working hours due to economic, technical, organisational or production reasons, removing the need to obtain an administrative authorisation and extending unemployment benefits;

d the non-application of certain employment conditions set out in the relevant collective bargaining agreements is no longer limited to salary conditions and, in the event of any disagreement, either party may submit the discrepancy to arbitration;

e the company's collective bargaining agreement prevails over inter-professional agreements, or state or regional industry-specific collective agreements; and

f collective agreements are not automatically extended beyond two years after the agreed date of termination.

Authorisation from the labour authorities is no longer required for collective dismissals. The collective dismissals is justified if the company is incurring (or forecasts to incur) losses, or is suffering a decrease in the level of income or sales. A decrease exists when there is a reduction in the level of income or sales in three consecutive quarters. Finally, compensation for unfair (individual) dismissal is reduced from 45 days of salary per year of service to 33 (with no back-pay being incurred).

VIII TAX LAW

The most significant recent tax law amendments affecting the M&A practice are aimed at increasing the Treasury's income, primarily through tax increases and the deletion or limitation of certain tax benefits. The following measures, *inter alia*, affect Corporate Income Tax ('CIT'):

a General restriction on the deduction of financing expenses: with effect as of 1 January 2012, the Spanish thin capitalisation rule (whose scope was substantially limited given that it did not apply to debts with EU residents) has been replaced by a general restriction on the deduction of financing expenses, by which net financing expenses exceeding 30 per cent of the operating profit of a given tax year are not deductible for CIT purposes.

b Non-deductibility of interest deriving from intra-group indebtedness used to finance the acquisition of shares from other group entities: a new general rule establishes that no financial expenses deriving from intra-group indebtedness will be deductible for CIT payers if the debt is incurred in order to acquire an interest in the share capital or equity of any type of entity from another group company, or increase the share capital or equity of any other group companies, unless the taxpayer evidences that there are sound business reasons for these transactions.

c Elimination of the free amortisation benefit: the free amortisation benefit formerly applicable to new tangible fixed assets and investments in real estate falling under the scope of the company's business activity has been eliminated.

d Temporary restriction on offsetting carry-forward losses: offsetting of carry-forward losses during 2011, 2012 and 2013 will be subject to the following limits: (1) companies with turnover of between €20 million and €60 million may only offset up to 75 per cent of their taxable income; and (2) companies with turnover exceeding €60 million may only offset up to 50 per cent of their taxable income.

e Temporary limit on annual goodwill deduction: as a temporary restriction only affecting tax periods starting in 2012 and 2013, the annual tax deduction of goodwill (including financial goodwill of non-resident companies and goodwill derived from the acquisition of a business through an asset deal, merger or spin off) has been reduced from 5 per cent to 1 per cent.

f Temporary restrictions on the application of certain tax credits, including for reinvestment.

g Minimum payments in advance on account of CIT during 2012 and 2013 for taxpayers with turnover exceeding €20 million.

Other relevant tax amendments aimed at fostering the repatriation of funds, investment and economic activity include:

a under certain conditions, a newly created special reduced 8 per cent optional tax rate (as an alternative to 30 per cent CIT) may apply to dividends and capital gains realised on the sale in 2012 of shares in non-resident companies that do not meet the Spanish participation exemption requirements;

b certain restrictions on the tax exemption of capital gains realised on the sale of shares in non-resident companies have been relaxed; and

c a 50 per cent exemption has been introduced on personal income tax, non-resident income tax and CIT for any capital gains realised on the sale of urban real estate acquired between 12 May and 31 December 2012.

Given the current economic situation, the financial downturn and the financial needs of the public sector, additional tax reforms are expected to take place in 2012 and 2013.

IX COMPETITION LAW

In 2011, the number of merger control proceedings submitted to the Spanish Competition Commission remained stable compared to 2010. The most active industries were banking, insurance, energy and distribution.

The Spanish Competition Commission has initiated proceedings against several companies for failure to notify concentrations (gun jumping). The infringements may result in the imposition of fines of up to 5 per cent of the total turnover of the infringing undertaking. In 2011, fines were imposed on Dorf Kettal, Gestamp, Essalt and Grupo Isolux for failure to suspend the execution of concentrations.

Under merger regulations, concentrations that are unlikely to significantly affect competition due to the limited market shares of the parties involved may resort to short-form notifications. In October 2011, the Spanish Competition Commission published a notice regarding short-form notifications of concentrations. The notice states that short-form notifications may not be used in cases in which a report from an industry regulator is required (e.g., banking, telecom and energy industries). The obligation to provide the report will also affect the timetable of the transaction, as it suspends the running of the maximum time limits in which to grant authorisation.

X OUTLOOK

After a slow first half of 2012 (mainly due to the uncertainties related to Spain's banking and sovereign debt crisis), the outlook for M&A transactions in the second half of the year and 2013 seems more promising. The ongoing reorganisation of the banking industry, the disposal of non-core assets by Spanish banks and corporations, the reduced market capitalisation of healthy corporations listed in Spain, the reduction in the valuation gap between sellers and purchasers, and a large privatisation programme by the Spanish government should all further the M&A activity for both domestic and, in particular, international, strategic and private equity investors. The labour, pension and other reforms implemented by Spain's new government should also, in the medium term, render Spain more attractive for foreign investments.

Finally, Spanish corporations are expected to continue growing stronger in foreign markets, where they already have a robust presence, specifically in several Latin American countries such as Brazil and Mexico. On the other hand, emerging countries (particularly Brazil and China) and sovereign wealth funds are expected to use Spain as a hub for their investments in Europe and Latin America, which could also help revive the Spanish M&A market.

Appendix 1

ABOUT THE AUTHORS

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Christian Hoedl was educated at the Universidad Autónoma de Madrid and holds a master's degree from the Centro de Estudios Tributarios y Financieros and the Universidad Complutense de Madrid. He joined Uría Menéndez in 1987, and became a partner in 1998. From 1999 to 2001, he was the resident partner in the firm's Bilbao office.

Mr Hoedl focuses his practice on privatisations, mergers and acquisitions and private equity. He is secretary or vice secretary to the boards of various companies.

During 1998, he lectured on commercial law at the Universidad Pontificia de Comillas in Madrid. From 2000 to 2001, he lectured at the Universidad de Deusto in Bilbao. He is also a regular speaker and commentator at law seminars and conferences.

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JAVIER RUIZ-CÁMARA

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Javier Ruiz-Cámara was educated at the Business, Economics and Law School (ICADE) of the Universidad Pontificia de Comillas. He joined Uría Menéndez in 1999 and was seconded to Slaughter and May from 2004 to 2005. From June 2005 until September 2007 he was head of the firm's Santiago de Chile office. He became a counsel of the firm in 2011.

Mr Ruiz-Cámara focuses his practice on mergers and acquisitions, private equity and financing and speaks fluent English and German.

He has lectured on company law at ICADE and on commercial contracts at the Universidad Nebrija. He has contributed to various publications focused on matters pertaining to his field of expertise.

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