ABOGADOS
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MAIN INNOVATIONS OF THE ROYAL DECREE-LAW 4/2014 OF 7 MARCH, ADOPTING URGENT MEASURES ON BUSINESS DEBT REFINANCING AND RESTRUCTURING

On 8 March 2014, the Royal Decree-Law 4/2014 of 7 March, adopting urgent measures on business debt refinancing and restructuring (hereinafter the "RDL") was published in the Official State Gazette. It entered into force on the day following its publication, and on 27 March 2014 it was confirmed by the Parliament, as required pursuant to Spanish law. However, it has been announced that the Parliament will discuss the final text recently confirmed and may make amendments in the coming weeks.

The main amendments to the existing legal framework contained in the RDL are the following:

1. PRE-INSOLVENCY MATTERS:

1.1. Amendments regarding the renegotiation notice provided for in section 5 bis of the Insolvency Act.

Since 2009, the Spanish Insolvency Act ("*Ley Concursal*") allows a debtor who is negotiating its debt with its creditors to serve notice to the courts of such renegotiation process, so as to avoid that the creditors may try to file an insolvency petition for certain months, and to avoid the directors' liabilities arising from a delay in filing the insolvency petition. The applicable regime to this notice has been modified dramatically:

(i) Prior to the reform, the negotiation of any type of re-financing agreement could be negotiated. Now the only agreements that will entitle the debtor to seek the protection of the renegotiation notice are those provided for under article 71 bis 1 (re-financing agreements which follow certain proceedings to obtain immunity against a claw-back insolvency action) or the ones laid down under the Fourth Additional Provision of the Insolvency Act (cram down procedure).

(ii) The communication will prevent the initiation or continuation of security enforcement against certain goods of the debtor in the following cases:

- When the assets affected by the security are necessary for the continuity of the business or professional activity of the debtor; and

- When creditors representing 51% of the debtor's financial liabilities have expressly approved the beginning of negotiations aimed at subscribing a re-financing agreement, committing themselves not to start individual enforcements against the debtor during the course of the negotiations (i.e., that at least 51% of the creditors representing financial liabilities are negotiating with the debtor and have agreed a stand-still).

If the secured debts arise from public law (i.e. if they are debts owed to public authorities), enforcement will not be affected.

1.2. Re-financing agreements:

Prior to the RDL, Spanish law provided for the possibility to protect a collective re-financing agreement from a possible claw-back action arising in the course of a subsequent insolvency proceeding of the debtor. For this protection to be granted, certain requirements were required (among others, its approval by a majority of 3/5 of the creditors and its validation by an independent expert appointed by the Commercial Registry). The RDL has amended the requirements to obtain the protection against a claw back in this sort of refinancing agreements, and has created a new category of agreements which do not require certain majorities to achieve protection (i.e., may be even reached between a single creditor and the debtor). As a consequence of such amendments, the following possibilities are now available:

(i) Agreements reached with a majority of creditors representing 3/5 of the liabilities of the debtor: these agreements will no longer require the validation of an independent expert. They will only require that the debtor's auditor certifies that the majority threshold provided in the agreement has been reached. It has also been clarified that this sort of agreement may provide for the termination of existing liabilities.

(ii) Agreements which are not supported by any type of majority, but that meet certain requirements which justify their immunity to an insolvency claw-back action. The requirements that need to be met (cumulatively) are the following:

- That the initial proportion of assets in relation to liabilities is increased.

- That the resulting current assets are equal to or greater than the current liabilities.

- That the value of the security granted in favor of the creditors who enter into the agreement does not exceed either: (x) 9/10 of the outstanding debt after the agreement; nor (y) the ratio of security/debt that such creditors had prior to the agreement.

- That the interest is not increased more than 1/3 over the applicable interest prior to the refinancing agreement.

- Execution of the agreement in the form of a notarial document which will need to include the economic grounds which justify the execution of the agreement.

On the one hand, this new possibility is interesting because it enables an agreement to avoid being subject to a claw back, even if it has only been entered into by a single creditor. However, it also entails a certain level of uncertainty as it is still not known if re-financing agreements which do not meet the aforementioned criteria could always be subject to a claw back action or only if they are detrimental to the insolvency estate (as any other agreement entered into by the debtor).

1.3. Cram down procedure:

The cram down procedure provided for in the Spanish Insolvency Act since 2011 has been dramatically amended, in order to expand the possible creditors that may be crammed down and to facilitate its application:

(i) The scope of application of the cram down is no longer based on the type of creditor (financial institutions), but on the type of liability (financial liabilities, which pursuant to Spanish Accountancy regulations are almost all liabilities subject to a term). The result of this change is a significant increase in the scope of creditors that may be affected by a cram-down. Liabilities derived from commercial relationships (i.e., debts of suppliers) and public-law credits are expressly excluded.

(ii) The majority threshold to approve an agreement is lowered from 55% to 51%, without counting the “persons having a special relationship with the debtor” to form such majority. Notwithstanding the foregoing, achieving such majority will protect the agreement against a possible claw-back action and grant preferential ranking to the fresh money injected (see 2 (ii) below), but will not grant the agreement the cram-down effect vis-a-vis opposing creditors. Specific majorities are required depending on the content of the agreement for such purpose:

- In order to obtain the cram-down effect vis-a-vis unsecured creditors, a majority of 60% is required for the less serious effects (deferrals of up to 5 years and conversion of their credits into equity loans for the same term) and of 75% for the most serious effects (deferrals of up to 10 years, unlimited releases, debt for equity swaps and payment in kind).

- secured creditors may be crammed down if certain majorities are reached among the creditors representing most of the value of the security. Such majorities are of 65% of the security value for the less serious effects described above and 80% for the most serious effects respectively. Broadly speaking, the value of each piece of security is 90% of the value of the asset given as security minus the value of all other security with a higher rank affecting such asset.

Another innovation, which is aimed at avoiding hold-out minorities in syndicated transactions, is that a stake of 75% (or, alternatively, any other lower majority provided in the agreement) may cram-down the remaining minority (the RDL does not make any distinction in this regard on whether the syndicated loan is secured or not).

2. INSOLVENCY MATTERS:

(i) **Standstill in security and similar recovery actions**. It is clarified that the shares in a vehicle holding an asset used by the insolvent debtor are not necessary goods for him to carry out his professional activity if the debtor can continue to use such asset after the enforcement.

(ii) **Changes in the credit ranking ("fresh money")**. During the following 2 years, cash revenues obtained under the framework of a re-financing agreement or under a cram down agreement, even if they come from specially related persons (such as directors or shareholders), will be considered credits against the insolvency estate in full (i.e. they will be excluded from the insolvency estate in full and will not be ranked for payment in accordance with insolvency law. They should be paid in full). However, they will only be considered as such for the subsequent two years (afterwards the general rules will apply again. Pursuant to such rules such credits as excluded only up to 50% and provided that they are not granted by specially related persons).

(iii) **Changes in the concept of specially related person**. The concept of "specially related person" is modified in order to prevent creditors who capitalize debts from being considered as specially related persons or de-facto directors. Being a specially related person causes that a creditor is considered subordinated pursuant to Spanish insolvency law.

(iv) **Changes in the qualification as "*culpable*" of the insolvency proceedings if a debtor does not accept a debt capitalization**. If creditors offer the debtor the possibility of capitalizing the debt (or transforming it into convertible instruments) to solve an economic crisis and he refuses to do so, in case that insolvency proceedings overcome later, it could be qualified as "culpable" under the following conditions:

- That the debt capitalization has a reasonable cause, which should be determined by an independent expert. The RDL permits several appointments, and in this case, the cause would be considered reasonable if the majority of the reports indicate so.

- That a preemption right has been conferred over the shares, stocks and instruments issued to the existing shareholders.

The qualification as "*culpable*" (broadly speaking, caused by willful misconduct or gross negligence) may cause the directors of the company, and even its shareholders to become liable.

3. OTHER COMMERCIAL REFORMS:

(i) **Changes of the provisions to be made by Banks in respect of refinanced or restructured transactions.** The Bank of Spain is requested to establish the requirements that will allow that a transaction restructured by means of the refinancing or cram-down procedures explained above not require a specific provision in the accounts of the refinancing banks.

(ii) **Amendments to the IPO Royal Decree (*Real Decreto de OPAs*)** to prevent that debt for equity swaps derived from a re-financing agreement could trigger the obligation to launch an IPO.

(iii) **Amendments to the Act on Structural Amendments of Companies (*Ley de Modificaciones Estructurales*)**, in order to release from the requirement of obtaining reports from directors and experts when the absorbing company holds 90% of the stake in the absorbed company or companies and offers the owners of the outstanding 10% the acquisition of their shares at fair value.

(iv) **Extension of certain exceptional accountancy rules**. Under Spanish law, losses may force a company to reduce its share capital, be wound up or be declared insolvent by the courts Losses derived from the loss of value of certain assets is taken into account for these purposes. To avoid massive winding-ups and insolvencies, the government approved a temporary exclusion of such losses in 2008, which has been extended on a yearly basis ever since. The RDL contains the extension for 2014. The exclusion currently covers the impairment losses derived from real estate, investment property and inventories, or from loans and receivables.

4. TAX MATTERS:

4.1. Amendment to the Royal Legislative Decree 4/2014, of 5 March approving the consolidated text of the Corporate Income Tax Act (*Real Decreto Legislativo 4/2014 por el que se aprueba el Texto Refundido de la Ley del Impuesto de Sociedades "TRLIS"*). With effects for the tax periods initiated from 1 January 2014, the following amendments will come into force:

(i) Debt for equity swaps shall be exempt both for the creditor and the debtor. However, if the tax value of the credit to be swapped is lower than its nominal value (which will occur if the credit was acquired from a third party below par) taxation will arise for the creditor. In such case, the creditor would have to include in the taxable base the difference between the amount of the portion of capital increase allocated to him, and the tax value of the capitalized credit.

This amendment reflects the criterion of the tax authorities set out, among others, in the response to the binding consultation V2220-13, of 5 July 2013, issued by the *Dirección General de Tributos,* for shareholders contribution (or loss recovery) via debt to equity swaps.

(ii) In addition, the Corporate Income Tax Act (new section 14 of article 19) is amended by introducing a new allocation rule for the income to be recorded as a consequence of a write-off or extension agreed pursuant to the terms of the Spanish Insolvency Act. Such income shall be recorded at the same time as the financial expenses derived from the debt which was subject to the write-off or extension is recorded.

However, if the amount of the income that needs to be accounted as a consequence of the extension or write-off is higher than the total amount of the financial expenses pending accounting, the allocation of the revenue will be carried out proportionately to the financial expenses recorded in each period.

This prevents the taxation on write-offs and extensions from constituting an obstacle to refinancing transactions and follows the rulings of the Supreme Court dated 10 November 2011 and 28 March 2012.

4.2. Amendment to the consolidated text of the Stamp Duty Act, approved by Royal Legislative Decree 1/1993 of 24 September (*texto refundido de la Ley del Impuesto sobre Transmisiones Patrimoniales y Actos Jurídicos Documentados, aprobado por el Real Decreto Legislativo 1/1993, de 24 de septiembre "TRLITPyAJD"*). With effect from 9 March 2014, notarial deeds documenting releases or write-offs in loans, credits or other obligations included in the re-financing or extra-judicial payment agreements provided for under the Insolvency Act will be exempt from stamp duty, as long as the taxable person is the debtor (article 45.I.B) 19 of the TRLITPyAJD).

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