Royal Decree Act 4/2014 concerning the improvement of the legal framework of corporate refinancing and debt restructuring agreements

The Cabinet has approved a Royal Decree Act (Order in Council) establishing urgent measures to expedite and streamline corporate refinancing and debt restructuring processes. In essence, these measures aim at ensuring the survival of companies that, notwithstanding the accumulation of excessive financial burden, are viable from an operational point of view through an orderly and balanced system of agreements with creditors and a wider range of refinancing options.

The Royal Decree Act amends some aspects of the Spanish Insolvencies Act of 9 July 2003 regarding the pre-insolvency proceedings stage so as to avert entry into said proceedings and subsequent company liquidation. Specifically, the Royal Decree Act amends the regime of homologated (court sanctioned) refinancing agreements, which may include, aside from deferrals, the forgiveness and capitalisation of debt. These homologated refinancing agreements may extend their effects to dissenting creditors where the majority requirement established in each case is met. In addition, issues such as "fresh money" are addressed.

Individual refinancing agreements

The Royal Decree introduces the possibility of reaching refinancing agreements with one or more creditors, without needing approval from the majority in value of the creditors, provided that such agreements comply with certain conditions foreseen in the Royal Decree (section 2 of new Article 71 *bis* of the Insolvency Act). Those requirements are intended to cover situations where the refinancing agreement should improve the debtor's financial position, and are generally referred to the proportional increase of the assets of the debtor versus its liabilities, the value of new guarantees granted in the refinancing agreement, and the interest rate applicable to the refinancing.

These agreements may only be rescinded by a judge at the request of the insolvency administrator, if and when the judge believes the legislative requirements are not met.

Non-homologated collective refinancing agreements

These agreements are simplified by eliminating the requirement of an independent expert report. Such report is replaced by an auditor's certificate confirming that the requirement concerning approval by three fifths (3/5) of the creditors has been met. In order to ensure legal certainty, these agreements may no longer be subject to subsequent rescission (unless they do not comply with the established requirements) if the company enters insolvency proceedings.

Finally, if the collective agreement provides for a capitalisation of debt, the debtor's refusal to such without good cause will trigger an "at fault" presumption in insolvency proceedings. In this regard, good cause will be deemed to exist if supported by a report issued by an independent expert. In addition, the proposed agreement must grant the debtor's shareholders a pre-emption right over the shares subscribed by creditors, as a result of capitalisation, in the event of subsequent disposal of such shares.

Homologated collective refinancing agreements

In order to facilitate speed and flexibility in these agreements, the judge will only have to verify compliance with formal and majority requirements to grant sanction. Once homologated, the agreements may not be rescinded if the company enters insolvency proceedings.

As with non-homologated collective agreements, the requirement of an independent expert report is removed and replaced by an auditor's certificate confirming that the requirement concerning approval by the majority in value of creditors has been met.

The majority needed for the agreement's homologation is brought down from 55% to 51% (a simple majority). This majority is not calculated in respect of the claims held by financial institutions, as hitherto, but in respect of all financial creditors. Such creditors are understood to be the holders of any financial debt (excluding, therefore, trade creditors and public administration (preferential) creditors), whether or not subject to financial supervision.

Another novelty is that the creditors of syndicated loans are taken to have endorsed the refinancing agreement when 75% of these, in value, have voted in favour of the same, unless the rules governing the syndication establish a lower majority.

The new regulation also includes 2 levels of decisions that can be imposed to unsecured dissenting creditors:

- If the refinancing agreement has obtained the approval of 60% of the financial creditors in value, unsecured dissenting creditors can be forced to the agreed deferrals of up to a maximum of five years, and to conversion of debt into profit sharing loans (*préstamos participativos)* for the same period.

- If the refinancing agreement has obtained the approval of 75% of the financial creditors, unsecured dissenting creditors can be forced to: (i) five to ten year deferrals, (ii) forgiveness of debt, (iii) debt for equity swaps, or (iv) conversion of debt into five to ten years profit sharing loans or debt for any other financial instrument with different characteristics, or (v) disposals of assets in payment of debts.

With respect to secured (fixed charge) claims, up to now the homologated refinancing agreements did not extend their effects to such secured creditors. With the reform, these claims are also affected by the homologated agreement, as follows:

- **The portion of the claim that exceeds the value of the security**: the effects of the agreement referred to above (deferrals, swaps, etc.) extend as with unsecured claims and with the same majorities.

- **Up to the value of the security**: the effects of the agreement referred to above are extended, when agreed by majorities of 65% and 80%, calculated on the basis of the value of the security of assenting creditors compared to the value of the secured debt.

Moreover, the possibility of homologated refinancing agreements including (and extending to dissenting creditors) debt for equity swaps is recognised. The resolution of the meeting of shareholders requires a simple majority and dissenting creditors may choose, as an alternative, forgiveness of debt. Also, as with non-homologated agreements, an at-fault presumption is triggered in insolvency proceedings if the debtor has rejected capitalisation without good cause. It must be noted that such at-fault presumption can eventually give rise to the responsibility of the shareholders that without good cause voted against the equity swap (in addition to the directors of the insolvent company) depending of their level of contribution to the blocking minority.

Measures common to homologated and non-homologated collective agreements

A stay in the enforcement of judgments over specific assets necessary to the continuity of the company as a going concern, from the moment the court is notified of the start of negotiations with creditors, is provided for. The stay would extend for a period of four months from notification by the debtor. The aim is to enable the negotiation of agreements to reach a satisfactory conclusion and prevent an accumulation of enforcements by creditors unwilling to negotiate.

Measures common to homologated and non-homologated individual and collective agreements

Currently only 50% of new money put into a refinancing agreement has insolvency priority, which means that claims are paid off on their respective maturity. This percentage is temporarily raised to 100% in order to provide this liquidity with the highest insolvency protection. The aim is to encourage additional financing as it is essential to ensure the company's transitory viability and to render the refinancing agreement itself practicable.

This rank extends to "fresh money" granted by the debtor or persons specially related to the same, excluding share capital increase transactions. It will run for two years from the entry into force of the Royal Decree Act and will apply to insolvency proceedings opened in the next four years.

Creditors who have directly or indirectly capitalised all or part of their claims under a refinancing agreement will not be considered insiders of the insolvent for the purposes of the subordination of claims held against the debtor as a result of the refinancing granted under the agreement.

Improved treatment of the provisions made by financial institutions

The Bank of Spain is charged with establishing uniform rules to improve the rating of subsisting debt after a refinancing agreement.

Other amended rules

- The Royal Decree Act of 12 December 2008 is amended so that the impairment losses recorded in the annual accounts of companies and deriving from plant and equipment, real estate investment, stocks or receivables, do not count during the financial years closed in 2014 in any insolvency (and insolvency proceedings), share capital reduction or winding-up event.
- The Takeover Bid Royal Decree 2007 is amended. Thus, acquisitions or transactions made in the context of the conversion or capitalization of credits in companies facing serious financial difficulties are exempt from filing a takeover bid, to the extent that the transaction is aimed to re-establish the financial situation of the company on a long term basis. The Spanish Securities and Market Authority (CNMV, its acronym in Spanish) has to issue an authorisation to confirm that that the relevant transaction is exempt from the takeover bid, except in the case of specific transactions directly resulting from an homologated refinancing agreement, provided such bid is supported by the opinion of an independent expert. Therefore, homologated refinancing agreements supported by an opinion of the independent expert do not need express authorization of the CNMV to be exempt from the takeover bid obligations.
- The Consolidated Text of the Spanish Corporate Income Tax Act is amended. Here the absence of taxation is established in cases of debt capitalisation, unless such has been subject to a buyback for a value other than its nominal value. Also, in relation to the tax treatment of income derived from forgiveness of debt and deferrals under the Spanish Insolvency Act, a deferred imputation system is determined for the revenue generated in the tax base according to the financial costs thereafter recorded.
- The Consolidated Text of the Spanish Transfer and Stamp Duty is amended. In order to contribute to the maintenance of companies as a going concern, Transfer and Stamp Duty exemption is extended to deeds containing forgiveness of debt (in full or in part), thereby facilitating refinancing or settlement agreements.