ROYAL DECREE-LAW 4/2014, OF 7 MARCH 2014, ON URGENT MATTERS IN RELATION TO REFINANCING AGREEMENTS AND DEBT RESTRUCTURING

*The Spanish Council of Ministers passed on 7 March 2014 the Royal Decree-Law 4/2014, on urgent matters in relation to refinancing agreements and debt restructuring (the "**RDL 4/2014**"). The RDL 4/2014 has been published on 8 March 2014 in the Spanish Official Gazette and it entered into force on the day immediately following its publication.*

*The main purpose of RDL 4/2014 is to amend Law 22/2003, of 9 July, on Insolvency (the "**Insolvency Law**") in order to ease the successful completion of refinancing and debt restructuring processes.*

1. THE PRE-INSOLVENCY STAGE (ART. 5 *BIS* OF THE INSOLVENCY LAW)

In relation to the communication to be filed with the competent court informing that the relevant debtor is negotiating with its creditors a refinancing agreement or a pre-insolvency creditors' composition agreement (the "**Pre-insolvency Status Request**"), the RDL 4/2014 introduces certain changes:

(a) once the filling has been made, the relevant debtor may not file another Pre-insolvency Status Request within a year term; and

(b) the Pre-insolvency Status Request will be published in the Spanish Public Registry of Insolvency Resolutions (*Registro Público Concursal*), save if otherwise expressly requested by the debtor.

In addition to the foregoing, pursuant to RDL 4/2014 no judicial enforcements over assets which are deemed necessary for the professional activities and business of the debtor can be initiated (and those initiated will be suspended) in the period between the filing of the Pre-insolvency Status Request and the earlier of (i) the formalization of the refinancing agreement, (ii) the provisional admission of a request for the endorsement of a refinancing agreement, (iii) the date when an out-of-court refinancing agreement is reached, (iv) the date when enough creditors have adhered to a pre-insolvency creditors' composition agreement, or (v) the insolvency declaration (which needs to be requested within 4 months since the filing of the Pre-insolvency Status Request -unless the insolvency situation has been overcome-). The abovementioned limitation does not apply to enforcements of public law credits (*créditos de derecho público*).

Furthermore, the RDL 4/2014 sets out that no single judicial enforcement promoted by creditors may be initiated (and those initiated will be suspended) when a percentage of creditors representing no less than 51% of the debtors financial liabilities have supported the beginning of negotiations in order to reach a refinancing agreement and have further committed not to pursue single enforcements within the negotiation period.

2. THE REFINANCING AGREEMENTS

The out-of-court formal refinancing agreements regulated until the publication of RDL 4/2014 under article 71.6 of the Spanish Insolvency Law are now ruled by new article 71 *bis* of the Insolvency Law.

In order to be protected against claw-back actions under the Insolvency Law in the event that the debtor becomes insolvent in the future, an out-of-court refinancing agreement must comply with the following requirements:

(a) it must increase the funds available for the distressed debtor or modify the existing terms of the debt either extending its tenor or replacing the debtor's obligations by new ones;

(b) the refinancing must be accompanied and supported by a viability plan;

(c) it must be entered into and approved by creditors representing at least $^{3}/_{5}$ of the debtors' total liabilities (without taking into account the intra-group debt);

(d) the debtor's auditor (or an auditor appointed by the Commercial Registry) has issued a certificate evidencing the fulfillment of the majority requirement mentioned in paragraph (c) above; and

(e) it is executed in a notarial deed before a Notary Public.

RDL 4/2014 has removed the need of an assessment of the viability plan by an independent expert appointed by the Commercial Registry. However, pursuant to article 71 *bis* 4 of the Insolvency Law (as drafted by the RDL), such independent expert assessment may still be requested either by the debtor or the creditors and has certain effects (see Section 5 and 8(b) below).

The regime set out in former article 71.6 of the Insolvency Law will still apply to those refinancing agreements the negotiation of which has been initiated prior to the publication of RDL 4/2014 provided that the appointment of an independent expert has already been requested to the Commercial Registry (save to the extent that the parties expressly agree in the refinancing agreement that the new legal framework set out in RDL 4/2014 shall apply).

Additionally, pursuant to RDL 4/2014 individual refinancing agreements and collective refinancing agreements which do not meet the requirements stated above will also be protected against claw-back actions provided they comply with the following conditions:

(a) increase the proportion of assets over the existing liabilities;

(b) that the resulting amount of current assets is higher or equal to the current liabilities;

(c) the value of the resulting security interests granted in favor of the creditors executing the agreement does not exceed (i) $^{9}/_{10}$ of the value of the outstanding debt owed to such creditors; nor (ii) the proportion of collateral versus outstanding secured debt of such creditors immediately before the execution of the agreement;

(d) that the applicable interest rate of the debt resulting from the refinancing agreement does not exceed in more than $^{1}/_{3}$ the interest rate applicable to the previous debt; and

(e) that the agreement is executed in a notarial deed before a Notary Public.

3. THE RANKING OF CLAIMS

RDL 4/2014 introduces some relevant changes regarding the ranking of claims.

(a) DIP financing / Fresh money

During the two years following the entrance into force of RDL 4/2014, "new money" made available to the debtor within the scope of a refinancing agreement of those regulated in article 71 *bis* or in the Fourth Additional Provision of the Insolvency Law will be regarded as claims against the insolvency estate (instead of just 50% of such "fresh money" as provided for in the former regulation). This extra privilege will only be applicable for a two-year term.

(b) Creditors which credits have been capitalized

RDL 4/2014 excludes from the concept of specially related persons (and therefore their claims will not be considered as subordinated on these grounds), the holders of financial liabilities which have been totally or partially capitalized in the framework of a refinancing agreement under the Spanish Insolvency Law.

4. ENFORCEMENT OF *IN REM* SECURITY INTERESTS

Once the opening of an insolvency proceeding has been declared, the creditors secured with an *in rem* security interest may not initiate enforcement proceedings over assets which are deemed necessary for the professional activities and business of the debtor until the earlier of (i) the approval of a creditors composition arrangement that does not affect such enforcement or (ii) the first anniversary of the date of opening of the insolvency proceedings. RDL 4/2014 expressly provides, in certain events, for the shares held by the debtor in other companies (e.g., project companies) not to be regarded as an asset necessary for the professional activities or the business of the debtor, provided that the debtor remains entitled to use the assets owned by such companies.

Prior to the amendment operated by RDL 4/2014, the restriction to initiate enforcement proceedings was drafted in broader terms and it seemed to affect the majority of the assets of the debtor related with its activity.

5. LIABILITY PHASE

RDL 4/2014 introduces a new rebuttable presumption whereby the existence of willful misconduct or gross negligence of the debtor is presumed (unless otherwise evidenced) for the purposes of an insolvency process being regarded as "culpable" if the debtor unreasonably rejects the capitalization of debt or an issuance of convertible securities or instruments and such rejection prevents the execution of a refinancing agreement, provided that a pre-emption right was granted to the shareholders of the debtor for the acquisition of the

relevant securities or instruments if they were to be transferred afterwards by the relevant creditor to a third party.

The capitalization shall be deemed reasonable when it is so declared by an independent expert appointed pursuant to article 71 *bis* 4 of the Insolvency Law prior to the debtor's refusal.

6. CRAM DOWN OF REFINANCING AGREEMENTS

Significant changes in the regime for the cram down of certain terms of refinancing agreements on dissenting lenders are introduced by RDL 4/2014.

(a) Financial liabilities

RDL 4/2014 clarifies that the percentage of the creditors needed to endorse a refinancing agreement shall be calculated over the total financial liabilities of the debtor. Therefore, according to RDL 4/2014, in order to endorse a refinancing agreement it shall be approved by creditors representing 51%, 60% or 75% of the financial liabilities (*pasivo financiero*) of the debtor. In order to calculate such threshold, the creditors with special related persons shall not be computed (although such credits may be affected by the endorsement).

For syndicated facilities, it shall be deemed that all of the lenders of a syndicated facility have voted in favor of the refinancing agreement when creditors representing 75% (or such lower percentage so provided for in the syndicated facility agreement) of such syndicated facility vote in favor of the refinancing agreement.

(b) Value of the *in rem* security

RDL 4/2014 introduces the concept of "Value of the *in rem* Security" as a key concept for the endorsement of refinancing agreements to secured creditors. The RDL distinguishes between (i) the amount of the credit covered by the Value of the *in rem* Security and (ii) the amount of the credit which exceeds the Value of the *in rem* Security. As further detailed below, the effects of the endorsement will be applied also to the amount of the credit which exceeds the Value of the *in rem* Security as if it was an unsecured credit.

The Value of the *in rem* Security will be (the value shall rank between zero and the amount of the secured credit) an amount equal to $^{9}/_{10}$ of the reasonable value of the asset given as collateral (depending on the kind of asset -real estate, movable asset, securities- the RDL 4/2014 provides for different procedures for its calculation) less the outstanding debt secured by the relevant collateral (provided, however, that such Value of the *in rem* Security may not be lower than zero nor higher than the outstanding balance of the secured debt).

(c) Effects of the endorsement

It depends on the different majorities that have approved the refinancing agreement which has been endorsed:

- Creditors representing 51% of financial liabilities

  If the refinancing agreement is approved by creditors representing 51% of the financial liabilities of the debtor, the agreement will be protected against claw back actions under the Spanish Insolvency Law, but it will not extend its effects to the dissenting lenders.

- Creditors representing 60% of financial liabilities

  If the refinancing agreement is approved by creditors representing, at least, 60% of the financial liabilities of the debtor, the following terms of a refinancing agreement may be crammed down on dissenting lenders (not secured by an *in rem* security) and on dissenting secured lenders, but only with respect to the amount of debt that exceeds the Value of the *in rem* Security:

  (i) stays for a term of no more than 5 years; or

  (ii) conversion of credits into profit participating loans with a tenor of no more than 5 years.

  The same effects may be extended to the amount of the credit covered by the Value of the *in rem* Security when the refinancing agreement is approved by creditors representing 65% of the total Value of the *in rem* Securities.

- Creditors representing 75% of financial liabilities

  if the refinancing agreement is approved by creditors representing, at least, 75% of the financial liabilities of the debtor, the following terms of a refinancing agreement may be crammed down on dissenting lenders (not secured by an in rem security) and on dissenting secured lenders, but only with respect to the amount of debt that exceeds the Value of the in rem Security:

  (i) stays for a term of no more than 10 years;

(ii) conversion of credits into profit participating loans with a tenor of no more than 10 years;

(iii) debt write off;

(iv) capitalization of debt (dissenting lenders may however opt for a write off instead of such capitalization);

(v) payment in kind of debt; or

(vi) conversion of debt in convertible notes, subordinated debt, PIK interest loans or any other financial instrument with tenor, ranking or other features different form the original debt.

The same effects may be extended to the amount of the credit covered by the Value of the *in rem* Security when the refinancing agreement is approved by creditors representing 80% of the total Value of the in rem Securities.

7. TAX RELATED ISSUES

RDL 4/2014 includes two relevant amendments to the Spanish Corporate Income Tax Act ("**CIT**"), applicable to fiscal years commencing as of 1 January 2014, aimed at mitigating certain adverse tax consequences arising in refinancing transactions:

(a) capitalizations of debt into equity would not imply a taxable event for CIT purposes (regardless of its accounting treatment) unless the debt has been previously acquired by the creditor at a discount on its nominal value. In this case the creditor (as opposed to the debtor) should recognize the taxable income, amounting to the difference between the equity increase (proportionally to its participation) and its tax base cost in the debt that is converted; and

(b) income recognized for accounting purposes by the debtor in debt stays or cancellations resulting from the application of the Insolvency Law, shall be deferred for CIT purposes and included in the debtor's CIT taxable base over the tax periods when the remaining debt accrues financial expenses.

The RDL 4/2014 also includes a new exemption in the Transfer Tax and Stamp Duty Act applicable to deeds formalizing debt stays or cancellations of amounts of loans, credits facilities or other debtor's obligations included in the refinancing agreements or out-of court refinancing agreements foreseen in the Spanish Insolvency Law, provided that, in all the cases, the taxpayer is the debtor.

8. CORPORATE REORGANIZATIONS AND PUBLIC TENDER OFFERS

The following changes are introduced by RDL 4/2014 in relation to the merger of companies and the public tender offers legal regime:

(a) When the merging company directly holds 90% or more (but not all) of the shares of the merged companies, no directors and independent expert report on the merger project will be requested to the extent that the minority shareholders of the merged entities are granted the right to transfer their shares in the merged companies to the merging company at their reasonable value and within a maximum one month term since the date when the merger is registered with the competent Commercial Registry.

(b) The Spanish Securities Exchange Commission (*Comisión Nacional del Mercado de Valores*) may exempt the obligation to launch a public tender offer if (i) the acquisition of shares in a listed company (representing 30% or more of its share capital) is the result of the conversion of debt into equity or the capitalization of debt; (ii) the listed company financial viability is at risk (and such risk is grave and imminent); and (iii) the capitalization of debt is aimed at ensuring the long term financial viability of the company. Such exemption will automatically apply, with no need to request it from the Spanish Securities Exchange Commission if the capitalization of debt is (a) completed within the scope of a refinancing agreement which has been endorsed pursuant to the Fourth Additional Provision of the Insolvency Law (see Section 6 above) and (b) supported by an independent expert report issued pursuant to article 71 *bis* 4 of the Insolvency Law.

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The information contained in this document is of a general nature and does not constitute legal advice

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