FOCUS · Royal Decree Law 4/2014: incentives for restructuring corporate debt

On 7 March, the government passed a Royal Decree Law (RDL) that reforms insolvency legislation and aims to improve the refinancing and restructuring of debt among those companies with an excessive financial burden but which are viable from an operational point of view.

The existing insolvency legislation did not promote such processes, leading to many firms in a delicate financial situation becoming involved in a meeting of creditors even though, in some cases, they may be viable in the medium or long term. Moreover, most of the firms undergoing a meeting of creditors are finally wound up with the consequent liquidation costs, losses for their creditors and the social costs resulting from the loss of jobs when the company closes.

To illustrate what kind of situation this RDL hopes to remediate, we shall use the balance sheet and profit and loss account of «Viable Firm, SA», below. Its balance sheet shows a large imbalance in assets (high proportion of debt compared with net assets) and negative working capital (higher short-term debt than working capital). The profit and loss account shows an operating profit before interest and tax but not enough to meet its debt payments (assuming an interest rate of 10%). The final outcome for the firm is therefore a loss, further damaging its net worth. Given this situation, one alternative would be to restructure the company's liabilities, for example by applying a debt remission or by converting part of this into capital. This new law aims to facilitate such restructuring processes. More specifically, the RDL:

Illustrative balance sheet of «Viable Firm, SA»

Assets	Liabilities
Fixed assets 70	Net assets 10
	Long-term debt 50
Working capital 30	Short-term debt 40

Illustrative profit and loss account of «Viable Firm, SA»

Income	100
Cost of sales	60
Gross margin	40
Operating costs	25
EBITDA	15
Amortisation and depreciation	10
EBIT	5
Financial costs	9
Loss before tax	–4
Tax on earnings	0
Net loss	–4

(i) *Helps to suspend enforcement proceedings on a debtor's assets* required for the company to continue operating. All that is required is notification to the court of the start of negotiations between the debtor and its creditors. This suspension can affect all the debtor's assets if requested by at least 51% of the company's creditors.

(ii) *Reinforces non-rescindable refinancing agreements should the company begin insolvency proceedings*. To this end it has eliminated the need for an independent expert report on the firm's viability plan. A new classification of agreements has also been established that does not require a majority of creditors and can even be with a single creditor provided the refinancing improves the debtor's equity position.

(iii) *Encourages loan capitalisation*. An insolvency may be regarded as «guilty» if the debtor does not accept the capitalisation offered by the creditors provided there is an independent expert report. In turn, the Spanish Securities and Investments Board (CNMV) will dispense with the need to launch a public offering (OPA) should these operations be designed to guarantee the company's long-term sustainability.

(iv) *Widens the sphere of pre-insolvency agreements that are legally «homologated»* (may not be subject to a claw-back action should the company become insolvent) and the majority required has been reduced to 51% (from 55%). In addition, these agreements will also apply to dissenting creditors if at least 60% (depending on the agreement type) of the creditors with financial liabilities support this before the court. Homologated agreements will also be applied to loans with security interest, both for the guaranteed part of the loan and also for the amount exceeding the security.

(v) *It encourages the injection of new money*. Temporarily, over the next two years, 100% (previously 50%) of any fresh money will be regarded as an estate claim (paid out ahead of all other claims). With this measure, the RDL aims to encourage, in the short term, the restructuring of debt in excessively leveraged firms.

The text approved by the government also contains other measures to encourage loan restructuring, including the exemption for property transfer tax of haircuts contained in refinancing agreements and the Bank of Spain treating restructured loans as «normal risk».