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**MAIN LAW DEVELOPMENTS IN SPAIN
AS ENACTED FROM LATE 2008 TO MID 2009**

The special economic circumstances our country is going through have forced the Spanish legislator to enact a series of laws that attempt to minimize any adverse impact in the Spanish economy.

There are two lines of action that have been followed to try to stimulate –yet it might be more correct to say "to protect"- the normal development of the Spanish economy.

On the one side it has been tried to provide credit institutions with funding opportunities -outside the normal channels- and on the other to help businesses cope with the problems of valuation of their fixed assets and clarify the framework for action of these enterprises in the restructuring of corporate groups and in the application of regulations on insolvency proceedings.

We will not look at the measures aimed to facilitate the financing of credit entities (and hence to promote the refinancing of individuals), because the number of recipients of such measures is limited, and they do not have a direct impact on the every day of Spanish companies.

It seems appropriate to set out, albeit briefly and limited to the general principles informing the law enacted, those measures that attempt in several ways to protect Spanish companies from the negative impact of this downturn in the global economy.

The legislation that stands out for its significance is the following:

I. – Liquidity enhancement.

Royal Decree Law (RDL) 10/2008, of 12 December authorising financial measures to improve the liquidity of small and mid-sized enterprises, and other complementary economic measures, has changed the art. 36.1.c) of the Commercial Code (CoC) and has made a clarification to the Public Limited Companies Act (PLCA) –*Ley de Sociedades Anónimas*-.

Thus, as regards the art. 36.1.c) of the CoC, the reform only points out that for purposes of distribution of benefits, mandatory reduction of share capital and the compulsory winding up for losses in compliance with the legal provisions regulating public limited companies –*sociedades anónimas*- and limited liability companies –*sociedades de responsabilidad limitada*-, the adjustments for changes in value arising from hedging of cash flows pending application to the profit and loss account shall not be considered equity net worth.

As for the PLCA, the clarification refers to the determination of losses in those cases of compulsory reduction of capital within the meaning of the second paragraph of article 163.1 of PLCA, and to the dissolution regulated in the arts. 260.1.4 PLCA and 104.1.e) of the Limited Liability Companies Act (LLCA).

In this sense, the RDL 10/08 provides that deterioration losses recognized in the annual accounts, arising from the Tangible Fixed Assets, Real estate investment, and Inventory will not be counted in.

Likewise, the RDL provides that the measure referred to in the preceding paragraph shall exceptionally apply in the two financial years closed after the RDL came into force, i.e. 13 December 2008.

II .- Modification of the insolvency law (Bankruptcy Act).

Amongst the measures adopted by the RDL 3/ 2009, of 27 March (modifying insolvency law –bankruptcy proceeding-), there stands out, for their extents, those concerning bankruptcy proceeding and its consequences.

The streamlining of the procedures involved in the bankruptcy declaration stands as a guiding principle of the reform. Thus, in addition to a positive bet on telematics communication to the parties, there has been an attempt at reducing some of the procedures that the practice had proved inadequate or too slow.

An important innovation is the creation of a Bankruptcy Public Register aimed to assist publication and agility of bankruptcy resolutions. However, its widely announced rules have not yet seen the light.

For a clearer presentation of the reforms, the outline below will keep the same law paragraphing:

1 .- <u>Administration of the Bankruptcy proceeding</u>.

As regards bankruptcy administration, the innovations refer to (i)the liability regime for judicial receivers when appointed by the Judge, (ii)the rules for determining the remuneration of bankruptcy trustees or receivers (yet they will come into force upon publication of a Royal Decree regulating the remuneration issue), (iii)the regulation relating to independent experts. Finally, the new law provides that the technical handling of any recourses or incidents involving the bankruptcy administration will be an integral part of the duties of the lawyer member of the bankruptcy administration.

2 .- <u>Reintegration and refinancing agreements</u>.

As to the incorporations to the bankrupt's estate and refinancing agreements, a major innovation is that "the securities granted in favour of public right credits and those in favour of the Wage Guarantee Fund, as recognised by recovery conventions or agreements under their specific rules" cannot be rescinded. It should be noted that, in addition to the said guarantees, neither can be subject to termination those acts that are common in the business or professional activity of the debtor in normal conditions, and those acts within the scope of special laws regulating the systems of payment and clearing and settlement of securities and derivatives.

On the other hand, a new **fourth additional provision** has been incorporated to the bankruptcy law. It favours the prior refinancing of companies that are in financial difficulties yet viable, by increasing guaranties in pre-bankruptcy operations focused on their non-rescindibility in the process. However, the effectiveness of those securities is conditional to the fulfilment of the following requirements:

- To have the refinancing (i.e. those business, acts and payments made for that purpose, and the guarantees issued to ensure performance) supported by at least three fifths of the creditors;

- To have a viability plan allowing the continuation of the debtor in the short and medium term;

- The existence of a report by an independent expert appointed by the commercial registrar of the place where the debtor's registered office is;

- To formalize the agreement in a public deed.

Once bankruptcy has been declared, only the judicial receiver, as pertinent, will be authorised to exercise challenging actions against the refinancing agreements.

3 .- Recognition and subordination of claims or credits.

From this standpoint, one of the elements that have undergone a major reform is the recognition and subordination of credits, as the reform has added a new class of subordinated credits. Specifically, such subordinated character is recognised to claims or credits arising from the contracts with reciprocal obligations mentioned in the law, when that the creditor, in the opinion of the judge and repeatedly, hinders the performance of the contract.

On the other hand, the new legislation establishes that the claims or credits of public law the governmental entities and their agencies may hold because of inspection or verification procedures, are recognized as contingent interest until their quantification. However, if for that reason they were reported late, such delay would not be enough cause to consider them subordinate.

Finally, it is pointed out that the claims or credits held by creditors secured by a surety, will be recognized in their own amount without any limitation whatsoever. Thus, where there is a subrogation for payment, that credit will be given the qualification that is less onerous for the bankruptcy proceeding between the creditor's or surety's (amendment that attempts to resolve the debate open in respect of the construction of art. 87.6 of the Bankruptcy Act).

4 .- Agreement with creditors

The agreement in the bankruptcy proceeding has been one of the specific areas more renewed. As a first innovation, the debtor is permitted not to file for bankruptcy voluntarily, without losing for that reason his ability to file for voluntary bankruptcy once he has initiated procedures to obtain an initial proposal for agreement and subject to attaining or not the necessary adhesions within 3 months time. Moreover, the requirements of adhesion required in this case are reduced, because if the application for bankruptcy is submitted with the advance proposal, it will suffice with the adhesion of 10% of the liabilities (including in this percentage subordinated creditors, even if later they do not have the right to vote). If the advance proposal is submitted after the application for bankruptcy, the percentage of votes to support the proposal then increases to 20%.

Likewise, in the case of bankruptcy of companies engaged in particularly far-reaching businesses, the new provisions reduce, as a general rule, the requirements that permit to exceed the limits legally established for the agreement with creditors; thus, the favourable report from competent economic authority authorising to exceed such limits is not longer needed and it will suffice with a judge's decision to the effect.

Furthermore, where the number of creditors exceeds 300, the law provides the possibility of not calling the Meeting of creditors, but going instead for the procedure of a written agreement.

The said written procedure will establish a 90-days period to submit the support or rejection to each of the different proposals. Such proposals may be submitted only after agreement on the written procedure and within up to sixty days prior to expiration of the aforementioned period.

5 .- Advance Liquidation.

With the aforementioned purpose of expediting the proceedings, there is now the possibility that the debtor submits an advance proposal of liquidation, until the fifteen days following submission of the report from the bankruptcy administration.

6 .- Procedural rules.

Within this area, the major reform refers to the inclusion of a greater protection of job and workers (unlike former regulation, which contemplated only the viability of the company), allowing the application and adoption of precautionary measures protecting those aspects at any time during the proceeding.

Besides, in line with such greater protection for workers, the new legislation provides that Labour force adjustment plans must be substantiated before the bankruptcy judge since the bankruptcy situation has been adjudged instead of upon application filing as it was before.

The rules contained in this reform came into force on April 1, 2009.

In general, and with some qualifications, this is a retroactive rule, as it will be applied to bankruptcy proceedings in the pipeline.

An exception to the above retroactivity are the rules on recognition and subordination of credits, which will apply, in general, to the bankruptcy proceedings that have commenced after the entry into force of this Royal Decree.

III. - Changes in taxation

The Companies Tax is modified with respect to deductions for R&D&I and Technological innovation. Thus, point 3 of the second derogative provision of law 35/2006, of November 28 on individuals income tax, and of partial amendment of the corporation tax regulation on the income of Non-Resident and on Capital Gains, and point 2 of the first transitory provision of the consolidated text of the Companies Tax Act, as approved by Royal Legislative Decree 4 / 2004 of March 5, have been modified.

The goal of the reform is to make possible the indefinite continuance of the deduction for R&D&I in the said Tax, maintaining its validity beyond 1 January 2012.

Law 35/2006 of the individuals' income tax, on its twenty-third additional provision established that the said deduction would disappear for tax periods subsequent to January 1, 2012.

The reform removes the time limit that the Law 35/2006 established for the R&D&I embodied in article 35 of the Royal Legislative Decree 4/2004 regulating the Companies Tax. Therefore, the deductions to the tax payable on the expenses incurred by the company in R&D&I activities are kept.

In general, the basis for deduction is the total sum of the expenses incurred in activities which can be categorized as innovation and development.

IV .- Restructuring operations of companies and corporate groups.

On the other hand, the Law on structural amendments in Corporations (Law 3/2009 of April 3), which is due to come into force on July 5 this year, with the exception of provisions relating to cross-border mergers that have entered into force on the day following its publication in the Spanish Official Gazette (i.e. April 5, 2009), regulates the structural modifications of corporations, and incorporates the Directive of Modification of the Second Directive into the Spanish law.

These notes will present below, yet in a very general manner, the regime that the said regulation provides for each of the matters it covers, namely:

• Transformation
• Merger
• Spin off
• Global Assignment of Assets and Liabilities
• International Relocation of registered office
• Amendments to the Public Limited Companies Act

A) TRANSFORMATION

Transformation of a company is generally understood as the change of a company into a different corporate form, while retaining its legal personality.

The Act on Structural Changes of Corporations (ASCC) extends the instances of transformations permitted by law, allowing the change of, inter alia, any civil or commercial company into any other corporation form.

The main innovations are:

a) Reinforcement of the right to information of the partners. Thus, when calling the General Meeting of Shareholder to discuss the transformation, the directors must leave in the registered office, available to partners, a series of documents as detailed in the new law. This requirement is not necessary if the resolution is adopted unanimously at a Universal Meeting.

b) The transformation balance sheet will be a balance sheet closed within the six months prior to the resolution (so far, the balance required for the registration of the transformation was the general balance sheet as closed the day before the date of the resolution and the final balance sheet as closed the day before the execution of the deed formalising the resolution), being duly audited, if pertinent. Similarly, directors must provide a report on significant property changes that may have occurred after closing the balance sheet.

c) Reduction in the number of notices of the transformation resolution; one in the BORME – the official gazette of company's registers- and another in a newspaper. Those notices can be replaced by individual communications to partners and creditors.

d) Members who do not vote for the transformation agreement will have the right of separation. This right is granted in all cases of transformation, including transformation of public limited companies into any other company, which previously were excluded.

e) A report is required on the company's equity worth from an independent expert, as it happened in the current regime with the transformation into public limited companies.

B) MERGER

A new concept of merger is incorporated, that of Intra-Community Cross-Border Mergers, to differentiate it from the merger in general.

a) General merger (domestic).

Among the main innovations introduced, the new regulation includes:

- The expert's report is necessary only when the company resulting from the merger (merged company) is a public limited company or a partnership limited by shares (*-acciones-)*.

- Even in the case of public limited companies, the expert report will not be necessary if so agreed by unanimity of the share capital.

- Reduction of the number of advertisements publicising the merger agreement that is now done in one paper (whereas before was in two) of wide circulation in the provinces in which each company has its registered office. Another outstanding novelty is that the new regime permits to replace the ads or notices in papers by individual communications to partners and creditors.

<u>As for the contents of the Merger Project, the new regulation includes such innovations as:</u>

- That it must put down the impact that the merger is to have on the contributions of industry or on ancillary services at the companies that disappear, and the compensations to be granted, if any, to the members affected in the merged company.

- The articles of association of the merged company.

- Information on the valuation of assets and liabilities of each company, which is transferred to the merged company.

- The dates of the accounts of the merging companies, as used to establish the conditions of the merger.

- Likely consequences of the merger on employment, and its eventual gender impact on the management bodies and the impact, if any, on corporate social responsibility.

<u>As regards the balance sheet of merger</u>:

The regulation permits to take the last balance of the financial year as the balance sheet of merger, provided that it was closed within six months preceding the date of the project (thereby extending the deadline applying to date, in which the balance to use should have been approved within the 6 months prior to the meeting).

b) Merger posterior to acquisition with indebtedness of purchaser.

The ASCC expressly regulates this type of mergers that materializes when one of the merging companies gets into indebtness within the three years preceding the merger either to gain control over another involved in the transaction or to acquire assets of the said company that are essential for its normal operation or material as to its equity worth value.

The new regulation strengthens the protection of members and creditors in this type of mergers, as it requires the application of rules like that (i)the merger project must indicate the resources and schedule foreseen to repay the debt, (ii)the report of directors must explain the reasons that justify the acquisition and the merger, as well as the economic and financial plan, and (iii) the experts' report must include an opinion on the reasonableness of the above details, determining also whether there is financial assistance.

c) Simplified mergers

Simplified mergers are among special mergers, and inside that concept, the ASCC includes the following:

Take-over merger of a 100% owned company

The ASCC provides a general procedure for instances with a direct participation, and some particularities for those with an indirect participation.

As regards instances of direct participation, in addition to what has already been excluded by this law, the ASCC sets out that the merger does not need to be approved by the General Meeting of the target or merging company.

In the case of indirect participation, new requirements are established such as a report of experts, a capital increase of the acquiring company, if applicable, and compensation from the acquiring company to the group company that is not involved in the merger, when the merger results in a decrease in its equity net worth for the loss of its participation in the merging company.

Take-over merger of a 90% owned company.

Where the acquiring company holds directly ninety percent or more, but not all of the company's capital, no reports are required from managers and experts, provided that the merger project offers the minority to buy its shares at fair value (which is not expressly defined in the ASCC, yet its article 38 Bis contains some elements necessary for its calculation), in a maximum period of one month following the date of registration of the merger.

d) Intra-community cross-border Merger

Mergers are considered Intra-community cross-border mergers when involving capital companies formed under the laws of a State party to the European Economic Area, and where at least two of them are subject to the laws of different Member States and one of the merging companies is subject to Spanish law.

The scheme applies only to capital companies (public limited companies, limited liability companies and partnerships limited by shares), thus excluding those cross-border mergers involving a cooperative or a collective investment company.

The provisions of Chapter II of the ASCC (Law 3/2009 of April 3) and supplementary provisions regulating merger in general are of application to intra-community cross-border mergers.

When the company resulting from the merger (merged company) is subject to Spanish law, then prior to registration the companies' registrar will check the legality of the procedure on the merger and the establishment of the new company or the changes in the acquiring company.

Similarly, the companies Registrar of the place where the registered office of the merging company is, will certify the proper implementation of the acts and procedures prior to the merger by the companies subject to Spanish law (then issue the corresponding certificate which attests due compliance).

Likewise, a new Title IV is incorporated to the Law 31/2006 of October 18 on the involvement of workers in European public limited companies and cooperatives. This new Title regulates the rights of workers to participate in the merged companies resulting from Intra-community cross-border mergers.

C) SPIN OFF

In Spin off scheme, the great innovation is the explicit regulation of *segregation and the formation of a wholly owned company by the transfer of the equity worth.*

Segregation is defined as the transfer en bloc by universal succession of one or more parts of the equity worth of a company -each of which forms an economic unit-, to one or several companies, where the segregated company (and its partners as in the case of a partial spin) receives in exchange shares, or quotas in the beneficiary companies.

The formation of a fully owned company by the transfer of equity worth is the operation by which a company transfers en block all its assets to a newly created company, receiving in exchange all the shares, or quotas in the beneficiary company.

D) GLOBAL ASSIGNMENT OF ASSETS AND LIABILITIES

The ASCC introduces the global transfer of assets and liabilities as a structural operation that provides a further instrument for the transfer of businesses with the benefit of universal succession.

The global assignment of assets and liabilities means that a company registered can transfer en block all its equity worth by universal succession, to one or more members or third parties in exchange for a consideration which cannot include shares or quotas of assignee's membership.

Another innovation is the requisite to make available to employees' representatives of both the draft of the global assignment project and the directors' report.

E) INTERNATIONAL TRANSFER OF REGISTERED OFFICE

Through the ASCC it is expressly regulated –yet leaving in force application of the Conventions to which Spain may be party- the international transfer of registered office.

<u>Transfer of Spanish company abroad</u>

The transfer abroad of the domicile of a company registered in Spain (which is not in liquidation or bankruptcy), can only be done to a country that allows the retention of legal personality of the company.

The directors of the company will draft and sign a transfer project, which must be agreed on by the general meeting of shareholders (and subsequently registered with the Companies Register). Members who voted against the agreement of transfer can separate from the company.

<u>Transfer of Foreign company to Spain</u>

Foreign companies within the European Economic Area (EEA) can move to Spain if the law of their home country allows it, maintaining its legal personality. They must however comply with Spanish legislation applying to the type of company involved.

The law also regulates the transfer of foreign capital companies from a non-EEA member state, which requires of an independent expert report to justify that the equity net worth of the company covers the amount of share capital required by Spanish law in each case.

F) AMENDMENTS TO THE PUBLIC LIMITED COMPANIES ACT.

The ASCC modifies some articles of the PLC Act and add new ones. The most important changes are:

Non financial Contributions

Unlike the current system which allows a difference of up to 20% between the value of no financial contributions as recorded in the memorandum (or deed recording an increase of capital) and the value determined by the expert, the ASCC provides that the value of the contribution in the memorandum cannot be higher than the valuation made by experts.

It is specifically regulated the responsibility of the expert to the company, the shareholders and the creditors for damage caused by the valuation.

Treasury Stocks

With regard to the acquisition of treasury stock, the new legislation extends the period for the general meeting to authorize the acquisition, from 18 months to five years, and current limits from 10% to 20% of capital in non-quoted companies, and from 5% to 10% in quoted companies.

In line with the new accounting model, there is no obligation to provide the reserve for own shares, except in the case of (derivative acquisition) acquiring shares of the controlling company.

Modifications on the pre-emptive right:

The ASCC has taken the opportunity to adapt the system of preferential subscription rights and convertible bonds of the Public Limited Companies Act to the ruling dated 18 December 2008 from the Court of Justice (ECJ).

Consequently, section 158.1 of the PLC Act is modified, excluding from the increases in the share capital with pre-emptive rights the holders of convertible bonds. Likewise, section 293 of the PLC Act is also amended, and so now the General Meeting may decide to cancel all or part of the preferential subscription rights shareholder may have in issuance of convertible bonds.

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