

Corporate Law

Legal Alert

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New Measures Approved in Spain to Compensate the Effects of the Depreciation of Assets and Avoid Mandatory Capital Reduction and Dissolution Due to Losses

Spanish Royal-Decree 10/2008, dated 12 December 2008, adopts certain financial measures aimed to improve the liquidity of Spanish companies and alleviate the economic difficulties that they are currently facing.

This Royal-Decree establishes, as an exceptional and temporary exemption, that Spanish regulations concerning mandatory dissolution and capital reduction due to losses will not apply if losses have been caused by the depreciation of tangible assets, real estate investments and inventories.

We summarize below the effect of this measure.

Mandatory dissolution and capital reduction due to losses

Spanish law states that a company must be dissolved if losses reduce its net equity to an amount less than half of the company's share capital, unless capital is increased or reduced in the required amount, and provided that there is no need to file for bankruptcy. This is applicable to both a Spanish limited liability company (*sociedad de responsabilidad limitada – SL*) and a corporation (*sociedad anónima – SA*).

Furthermore, an SA must reduce its capital where losses have reduced its net equity to less than two-thirds of the share capital, and a fiscal year has elapsed without the net equity being increased.

Royal-Decree 10/2008 provides a new definition of net equity. Moreover, it states that for the purposes of calculating the losses incurred by a Spanish company to determine whether the entity is in a situation of mandatory dissolution and/or capital reduction, losses derived from the impairment of the tangible assets, real estate investments and inventories will not be taken into consideration.

This exemption will apply only for the two fiscal years closed after the Royal-Decree 10/2008 came into force, that is, 13 December 2008. Therefore, companies with a calendar fiscal year may benefit from this provision for fiscal years ending December 31, 2008 and 2009.

Effects of this measure

This temporary exemption may have a beneficial effect on many Spanish companies taking into account that: (i) in accordance with Spanish GAAP, Spanish entities must correct and reduce the value of their recent investments in real estate (which may have been acquired during the real estate boom), if "there are indications that the real estate investments have decreased their value"; and (ii) Spanish entities are not allowed to increase the value of the real estate investments booked at their historical cost following the principle of prudence.

With this new measure, even if losses caused by the depreciation of tangible assets, real estate investments and inventories reduce the net equity of a company and put the company in a situation of mandatory capital reduction or dissolution, the company's directors will not be obliged to take any steps to increase the company's net equity (such as an increase of capital, which may be subject to a 1% capital duty).

In addition, the shareholders and creditors of a company will not be in a position to claim liability against the company's directors for the company's debts on grounds of the Spanish regulations concerning mandatory capital reduction and dissolution, if losses are due to the depreciation of tangible assets, real estate investments and inventories.

However, this measure does not release a Spanish company from the obligation, and does not prevent the company's creditors from their right, to file for bankruptcy. Under Spanish law, a company is in a situation of bankruptcy if it is not able to meet its payments on a regular basis.

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