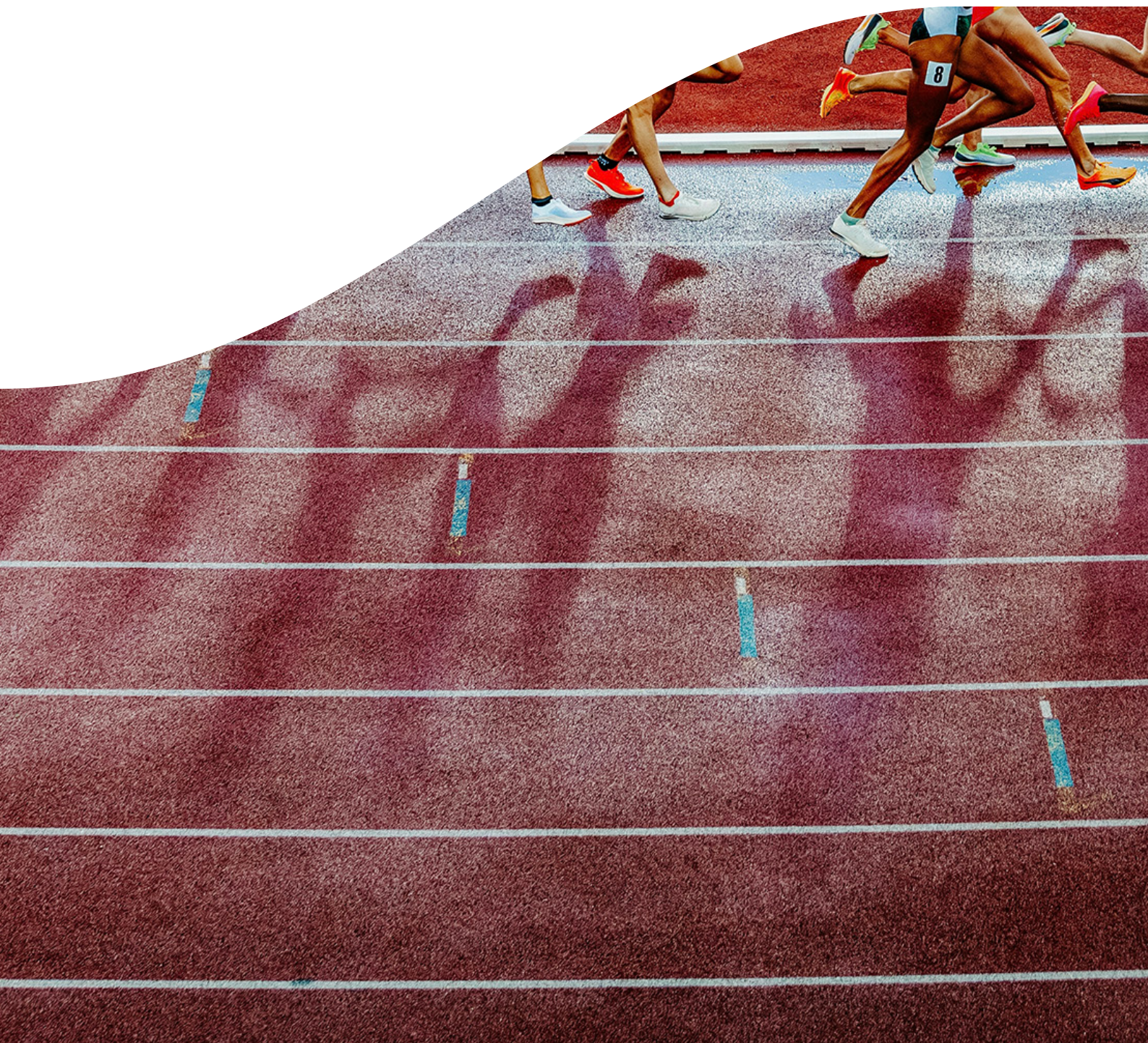


# Funds and debt restructuring in Spain



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# 1. Introduction

The position of funds or institutional investors regarding Spanish restructuring regulation is not consistent, and depends mainly on the strategy of each of such investors. Debt funds are concerned about the regulation of restructuring plans, while those buying financially distressed businesses are more interested in the regulation on the transfer of production units. There is a third group, that of buyers of distressed debt portfolios, who are generally less interested in these matters, their main concern being the insolvency of individuals and the release of unpaid debt, both of which have a significant impact on their rate of return.

This paper summarises our conversations held with different types of investors, and it is focused on their views on debt restructuring as completed in Spain since the end of 2022, leaving everything else aside. The group of funds interviewed was limited, so this document does not reflect the opinion of the entire sector and, even though we agree with the input of many of the interviewees, we do not always share their views.



## 2. Overall assessment

For many investors, Spain remains a jurisdiction where the interests of the debtor receive more attention than those of the creditor. However, most investors see as a step forward the ability to cram down trade creditors, or the option to suspend enforcement of guarantees provided by group companies not subject to a restructuring plan, if such enforcement could lead to the insolvency of the guarantor and the debtor itself. The assessment is also positive with regard to the temporary moratorium instrument (pre-insolvency), as a platform of stability enabling debt restructuring, in particular when not only large companies but also medium-sized companies are allowed to use it, as in other countries.

On the downside, investors note that restructuring in Spain continues focussing on debtor liabilities, and no plans to provide for particularly operational restructuring are being approved. When restructuring does not entail changes in the management team, and the plan goes ahead thanks to the alliance between the debtor and some of the creditors (public or commercial) who approve a non-consensual plan (involving the cram-down of other creditors, usually of a financial nature), doubts about the debtor's viability increase. This would be so because, according to the views expressed, it is clear that the debtor who opts for restructuring this way will be denied access to credit by the crammed down financial creditors and, therefore, will find it very difficult to finance the new business plan.

But, above all, institutional investors take a negative view of the fact that restructuring processes continue to be led by the debtor and not by the creditors, despite the fact that the reform of Spanish regulations was supposed to change this trend.

Below, we turn to more specific issues on Spanish restructuring as shared with us by some debt funds.

### Figures on restructuring plans approved in Spain

	2023	2024	2025 (Q2)	Total
Restructuring plan	341	334	135	810

Source: Informa D&B, Insolvency proceedings and dissolutions

### a. “Duty shifting”

Even though, in the mere likelihood of insolvency, shareholders remain the primary target of the trust funds interests of the debtor's managing body, for institutional investors, in an imminent insolvency scenario, the target of such duties should be the creditor, in what is known as *duty shifting*. As in a restructuring process, unlike in insolvency proceedings, creditors cannot rest and rely on the work of the judge and the receivers; it is primarily the debtor's management body who shall defend their interests during a debt restructuring process. And this, in the view of institutional investors, is not the case in Spain. The reason they see for this not happening is because the Spanish regulator did not consider it appropriate to regulate the administrators' trust duties towards creditors in pre-insolvency scenarios, on the understanding that the criteria for the protection of stakeholders under the Restructuring Directive were already implicit in Spanish legislation.

### b. Public debts

The situation of public debt in Spanish restructuring is paradigmatic: from having no role—or practically none—before the reform, to now becoming decisive in approving a restructuring plan, even though, the impact of the restructuring does not affect those claims as it does affect others. In fact, the excess weighting and overprotection of such claims is not well understood by private creditors. Moreover, such privileges end up extending to claims which, under Spanish law, are not strictly speaking public law claims, or at least would not be so in an insolvency scenario.

For investors, all such circumstances effectively amount to an expropriation of value from the private-law claims affected by the restructuring in favour of public claims, without any form of compensation or remuneration for such expropriation. In view of these issues, some investors propose as a solution the amending of Spanish legislation to deprive the holders of public claims affected by the plan of voting rights.

### **c. Scope of the restructuring process**

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Spanish legislation grants considerable room for discretion to the initiator of a restructuring process, to define the scope of the affected or committed debt, but at the same time requires justification as to why some claims are part of the restructuring while others are left out. The issue for the funds we have spoken with is that this flexibility in shaping the contours of the restructuring creates potential room for defining debt scopes that do not always follow clear, justified, or equitable criteria, which may jeopardise creditors confidence and the viability of the restructuring process itself.

Institutional investors have no conceptual problem with this flexibility, but they do reject the use that some debtors have made of it. The funds with whom we have discussed this matter have identified several cases where this flexibility has been used to leave out of the scope – and, therefore, without experiencing the sacrifices of restructuring – subordinated claims, liabilities unduly considered as public law claims, claims of creditors who opposed the plan and whose vote against would have meant the failure thereof, etc. Usually, in these cases, all the effort is placed onto a few creditors, to the benefit of all the others, without the promoter of the plan offering objective and plausible reasons as to why the sacrifice should be borne exclusively by those few creditors.

Moreover, as some investors have told us, the fact that the Spanish legislator has not expressly provided for a procedural channel to challenge the definition of the restructuring scope, only increases the risk of arbitrariness and malpractice. Some institutional investors argue that it would be desirable that Spanish legislation incorporates a channel to challenge, separately, the composition of the affected scope, or establishes objective criteria to indicate when a claim can and cannot be excluded from the restructuring.

### **d. Composition of claim categories**

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The investment funds with whom we have discussed this issue have been very assertive in sharing their views with us, drawing our attention to the reforms that should be implemented by Spanish laws. In Spain, as in the remaining member States of the European Union, the composition of claim categories must conform to objective criteria. The funds understand that these criteria should be based on the idea that unsecured claims should only form different categories where clear and indisputable grounds so justify. According to these funds, what happens is that, in a significant number of restructuring processes and given

the category majority system that allows a restructuring plan to be approved, there have been instances of artificial structuring or manipulation of claim categories, for example, through their ‘multiplication’. The greater the number of categories of claims, the higher the chances of securing a majority among them. Institutional investors feel that this is done with no apparent purpose other than to secure a majority of claim categories (which represent a very small percentage of the company’s liabilities) in order to impose a particularly burdensome restructuring plan on a minority of claim categories (which, however, comprise the majority of the liabilities). The funds we have spoken to have expressed their disappointment at the way in which the principle of minimum intervention (which does not allow the Spanish courts to put a stop, ex officio and at an early stage, to these actions) works in practice. This circumstance is largely forcing creditors negatively affected by such pathological composition of categories, to challenge the plan and to prove in a higher court the infringement of legal rules, including the fraudulent or abusive intent of the debtor. As a result of this deliberation process – which often requires a significant investment from the affected creditors – the transaction costs of a restructuring process increase, even though the plan is ultimately bound to be redesigned if it is to succeed. This is, as we have been told on several occasions, a sub-optimal functioning of the Spanish restructuring system, which should devise a formula to avoid this type of situation.

### **e. Business viability**

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Institutional investors are rather sceptical that the restructuring plans being approved in Spain will allow the debtor to overcome its insolvency. In the case of consensual plans, as we are told, there is a risk that the viability plan “falls short” and that the debtor is forced to renegotiate a new restructuring plan eighteen months after getting the first plan approved by the court. As commented by these same investors, such risk is even greater where the plan is non-consensual.

Similarly, in non-consensual plans where significant write-downs are imposed on dissenting financial creditors, the investors we consulted emphasized the need for extreme caution in assessing how the debtor will be financed post-restructuring. They also warned that the risk departments of dissenting lenders are likely to place the debtor on a ‘blacklist’ and refrain from extending further credit – an issue that becomes more severe as the number of financial creditors dragged into the non-consensual plan increases.

## Main restructuring plans 2023 (by liability)

COMPANY NAME	SALES	YEAR	EMPLOYEES	Type of business (CNAE)
COMPANIA ESPAÑOLA DE LAMINACION SL	1.332.260.000	2021	842	Steel casting
GLOBAL STEEL WIRE, SA	455.335.000	2020	613	Production of basic iron, steel and ferro-alloy products
NERVACERO S.A.	387.856.000	2020	330	Production of basic iron, steel and ferro-alloy products
CELSA ATLANTIC S.L.	353.649.000	2021	246	Production of basic iron, steel and ferro-alloy products
FERIMET S.L.	280.276.000	2021	204	Wholesale of waste and scrap
ATUNES Y LOMOS S.L.	221.563.904	2022	37	Wholesale of fish and seafood and other food products
GLOBAL SPECIAL STEEL PRODUCTS, S.A.U.	205.371.000	2020	339	Cold wire drawing
FOOD DELIVERY BRANDS SA.	160.111.952	2021	106	Restaurants and food stalls
MOREDA RIVIERE TREFILERIAS SA.	157.865.000	2020	357	Cold wire drawing
EZENTIS FIELD FACTORY S.L.	141.595.000	2020	1436	Technical engineering services, and other technical advice related activities

Source: Informa D&B, Insolvency proceedings and dissolutions (2024)

## f. Linked debt

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To the funds, it is inconsistent that claims held by creditors linked to the debtor—subordinated by definition—may fall outside the scope of the restructuring, and that, when affected by the plan, they have a say in the voting on non-consensual restructuring.

For many of these investors, the problem stems from the fact that the Spanish rule grants voting rights to all creditors whose claims will be affected by the plan, which ends up attributing decision-making power also to subordinated creditors. In their view, this issue could be resolved by amending Spanish law to deprive subordinated creditors of voting rights, except in two specific cases: when they are ‘in the money’ and therefore have a genuine stake in the restructuring, or when the plan is consensual and the participation of the subordinated creditor in the negotiations is accepted by a majority of the remaining categories of creditors.

## g. Principle of absolute priority

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In Spanish restructuring, the absolute priority rule has been designed to protect the recovery of senior creditors by prohibiting “leakage” – of money or equity instruments – in favour of junior creditors or shareholders. We have heard investors say on several occasions that a rigorous application of this rule should prevent the Spanish courts from approving non-consensual plans that impose insufficiently remunerated write-downs or waivers on creditors where, at the same time, the debtor’s shareholders maintain their stake in the capital, since, in these cases and by definition, this rule would be ignored.

The Spanish rule clearly introduces an exception to this rule, by allowing the court approval of a restructuring that “escapes” the principle of absolute priority, as long as it is essential to ensure the viability of the company and does not cause unjustified damage to creditors. The problem for investors is that, in practice, the verification of these conditions is either not taking place or, at the very least, the available evidence is far from conclusive. For our interlocutors, it is imperative that in Spain the debtor is forced to produce an economic-financial analysis showing that, without this exception to the absolute priority rule, the business would not be viable. In this way, according to the funds, decisions based on mere declarations by the debtor would be avoided and, above all, the legal exception would be applied to situations where, otherwise, there would be a high probability of imminent and irremediable liquidation of the business.

## h. Competing plans

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For institutional investors, one of the major shortcomings of our regulations is the lack of provisions on competing schemes. In other jurisdictions, institutional investors have been involved in restructuring processes where different restructuring plans “compete” with each other to gather more support, which typically raises the recovery ratio of creditors and, most importantly, helps mitigate asymmetries in the dissemination of information and enhances monitoring of the debtor’s business plans. The general position of our courts so far has been to apply the rule of temporal preference (*first come, first served*), so that only the first of the plans submitted is processed. In the funds’ view, the application of this rule benefits debtors because they are the only ones who, in most cases, will have the necessary information to first develop and propose a restructuring plan, in an agile and even accelerated manner. It also discourages the parties from exhausting the possibilities of reaching an agreement on a consensual plan, and removes the pressure to present the best possible plan.

Institutional investors believe that the safest way to correct this shortcoming is to amend Spanish law. A legal reform that unequivocally enables the submission of competing restructuring plans would also solve a large number of issues, since it would promote the negotiation of consensual plans among affected stakeholders, mitigate incentives to take risks regarding definition of the scope of the restructuring, classification of creditor groups, and unequal treatment of unsecured claims.

## i. Equal treatment of unsecured claims

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Another issue that institutional investors struggle to fully grasp is the possibility that their claims may receive less favourable treatment than other claims of the same rank. Such an outcome may result through various mechanisms. Firstly, by defining the scope of the restructuring in a self-serving manner, excluding – without proper justification – claims that share the same insolvency rank than those that are indeed affected by the restructuring. Another path taken quite often to reach the same result is the composition of categories aimed at placing claims of the same rank in different categories, establishing different treatment for each of these categories.

Institutional investors emphasize that, under Spanish law, the composition of categories should always take into account the existence of a common interest among the creditors comprising each category of claims, to be

established according to objective criteria. But, at the same time, Spanish law allows unsecured claims to be separated (disaggregated) into different categories of claims, where there are sufficient reasons that so justify. The practical result of this is that claims of the same rank may be affected differently by the restructuring, as they are part of different categories. This is so because Spanish law rejects disparate treatment among claims of the same category, but not among claims of different categories. Institutional investors do not question this flexibility, but rather the fact that it can be done without sufficient grounds, for the benefit of more junior creditors or the debtor's shareholders, and without the consent of the creditors who bear the effort of the restructuring to a greater extent.

#### **j. Disproportionate sacrifice, and the creditors' best interest test**

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Institutional investors understand the concept of "disproportionate sacrifice" as a useful tool because it represents a limit or boundary when restructuring is to be imposed on dissenting creditors. These creditors, by invoking the "boundary" of 'disproportionate sacrifice' may avoid bearing an economic burden that exceeds what is reasonable in light of the objectives of the restructuring plan and the position of other creditors. Furthermore, and as far as the best interest test is concerned, the funds with whom we have discussed this issue understand that it is another guarantee for them because it is designed to prevent the value of the restructured debt from falling below the share that would correspond to the creditor in a bankruptcy liquidation.

In the view of institutional investors, if the most well-known Spanish restructuring processes since the adoption of the new system had been analysed more strictly on certain core economic aspects, it would have been concluded that a disproportionate sacrifice was being demanded from some creditors. Some of these economic aspects, as we have identified in our discussions with investors are, for example, whether the effort required of a creditor is objectively excessive compared to that made by other creditors; whether the loss imposed on the creditor exceeds what is necessary for the viability of the business; whether loss is imposed

when the debtor is not reasonably viable; whether there is an inequitable distribution of effort between different categories of creditors with similar positions; or whether creditors in non-equivalent positions (e.g. unsecured and subordinated creditors) are imposed the same sacrifice (the same write-downs, for example, or similar waivers).

As for the best interest of creditors test, the funds have identified restructuring processes where dissenting creditors have invoked this test, so far without much success.

#### **k. Lack of transparency and information to creditors**

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Spanish law allows the debtor who applies for a moratorium or a pre-insolvency in order to negotiate a restructuring, to do so in a reserved manner, without their distressed situation being reflected in the public registries. While maintaining confidentiality regarding the existence of negotiations with creditors offers clear advantages, it has also drawn criticism from the investor community. This is due to its strategic use by certain debtors, particularly when combined with information asymmetry and the absence of any obligation to negotiate with all creditors.

Another aspect that some institutional investors criticise is that Spanish law does not require the debtor to make available to creditors the full package of documentation and information supporting the restructuring plan. In financial and business terms, the likelihood of a plan being approved depends, to a large extent, on the quality and completeness of the information provided to creditors. Only in this way will creditors supporting the restructuring be able to design the necessary mechanisms to remedy deviations from the business plan, or even to waive occasional breaches of the plan. In this regard, institutional investors with whom we have discussed this issue insist that "good practice" in Spanish restructuring would be for the debtor promoting the plan to sufficiently anticipate the information needs of creditors, by providing detailed and relevant documentation from the early stages of the negotiation, as a way to build a more solid and resilient plan to the ups and downs that commonly follow the judicial approval of the restructuring.

## Main restructuring plans 2024 (by liability)

COMPANY NAME	SALES	YEAR	EMPLOYEES	Type of business (CNAE)
SOLTEC ENERGÍAS RENOVABLES SLU	339.612.077	2022	497	Production of other types of electricity
ASTURIANA DE LAMINADOS S.A.	133.101.548	2022	-	Lead, zinc and tin production
FANDICOSTA, SA	121.632.680	2021	-	Wholesale of fish and seafood, and other food products
MEETING POINT SPAIN	117.718.837	2022	143	Travel agency activities
AGENCIA FERNÁNDEZ DE SOLA SL	116.947.861	2022	102	Other supporting transport activities
DURO FELGUERA SA	99.998.000	2023	377	Construction of electricity and telecommunications networks
INTERCEMENT TRADING E INVERSIONES SAU	99.251.000	2022	-	Accounting, bookkeeping, auditing and tax advice activities
ENERGÍA Y SERVICIOS PARA EL BIENESTAR Y LA MOVILIDAD VILALTA CORPORACIÓN	98.666.255	2023	-	Wholesale of solid, liquid and gaseous fuels, and similar products
SOLAR PROFIT ENERGY SERVICES SLU	96.784.513	2022	-	Electrical installation
SOCIEDAD ANÓNIMA COMERCIAL DE PESCADOS Y MARISCOS PEIXEMAR	83.283.122	2021	-	Wholesale of fish and seafood and other food products

Source: Informa D&B, Insolvency proceedings and dissolutions (2024)

## I. Gifting

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Gifting, which is the voluntary transfer of the restructuring surplus from higher-ranking claim classes in favour of lower-ranking classes or the shareholders, is one of those topics that comes up quite frequently in discussions with institutional investors. This seems astonishing considering that this practice has very limited precedent in Spain.

The main problem for funds lies on the reasons behind gifting. If such reasons are legitimate, or do not unduly harm third parties, investors have nothing to reproach for. But if, behind the transfer, there is an incentive to artificially undervalue the debtor, unduly leaving the dissenting middle class out of the money, the matter looks quite different, since we may be dealing with a collusive practice to the detriment of the dissenting class (which raises the question whether the senior creditor would be transferring the restructuring value that really belongs to them or whether, on the contrary, such value should belong, at least in part, to the dissenting middle class). And, should this be the case, the middle class would have good reasons to oppose gifting on the grounds that the absolute priority rule is not being abided by.

The funds insist that, if there are guarantees that the assessment of the debtor is rigorous and objective, there should be no problem in admitting gifting as one of the tools available to operators when negotiating and approving restructuring plans in Spain.

## m. Restructuring expert

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Among institutional investors, the idea has taken root that the expert tends to work in the interest of the person who has appointed him/her, and would not, therefore, be strictly independent, as required by Spanish law. This is a widespread perception we do not share in most cases. However, institutional investors have identified the tools that allow them to promptly replace the expert appointed by the debtor, or by a minority of creditors, where they become aware of circumstances they do not share, or simply do not approve such a course of action. Institutional investors are indeed very demanding in terms of independence, informed judgement, experience and professionalism in the performance of the expert's role, and are particularly vigilant to dynamics that deviate from restructuring standards or best practices.

## n. New money

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The treatment of interim and new financing in Spanish legislation is unattractive to institutional investors. The privileges granted to the provider of this financing, in the event of the debtor's subsequent insolvency, are of no or very limited value to the investors with whom we have discussed this issue.

Thus, most of them will only consider interim or new financing in the following cases: if they need to protect their previous exposure to the debtor; as part of a takeover or a stake in the debtor; if the debtor owns assets that can be pledged as collateral for the new money on a preferential basis; or, should the latter not be possible, where the already secured creditors agree to share their collateral with the new money provider.

## o. Assessment by the funds on the role of Spanish courts

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Generally speaking, it is difficult for institutional investors to understand why there are so many contradictory pronouncements on basic elements of the restructuring system. For them, the inability to issue an appeal against potentially erroneous Court rulings, before a body that unifies and corrects the doctrine and criteria of other territories and judicial levels, does not reconcile well with the principle of legal certainty, and raises, as an additional disadvantage, the possibility of generating local case-law "*à la carte*".

The funds with whom we have discussed this issue consider that the ability to appeal against a judgement approving a restructuring plan, before a higher level Court, would not only encourage settlement and reduce the risk of abuse, but would also be more respectful of the principle of legal certainty and, in the long run, reduce interpretation discrepancies. Obviously, these same funds are aware that a restructuring cannot be subject to an appeal for a long time, so any amendment to the appeal system in order to facilitate harmonisation of judicial criteria should enable decisions to be taken in an urgent and promptly manner, as a starting point.

Another issue that continues to cause concern is the pro-debtor or pro-plan bias as perceived among institutional investors. In the opinion of many, for our judges the property rights of the debtor's shareholders seem to deserve more protection than those of the creditors.

Further, investors have no problem with the principle of minimum intervention that usually guides the intervention of the Spanish judge analysing the restructuring plan. However, they understand that such principle should cease to operate where, once the negotiations have been completed and the plan has been approved, its promoters ask the judge to validate it, and they find it difficult to understand that this principle of minimum intervention does not turn towards more intense supervision at the very moment a plan is brought to the courts.

This view may not be entirely correct, especially when our courts are reproached for not analysing *ex officio* whether the plan respects the absolute priority rule, the parity of treatment among claims of the same rank, or the grounds and reasons for the disaggregation into different classes of claims of the same rank (all such matters fall, in principle, outside the scope of judicial scrutiny by the Spanish courts on validating a restructuring plan with no prior opposition). However, we do share the idea expressed by some funds that the principle of minimum intervention should evolve towards a more qualified intervention as from the judge being called upon to approve the plan, and that the Spanish rule is to convey a clear message that the judge can refuse to approve a non-consensual plan if a critical reading of the documentation submitted raises doubts about the fulfilment of the requirements for such approval.

Finally, a recurring theme in discussions with institutional investors is the excessive length of Spanish restructuring processes. This view, of course, does not take into account the lack of material and human resources in our courts, which has a budgetary origin that has nothing to do with the professionalism of Spanish judicial bodies. But this is indeed a key challenge. It seems logical that restructurings and related discussions were initially protracted while the system was being tested by all stakeholders; however, investors perceive that the system will be more successful the sooner it can provide a prompt response to the often urgent and unavoidable needs of distressed businesses.

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