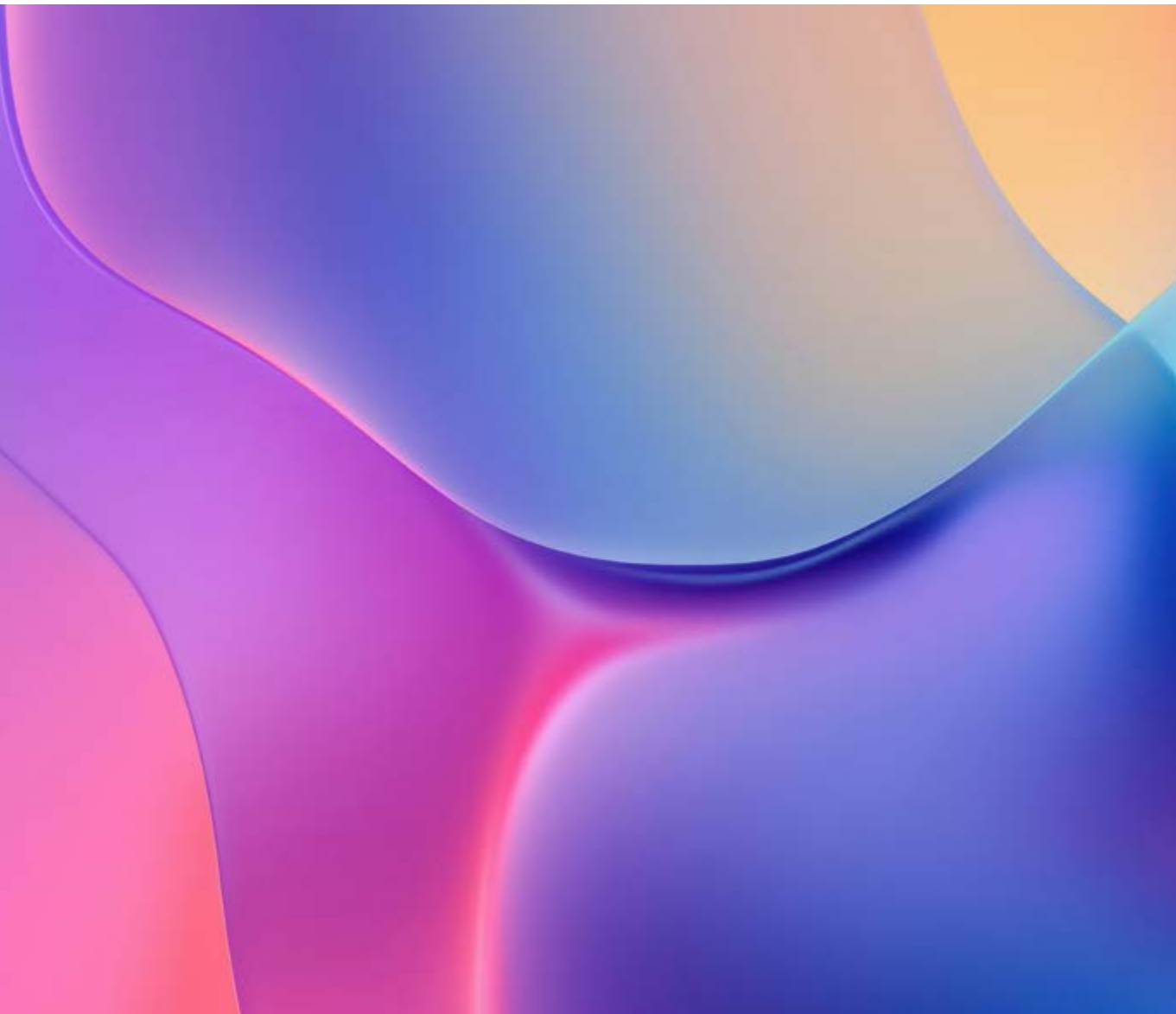
CUATRECASAS

Private equity: Alternative instruments and strategies

July 2025



Índice

1 Some legal considerations

In recent years, an increasing number of private equity funds and financial sponsors are adopting alternative investment strategies different from traditional buyouts, and many traditional funds have redefined or diversified their strategies and products. On the one hand, companies are increasingly seeking the alternative financing offered by this type of funds in transaction structures that allow them to retain control. On the other hand, the need to stand out in a competitive environment, to gain exclusive transactions and avoid bidding processes, is also a factor that is compelling funds to be more creative when generating opportunities and designing investment structures. Further, such alternative strategies will most often result in innovative structures and instruments (minority investments, preferred equity, hybrid debt / equity instruments) since they are often more flexible and can be adapted to the company's needs and to the risk profile and return targets of different types of investors.

However, these instruments must be used cautiously and with full awareness of how they differ from traditional capital investments, particularly in anticipation of potential conflicts, events of default, financial difficulties or insolvency scenarios. This is particularly important for foreign investors and funds, given the differences between regulations applicable to a given instrument under Spanish law and its equivalent in other jurisdictions.

2 Minority investments

This is an attractive tool for companies in different circumstances and stages of growth. In addition to raising capital, the company may benefit from the investor's financial and management knowledge gained from prior experience and professional standing, as well as its contacts in the sector and resources to carry out acquisitions or enter into new markets. Minority investments allow founders or controlling shareholders to maintain a reasonable degree of control over the business and to participate in the future sale or exit alongside the investor.

From an investor standpoint, in these structures it becomes essential to negotiate a shareholders agreement setting out the provisions and mechanisms that are necessary to ensure the effective protection of its investment, given that the minimum rights provided by law are usually insufficient, including, among others, the following aspects:

- The investor's right to appoint one or more directors (or an observer, or both).
- The key decisions or reserved matters requiring the consent of the investor or its representatives at a General Shareholders' Meeting or Board of Directors (such us changing the articles of association, approving a capital increase, approving or amending the business plan, entering into material contracts and related-party transactions).

- Information and reporting obligations vis-à-vis the investor, with an adequate scope and frequency to enable it to properly monitor the investment.
- Rules and mechanisms to ensure that the founders and key managers are retained, together with a long-term incentive plan linked to an increase in the value of the business.
- Protection against potential dilution resulting from certain future situations or transactions.
- Dividends and distributions policy.
- Exit formulas and mechanisms to implement the future divestment (e.g., drag-along and tag-along provisions, trade sale, IPO if market conditions are favorable, put option against the founder or the company, etc.).

3 Preferred equity

Preferred equity may be interesting for companies seeking to raise new capital in scenarios of financial difficulties, growth and other special situations, or to offer a different treatment to parties investing in different stages of the project. For investors, preferred equity is to a certain extent a hybrid instrument combining equity and debt features, in terms of risk and profitability. From a legal perspective it is share capital, with the risks inherent to the equity (although it will normally require the recognition of a financial liability in the balance sheet), but it provides downside protection since the investor is usually guaranteed a certain return (preferred dividend) and recovery of the investment with priority over ordinary shareholders. In any event, investors will have to consider the limitations and features of this instrument under Spanish law, including the following:

- Its issue (and any subsequent changes of its terms) requires approval by the General Shareholders' Meeting with the majorities set out for the amendments to the articles (or even the shareholders' individual consent when involving a private limited company (Sociedad Limitada)).
- There is significant freedom when setting out the type of privileges or preferences: a fixed dividend (comparable to fixed income securities or a bond), a minimum dividend or a mixed structure, or with different features changing throughout the life of the investment.
- The instrument has some relevant limitations to be considered, e.g. it is not possible to fully exclude the preferred shareholders from the company's profits or losses, or to provide for the accrual of interest on the invested capital.
- Unlike pure debt instruments, the right to a preferred dividend requires (i) the existence of distributable profits, and (ii) the approval of its distribution by the General Shareholders' Meeting.
- The Parties can agree that, if not fully or partially paid in a given year, the dividend will have a cumulative nature. Further, the preferred equity may be 'participating', so that after being paid the preferred dividend the investor is entitled to the same dividends that may be payable to the

ordinary shareholders. Investors sometimes Preferred equity Private equity: alternative instruments and strategies 3 negotiate conversion rights into ordinary equity, although this is less material than in other countries as, in addition to the preferred dividend or liquidation preference, preferred equity in Spain usually confers its holders the same voting and economic rights as ordinary equity.

- Investors also commonly negotiate a preferred right to receive a minimum amount in a liquidity event (e.g., sale of the shares or the assets to third parties, IPO, liquidation of the company, etc.), equivalent to the reimbursement of the investment, or to receive its liquidation quota before the ordinary shareholders.
- The investor can also negotiate privileges in relation to the voting rights, through multiple voting rights structures or by virtue of veto rights or qualified majorities in relation to certain matters.

4 Non-voting shares

Non-voting shares are another type of hybrid instrument with debt and equity characteristics. While rarely used in practice, it may be attractive for family-owned businesses or other types of companies seeking to strengthen their equity without altering the voting and control structure, and for investors willing to remain as passive shareholders with no interest beyond the financial aspects of the investment. In exchange for not holding voting rights, the non-voting shareholders have, by operation law, certain economic benefits and advantages vis-à-vis ordinary shareholders:

- First and foremost, the statutory right to receive an annual minimum fixed or variable dividend, which is cumulative if it cannot be paid out in a given year (with a maximum of five years to settle), and additional to the ordinary dividend.
- If the minimum dividend is not paid the investor will hold voting rights insofar as payment remains outstanding, under the same conditions as the ordinary shareholders, while maintaining the economic advantages.
- Statutory priority to recover the investment in the event of liquidation of the company.
- If the company reduces its share capital to offset losses, non-voting shares would only be affected when the reduction exceeds the nominal value of the ordinary shares.
- The favorable vote of a majority of the non-voting shareholders is required to approve any amendments to the articles of association that may be detrimental to their interests.
- Finally, there is a limit on the issue of non-voting shares: their nominal value cannot exceed one half of the share capital, in case of a private limited company (*Sociedad Limitada*), or one half of the paid-in share capital in case of a public limited company (*Sociedad Anónima*).

Investors will often seek to negotiate conversion rights, so that they are able to convert the non-voting shares into ordinary shares, at all times or in certain situations, to increase the liquidity of their investment and facilitate a future exit.

5 Issue of bonds

The issuance of bonds is an investment mechanism that provides structured and regulated means to obtain capital. In Spain, corporate companies may issue and secure numbered series of bonds or other securities that acknowledge or create a debt.

Public limited companies may issue bonds, even if the total amount of outstanding debt securities exceeds the sum of paid-up capital plus the reserves in the last approved balance sheet and the balance sheet regularization and revaluation accounts. On the other hand, the total amount of securities issued by private limited companies may not exceed twice their own equity, unless the issue is secured by a mortgage, a pledge of securities, a public guarantee or a joint and several guarantee from a credit institution. The issue must be recorded in a public deed executed by the company's representative and, where applicable, by the commissioner (appointed by the issuer).

6 Convertible debt

Convertible loans (or other debt securities or instruments convertible into equity) are becoming increasingly popular in the market. Investors retain the option to choose between two alternatives upon occurrence of the agreed conversion event(s): (i) either to become an equity holder by converting the loan, with the prospect of higher future yields, or (ii) to recover the investment at that time through the repayment of principal and accrued interest. Sometimes the parties agree that the loan may be convertible only partially, or that only one of its tranches is convertible. In exchange for the entitlement to convert the loan, the company (borrower) will normally pay a lower interest rate and offer fewer guarantees or security, and the maturity will usually be longer. When structuring and negotiating a convertible loan, the following legal aspects should be considered, among others:

- The parties are free to negotiate the terms and conditions. As well as the features inherent to any loan (e.g., maturity date, repayment and interest), the parties will have to define the conversion windows or events (e.g., new share capital increase or round of financing, change of control, liquidity event and maturity date).
- An essential aspect is reaching a prior agreement regarding conversion and the valuation of the company to be used for such purpose (or the parameters and process, if appropriate, to determine those aspects).

- The conversion is implemented through a share capital increase whereby the investor agrees to subscribe for company shares by offset the receivable arising from the loan. Even though the remaining shareholders will not have a preferential subscription right, the approval from the General Shareholders' Meeting will be required. It will therefore be advisable to seek formulas to mitigate enforceability and execution risks (e.g., commitment from shareholders to vote in favor of the future conversion, penalty clause, pledge over shares with step-in rights for the investor, etc.).
- Since it will normally become a minority shareholder, the lender (investor) may want to negotiate in advance the main terms of the future shareholders agreement with customary protections, which would automatically become effective upon conversion.
- As it is the case with any structure that combines debt and equity features (either simultaneously or at different stages), an analysis must be performed in connection with the risk of the debt being classified as a subordinated claim under the Spanish Insolvency Act, given that the holder of the debt could potentially be deemed as a "specially related person" to the debtor.
- An analysis of the potential risk of the lender being considered a de facto or shadow director must be performed if the lender has appointed an observer to the company's board of directors.

A convertible loan is often also structured as a profit participating loan ("*préstamo participativo*"), which (i) must bear interest that is linked (fully or partially) to the company's performance (profits, turnover or other parameters), (ii) is normally considered equity for accounting and company law purposes, and (iii) is legally subordinated to any other loan or third party liability of the company and has priority only over the equity.

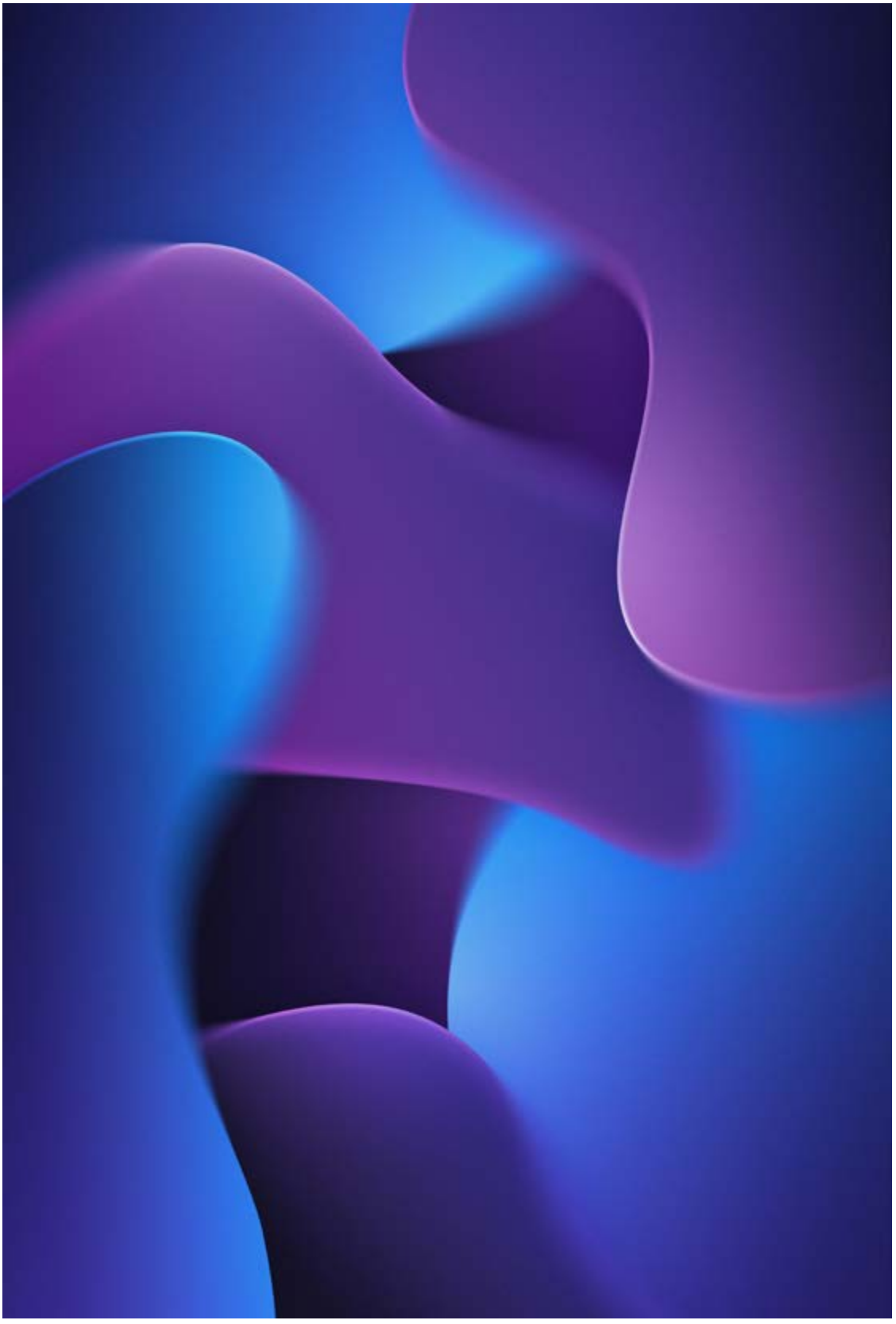
7 Warrants

Warrants are financial derivatives often issued as a complement to a loan (usually a subordinated or mezzanine loan), which grant the investor a right—but not an obligation—to subscribe for shares of the company (borrower) at a pre-agreed price, on a certain date or during a certain period. Warrants are becoming increasingly common in the context of the restructuring of companies with financial difficulties or distressed situations, and can be attractive for investors because, in addition to the the fixed income associated with the financing, they provide an equity upside, i.e. the opportunity to acquire equity in the borrower and therefore being entitled to a share of the company's profits in the future.

Warrants are complex financial instruments without a specific legal framework in Spain, although for public limited companies (*Sociedades Anónimas*) warrants are deemed subject to the same rules applicable to convertible bonds. Further, as with convertible debt, the parties may freely negotiate their terms and conditions. Their essential features are as follows:

- Unlike convertible debt, warrants do not create or recognize debt, and their exercise would not necessarily lead to the cancellation of the associated debt.
- The terms of the warrants must contemplate: (i) how many shares the investor may acquire upon exercise of the warrants, as a fixed number or percentage, (ii) adjustments to the conversion formula due to possible changes in the share capital, (iii) the acquisition price (to be paid in cash or by offsetting the debt), (iv) the exercise date or period, and (v) the maturity date.

The issue of shares upon exercise of the warrants will normally require a share capital increase to be approved by the General Shareholders' Meeting. Public limited companies (*Sociedades Anónimas*) may use treasury stock or approve the share capital increase in advance, authorizing the board of directors to execute it (i.e.to effectively issue of shares), in order to mitigate the execution risk and provide the instrument with a greater degree of automatism. This is not possible with private limited companies (*Sociedades Limitadas*), which makes its implementation more complex and the instrument less attractive.



Contacts

MADRID

Francisco J. Martínez Maroto
Partner

franciscoj.martinez@cuatrecasas.com
T +34 915 247 806

BARCELONA

Marco Antonio Sanz
Partner

marcoantonio.sanz@cuatrecasas.com
T +34 933 129 530

Julene Areitio
Associate

julene.areitio@cuatrecasas.com
T +34 932 905 458

CUATRECASAS

Spain & Portugal	› Alicante › Barcelona › Bilbao › Girona › Lisbon › Madrid › Málaga › Palma de Mallorca › Porto › San Sebastián › Seville › Valencia › Vigo › Vitoria › Zaragoza
International	› Bogotá › Brussels › Casablanca › Lima › London › Luanda* › México City › New York › Santiago › Shanghái

* *in association with the respective local law firm*

www.cuatrecasas.com