Portugal


Ricardo Andrade Amaro


Pedro Capitão Barbosa

Morais Leitão, Galvão Teles, Soares da Silva & Associados

1 Overview

1.1 What are the most common types of private equity transactions in Portugal and what is the current state of the market for these transactions?

Private equity in Portugal has experienced significant growth, despite the financial crisis and sovereign debt crisis which have loomed in the country in the last few years. According to the latest data available, value under management by private equity players has been steadily rising since 2003, reaching 3.2 billion euros at year end 2013.

Turnaround or distressed transactions have been the most relevant types of private equity deals in Portugal in the last few years, followed by growth capital investment. It is worth noting that the amount invested in management buy outs and management buy ins is small and that venture capital investment (start-up, seed capital, early stage investment) is dwarfed by more "traditional" private equity (distressed and growth) (12.5% against 87.5%, respectively).

With regards to industry sectors which have been the target of private equity investment in Portugal, energy, manufacturing and non-financial holding companies take the lead.

1.2 What are the most significant factors or developments encouraging or inhibiting private equity transactions in Portugal?

The market for investing in private equity funds is currently buoyant as economic growth in Portugal is again picking up (expected to be close to 2% in 2015) and institutional investors have plenty of liquidity and are searching for higher yielding asset classes following commencement of the European Central Bank's quantitative easing programme. Also, the record number of insolvencies in the aftermath of the crises has sparked interest in investors to put money in distressed buyout funds.

The sector is currently undergoing a regulatory overhaul with the enactment of Law no. 16/2015, of February 24 ("**Law 16/2015**") and of Law no. 18/2015, of March 4 ("**Law 18/2015**"), both which transpose EU Directive no. 2011/61/EU, of the European Parliament and the Council (the "**AIFM Directive**") to Portugal. The statutes introduce relevant changes to the legal framework of private equity investment in Portugal in areas as diverse as remuneration, regulatory disclosures, risk and liquidity management and outsourcing. EU passport rules, enabling the marketing of large private equity funds, have also been approved by the aforementioned diplomas.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in Portugal?

The typical private equity transaction in Portugal is made through a private equity fund. Pursuant to this structure, the fund participants, or LPs (as well as the managing entity, which retains some "skin in the game") subscribe and pay-up units in the fund, after the latter is registered before the relevant regulatory authority in Portugal (the Portuguese Securities Market Commission – "**CMVM**").

The aforementioned investment vehicles then either: (i) acquire equity participations directly or subscribe newly issued shares by the target company (in a typical buyout, growth or venture capital deal); or (ii) acquire debt instruments or securities (notably senior bank loans) and convert such instruments into equity, thereby gaining control of the target (in distressed or turnaround transactions).

If the private equity investor does not ultimately come to hold the entirety of the company's equity, a shareholder agreement is generally entered into with the surviving shareholders.

2.2 What are the main drivers for these acquisition structures?

The main drivers for these structures relate to incentive alignment and tax reasons.

Investment using private equity funds is an efficient way for various institutional investors to pool money into alternative asset classes which potentially offer higher yields than public equities or bonds, while avoiding operational risks and regulatory hurdles which would arise from investing directly in non-listed companies. In private equity funds, the managing entity retains a residual equity participation in the fund to signal that it is committed to act on the best interests of the LPs. The carried interest remuneration structure (detailed below) also helps align incentives.

Tax-wise, private equity funds incorporated in Portugal are exempt from corporate income tax and any gains made are directly attributed to its LPs, at a favourable rate.

2.3 How is the equity commonly structured in private equity transactions in Portugal (including institutional, management and carried interests)?

As explained above, equity in private equity transactions is supplied via private equity funds.

Remuneration of such equity is typically made through a simple waterfall and carried interest payment structure, whereby any distributions made by the fund would be done in the following order: (i) all unit holders recoup their nominal investment; (ii) the LPs are paid a minimum hurdle rate; and (iii) any amounts left shall be distributed 80%-85% to the LPs and 15%-20% to the GP/managing entity.

It is worth noting that the entry into force of the provisions transposing the AIFM Directive (i.e. Law 18/2015) may have a significant impact on the abovementioned equity remuneration structure for large private equity funds (i.e. which have over 500,000,000.00 euros of assets under management, if not leveraged or 100,000,000.00 euros of assets under management, if leveraged). Notably, requirements that at least 40% of the variable remuneration is deferred over a period of at least three to five years and that at least 50% of any variable remuneration must consist in units of the fund will put into question many of the existing remuneration arrangements set out in Portugal.

2.4 What are the main drivers for these equity structures?

These equity structures are used primarily for inducing risk sharing between investors and management, thus aligning their incentives.

2.5 In relation to management equity, what are the typical vesting and compulsory acquisition provisions?

Stock option plans or "phantom stock" option plans are increasingly being used in venture capital transactions in Portugal. Vesting of the schemes is usually associated with the achievement of certain operating figures (e.g. the company having an EBITDA over a certain figure).

Good leaver/bad leaver provisions are also common, and a bad leaver will often trigger call/put options for investors/managers' equity participation in the target company in order to dissolve the "partnership" established between the manager and the private equity investor.

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies?

Private equity investors will commonly have one or more representatives on the board of directors of portfolio companies to serve as non-executive directors. Other typical features of governance structures of portfolio companies is the set up of a remuneration committee and/or related party transactions committee used for the private equity investor to monitor the company.

3.2 Do private equity investors and/or their director nominees typically enjoy significant veto rights over major corporate actions (such as acquisitions and disposals, litigation, indebtedness, changing the nature of the business, business plans and strategy, etc.)?

Yes. Usually shareholders' agreements entered into between private equity investors and management/surviving shareholders/partnering shareholders will have "restricted board matters" (via supermajorities or share classes) involving material aspects of the business regarding which the private equity investor enjoys a veto right.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

No limitations usually exist. Restricted board matters are almost without exception transposed into the company's by-laws, making them enforceable towards third parties.

Similarly, on matters where shareholders have the last say (which would depend on the type of company in question) the shareholders' agreement and by-laws create a set of restricted matters (again supermajorities or share classes) for shareholders resolutions as well, granting a veto right to the private equity investor.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or vice versa)? If so, how are these typically addressed?

No special statutory duties exist regarding private equity investors in relation to minority shareholders or otherwise.

It is, however, worth noting that Portuguese law provides for several special rights of minority shareholders, such as the right to appoint directors from a separate list (if such mechanism is included in the by-laws) or the right to annul resolutions approved by the majority shareholders, if proved to be to their detriment (e.g. on self-dealing transactions).

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including governing law and jurisdiction)?

Under Portuguese law, it is generally understood that the provisions of shareholders' agreements are binding only upon the parties and, thus, are not enforceable towards third parties nor towards the company itself.

Other restrictions set out in the law regarding the contents of a shareholders' agreement include: (i) no provisions may be included restricting the actions of members of the company's management or audit bodies; (ii) no shareholder may commit to always vote in accordance with the instructions or proposals given/made by the company or its management or audit bodies; and (iii) no shareholder may exercise or not exercise its voting right in exchange for "special advantages" (i.e. prohibition of vote selling).

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies?

Directors appointed by private equity investors should be aware that, under Portuguese law, they owe fiduciary duties (care and loyalty) to all shareholders of the portfolio company, and may not cater only to the interests of the private equity investor.

On the other hand, private equity investors, if they exercise a significant influence in the company to allow it to be qualified as a *de facto* board member, may be held liable should the company be declared insolvent, if is proven that the insolvency was the result of culpable action by the investor.

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

At fund level, conflicts of interest are typically addressed through an Advisory Council, in which attributions typically entail issuing opinions on certain transactions undertaken by the fund, notably related party transactions, and other conflicts of interest.

At portfolio company level, a related party transaction committee is often set up to deal with vertical (company-fund) and horizontal (portfolio company-portfolio company) conflicts of interest.

More generally, statutory corporate law provisions contain mandatory provisions whereby shareholders and board members are impeded to vote in the relevant meetings if they are deemed to be in a conflict of interest.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in Portugal, including competition and other regulatory approval requirements, disclosure obligations and financing issues?

Timetable constraints and other formalities for transactions in Portugal involve, generally, the following:

a) waivers from financing banks, in direct or, sometimes, indirect changes of control;

b) securing financing for the transaction;

c) in asset deals (e.g. transfer of business via agreement or prior statutory demerger), formalities related to employment matters, notably town hall meetings and opinions from employees representative structures;

d) in large deals, waivers from competition authorities; and

e) deals in some regulated sectors (especially banks, insurance companies and other financial institutions) require prior approval from the respective regulatory authorities.

Following the implementation of the AIFM Directive in Portugal, Law no. 16/2015, of February 24, has imposed disclosure requirements for managing entities of alternative investment funds (which include private equity funds) when acquiring private companies. Pursuant to the newly approved rules, private equity fund managers must now disclose to CMVM: (i) the acquisition or divestment of a significant shareholding in the company; (ii) acquisition of control over the company; and (iii) if acquiring a position of control in a company, intentions regarding the future activity of the company and the probable repercussions in the company's headcount.

4.2 Have there been any discernible trends in transaction terms over recent years?

No trends in transaction terms have arisen over the past few year0.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

Only one private equity public-to-private transaction has ever been recorded in Portugal (i.e. the acquisition of Brisa, a highway toll operator, in 2012, by a joint venture formed by a Portuguese family office holding company and a European infrastructure fund).

Since there is but one example of this type of transaction in Portugal, it is not possible to assess patterns or trends.

5.2 Are break-up fees available in Portugal in relation to public acquisitions? If not, what other arrangements are available, e.g. to cover aborted deal costs?

Please see the answer above.

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors in Portugal?

Common variations to the price payable by private equity investors in Portugal to shareholders of portfolio companies include: (i) deduction of the amount corresponding to non-current net debt; (ii) when relevant, accrual of net working capital; and (iii) sometimes, when management is expected to stay on board, earn-outs in accordance with commonly used financial indicators (e.g. EBITDA).

6.2 What is the typical package of warranties/indemnities offered by a private equity seller and its management team to a buyer?

Standard representations and warranties involving mostly the underlying assets of the portfolio companies (as opposed to management) are offered.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

Covenants and other undertakings usually include non-compete provisions. Assset-specific covenants are also provided, when applicable.

6.4 Is warranty and indemnity insurance used to "bridge the gap" where only limited warranties are given by the private equity seller and is it common for this to be offered by private equity sellers as part of the sales process?

Warranty and indemnity insurance is scarcely used.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

Caps and baskets are the most usual limitations to liability in private equity exit transactions.

6.6 How do private equity buyers typically provide comfort as to the availability of equity finance and what rights of enforcement do sellers typically obtain if commitments are provided by SPVs?

Corporate guarantees/comfort letters are common. To a limited extent, bank guarantees are also provided.

6.7 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Reverse break fees are not common.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

No IPO exit from a private equity investment has ever been made in Portugal.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

As mentioned above, there is no factual basis to answer the question as no IPO exit from a private equity investment has ever been made.

7.3 To what extent can rights in pre-existing shareholders' agreements survive post-IPO?

Depending on the amount of shares being listed, and thus the dilution suffered by the original shareholders, some of the rights in pre-existing shareholders' agreements may outlive their usefulness. For instance, supermajority provisions for shareholders' resolutions may not be of relevance if more than half of the share capital is listed following the IPO.

It should be mentioned that the Portuguese Securities Code mandates that the entering of a shareholders' agreement for the purposes of acquiring or maintain control in a listed company or to frustrate a public tender offer must be disclosed to CMVM by any of its contracting parties. CMVM may, if it considers relevant, disclose all or part of said shareholders' agreement.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in Portugal and provide an overview of the current state of the finance market in Portugal for such debt.

Due to the fact that the median value of private equity transactions in Portugal is small, deals involving private equity investors are made almost exclusively through the funds' equity, raised from its participants. Debt financing of transactions is thus rare.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

Notwithstanding the abovementioned response, it is worth noting that financial assistance (i.e. contracting loans or providing securities for the acquisition of the company's shares) is restricted under Portuguese law, thus undermining the possibility of pursuing leveraged buyouts.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in Portugal?

As mentioned above, private equity funds are considered neutral vehicles for tax purposes, and as such are exempt from corporate income tax. Any gains derived from private equity funds, on the other hand, is subject to a 10% withholding tax (whether personal or corporate income tax), except when the beneficiaries of such income are entities exempt from income on capital gains or entities with no permanent establishment in Portugal to which the income are attributable, excluding: (i) entities which are resident in tax havens; or (ii) non-resident entities held, directly or indirectly (more than 25%), by resident entities.

Private equity companies (*sociedades de capital de risco*) also benefit from a tax allowance of a sum corresponding to the limit of the sum of the tax base of the five preceding years, as long as such deduction is used in investing in companies with high growth potential. On the other hand, dividends payable by private equity companies to its shareholders do not receive any special treatment (i.e. 28% flat rate for individuals and the current corporate income tax rates for companies).

Alas, the treatment of income derived from carried interest and other variable private equity managers' compensation is not clear from tax legislation. As such, due to the fact that, from a tax perspective, treatment of such income is not clear, there have been several calls to, like in many other jurisdictions, clearly state that variable management compensation is taxed as capital gains.

9.2 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors or transactions and are any anticipated?

In January 2015, Decree-Law no.7/2015, of January 13, was enacted, which reformed the tax regime of collective investment vehicles. However, private equity funds were excluded from such reform and the tax treatment of variable private equity management compensation is yet to be clarified.

10 Legal and Regulatory Matters

10.1 What are the key laws and regulations affecting private equity investors and transactions in Portugal, including those that impact private equity transactions differently to other types of transaction?

Currently, the main provisions regulating private equity investment in Portugal are Law 16/2015 and Law 18/2015, mentioned earlier, which were enacted following the regulatory overhaul of the alternative investment fund sector by the AIFM Directive.

10.2 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

Law 16/2015 and Law 18/2015 provided several major changes to the regulation of private equity in Portugal. Highlights include:

a) Investment compartments – the management regulations of private equity or venture capital funds may now establish that the fund may be divided into several investment compartments, named "subfunds".

b) Management may change certain aspects of the management regulations (e.g. details of the manager; reduction in management fees) in private equity funds without the consent of unit holders.

c) Own funds requirements – private equity and venture capital companies must have own funds corresponding to 0.02% of the amount of the net value of assets under management exceeding 250,000,000.00 euros.

However, the main innovation put in place by the enactment of Law 18/2015 is imposing a more demanding regulatory framework to management entities of collective undertakings which have assets under management with a value exceeding: (i) 100,000,000.00 euros, when the respective portfolios include assets acquired with leverage; or (ii) 500,000,000.00 euros, when the respective portfolios do not include assets acquired through leverage and regarding which there are no reimbursement rights which may be exercised during a five-year period counting from the date of initial investment.

Such funds are now subject to, *inter alia*, the following obligations:

a) their incorporation is subject to the prior authorisation of the Portuguese Securities Market Commission (CMVM);

b) risk management should be functionally and hierarchically separated from the operating units, including the portfolio management function;

c) measures should be taken to identify situations of possible conflicts of interest as well as to prevent, manage and monitor conflicts of interest;

d) CMVM shall be informed of the intention to delegate services to third parties for carrying out functions in the name of the abovementioned managing entities;

e) managing entities shall employ an appropriate liquidity management system; and

f) applicability of "EU passport rules" (i.e. the ability to market units of private equity funds in other EU countries or third countries).

10.3 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

Law no. 25/2008, of June 5, established several obligations on, among others, know your customer and due diligence procedures and disclosure of monetary flows for purposes of preventing money laundering transactions and the financing of terrorism. These obligations are applicable to private equity funds (as well as to banks and other financial institutions).

The aforementioned reporting duties have an impact on due diligence procedures taken during fund structuring, as the private equity investor shall for instance be obliged to know what is the controlling structure of its clients (the fund LPs) and who is the ultimate beneficial owner of such LPs. Consequently, the major private equity players in Portugal have instated official know your customer procedures in an effort to not fall foul of the law's provisions.

10.4 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies; and (ii) one portfolio company may be held liable for the liabilities of another portfolio company)?

Private equity funds enjoy full limited liability and asset partitioning in relation to its portfolio companies and participants, respectively. In this sense, the fund may not be liable for debts and other liabilities of the portfolio companies, unless it has provided guarantees for the benefit of such companies.

As for private equity companies, if the latter holds 100% of the share capital of a portfolio company incorporated in Portugal, mandatory corporate law provisions assume a "co-mingling of assets" of sorts and state that they are liable before the creditors of said portfolio companies.

In the case of portfolio companies being liable before one another, assuming that they are both directly held by the same private equity investor (i.e. horizontal group relationship), no subsidiary liability may arise.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in Portugal or should such investors otherwise be aware of in considering an investment in Portugal?

Nowadays, private equity investment in Portugal faces the issue of lack of opportunities to invest in relation to the money being raised. Due to the economic frailties that the country still faces, not many investment opportunities are arising (notwithstanding the prevalence of distressed or turn-around acquisitions) in relation to the funds being raised.

Ricardo Andrade Amaro
Morais Leitão, Galvão Teles, Soares da Silva & Associados
Rua Castilho, 165
1070-050, Lisboa
Portugal

Tel: +351 21 381
Fax: +351 21 371 74 99
Email: ramaro@mlgts.pt
URL: www.mlgts.pt/en

Ricardo Andrade Amaro is a senior lawyer in MLGTS and is part of the corporate, M&A, capital markets team and energy law team.

He is a lawyer with great experience in corporate and commercial law, securities law, as well as in energy law. Ricardo has, inter alia, acted as legal advisor in the setting up of the first private equity fund in Portugal exclusively dedicated to the recovery of companies (turn-around fund), which is currently the largest Portuguese private equity fund.

Ricardo was also engaged as a junior assistant at the Law faculty of the University of Lisbon from 2005 to 2009.

Ricardo Andrade Amaro has a law degree from the University of Lisbon (2002) and a postgraduate degree from the Catholic University in Corporate Law (2004). He is a member of the Portuguese bar association since 2004 and of the Securities Institute (also from 2004).

Pedro Capitão Barbosa
Morais Leitão, Galvão Teles, Soares da Silva & Associados
Rua Castilho, 165
1070-050, Lisboa
Portugal

Tel: +351 21 381 74 38
Fax: +351 21 371 74 99
Email: pcbarbosa@mlgts.pt
URL: www.mlgts.pt/en

Pedro Capitão Barbosa is an associate with MLGTS and is part of the corporate, M&A and capital markets team. Pedro joined the firm in 2011, and previously worked with the real estate team.

Pedro Capitão Barbosa has a degree from the New University of Lisbon (2010) and has obtained a LL.M. in Finance & Law from the Duisenberg School of Finance (in partnership with the University of Amsterdam). He has been a member of the Portuguese bar association since 2014.

Morais Leitão Galvão Teles Soares da Silva

Independent and internationally recognized as a leading law firm in Portugal, Morais Leitão, Galvão Teles, Soares da Silva & Associados's (MLGTS) reputation is based on the excellence of its legal services, the professionalism and the innovative solutions of our team. With more than 180 lawyers at a client's disposal, MLGTS has three offices in Portugal.

As a result of our network of associations with local firms and the creation of the MLGTS Legal Circle, MLGTS also operates through offices in Angola, Macau (China) and Mozambique.

MLGTS offers specialised services in the main areas of law, having been involved in many of the largest and most important deals in Portugal, as well as in high-value cross-border transactions and disputes. Its client list includes some of the largest Portuguese and international companies and business groups as well as public and private entities, giving the firm deep insight into the national and international business environment from a legal perspective.