IX. Company restructuring and insolvency

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Glossary

Decree-Law 10-J/2020

Decree-Law 10-J/2020, of 26 March, which provides for exceptional measures for protection of the credit of families, companies, voluntary organisations and other third-sector entities, as well as a special scheme of personal guarantees by the State, within the context of the COVID-19 pandemic

PER

Special Revitalisation Process

RERE

Extrajudicial Framework for Business Recovery

IX. COMPANY RESTRUCTURING AND INSOLVENCY

IX.A. Background

The current pandemic caused by the novel coronavirus has led to an increasing deterioration of the economic and financial context, at both national and international level, which is expected to aggravate the situation of many Portuguese companies, particularly as regards their cash flow, as a result of the increase in defaults, or at least the delay in meeting contractual obligations.

This may give rise to a significant increase in the number of companies making use of the judicial and extrajudicial mechanisms provided by Portuguese legislation for company restructuring, namely the Special Revitalisation Process ('PER') and the Extrajudicial Framework for Business Recovery ('RERE'). It should be noted that, as explained in greater detail below, both PER and RERE allow debtors to enter into negotiations with their creditors, with a view to reaching an agreement which will enable recovery to take place.

Similarly, if the exceptional situation which we are currently experiencing persists, with the consequent worsening of the economic and financial profile of Portuguese business, a substantial increase is anticipated in the number of insolvency proceedings.

For the time being, no specific alteration has been announced to the legal frameworks for PER and RERE. Moreover, only the following legislative developments related to the current pandemic scenario have direct implications for PER, RERE and the insolvency process. They are the following:

(i) Urgent processes, which include PER and insolvency processes, continue to run without any suspension or interruption of terms, acts, or hearings, the following being observed in relation thereto:

- In hearings that require the parties to be physically present, or for their representatives or other case participants to be present, any procedural acts or proceedings will be conducted via suitable remote communication means, specifically teleconference, video call or equivalent;
- If it is not possible, or suitable, to ensure that acts are carried out or hearings are held as set forth under the previous item, the regime for general suspension of process deadlines will also apply to PER and insolvency processes;

(ii) The deadline for submitting the debtor to insolvency is suspended, which, according to the law, is 30 days from the knowledge of the insolvency situation;

(iii) The provisions of Decree-Law 10-J/2020, in relation to the establishment of a standstill period for certain debts, as such a standstill may be relevant for assessing the insolvency situation of a certain debtor, if it is granted such a period. It should be highlighted that Article 6 of Decree-Law 10-J/2020 makes it clear that in the case of a declaration of insolvency or application for PER or RERE by an entity in a standstill period, the affected financial and credit institutions may exercise any actions to which they are entitled.

Being aware of the Government's intention to encourage a relaunch of the Portuguese economy and avoid job losses, we believe that the legislature can be expected to review the

legal framework of these business restructuring mechanisms, and possibly of the insolvency process as well, in order to adapt them to the reality of the current situation.

If it does come about that a review takes place of the legal frameworks relating to PER and RERE, it is anticipated, although, as stated, no such intention has so far been announced by the legislature, that such alterations will seek to mitigate certain obstacles which currently prevent access to these business restructuring mechanisms, thereby contributing to the creation of a more favourable environment for business recovery, at the expense of the alternative solution of liquidation of the assets of the insolvent party, which, most of the time, carries a high risk that creditors will not recover their debt.

We shall look briefly at the main characteristics of the two business restructuring mechanisms, analysing firstly PER and then RERE. Finally, we shall set out some notes on the insolvency process.

IX.B. Special Revitalisation Process (PER)

PER is enshrined in the Insolvency and Business Recovery Code, more specifically in Articles 17(A) to 17(I). It was created in 2012, and, in terms of business recovery, it has been the main corollary of the financial assistance programme entered into in 2011 between Portugal and the European Central Bank, the European Commission and the International Monetary Fund.

PER is an urgent measure, and in court proceedings it takes precedence over other cases. On the other hand, PER is a voluntary process, in that creditors have no means of forcing a debtor company to apply for it; only the debtor company itself can take the decision to set up a PER.

Companies which may apply for PER are those in a difficult financial situation or in a situation of imminent insolvency, where recovery is still possible. By law, a debtor which faces serious difficulty in meeting its obligations punctually, specifically due to a lack of liquidity or an inability to obtain credit, is in a difficult financial situation.

As regards the purpose of PER, it is intended to give companies the opportunity to enter into negotiations with their creditors, with a view to reaching an agreement with them which leads to their revitalisation. Such an agreement, normally referred to as a recovery plan, may contain various provisions which affect the debtor's liabilities, with the corresponding impact on the position of each creditor, such as, for example: complete or partial write-off of the debtor's debts; modification of the due dates or interest rates of debts; assignment of assets to creditors; linking repayment of the debts or part of them to the debtor's available funds, etc.

A PER process is begun by a written declaration of the wish of the debtor and of one or more creditors, unrelated to the debtor, which hold at least 10% of the unsubordinated debt[1], to enter into negotiations leading to its revitalisation by means of the approval of a recovery plan. In addition, when applying for PER, in addition to submitting a preliminary proposal for the recovery plan, the company must present a declaration, signed within the last 30 days by a certified accountant or auditor, stating that it is not in a situation of insolvency.

On submission of this documentation to the court, the judge must appoint a temporary administrator who will deal with the process. This decision by the judge prevents any actions being filed for enforcement of debts against the debtor, and, during the negotiations, suspends

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[1] Subordinated debt is, for example, debts to suppliers, and, typically, debts to companies in a group relationship with the debtor or to directors of the debtor.

any similar actions which may be under way. In another step, during the PER, any acts of administration considered to be of particular importance (such as, for example, the sale of the company or the purchase of real estate) by the debtor company require the authorisation of the temporary administrator.

The debtor then notifies all its creditors which have not signed up to the written declaration referred to above, by recorded-delivery letter, that it has entered into negotiations with a view to its revitalisation, inviting them to take part in the negotiations. Any creditor which so wishes may take part in the negotiations with the debtor company.

Creditors have 20 days as from the date of appointment of the temporary administrator to register their debts. At the end of this period, the temporary administrator must within five days draw up a provisional schedule of creditors, which may be contested by the debtor or by any creditor within an identical period. Within a like period, the judge must rule on these objections.

As from this time, the creditors and the debtors have a period of two months to conclude the negotiations which they have begun. This period may be extended by agreement with the temporary administrator, on a single occasion and for one month.

Once the negotiations have concluded, the debtor must put the recovery plan to a vote by the creditors. In order for the recovery plan to be considered approved, one of the following must apply:

(i) On being voted on by creditors representing at least one third of the total amount of registered debt with voting rights, it receives the favourable vote of more than two thirds of the total number of votes cast and more than half of the votes cast by holders of unsubordinated debt; abstentions are not counted;

(ii) It receives the favourable vote of creditors representing more than half of the total amount of registered debt with voting rights and more than half of these votes cast by holders of unsubordinated debt; abstentions are not counted.

If the plan is approved by the creditors, the judge must decide within ten days whether to approve the recovery plan. Within this framework, the judge must assess the content of the recovery plan and the way the process was conducted, determine whether the procedural requirements of PER were met, and also whether the plan follows the general principles of equality of treatment among creditors of the same class and not placing any creditor in a less favourable position, within the context of the recovery plan, than the position it would be in if the company were to be wound up in insolvency proceedings.

Once it has been approved by the court, the recovery plan is binding on all creditors, in respect of debts in existence as at the date of appointment of the temporary administrator. The creditors bound by the recovery plan include those which voted against approval or did not register their debts or take part in the negotiations.

In terms of time required, practice shows that on average approval of the recovery plan by the judge occurs around six months after application for PER.

As an alternative to the legal framework of PER, Article 17(I) of the Insolvency and Business Recovery Code provides for simple approval of the extrajudicial business recovery agreement. The main difference with the PER framework described above is that, in the case of extrajudicial agreement for business recovery, the debtor company initiates the process with the said agreement already signed by creditors representing the majority required for approval of the equivalent recovery plan under PER.

Therefore, once the process has been initiated with the submission of the extrajudicial agreement for business recovery, signed by the debtor company and its creditors, the time required for obtaining a decision on approval of the agreement by the court is shorter, since the judge must make such a decision once the creditors, which have not signed the agreement, have registered their debts. Following this route, our experience is that two months may be sufficient between the initiation of the process by submission of an extrajudicial business recovery agreement and the making of a decision on approval by the court.

Both the legal framework of PER and that relating to extrajudicial agreements for business recovery provide for the possibility of application for processes of this kind relating to the same group of companies.

PER provides for the granting of tax benefits relating to IRC (corporation tax), stamp duty and IMT (municipal property transfer tax), even where it deals with an extrajudicial business recovery agreement.

IX.C. Extrajudicial Framework for Business Recovery (RERE)

The implementation of one of the measures of the Capitalise Programme, launched in the previous parliamentary term, led to the creation of RERE, an instrument by which a company in economic and financial difficulties can reach a restructuring agreement with all or just some of its creditors. The main characteristics of RERE are as follows:

(i) It is a wholly extrajudicial business restructuring mechanism, free from any intervention by the courts; and
(ii) It is a mechanism which tends to be confidential.

Any company in a difficult financial situation or in a situation of imminent insolvency, i.e. facing serious difficulties in meeting its obligations, but still capable of recovery, may apply for RERE. Companies already in a situation of insolvency may not, therefore, make use of this business restructuring mechanism.

Under RERE, the company and its creditors may agree a protocol to ensure favourable conditions for the negotiation of the restructuring agreement, for example, by the suspension of any legal proceedings under way against the company or by a ban on the interruption of the provision of essential services to the company (water, electricity, telecommunications), in order for the respective activity to remain in operation.

Apart from the debtor company and those creditors which wish to take part, Social Security and the Tax Authority are also required to take part where they are creditors.

Negotiations must be conducted in good faith and transparently; any creditor may join them at any time.

The content of the restructuring agreement is freely determined by the parties, and, specifically, may include the terms of the restructuring of the company's business activity, rescheduling of its debt, any new finance to be granted, fresh guarantees to be given, etc.

The restructuring agreement is entered into in writing and must be accompanied by the declaration of an auditor certifying that as at the date of the agreement the company is not in a situation of insolvency.

The restructuring agreement is an executable instrument with regard to the obligations assumed in it by the company, but is not binding on any creditors which did not take part in it.

RERE allows for tax benefits similar to those granted under PER, where certain conditions are met.

If the restructuring agreement is signed by creditors representing the majorities for approval specified for PER, the debtor company may apply for court approval, with a view to extending it to those creditors which did not sign the said agreement.

The main differences between PER and RERE are as follows:

(i) RERE enables the debtor company to negotiate an agreement with some or all of its creditors, whereas PER always covers all creditors;
(ii) RERE is a wholly extrajudicial framework, whereas PER provides for the involvement of the courts, which means that, under PER, the recovery plan is binding on all the company's creditors, including those which voted against it or did not take part in the process;
(iii) RERE is a confidential mechanism, unlike PER, which is subject to publicity;
(iv) Unlike what happens under PER, the fact that a restructuring agreement is being negotiated under RERE does not necessarily imply that this will prevent debt collection proceedings from being brought against the debtor, or that any similar proceedings under way will be suspended;
(v) Under PER, the court appoints a temporary administrator, who has, among others, the power not to authorise the conduct of acts of administration of particular importance to the debtor company, which does not happen under RERE.

IX.D. Insolvency Process

The insolvency process is fundamentally a universal execution procedure which aims to satisfy creditors' claims, specifically by liquidating the assets of the insolvent debtor and distributing the proceeds between the creditors in accordance with legally-determined criteria of priority.

Although it is theoretically possible to recover a company which has already been declared insolvent, i.e. in insolvency proceedings, experience shows that this very rarely happens; in most cases, once insolvency has been declared, the company ceases to operate. This is due, on the one hand, to the usual lack of liquidity of a company declared insolvent, and, on the other, to the stigma associated in Portugal with a declaration of insolvency, which is often viewed by other actors in the business world as the death of the company.

Under the Insolvency and Business Recovery Code, a company which is unable to meet its obligations as they become due is considered to be in a situation of insolvency. Similarly, the facts that a company's liabilities are evidently greater than its assets may mean that it is insolvent.

The insolvency process may be begun in one of two ways:

(i) The debtor company may file for bankruptcy, applying to the court to be declared insolvent;
(ii) A creditor (or other bodies laid down by law, such as the Public Prosecutor's Office in certain circumstances) may apply for a winding-up order of the debtor company, based on the presumption that it is insolvent.

Where application is made by a third party for a winding-up order, the company may oppose the application, by submitting evidence that, among other things, it is not insolvent.

If a winding-up order is granted by the court, an official receiver is appointed. Among others, the official receiver has the powers to administer

and dispose of the goods which comprise the company's assets, together known as the 'insolvent estate'.

In the context of the insolvency process, creditors must prove their debts, which, once registered and allocated to a class, will be paid out of the proceeds of the liquidation of the assets of the insolvent company.

The Insolvency and Business Recovery Code divides creditors into the following classes:

(i) Secured and preferential creditors, which are the holders of debts which are covered, respectively, by securities (such as, for example, a mortgage or pledge), including special preference, and by general preference over the assets comprising the insolvent estate, up to the amount of the value of the assets covered by securities or general preferences;
(ii) Subordinated creditors, which are, among others, the holders of debts to suppliers, and, typically, debts to companies in a group relationship with the debtor or to directors of the debtor;
(iii) Ordinary creditors, which are the holders of the remaining debts.

It should be pointed out that, under the insolvency process, there are two particularly important procedural events, both for the debtor company and its directors/managers, and for the creditors. They are the annulment of acts in favour of the insolvent estate and the classification of the insolvency as fortuitous or culpable.

The annulment of acts in favour of the insolvent estate seeks to reclaim assets for the insolvent estate which may subsequently be liquidated and the proceeds used to pay creditors.

In the context of the insolvency process, any acts prejudicial to the estate carried out in the two years preceding the date of commencement of insolvency proceedings may be annulled. Any acts which diminish, frustrate, hinder, place at risk or delay the satisfaction of the insolvency creditors are considered prejudicial to the estate. With the exception of certain situations laid down by law, annulment assumes bad faith by the third party, which is presumed in relation to acts performed or omitted within the two years preceding the commencement of the insolvency proceedings participated in or benefited from by a person in a special relationship with the insolvent (such as, for example, one of its directors or managers), even though the special relationship did not exist at that date.

Specifically, bad faith is taken to mean the knowledge, as at the date of the act, of any of the following circumstances:

(i) That the debtor was in a situation of insolvency;
(i) Of the prejudicial nature of the act and that as at that date the debtor was in a situation of imminent insolvency;
(i) Of the commencement of insolvency proceedings.

The order may be made by the official receiver, by recorded delivery letter with advice of receipt, in the six months following the awareness of the act, but never more than two years after the date of declaration of insolvency.

The order may be contested, within a period of three months from the date it is implemented, by any affected party, by means of an action against the insolvent estate.

If an order is made annulling the act in favour of the insolvent estate, the situation which would exist if the act had not been performed or omitted, as may be the case, must be restored.

Classification of the insolvency seeks to penalise whoever was at fault for the company's

insolvency, in those cases in which the situation was created or aggravated by the wilful or negligent acts of the debtor, or of its directors, in law or in fact, in the three years preceding the commencement of insolvency proceedings.

If the insolvency is classified as culpable by the court, those concerned may be liable to severe penalties, as follows:

(i) A prohibition on administering the assets of others for a period of between two and ten years;
(ii) A prohibition on running a business for a period of between two and ten years, as well as on holding any post in the governing body of a commercial or civil company, association or private foundation engaging in economic activity, public undertaking or cooperative;
(iii) The loss of any claims against the insolvency or against the insolvent estate by persons affected by the classification and an order to return any assets or rights already received in payment of such claims;
(iv) An order for compensation of the creditors of the debtor declared insolvent in the amount of unsatisfied claims, up to the extent of their respective assets, with all affected persons being jointly and severally liable.

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