



Inside Story – March 2019

Pre-Insolvency in Portugal: A New Legal Framework

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Introduction

In Portugal, through Law no. 8/2018, a new pre-insolvency instrument has entered into force: the regime of out-of-court corporate restructuring (in Portuguese, the “Regime Extrajudicial de Recuperação de Empresas” or simply the “RERE”). The RERE is an out-of-court recovery instrument which aims at achieving a voluntary, confidential and free content restructuring agreement through negotiations engaged by the debtor with all or only some of its creditors.

Debtors who may resort to RERE are those in a state of near insolvency or with mere economic and financial difficulties (such as serious difficulty in complying with payment obligations due to lack of liquidity or access to credit), but capable of financially recovering. Exceptionally, during the first eighteen months after the text enters into force, a debtor in a situation of insolvency may resort to RERE as long as it has not yet been declared insolvent by a Court.

The Negotiation Protocol and Principles

The RERE legal regime defines specifically the fundamental principles governing the negotiations, which are good faith and transparency. Another fundamental principle of the RERE process is that participation by the creditors in both the negotiations and the restructuring agreement is voluntary. Furthermore, the debtor may summon all or only some of its creditors to that effect, depending on the approach it deems most appropriate in order to reach an agreement. Notwithstanding this, the Social Security and the Tax Authority must participate in negotiations in cases where they are creditors.

Within the RERE, the debtor and one or more of its creditors representing at least 15% of its non-subordinated credits may deposit at the Commercial Registry Office a negotiation protocol

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in which they express their desire to resort to RERE. However, such a negotiation protocol is not mandatory, which means that it does not have to be deposited at the Commercial Registry Office for the parties to resort to RERE. This means that, whenever the parties have not entered into a negotiation protocol, they may negotiate freely with their creditors, reach an agreement with them, following which, for the agreement to be subject to the RERE legal regime, they then deposit the agreement at the Commercial Registry Office.

Whenever one exists, the negotiation protocol must be signed by the debtor and the participating creditors, after which it is deposited at the Commercial Registry Office. Unless otherwise agreed by the parties, the negotiation protocol is confidential.

By depositing the negotiation protocol, the debtor agrees to:

- (i) maintain the normal course of business;
- (ii) avoid performing unauthorized extraordinary acts of administration of assets; and
- (iii) communicate its eventual decision to terminate the negotiations to the participating creditors and to the Commercial Registry Office.

Moreover, creditors signing the protocol agree to honour commitments undertaken through the protocol during the agreed negotiation period, namely not to initiate any enforcement, asset seizure or insolvency proceedings against the debtor during the course of the negotiations. This remains the case even if, subsequently, they no longer wish to participate in the negotiations (this obligation is binding to any credit acquirer in the event a debt is assigned in the course of the negotiation period). Additionally, any insolvency proceedings filed by a participating creditor against the debtor are suspended and the so-called essential service providers (namely, water, electricity, gas, postal and electronic communications) are not allowed to interrupt supply for a maximum period of 3 months.

The Restructuring Agreement

When the parties have entered into a negotiation protocol, the negotiations close with the deposit of the restructuring agreement or the expiry of the negotiations period without there being any restructuring agreement deposited or an agreement regarding the extension of that period. Once the negotiation period expires, the debtor may, in any case, enter into new negotiations under the RERE with the same or other creditors, as long as it is not insolvent. The closing of negotiations causes the above-mentioned effects of the protocol to cease.

In analyzing the RERE legal regime, the conclusion may be easily reached that, although the content of the restructuring agreement may be freely agreed between the parties, it should include suitable recovery measures, namely restructuring terms concerning:

- (i) the debtor's economic activity;
- (ii) its financial liabilities;
- (iii) new financing to be granted; and
- (iv) security to be provided.

The RERE also provides for the possibility of appointing a Business Recovery Mediator who may or may not be a formal judicial administrator. Naturally, the restructuring agreement binds all signing parties (debtor, creditors and security holders).

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One point that can be highlighted is that the RERE provides for tax benefits which are identical to the ones conferred under the Portuguese PER (“Processo Especial de Revitalização”), as long as:

- (i) the restructuring agreement affects at least 30% of the debtor’s total non-subordinated financial liabilities; and
- (ii) it is accompanied by a certificate issued by a statutory auditor declaring that the agreement will benefit the debtor’s financial situation.

Depending on the appropriate authorization by the Tax Authority, these tax benefits may also apply to subordinated debt and to situations in which the restructuring agreement affects less than 30% of the debtor’s total non-subordinated financial liabilities.

In the event the debtor is subsequently declared insolvent, legal transactions involving new financing and the constitution of security remain valid and are not subject to claw-back actions provided that such transactions are expressly provided for in the restructuring agreement (or in the negotiation protocol).

Finally, in the event the restructuring agreement is subscribed to by creditors representing the requisite majorities of approval provided for under the PER, the debtor may formally initiate a PER for the purpose of binding all the creditors, including dissenting ones.

Comparing RERE and PER

A number of obvious comparisons may be made between the RERE and the PER:

- (i) Unlike RERE, PER cannot, in any case, be used by debtors in a state of insolvency.
- (ii) While PER requires judicial intervention (namely court homologation of the recovery plan and a judicial administrator), RERE is a completely out-of-court recovery instrument.
- (iii) When resorting to RERE, parties are free to agree on the time-period for negotiations while PER provides a legal deadline for that purpose (a maximum of three months).
- (iv) A debtor resorting to PER is obliged to invite all its creditors to take part in the negotiations, while one resorting to RERE may summon only some of its creditors, depending on what it deems most appropriate.
- (v) Under PER, all enforcement and insolvency proceedings against the debtor are suspended during the negotiations. In RERE, only actions by participating creditors are affected, although essential service providers are bound to continue supply for a period of up to 3 months.
- (vi) Even more important is that, under RERE, the restructuring agreement does not bind the non-participating creditors; in contrast, under PER, in cases the recovery plan is homologated by the court, it binds all the creditors, including the ones who have not participated in the negotiations or that have voted against the approval of the recovery plan.
- (vii) In cases where a restructuring agreement is not reached, and unlike PER, RERE foresees no limitations (other than not being insolvent, other than as noted above during the exceptional eighteen month period following the law’s enactment) for the debtor to start new negotiations with the same or with different creditors.
- (viii) Lastly, unlike PER, creditors who provide new financing during RERE are not attributed any legal privileges.

Conclusion

The advent of the new RERE procedure offers a considerable number of advantages to debtors and will undoubtedly find a place in the tool-box of procedures in Portugal. It remains to be seen, as familiarity with its structure grows, whether the take-up will match the expectations of the legislator in introducing this new law.