Private equity in Portugal: market and regulatory overview

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A Q&A guide to private equity law in Portugal.

The Q&A gives a high level overview of the key practical issues including the level of activity and recent trends in the market; investment incentives for institutional and private investors; the mechanics involved in establishing a private equity fund; equity and debt finance issues in a private equity transaction; issues surrounding buyouts and the relationship between the portfolio company's managers and the private equity funds; management incentives; and exit routes from investments. Details on national private equity and venture capital associations are also included.

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Market overview

1. What are the current major trends in the private equity market?

The private equity market in Portugal is dominated by private equity funds run by Portuguese based management entities. Private equity investment done directly through private equity companies is currently at negligible levels in relation to investments made through private equity funds.

The biggest and most prominent funds in Portugal are "distressed" or "turnaround" funds. These funds invest in companies whose funding relies on bank finance and are in financial distress (that is, pre-insolvent, insolvent or under a judicial recovery procedure).

Recently, however, the deleveraging of domestic groups, the real estate expansion (especially in Lisbon and Porto) and even the tourism boom, among other factors, have brought Portuguese assets to the attention of yield searching international private equity fund managers. In this respect, several high-profile deals have been entered recently

regarding a variety of assets, ranging from infrastructure to industrial enterprises and also to financial sector companies.

Venture capital, a sub-sector of private equity investments, appears to be gaining pace in Portugal, with several "seed" and "early-stage" investment rounds being made by national and international funds in Portuguese based start-ups.

Another interesting fact is that the government changed the criteria for granting "golden" visas, reducing the amount of investment to EUR350,000 in investment funds (as opposed to the historical EUR500,000 required in the real estate sector), provided that this investment is intended for the capitalisation of Portuguese companies. This has attracted new types of investors and has driven innovation in fund structuring.

In addition, at least one private equity player implemented a private equity fund aiming to allow for the deduction of a significant part of the investment by corporate players in their corporate income tax. The fund has been incorporated and the application to obtain the tax credit has been submitted. It is unknown whether the application was or will be successful.

Further, a second amendment to the Legal Framework of Private equity, Social Entrepreneurship and Specialised Investment was approved, but will only be in place as of 1 January 2020. This change establishes the creation of credit funds, aiming to improve complementarity between the banking sector and the private equity and securitisation sectors.

2. What has been the level of private equity activity in recent years?

Fundraising

No public data is available on fundraising of private equity funds. It is apparent that fundraising for private equity funds in Portugal is dynamic after the last few years of tepid activity. Factors that may influence this rebound of fundraising include the Portuguese economy returning to growth (although modest), a tourism boom, and deployment of EU funds into programmes designed specifically to fund private equity investment structures (and which are "crowding-in" private co-investment as a result) and, more recently, the "golden" visa programmes allowing for investment through private equity funds (*see Question 1*).

Investment

According to the latest data available (that is, Portuguese Securities Market Commission data from 2017), Portuguese private equity investment (equity participations and other financing) decreased on a year-on-year basis by 1.1% in 2017 to EUR3.5 billion, as a result of the EUR38.1 million decrease observed in private equity funds and the 2.1% decrease in private equity companies.

On the other hand, assets under management have continued to grow over the past few years and have risen 3.1% between year-end 2016 and year-end 2017.

In relation to changes in levels of activity in different stages of development of portfolio companies, venture capital investing is on the rise. The more traditional private equity investment in mature companies still dominates the market. However, particularly in the last few years, there has been great growth in investment in start-up companies, due to the interest that these types of undertakings have shown in Portugal.

Transactions

According to the latest data available (that is, Portuguese Securities Market Commission data from 2017), despite a slight decrease since last year's figures, "turnaround" transactions are still the dominant type of transactions in the market (in 2017, around 33.8% of the value in private equity transactions arose from distressed or turnaround deals). The slight decrease was partially offset by the increase of replacement capital transactions (4.4%).

The cases in which private equity supported management in the acquisition of company capital (management buy-out) registered a decrease in the value invested, while the weight of cases in which an external management buy-in team acquired the capital of a company remained residual (0.4%).

Leveraged buyouts in Portugal are essentially performed by foreign private equity investors and are still not a trend in the local private equity market.

Exits

According to the latest data available (that is, Portuguese Securities Market Commission data from 2017), exits from private equity investments in Portugal were mainly concentrated on trade sales and write-offs, which accounted for 45.3% of the number of exits and 37.3% of the total amount exited (EUR193.7 million). There were ten forward sales transactions, corresponding to 11.9% of the amount disinvested.

The only record of an exit through initial public offering (IPO) in the Portuguese private equity market was Raize's public offer. Raize is a "peer-to-peer" lender and crowdfunding platform, branded as one of the alternative reference financiers of Portuguese micro and small enterprises.

Funding sources

3. How do private equity funds typically obtain their funding?

There is no publicly available information as to the funding composition of private equity funds in Portugal. From experience and anecdotal evidence, we estimate that banks still correspond to the largest stake of holders of private equity (either in funds managed by the bank's affiliates or in "independently" managed private equity holders). Other investor classes include:

- Family office vehicles.

- Sometimes the state, either through specific investment vehicles that are state, or EU funded or direct granting of funds to existing private equity investment structures.
- Retail investors (owing to the recent interest in the subscription of units in private equity funds for the purposes of obtaining "golden visas"). These investors are, notably, residents outside of the European Union and European Economic Area.

Tax incentive schemes

4. What tax incentive or other schemes exist to encourage investment in unlisted companies? At whom are the incentives or schemes directed? What conditions must be met?

Incentive schemes

Tax incentive schemes are not specifically directed to unlisted or listed companies. However, there are several existing tax incentives, including incentives especially applicable to private equity undertakings such as private equity funds and private equity companies.

The tax system comprises several tax incentives, which can be attractive to private equity investors, depending on the activity and area of investment (for example, there are specific tax benefits applicable to research and development (R&D) activities and to investment in small enterprises).

The relevant general tax exemptions are the:

- "Inbound" participation exemption regime, applicable to dividends received and capital gains realised by a resident company from a domestic or foreign shareholding. These types of income are tax exempt, provided the shareholder:
    - is not considered a transparent entity; and
    - has held, directly or indirectly, at least 10% of the capital or voting rights of the investee company for at least 12 months.
- The distributing company should be subject to and not exempt from Corporate Income Tax (CIT), Gambling Special Tax, an income tax set out in Article 2 of Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States or an income tax identical or similar to CIT, whose tax rate is not less than 60% of the CIT rate of. 12.6%.
- In addition, the exemption for dividends is not applicable if the payment is deductible for the distributing entity.

- "Outbound" regime, under which dividends distributed by a company resident in Portugal, not subject to tax transparency, to a non-resident entity may be exempt from withholding tax. To benefit from this exemption the beneficiary of the income must:
    - be a tax resident in another EU country, an EEA country bound to administrative cooperation in tax matters similar to the one that exists between EU countries or a country with which Portugal has executed a double tax treaty;
    - be subject in its residence state to a corporate income nominal tax rate of at least 12.6% (that is, 60% of the current Portuguese corporate income tax rate); and
    - hold, directly or indirectly, at least a 10% stake in the company resident in Portugal for, uninterruptedly, 12 months before the distribution of dividends.

At whom directed

Tax benefits are, generally, applicable to all companies (whether they are listed or unlisted).

Conditions

See above, *Incentive schemes*.

Fund structuring

5. What legal structure(s) are most commonly used as a vehicle for private equity funds in your jurisdiction?

Private equity investment in Portugal is usually done onshore. The notable exception occurs when international private equity funds acquire assets in Portugal. In these cases, acquisition structures often encompass foreign special purpose vehicles (such as LuxCos), investing directly or through Portuguese subsidiaries.

The most common legal structure to invest in private equity in Portugal is through a private equity fund, which in turn is managed by a private equity company, both domestic entities incorporated under the provisions of Law no. 18/2015.

Newcomers in the market usually start by investing through proprietary structures, notably through holding companies. Typically, it is only when these entrants to the market seek to attract outside or professional investment that they advance to the regulated structures.

6. Are these structures subject to entity level taxation, tax exempt or tax transparent (flow through structures) for domestic and foreign investors?

Investment through private equity funds

Private equity funds are tax-exempt.

As regards the holders of participation in private equity funds, the tax framework regime differs depending on whether they are tax resident individuals or entities, non-resident individuals or non-resident entities.

Tax resident individuals investing in private equity funds will generally benefit from both:

- 10% final withholding tax rate on income paid by the private equity funds or through redemption of participation units.
- 10% tax rate on capital gains made on the disposal of participation units.

Tax resident entities investing in private equity funds will generally benefit from both:

- 10% withholding tax rate on income paid by the private equity funds or through redemption of participation units.
- 10% tax rate on capital gains made on the disposal of participation units. Within this scope, the relevant tax regime does not expressly foresee that the capital gains made on the disposal of participation units are subject to a 10% tax rate. It can be argued that income from the redemption of units is generally treated as capital gain, so there should be no reason to distinguish capital gains from the sale of units from capital gains from the redemption of units. However, in the absence of an explicit rule, the Portuguese Tax Authorities may argue that the capital gains obtained by resident companies from the sale of units of private equity funds should be subject to corporate income tax in accordance with the general terms.

Non-resident individuals investing in private equity funds will generally benefit from both:

- Tax exemption on income paid by the private equity funds or through redemption of participation units, assuming that the concept of "non-resident entities" included in the relevant exemption rule also includes non-resident individuals. Otherwise, this income should be subject to tax at the rate of 10%.
- Tax exemption on capital gains, provided that some requirements are met, otherwise these capital gains are subject to tax at the rate of 10%.

Non-resident entities investing in private equity funds will generally benefit from both:

- Tax exemption on income paid by the private equity funds or through redemption of participation units.

- Tax exemption on capital gains, provided that some requirements are met, otherwise such capital gains is subject to tax at the rate of 10%.

Both benefits are only applicable when the beneficiary is either of the following:

- An entity that is not resident in a blacklisted jurisdiction.
- A non-resident entity held, directly or indirectly (more than 25%), by entities resident in Portugal. In this case, the general withholding tax is 35% in the case of blacklisted entities, and 25% in the case of non-resident entities held by resident entities.

Tax benefits to private equity companies

Private equity companies can benefit from a tax allowance of a sum corresponding to the limit of the sum of the tax base of the five preceding years, if that deduction is used to invest in companies with high growth potential. On the other hand, dividends payable by a private equity company to its shareholders do not receive any special treatment (currently, they are subject to a 28% final rate for individuals and the current general corporate income tax rates for companies).

> 7. What (if any) structures commonly used for private equity funds in other jurisdictions are regarded in your jurisdiction as being tax inefficient (whether by not being recognised as tax transparent or otherwise)? What alternative structures are typically used in these circumstances?

The regime for tax transparency does not apply to private equity companies or funds. Investors who wish to benefit from transparency can invest through other EU companies in jurisdictions that recognise the tax transparency of private equity funds incorporated in other jurisdictions.

Fund duration and investment objectives

> 8. What is the average duration of a private equity fund? What are the most common investment objectives of private equity funds?

Duration

Official data concerning effective fund duration is not available. The life of funds is usually about ten years, because the typical limitation to the period funds could hold equity or debt instruments in portfolio companies was ten years. Although this limitation is not currently applicable due to change in the law, the amendment is too recent to allow for evidential data in relation to the duration of funds. In any case, it is also usual to extend the initial duration of private equity funds for one to two additional years, to allow smooth divestment of the latter's assets (through share deals). Usually the investment period is about half of the initial duration of the fund (five years), although there is no statutory provision in this respect.

Investment objectives

Private equity funds typically pursue:

- Restructuring or turnaround transactions in companies that are experiencing financial distress.
- Growth transactions in small and medium scale enterprises aiming at internationalisation or increase in scale.
- Seed, start-up and early stage funding to start-ups.

In addition, a trend is emerging where investment is being directed to building or revamping retail or consumer brands with potential.

There is no public data on rates of return sought. However, certain private equity fund regulations set hurdle rates (that is, minimum internal return rates payable to common unit holders before the fund manager is entitled to receive carried interest), which vary from 5% to 8%. These variations appear to be correlated to the risk profiles of each fund but may also be caused by other idiosyncratic or market wide factors.

Fund regulation and licensing

9. Do a private equity fund's promoter, principals and manager require authorisation or other licences?

Private equity fund managers require an authorisation from the securities market regulator to operate under Portuguese law.

Management of private equity funds can be carried out by:

- Private equity companies.
- AIFM Directive compliant private equity fund management companies.
- Regional development companies.

- Collective undertakings' management entities (*sociedades gestoras de organismos de investimento coletivo*) (formerly known as "entities authorised to manage close-ended alternative investment funds" as the terminology was updated as of 1 January 2020 when the second amendment to the Legal Framework of Private equity, Social Entrepreneurship and Specialised Investment came into force).

In relation to the two most common types of management entities, private equity companies and AIFM Directive compliant private equity fund management companies, the following differences apply:

- Private equity fund managers regulated under the provisions of Law no. 18/2015 must obtain authorisation before the Portuguese Securities Market Commission to operate as AIFM Directive compliant private equity fund management companies, if they exceed the following thresholds:
    - EUR100 million of assets under management, when the respective portfolio includes assets acquired through leverage;
    - EUR500 million of assets under management, when the portfolio does not include assets acquired through leverage and regarding which there are no redemption rights which may be exercised during a five-year period from the date of the initial investment.
- Authorisation is made in accordance with the relevant provisions of Law no. 18/2015 and the AIFM Directive, and relevant regulations (notably Regulation (EU) 231/2013 on exemptions, general operating conditions, depositaries, leverage, transparency and supervision).
- Private equity fund managers regulated under the provisions of Law no. 18/2015 that do not meet the above thresholds must register with the Portuguese Securities Market Commission.
- Private equity funds are also subject to registration before the Portuguese Securities Market Commission. Registration is not required under the fast track procedure (which requires only prior notice to the regulator), where the:
    - fund is not marketed to the general public; and/or
    - fund's unitholders are solely qualified investors or the minimum subscription value per investor is of EUR500,000.

Private equity investors do not require a particular authorisation or licence to subscribe units in private equity funds.

10. Are private equity funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

Regulation

Private equity vehicles (funds and companies) are subject to regulation under Portuguese law and to the supervision of the Portuguese Securities Market Commission. This regulation and supervision is, however, less stringent than that of other fund management companies.

Private equity vehicles, being issuers of securities, are subject to the general restrictions on marketing and advertisement of securities set out under the Portuguese Securities Code, in particular rules on public offers. A public offer entails several disclosure obligations, notably the preparation of a prospectus subject to the approval of the Portuguese Securities Market Commission.

Exemptions

Usually units are placed through private placement, meaning through an offer of securities generally exempt from public offer rules. The following offers are not deemed public offers:

- Offers addressed solely to qualified investors (that is, financial institutions, high net-worth individuals, pension funds, and investment fund management companies).
- Offers addressed to fewer than 150 persons who are not qualified investors.
- One or more offers within a 12-month period with an aggregate value of less than EUR5 million.

11. Are there any restrictions on investors in private equity funds?

No restrictions exist, apart from applicable rules and regulations governing certain sectors (for example, banking, insurance, and pension funds sectors), in particular arising from Basel III, solvency requirements for insurance companies and similar regulations (for example, where subscription of units would cause in imbalance in regulatory ratios).

Also, marketing units in private equity funds to non-qualified investors may be deemed to be a public offer and require the preparation of an offer prospectus subject to the approval of the Portuguese Securities Market Commission (*see Question 10*).

12. Are there any statutory or other maximum or minimum investment periods, amounts or transfers of investments in private equity funds?

There is no statutory minimum or maximum investment period in a private equity fund (although in practice a maximum duration of a fund of ten years is established). There are also no limits to investment amounts or transfers of investments.

13. How is the relationship between the investor and the fund governed? What protections do investors in the fund typically seek?

Although not common, relationships between investors and the fund and fund manager are primarily governed by a set of general principles and protections granted by the law. Additionally, those relationships are also governed under fund bye-laws (also known as management regulation).

Common protections sought by investors typically include:

- Establishment of rights of first refusal in transferring participation units in the fund.
- Set-up of investment committees with advisory powers.
- Establishing minimum hurdle rates.
- Establishing rules on co-investments.
- Supermajority provisions in resolving on certain governance matters.

Several private equity fund managers comply with the Handbook of Professional Standards published by Invest Europe, which provides a number of recommendations for fund governance and in particular for the relationship between investors and fund managers.

Interests in portfolio companies

14. What forms of equity and debt interest are commonly taken by a private equity fund in a portfolio company? Are there any restrictions on the issue or transfer of shares by law? Do any withholding taxes or capital gains taxes apply?

Most common form

According to the latest data available (that is, Portuguese Securities Market Commission data from 2017), investment by private equity funds is in its majority made through:

- The acquisition of receivables, including shareholder loans (loans and quasi-equity contributions that do not confer voting, dividend or otherwise control rights in the target company).

- Debt instruments.

These together make up around 51% of assets under management and perhaps reflect the predominance of turnaround investing in the sector.

However, many management regulations self-limit investments in debt instruments.

Other forms

Receivables and other credits are followed at a distance by:

- Equity participations (that is, shares or other equity participations representative of share capital in companies that confer, among others, voting rights and rights to receive dividends generated by such companies) at 19.9% of assets under management.
- Investments in participation units in other private equity funds at about 0.29% of assets under management.

Restrictions

Restrictions on issuance and transfer of equity and/or debt interests are as follows:

- Transfers of shares or other equity instruments in limited liability companies under Portuguese law may be restricted under the law or the articles of association by:
    - the need for consent by the company;
    - pre-emption rights.
- Transfers of credits under Portuguese law are valid without the consent of the debtor but are subject to notice to the latter for the transfer to be opposable to the debtor.
- Issuance of equity interests are subject to resolution of the competent corporate bodies. In addition, shareholders may have a pre-emption right on the subscription of new equity interests in cash capital increases (which may be limited or suppressed by a shareholders' resolution).
- Issuance of bonds is subject to the pre-requisite, among others, that the company's share capital is fully paid-up. In addition, shareholders have a pre-emption right in the subscription of convertible bonds (which may be limited or suppressed by a shareholders' resolution).

Other contractual restrictions not opposable to third parties (set out in shareholders' agreements) may also apply.

Taxes

The Portuguese tax system has an inbound and outbound participation exemption regime applicable both to dividends distributions and capital gains arising out of share transfers (*see Question 4*).

The payment of interest is generally subject to withholding tax. However, it may also be exempt from withholding tax provided that the requirements of the Directive 2003/49/EC on a common system of taxation applicable to

interest and royalty payments made between associated companies of different Member States (Interests & Royalties Directive) are met.

A tax rate of 35% applies to dividends and interest paid to residents in blacklisted jurisdictions.

Short-term loans, including the respective interests, made by private equity companies to entities in which the latter hold equity participations, by dominant companies to their respective dominated companies or by companies having a shareholding of at least 10% in another entity, should benefit from a stamp duty exemption provided certain requirements are met. The same stamp duty regime applies for shareholder loans.

Buyouts

15. Is it common for buyouts of private companies to take place by auction? If so, which legislation and rules apply?

Buyouts of private companies occasionally take place through an auction procedure. No specific legislation applies to auction procedures. General contract and civil law provisions apply and therefore vendors are generally free to set their own rules, provided basic bona fide provisions are complied with.

16. Are buyouts of listed companies (public-to-private transactions) common? If so, which legislation and rules apply?

Buyouts of listed companies are uncommon. It appears that only one private equity type public-to-private transaction has ever been recorded in Portugal (that is, 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 through a public takeover).

The Portuguese Securities Code applies to public takeovers of listed companies.

Principal documentation

17. What are the principal documents produced in a buyout?

The main legal instruments executed in a buyout are the following (chronologically):

- Non-disclosure agreement.
- Non-binding and binding offers (if an auction procedure is undertaken).
- Share purchase agreement.
- Shareholders' agreements (when less than 100% of the target company is acquired).
- Financing documents (when buyouts are leveraged).
- Closing documents.

Buyer protection

18. What forms of contractual buyer protection do private equity funds commonly request from sellers and/or management? Are these contractual protections different for buyouts of listed companies (public-to-private transactions)?

Private equity investor protection mechanisms typically include:

- Fund's own due diligence on the target investment.
- General information rights.
- Representations and warranties often combined with escrow mechanisms to ensure liquidity if a breach is claimed.
- Tax specific indemnities.
- Exit mechanisms in shareholders' agreements, such as put options or tag/drag along rights. These mechanisms may be exercised at zero or very low prices (for example, following a "failed" investment) or at a price incorporating a specified internal rate of return (IRR) (after the term of a stand-still/lock-up period).
- Conversion rights of the shareholders' loans or quasi-equity contributions.
- Good and bad leaver rules (including indemnification) applicable to key managers and/or anchor shareholders.

- Stand-still and/or lock-up provisions for periods of three to five years.
- Supermajorities and right of first refusal for share capital increases.
- Price adjustments (through earn-outs).
- Liquidation preferences (which tend to be more common in venture capital).
- Anti-dilution provisions (typically on a "weighted average" basis).

Anyone who breaches an obligation to which he or she was subject, by virtue of having entered into an agreement (that is, articles of association, investment agreement, shareholders' agreement, JV agreement, and so on), is liable for failure to comply with the general terms of civil law (and, in the case of articles of association, commercial law). Therefore, there are four main consequences of non-compliance with a shareholders' agreement:

- Moral disapproval by the other parties.
- Payment of any penal clauses.
- Compensation for damages caused.
- Recourse to specific enforcement under Article 830 of the Civil Code.

Breach of private equity protections, provided by managers or selling shareholders, are usually governed under general indemnification rules and capped to a certain amount that varies from 20% to 100% of the investment. Tax specific indemnities are usually not limited or less limited.

Public-to-private transactions are governed essentially by public takeover rules. Solely public information is known by the private equity provider and in general non-public information cannot be disclosed unless it is also disclosed to the market and the general public. The private equity provider's protection is then granted under general rules of liability of managers, independent directors and supervising boards of listed companies (*Portuguese Securities Code*).

19. What non-contractual duties do the portfolio company managers owe and to whom?

Members of management bodies of portfolio companies are bound by several statutory fiduciary duties towards the company and its shareholders:

- Duty of care.
- Duty of loyalty.
- Non-competition.

Obligations of managers are governed by company law (and not by employment law, as is the case of most European jurisdictions), save for very few exceptional circumstances. Therefore, managers can be found liable before the

shareholders, the general creditors, tax and social security and the company itself. These duties essentially lead managers to take all actions deemed rational from a business standpoint as opposed to any other interests (including their own or even the shareholders').

The law does not prohibit directors from being involved in a management buyout (MBO), but they must act in good faith and avoid conflicts of interests or breach of fiduciary duties. Directors involved in an MBO should abstain from voting (and participating) on matters relevant to the transaction.

20. What terms of employment are typically imposed on management by the private equity investor in an MBO?

MBOs are not common transactions in Portugal. Managers' functions are governed by companies' law (and not by employment law, as it is the case of most European jurisdictions). From a contractual standpoint, managers' duties are usually governed under either/both:

- A management agreement entered between the manager and the target company (and occasionally also with the shareholders).
- The shareholders' agreement, when managers are simultaneously shareholders.

Contractual arrangements usually contain non-compete, non-solicitation and confidentiality obligations.

Economic incentives may also be agreed, notably incentive schemes under which the level of remuneration is linked to the achievement of business plan prospects or good and bad leaver provisions.

21.What measures are commonly used to give a private equity fund a level of management control over the activities of the portfolio company? Are such protections more likely to be given in the shareholders' agreement or company governance documents?

The most commonly used measures to give a private equity fund a level of management control include:

- Restrictions on the management's actions without the consent of the private equity fund, until exit is achieved (veto rights and negative covenants).
- Right to be represented at the board level of the target investment and subsidiaries.
- Limitations preventing the management from developing competing businesses for a period after the investment and/or them ceasing to be a manager or shareholder of the target investment.

Articles of association of Portuguese companies are available to the public. On the other hand, not all governance rules in Portuguese companies can be included in the articles of association. Therefore, contractual control rights are usually included in shareholders' agreements and not in the articles of association.

Debt financing

22. What percentage of finance is typically provided by debt and what form does that debt financing usually take?

Because the average value of private equity transactions in Portugal is small, deals involving private equity investors are made usually through a fund's equity, raised from its investors. Debt financing of transactions is therefore reserved for the largest transactions.

Debt financing of private equity transactions is usually made through senior secured loan facilities (usually composed of an acquisition facility and a revolving facility), through which several high-profile acquisitions involving international funds have recently been carried out.

Lender protection

23. What forms of protection do debt providers typically use to protect their investments?

Security

Securities commonly provided under financing transactions include:

- Pledges on shares (Bidcos and target companies' subsidiaries) and credits (receivables, bank account balances).
- Mortgages on real estate properties.

Contractual and structural mechanisms

Lenders usually demand covenants, such as financial ratios. Other common mechanisms include:

- Representations and warranties on assets and financial situation of the borrower.
- Mandatory repayment (cash sweep) provisions.
- Shareholder loan subordination.

Financial assistance

24. Are there rules preventing a company from giving financial assistance for the purpose of assisting a purchase of shares in the company? If so, how does this affect the ability of a target company in a buyout to give security to lenders? Are there exemptions and, if so, which are most commonly used in the context of private equity transactions?

Rules

A company by shares cannot provide loans or securities (or moneys in any other way) to assist in the purchase (or in any other transaction that leads to the purchase) of its shares by a third party, including a private equity fund. There is no "whitewash" procedure under Portuguese law.

Exemptions

Exceptions to the rule are:

- Transactions carried out in the ordinary course of business of banks and other financial institutions.
- Operations aiming to acquire shares by or for the employees of the company (or a related company).

However, these transactions cannot result in the net assets of the company being lower than the sum of the amount of the subscribed share capital of the company and the statutory reserves.

Insolvent liquidation

25. What is the order of priority on insolvent liquidation?

First, the debts of the insolvency estate are liquidated. Following that, the order of priority on insolvent liquidation is:

- **Secured debts (debts secured by guarantees in rem).** Payment is made with the proceeds of the liquidation of the assets secured. If the proceeds of the sale of the secured assets are not enough to pay the secured debts, the part of the debt which is not paid becomes an ordinary debt.
- **Debts with credit privileges.** These are paid with proceeds of the liquidation of assets that are not guaranteed in rem. There are some credit privileges provided by law that are ranked with priority over secured debts, although they are not paid with the proceeds of the secured assets.
- **Ordinary debts.** All the debts that are not subordinated, secured or privileged are considered ordinary debts. If the insolvent estate does not possess sufficient assets to repay all creditors, ordinary debts are paid on a pro rata basis.
- **Subordinated debts.** These are paid, in order of priority:
    - debts to related parties of the debtor;
    - debts of related parties of the debtor acquired up to two years before the insolvency proceedings;
    - interests of non-subordinated debts arising after the insolvency proceedings (excluding those covered by a guarantee in rem and excluding debts with associated credit privileges);
    - debts which are classified as "subordinated" through a contractual arrangement (such as with certain intra-group loans within the context of debt financing transactions with banks);
    - gratuitous debts;
    - debts owed to creditors in bad faith as a result of termination of transactions to the benefit of the insolvent estate;
    - interests of subordinated debts arising after the insolvency proceedings;
    - shareholder loans.

Equity appreciation

26. Can a debt holder achieve equity appreciation through conversion features such as rights, warrants or options?

Credits (such as receivables or shareholder loans and quasi-equity instruments) can be converted into share capital through a share capital increase. Option rights to enact appreciation rights (by, for example, triggering the conversion of credits into share capital) can be contractually agreed by the parties. Issuance of warrants (granting the holder rights to acquire shares of the issuer at a pre-defined price) is also admitted under Portuguese law.

Portfolio company management

27. What management incentives are most commonly used to encourage portfolio company management to produce healthy income returns and facilitate a successful exit from a private equity transaction?

Commonly used management incentives are:

- Remuneration schemes partially based on the achievement of key metrics (business plan/EBITDA) by the target investment.
- Stock options structured as a right for an individual manager to buy shares or vested shares of the company at a discounted price, or even to be granted shares without payment.
- Fixed or variable bonus on exit, including a percentage of the proceeds on a share deal or an IPO.

28. Are any tax reliefs or incentives available to portfolio company managers investing in their company?

The investment (and subsequent income on the vesting) in a company through a stock option plan is generally considered employment income and therefore does not benefit from any specific tax relief.

However, the 2018 State Budget includes a tax benefit that foresees the exemption for personal income tax (PIT) of gains arising from stock option plans up to the amount of EUR40,000 received by the start-ups/emerging companies' employees.

For this tax exemption to apply:

- Employers must qualify as micro or small enterprises and have developed their activities for a period not longer than six years within the technological sector.
- Employees must own the relevant stocks for at least two years, not be a member of any corporate body and not hold a participation higher than 5% in the respective company.

29.Are there any restrictions on dividends, interest payments and other payments by a portfolio company to its investors?

Company law subjects any distribution of company assets to its shareholders (that is, not only cash or cash equivalents but any assets owned by the company) to the following requirements/restrictions:

- Distribution of profits is subject to a resolution by the company's shareholders, unless the bye-laws provide otherwise, by simple majority of the shareholders attending the relevant shareholders' meeting.
- Distribution of profits cannot be made if, as a result of the distribution, the company's equity drops below the sum of company's share capital, legal reserves and statutory reserves which according to the bye-laws cannot be freely distributed.
- Profits resulting from increments in the fair value of equity components can only be distributed to shareholders when the underlying assets or rights which have originated those increments are realised (that is, sold, redeemed and so on).
- Amounts regarding hidden reserves cannot be distributed.
- Income and other positive changes in a company's net worth accounted because of the use of the equity method (for example, in minority stakes in other companies) can only be distributed to shareholders when they are realised (for example, when dividends in the relevant associated companies are distributed).

Distribution of dividends

According to mandatory corporate law provisions, shareholders are entitled to receive, annually, at least 50% of the company's year-end profits, except if the company's bye-laws or a resolution approved by shareholders holding 75% or more of the voting rights representative of the company's share capital provide otherwise.

In addition to these restrictions, year-end profits cannot be distributed to shareholders if they are required to:

- Cover losses carried forward.
- Replenish legal or contractual reserves.
- Cover expenses related to the incorporation of the company or to research and development.

Profits carried forward and reserves that are distributable can be distributed at any time, subject to the requirements and restrictions set out above and provided that a special balance sheet is drawn-up for that purpose.

Advance payments on profits (interim dividends)

Advance payments on year-end profits are allowed under company law, provided that the following rules are complied with:

- The bye-laws of the company allow advance payments on profits.
- The board of directors resolves paying year-end profits in advance.
- Consent of the company's audit body.
- Resolution of the relevant management body is preceded by an interim balance sheet prepared for this purpose and certified by the company's statutory auditor. That balance sheet must have an end date of up to 30 days' older than the date of the resolution.
- Only one advance payment of year-end profits can be resolved per year.
- Sums to be paid in advance to shareholders cannot exceed half of the value of year-end profits that would in theory be distributable to shareholders.

Interest

Interest resulting from shareholder loans is paid under the relevant agreement between the company and the shareholder, if the agreement (and the agreed interest rate) has been entered on an arm's-length basis.

30. What anti-corruption/anti-bribery protections are typically included in investment documents? What local law penalties apply to fund executives who are directors if the portfolio company or its agents are found guilty under applicable anti-corruption or anti-bribery laws?

Anti-corruption/bribery provisions are usually included in the investment document through representations and warranties. Restrictive covenants on anti-corruption/bribery are commonly included in the shareholders' agreement.

Directors who are convicted of criminal offences related to corruption and bribery can be imprisoned or fined depending on the applicable quantum of the sentence. Also, if convicted, those persons may be impeded from being appointed as members of corporate bodies of various types of companies in the financial industry, including private equity companies.

In addition, private equity companies and fund managers are bound by anti-money laundering and anti-terrorist financing rules, and are notably obliged to implement know your customer (KYC) and know your transaction (KYT) procedures (which includes the identification of counterparties before entering into the relevant transactions).

Exit strategies

31. What forms of exit are typically used to realise a private equity fund's investment in a successful company? What are the relative advantages and disadvantages of each?

Forms of exit

The most common form of exit is a trade sale. There are a few cases of secondary buyout.

Initial public offering (IPO) is the preferred exit form, but the first known IPO in Portugal of a private equity sponsored company is the peer-to-peer lender and crowdfunding platform operator Raize, which made its successful debut in the public markets in 2018.

Advantages and disadvantages

The following advantages/disadvantages apply:

- **Trade sale.** This is a smooth process well known and tested in the industry. It is the least expensive process, but typically it is not the one allowing for the highest proceeds. Sellers (that is, private equity funds) are usually requested to provide representations and warranties with an expiry date that needs to be adjusted to the duration of the fund.
- **Secondary buyout.** This is a transaction between peers in industry, which can make negotiations easier and limit the issues with representations and warranties. The proceeds tend to be lower than in a trade sale.
- **IPO.** While this would be the preferred form of exit for sellers and managers, it is very difficult to achieve. The structuring fees are substantially higher.

32. What forms of exit are typically used to end the private equity fund's investment in an unsuccessful/distressed company? What are the relative advantages and disadvantages of each?

Forms of exit

The most common forms of exit are:

- Secondary buyouts to specialist turnaround funds.
- MBOs.

- Liquidation or insolvency.

Advantages and disadvantages

The following advantages/disadvantages apply:

- A sale of the company (to a fund or the management) or its assets allows the fund to receive at least part of its investment.
- In liquidation, the company must satisfy all its debtors, before making any distributions to shareholders. The liquidation procedure is time consuming.
- MBOs are smoother and less disruptive to the company, employees and suppliers.

Reform

33. What recent reforms or proposals for reform affect private equity in your jurisdiction?

The private equity sector has witnessed material changes with the enactment of legal instruments implementing Directive 2011/61/EU on alternative investment fund managers (AIFM Directive). The new regulatory framework has introduced important changes to private equity fund managers that fall under the scope of the AIFM Directive, imposing several additional compliance requirements, in particular adopting rules on conflicts of interest, remuneration and risk management.

Recent crowdfunding legislation, which provides a framework for the creation of platforms for equity crowdfunding (which is becoming increasingly relevant for venture capital investment in the Portuguese market), has now entered into force.

This legislation allows for the creation of crowdfunding platforms (subject to the supervision of the Portuguese Securities Market Commission) and, in addition, for the raising of funds in these platforms up to:

- EUR5 million per activity or product during a 12-month period, if the funding is made by legal persons and/or natural persons with an annual income equal to or higher than EUR70,000.00
- EUR1 million per activity or product during a 12-month period, if otherwise.

It is also worth mentioning that, recently, additional changes have been enacted to legislation regulating private equity fund managers, within the context of the transposition of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 (MiFID II) into Portuguese law. Such adjustments (which are not expected to have a material impact on the organisation of private equity funds) consist mainly of:

- Eliminating the principle, previously enshrined in the law, that private equity investment must be made in a limited period (although a ten-year limitation for investments made by private equity companies and private equity funds still applies).
- Adopting more stringent requirements regarding good repute, qualification and professional experience of members of corporate bodies of private equity fund managers (aligning them with those applicable to financial institutions).
- Adapting to the Portuguese legal system EU regulations concerning European Long-Term Investment Funds, European Venture Capital Funds, and others.

In addition, the recent second amendment to the Legal Framework of Private Equity, Social Entrepreneurship and Specialized Investment transfers the duties and powers of prudential supervision of investment fund management companies and credit securitisation funds from the Portugal Bank to the Portuguese Securities Market Commission.

The creation of credit funds, with the aim of improving complementarity between the banking sector and the venture capital/private equity and credit securitisation sectors. Credit funds were designed to improve the financing of the economy through the granting of credit to companies and through the acquisition of credits, including overdue credit, held by banks, which are therefore free to recommence their credit granting activity.

Lastly, a draft Portuguese Securities Market Commission regulation concerning anti-money laundering/anti-terrorism financing (affecting private equity companies and fund managers) is currently under public consultation and is expected to be published soon.

Contributor profiles

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Areas of practice. Corporate and commercial (corporate law, mergers, acquisitions and joint ventures, private equity structures and M&A, investment fund structures); capital markets (IPOs, takeovers and other public offerings).

Non-professional qualifications. Law Degree, Law Faculty of the University of Lisbon, 2005; Postgraduate Studies in Commercial Law, Law Faculty of the Portuguese Catholic University, 2008

Recent transactions

- Acting for a major private equity manager in structuring issues (existing funds and new ones to be incorporated).
- Structuring of private equity addressed to high net worth individuals seeking "golden" visas.
- Acting for leading Portuguese utility "corporate venture capital" unit in the incorporation of private equity fund manager and private equity fund, and several M&A investments in start-ups dedicated to energy efficiency projects.
- Acting for a UK-based international private equity and infrastructure fund manager in the acquisition of a majority stake in a Portuguese infrastructure company which manages a hospital building in Portugal.

Languages. Portuguese, English

Publications

- Securities World, Jurisdictional comparisons (The European Lawyer Reference), Third edition 2011 (with Ricardo Andrade Amaro).
- Securities World, Jurisdictional comparisons (The European Lawyer Reference), Fourth edition 2014 (with Ricardo Andrade Amaro).
- Practical Law Global Guide to Private Equity in Portugal: Market and Regulatory Overview 2017, by Thomson Reuters (with Pedro Capitão Barbosa).
- Practical Law Global Guide to Private Equity in Portugal: Market and Regulatory Overview 2018, by Thomson Reuters (with Pedro Capitão Barbosa).
- The Legal 500: Private Equity Country Comparative Legal Guide 2019 - Portugal (with Pedro Capitão Barbosa).

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Areas of practice. Corporate and commercial (corporate law, mergers, acquisitions and joint ventures, private equity); capital markets (IPOs, takeovers and other public offerings).

Non-professional qualifications. Law Degree, Law Faculty of Nova University of Lisbon, 2010; LL.M in Finance and Law, Duisenberg School of Finance, 2011

Recent transactions

- Acting for a leading Portuguese utility corporate venture capital unit in the incorporation of private equity fund manager and private equity fund.
- Acting for a leading Portuguese utility corporate venture capital unit in several seed and early-stage investment rounds.
- Acting for selling shareholders in the sale of Norscut (highway toll operator) to infrastructure fund manager.

Languages. Portuguese, English, Spanish

Publications. *International Comparative Legal Guides, Private Equity (Portugal Chapter), 2016 edition and 2017 edition (with Ricardo Andrade Amaro).*

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Professional qualifications. Advogado, Portuguese Bar Association, 2002

Areas of practice. Tax (administrative and judicial tax litigation, financial taxation, international tax and tax planning, tax inspections and audits).

Non-professional qualifications. Law Degree (Law Faculty of the University of Coimbra, 2000). Postgraduate Studies in Economic and European Criminal Law (Law Faculty of the University of Coimbra, 2000); Postgraduate Studies in Taxation (Instituto Superior de Gestão, 2001); LL.M. in Taxation (London School of Economics and Political Sciences, 2004); Master's Degree in Corporate Law (Law Faculty of the University of Lisbon, 2007); Postgraduate Studies in Accounting Normalization System and IRC Code (IDEEF, Faculdade de Direito da Universidade de Lisboa, 2009); Specialist Lawyer in Tax (title awarded by the Portuguese Bar Association in 2012)

Recent transactions

- Acting for Exus Management Partners on the sale of a windfarm.
- Acting for the EDP on the acquisition of wind turbines to implement an off-shore windfarm.
- Acting for Digital Bridge in the process of acquisition of telecommunication towers.
- Acting for B&B Hotels in the acquisition of a property to build a new hotel in Lisbon.

Languages. Portuguese, English, French, Spanish

Publications. *Getting the Deal Through: Tax on Inbound Investment, Law Business Research (2017 and 2018 chapters), International Tax Law from Mozambique. The Conventions for the Avoidance of Double Taxation (with special emphasis on Macao and Portugal), Almedina, 2017, Personal Income Tax Reform Update on the New residence rules, Journal of International Taxation, Thomson Reuters, 2015 (with Beatriz Gil)*

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