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Private equity in Portugal: market and regulatory overview

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MARKET OVERVIEW

1. What are the current major trends and what is the recent level of activity in the private equity market?

Market trends

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

The biggest and most prominent funds in Portugal are still "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 PE 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.

Another interesting fact is that in 2018 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. Following recent changes in the law (enacted in 2021) the minimum investment amount will be increased back to EUR500,00 starting from 1 January 2022.

In addition, also following recent changes to tax laws (SIFIDE programme), several PE players have implemented PE funds which allow the respective unit holders to deduct from the amount of corporate income tax assessed (part of) the amounts which are paid for the subscription of participation units of those funds, provided that the fund invests in R&D intensive companies (that is, more venture capital (VC) based companies).

VC, a sub-sector of PE investments, is gaining pace in Portugal, with several seed and early-stage investment rounds being made by national and international funds in Portuguese based start-ups.

Finally, credit funds have been created and regulated very recently, which aims to improve complementarity between the banking sector and the PE and securitisation sectors.

Fundraising

No public data is available on fundraising of PE funds. It is apparent that fundraising for PE 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) before the COVID-19 pandemic.
- "Golden visa" programmes.
- A tourism boom.
- Deployment of EU funds into programmes designed specifically to fund PE investment structures (and which are "crowding-in" private co-investment as a result).

It remains to be seen what medium/long term effect the current pandemic will have in fundraising efforts by PE managers. While there was an abrupt decrease in activity in the first months of the pandemic, new fundraising projects have picked up significantly, motivated mostly by start-up investing, golden visa eligibility and investment tax benefits (*see Question 33*).

Investment

According to the latest data available (that is, Portuguese Securities Market Commission (PSMC) data from 2019), Portuguese PE investment (equity participations and other financing) increased on a year-on-year basis by 6.6% in 2019 to EUR5.1 billion in assets under management, as a result of the EUR279.6 million increase observed in PE funds and the 15.1% increase in PE companies.

On the other hand, the average amount of assets under management per PE fund has slightly decreased by EUR3.5 million between year-end 2018 and year-end 2019.

In relation to changes in levels of activity in different stages of development of portfolio companies, VC investing is on the rise and in 2019 it increased 10.5% in comparison to 2018. While more traditional PE investment in mature companies still dominates the market, particularly in the last few years there has been evident growth in investment in start-up companies, due to the interest that these types of companies have demonstrated in Portugal.

Transactions

According to the latest data available (that is, PSMC data from 2019), despite a decrease since last year's figures, "turnaround" transactions are still the dominant type of transactions in the market (in 2019, around 28.8% of the value in PE transactions arose from distressed or turnaround deals). The slight decrease was partially offset by the increase of replacement capital transactions (increase of 58.6% in comparison to 2018) and support for expansion/growth (22.9% of the total value in PE transactions).

PE supported management acquisitions of company capital (management buy-out) decreased in the value invested, while cases where an external management buy-in team acquired the capital of a company remained residual at an aggregate value of EUR 4.2 million.

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

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Exits

According to the latest data available (that is, PSMC data from 2019), exits from PE investments in Portugal were mainly concentrated on trade sales, acquisitions from management team/minority shareholders and write-offs, which accounted for 53.4% of the number of exits and 60.4% of the total amount exited (EUR326 million).

There were no records of an exit through an initial public offering (IPO) in the Portuguese PE market in 2019.

2. What are the key differences between private equity and venture capital?

The regulatory differences between PE and VC investments are few:

- They tend to use the same investment vehicles (that is PE funds, PE companies or unregulated corporate structures).
- Regulatory disclosure requirements and tax treatment are equivalent (see, however, *Question 1*, SIFIDE structures which are more geared towards VC investments).
- There are no remarkable differences in fund governance between the two types of investment.

There are more differences between the commercial terms of fund raising and the economics of investments made. Funds designed for VC investment are generally smaller and the participation of state-owned/public investors is more prevalent (which results in more restrictions in the investments).

Investment in VC is usually made via equity and quasi-equity convertible instruments (rather than complemented with debt, more common in buyout and growth investments) and in very different terms and conditions from traditional buyout and growth investments. This means that venture capitalists typically acquire smaller stakes in investee companies vis-à-vis buyout and growth investors, and therefore have less involvement in management, but also negotiate tougher mechanisms designed to protect against the reduction of the economic value of their investments through liquidations preferences and anti-dilution provisions.

FUNDING SOURCES

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

There is no publicly available information as to the funding composition of PE funds in Portugal. From experience and anecdotal evidence, we estimate that banks still correspond to the largest stake of holders of PE (either in funds managed by the bank's affiliates or in "independently" managed PE 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 PE investment structures.
- Retail investors (owing to their interest in the subscription of units in PE funds for the purposes of obtaining "golden visas"). These investors are, notably, residents outside EU and European Economic Area (EEA).

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 PE undertakings such as PE funds and PE companies.

The tax system comprises several tax incentives, which can be attractive to PE 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 must 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%.
- The distributing company must not have its tax residence in a jurisdiction included in the Portuguese list of "tax havens", approved by the Ministerial Order No. 150/2004, of 13 February and further amendments.
- In addition, the exemption for dividends is not applicable if the payment is deductible for the distributing company.
- "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?

PE investment in Portugal is usually done onshore. The notable exception occurs when international PE 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 PE in Portugal is through a PE fund, which in turn is managed by a PE 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

PE funds are tax-exempt.

As regards the holders of participation in PE 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 PE funds will generally benefit from both:

- 10% final withholding tax rate on income paid by the PE 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 PE funds will generally benefit from both:

- 10% withholding tax rate on income paid by the PE 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 PE funds should be subject to corporate income tax in accordance with the general terms.

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

- Tax exemption on income paid by the PE 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 PE funds will generally benefit from both:

- Tax exemption on income paid by the PE 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%.

The tax exemptions available to non-residents 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 not 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

PE 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. However, this tax benefit expired on 31 December 2018 and is no longer available for new investments, applying only to investments made before that date. On the other hand, dividends payable by a PE 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 foreign private equity structures are tax-inefficient in your jurisdiction? What alternative structures are typically used in these circumstances?

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

PE funds are mandated to have a limited duration (unless their units are admitted to trading); however, the law does not provide a time limit for such 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 (this statutory limit has since been overturned). 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 PE 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

PE 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 PE 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.

In addition according to publicly available data (PSMC, 2019) around 33.9% of PE sale transactions in Portugal resulted in capital gains (when compared to the stated value of the relevant assets in the funds' accounts).

FUND REGULATION AND LICENSING

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

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

Management of PE funds can be carried out by:

- PE companies.
- AIFM Directive compliant PE 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 PE, Social Entrepreneurship and Specialised Investment came into force).

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

- PE fund managers regulated under the provisions of Law no. 18/2015 must obtain authorisation before the PSMC to operate as AIFM Directive compliant PE 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).
- PE fund managers regulated under the provisions of Law no. 18/2015 that do not meet the above thresholds must register with the PSMC.
- PE funds are also subject to registration before the PSMC. 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.

PE investors do not require a particular authorisation or licence to subscribe units in PE funds.

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

Regulation

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

PE 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 PSMC.

Exemptions

Usually units are placed through private placement, meaning through an offer of securities generally exempt from public offer rules. The following offers (among other things) 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 an imbalance in regulatory ratios).

Also, marketing units in PE 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 PSMC (*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 PE 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?

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 PE 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, PSMC data from 2019), investment by PE 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 reflect the continued 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.
- Deposits at 12.3% of assets under management.
- Investments in participation units in other PE funds at about 2.55% of assets under management.
- Pure equity investments occur more frequently in VC transaction (the intention being to reinforce investee companies' balance sheet; also, there are no taxable gains to offset debt payment deductions) rather than in more traditional PE investments (buyout or growth).

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.

Further, interest from debt securities issued by Portuguese companies and made available to non-residents may also be exempt from withholding tax under the Decree-Law No. 193/2005 of 7 November, provided that the relevant requirements are met. In addition, capital gains eventually made by non-residents with the transfer of the debt securities may also benefit from a tax exemption in Portuguese territory as result of the application of this regime.

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 PE 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? 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? Which legislation and rules apply?

Buyouts of listed companies are uncommon. It appears that only one PE 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 and about 80% of that same company has recently been acquired by a consortium of infrastructure PE investors in a secondary sale).

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

Principal documentation

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

Acquisition of a private company

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.

Acquisition of a listed company

- The main legal instruments executed in a public to private buyout (necessarily through a tender offer) are the following (chronologically):
- NDAs with key shareholders and execution of irrevocable commitments from the latter to accept tender offers (eventual).
- Preliminary tender offer announcement.
- Request for registration of the offer before the PSMC.
- Report from the target company's Board of Directors.
- Financing agreements (if offer is leveraged).
- Squeeze-out offer announcement (if following tender offer more than 90% of capital and voting rights are acquired).

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)?

PE 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 VC).
- 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 under 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 liquidated damages (valid under Portuguese law, unlike other European jurisdictions).
- Compensation for damages caused.
- Recourse to specific enforcement under Article 830 of the Civil Code.

Breach of PE 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 PE provider and in general non-public information cannot be disclosed unless it is also disclosed to the market and the general public. The PE 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 PE fund a level of management control include:

- Restrictions on the management's actions without the consent of the PE 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 PE transactions in Portugal is small, deals involving PE 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 PE 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 any exemptions?

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 PE 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, except for acquisitions by the management.

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 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.
- Management incentives are generally not subject to regulatory oversight.

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.

Despite this, the Portuguese tax system currently sets out a tax benefit according to which the gains arising from stock option plans up to the amount of EUR40,000 received by the start-ups/emerging companies' employees may be exempt from personal income tax (PIT).

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 "monetised" by the company (for example, when dividends in the relevant associated companies are received by the company).

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 on the payment of 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. It is also possible that the agreement does not establish an interest rate to the extent there is a fair basis on which the operation can be deemed "free of payment".

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?

Protections

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.

Penalties

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 PE companies.

In addition, PE 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 PE 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, PE 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.
- In VC funds, although no concrete data is available, it appears that successful investee companies are most frequently sold to industrial players or other (larger and more established) start-ups.
- In later stage investment rounds we are also seeing secondary transactions occur (direct sales of shares from founders to VC investors) which enable founders to gain liquidity in an earlier phase of the start-up lifecycle.

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 in PE are generally:

- Secondary transactions, notably secondary buyouts.
- MBOs.
- Liquidation or insolvency.
- In VC funds, although no concrete data is available, it appears that write-offs are by far the most prevalent option (as most early stage companies fail).

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?

Regulatory. Regulation No. 5/2020 of the PSMC regulates the creation of credit funds (*see Question 1*) (under Decree-Law No. 144/2019 of 23 September), establishing:

The possible assets that a credit fund's portfolio can include.

The risk management system and the processes for assessing, monitoring and controlling credit risk, in addition to the performance of stress testing at least on a quarterly basis.

The relationship of the credit funds with the borrowers.

An annual reporting duty by the respective management companies to the PSMC.

The information to be submitted in the application for authorisation of PE fund management companies and investment companies (which surpass the relevant thresholds).

Compliance. Decree-Law No. 25/2020 of 7 July amended the following regimes to adapt the sanctions applicable to, among others, PE fund managers:

- Legal Framework of Private Equity, Social Entrepreneurship and Specialized Investment.
- Legal Regime of Collective Investment Schemes.
- Legal Regime of Credit Securitization.
- Securities Code.

In addition:

- Regulation No. 2/2020 of the PSMC created new substantive and reporting requirements, in relation to the prevention of money laundering and the financing of terrorism for PE fund managers.
- Law No. 58/2020, of 31 August, among other changes, clarified the rules for assessing ultimate beneficial owners of investment funds (including PE funds).
- Sustainable Finance Disclosure Regulation (SFDR) (*Regulation* (EU) 2019/2088) that entered into force in March 2021 and lays down harmonised rules for financial market participants and financial advisers on transparency with respect to financial products, including PE funds, is expected to have a relevant impact on the activities of PE fund managers, notably on reporting obligations to CMVM and disclosures in marketing documents.

No other relevant legislative changes affecting PE investing are currently anticipated in Portugal.

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Professional qualifications. Attorney at law, Portuguese Bar Association, 2008

Areas of practice. Corporate and commercial (corporate law, mergers, acquisitions and joint ventures and M&A), transactional PE and fund formation; 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

- Acquisition of an 81.1% interest in Brisa – the largest Portuguese toll road operator – by the family office José de Mello and Arcus, a PE player. Acting as leading PE counsel on the Portuguese side of the transaction for acquirer consortium of three PE players (APG, NPS, SLAM).
- Sale by EDP (the largest utility company and industry conglomerate in Portugal) of six large dams (large hydroelectric plants) in Douro to a consortium led by Engie and formed by Mirova and Crédit Agricole Assurances. Acting as leading PE counsel responsible for structuring and implementing the carve-out and spin-off of the assets.
- Acquisition of Idealista (market leader in online real estate classified platforms in Portugal, Spain and Italy) by EQT - a global investment company with more than 40 billion in assets under management - from Apax Partners an independent global partnership focused on long-term investment in growth companies. Led ML's multidisciplinary team.
- Acting for leading Portuguese Group (postal service concessionaire and leading player in the field of logistics and communications) in the incorporation of PE fund dedicated to pre seed, seed, Series A and Growth Stage start-ups.

Languages. Portuguese, English

Publications

- *Securities World, Jurisdictional comparisons (The European Lawyer Reference).*
- *2011 and 2014, by Thomson Reuters (with Ricardo Andrade Amaro). Practical Law Global Guide to Private Equity in Portugal: Market and Regulatory Overview 2017.*
- *2018 and 2020, by Thomson Reuters (with Bruno Santiago and Pedro Capitão Barbosa). The Legal 500: Private Equity Country Comparative Legal Guide 2019 Portugal, by The Legal 500 (with Pedro Capitão Barbosa).*
- *Global Practice Guide to Investment Funds 2020 Portugal, by Chambers and Partners (with Ricardo Andrade Amaro, Bruno Santiago and Pedro Capitão Barbosa).*
- *Global Practice Guide to Private Equity 2020 Portugal, by Chambers and Partners (with Ricardo Andrade Amaro and Pedro Capitão Barbosa).*
- *Global Practice Guide to Investment Funds 2021 Portugal, by Chambers and Partners (with Ricardo Andrade Amaro, Bruno Santiago and Pedro Capitão Barbosa).*

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

Non-professional qualifications. Law Degree, Law Faculty of Nova University of Lisbon, 2010; LLM 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 PE fund manager and PE fund.
- Acting for Chinese immigration services firm in the promotion of several PE funds.
- Acting for a leading Portuguese energy supplier in Series B investment round in Irish start-up specialised in electricity storage and capacity market services.

Languages. Portuguese, English, Spanish

Publications

- *International Comparative Legal Guide to Private Equity 2016 - 2020 Portugal, by Global Legal Group (with Ricardo Andrade Amaro).*
- *Practical Law Global Guide to Private Equity.*
- *in Portugal: Market and Regulatory Overview 2017 – 2020, by Thomson Reuters (with Bruno Santiago and Diana Ribeiro Duarte). The Legal 500: Private Equity Country Comparative Legal Guide 2019 Portugal, by The Legal 500 (with Diana Ribeiro Duarte).*
- *Global Practice Guide to Investment Funds 2020 and 2021 Portugal, by Chambers and Partners (with Ricardo Andrade Amaro, Bruno Santiago and Diana Ribeiro Duarte).*
- *Global Practice Guide to Private Equity 2020 Portugal, by Chambers and Partners (with Ricardo Andrade Amaro and Diana Ribeiro Duarte).*

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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); LLM 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

- *Personal Income Tax Reform Update on the New residence rules, Journal of International Taxation, by Thomson Reuters, 2015 (with Beatriz Gil).*
- *International Tax Law from Mozambique. The Conventions for the Avoidance of Double Taxation (with special emphasis on Macao and Portugal), by Almedina, 2017.*
- *Practical Law Global Guide to Private Equity in Portugal: Market and Regulatory Overview.*
- *2017 - 2020, by Thomson Reuters (with Diana Ribeiro Duarte and Pedro Capitão Barbosa). Getting the Deal Through:Tax on Inbound Investment*
- *2017 - 2019 Portugal, by Law Business ResearchGlobal Practice Guide to Tax Controversy 2019 Portugal, by Chambers and Partners (with Francisco de Sousa da Câmara and Inês Salema).*
- *Global Practice Guide to Corporate Tax 2020 Portugal, by Chambers and Partners (with Francisco de Sousa da Câmara, António Lobo Xavier and António Pedro Braga).*
- *Global Practice Guide to Investment Funds 2020 and 2021 Portugal, by Chambers and Partners (with Ricardo Andrade Amaro, Diana Ribeiro Duarte and Pedro Capitão Barbosa).*

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Professional qualifications. Advogado, Portuguese Bar Association, 2018

Areas of practice. Tax (both in domestic and international taxation, namely with questions related with corporate restructurings and foreign investment with particular focus in corporate income tax issues).

Non-professional qualifications. Law Degree (University of Lisbon School of Law, 2013). Master's Degree in Law and Management (Católica Oporto School of Law, 2014). Postgraduate Studies in Tax (Católica Lisbon School of Law, 2017)

Recent transactions

- Acting for a leading international Real Estate group in the investment in several real estate assets in Portugal;
- Acting for a leading multinational group in the acquisition of windfarm assets.
- Acting for a leading multinational group in the energy sector within the scope of a major corporate restructuring.

Languages. Portuguese, English

Publications

- *SIGI "Be welcome and stay long", Iberian Property, 2019 (with Bernardo Silveira).*
- *The Portuguese personal income tax regime applicable to capital gains obtained by non-resident individuals with the transfer of real estate located in Portugal, Iberian Property, 2020.*