Restructuring in Portugal

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If you are a client of Macedo Vitorino & Associados and wish to discuss any of the matters covered in this briefing please contact:

Tel.: (351) 213 241 900 – Fax: (351) 213 241 929

Email: mva@macedovitorino.com

Contents

1. Introduction 1

2. Insolvency order...2

2.1. The filing of the proceedings 2

2.2. The insolvency order...2

2.3. Challenging the insolvency order 3

3. Lodging and ranking of credits 3

3.1. Lodging the credits..3

3.2. Categories of credits 3

4. Administration of the insolvency estate 4

4.1. The powers of the insolvency administrator 4

4.2. The creditors' committee...5

4.3. The creditors' meeting 6

4.4. Administration by the insolvent 6

5. Effects of the declaration of insolvency: stays of proceedings, suspension of payments, etc...6

6. Voidable transactions..7

6.1. Prejudicial transactions 7

6.2. Other voidable transactions 8

7. Restructuring proceedings 9

7.1. The restructuring plan 9

7.2. Types of reorganisation measures..9

7.3. Voting and approval of the restructuring plan...10

7.4. Refusal of the restructuring plan 10

8. Liquidation and payment of credits 10

9. Closing of the proceedings 11

As the financial crisis unfolds, many companies now face situations of distress. The number of insolvencies around the world and in Portugal is increasing.

The purpose of this briefing is to review some of the legal issues concerning the insolvency of Portuguese companies so that creditors and other stakeholders may develop strategies to improve the chances of restructuring the business, if possible, or to mitigate their losses.

1. Introduction

The relevant Portuguese legislation with regard to insolvencies is Decree-law 53/2004 of 18 March 2004, as amended by Decree-law 200/2004 of 18 August 2004 (the "Insolvency Code").

The Insolvency Code was enacted as a consequence of the 2001 recession which led to an increase in the number of insolvencyies in particular among small businesses.

Prior to the enactment of the Insolvency Code in 2004, Portuguese insolvency procedures were regulated by Decree-law 132/93 of 23 April 1993. Originally, the old bankruptcy and restructuring code was exclusively applied to business organisations. The former insolvency laws had the puropose of facilitating the reorganisation of the insolvent's business. However, this attempt proved unsuccessful, for several reasons, as the insolvent company normally regarded legal protection as a last resort and the judicial process was slow.

One of the main novelties introduced by the Insolvency Code is the merger of the former restructuring and bankruptcy proceedings into a single proceeding, named "insolvency proceeding", which will lead to either the liquidation or the restructuring of the insolvent company.

Another important aspect is the recognition of contractual subordination. The Insolvency Code sets out a list of the credits that are subordinated by operation of law, including among others (i) shareholder loans, (ii) the debts to persons or companies which are controlled or related to the insolvent company and (iii) the company's obligations towards its directors created during the two years prior to the insolvency order.

Unlike the former bankruptcy laws, the administrator may now void any security given by the debtor securing existing obligations or new security replacing existing security during the year before the initiation of the insolvency proceedings and any security given to secure obligations undertaken in the sixty days prior to the initiation of the insolvency proceedings.

Lastly, the Insolvency Code has expanded the powers given to both the insolvency administrator and the creditors so that now creditors have the power to decide whether the company will be liquidated or restructured.

Although the Insolvency Code has improved substantially the legal proceedings and increased the powers of creditors as to the running of the insolvent's business, creditors still regard the insolvency proceeding as a mean to liquidate companies rather than a form of protecting businesses and allow all parties to agree on the restructruing measures, when possible, or, if not, to liquidate the assets in an orderly fashion so that losses can be mititgated.

The purpose of this briefing is to give an overview of insolvency proceedings for Portuguese corporations so that creditors and other stakeholders may understand some of the legal ossues surrounding Portuguese insolvencies and be able to act in the proceedings in a manner that best serves their interest.

2. Insolvency order

2.1. The filing of the proceedings

Insolvency proceedings start with the filing of a petition seeking the declaration of the insolvency of the company, which must state the reasons for the petition and evidence of the insolvency situation.

Any creditor may petition the insolvency of a company if (i) such company has not complied with one or more of its obligations, revealing that it is unable to comply with most of them, (ii) its directors or managers have escaped as a result of its insolvency or have abandoned the company's offices, (iii) the creditors became aware that the assets of the insolvent have been depleted or that the directors or shareholders of the company took any actions with the intent of causing the company's insolvency, or (iv) the company fails to comply with its tax or social security obligations or to pay its employees' wages.

Company directors must petition the insolvency of a company within sixty days as from the date they became aware that the company has become unable to comply with its outstanding obligations. For instance, if it has not paid to one of its major creditors or it defaulted on a contract that would put at risk the continuation of its business.

2.2. The insolvency order

The Court will immediately issue the insolvency order when the petition was filed by the insolvent.

If the petition was filed by a creditor, the Court will notify the company to respond within ten days and provide a list of its five main creditors. The Court will then take one of two decisions:

- If the company does not challenge the petitioned proceedings, order its insolvency; or
- If the company challenges the insolvency petition by alleging that it is not insolvent, hear the parties and review the evidence submitted by them.

In the insolvency order, the Court will:

- Appoint an insolvency administrator (*administrador da insolvência*), who will, among other things: (i) manage and dispose of the company's assets; (ii) provide for the sale of the company's assets and (iii) prepare the payment of all its debts;

- Order the insolvent to deliver the accounts and other relevant elements concerning its assets to the insolvency administrator;
- Set the date for the creditors to file their claims;
- Notify the creditors to inform the insolvency administrator of security interests over the debtor's assets;
- Order the debtors of the insolvent to make any payments in arrears to the insolvency administrator; and
- Set a date for the first creditors' meeting (*assembleia de credores de apreciação do relatório*) to review the administrator's report, which will take place within forty five to seventy five days.

2.3. Challenging the insolvency order

The insolvent company may challenge the insolvency order if it was not notified of the proceedings. Creditors who invoke facts that should have been reasonably taken into consideration in the decision may also oppose to the insolvency order, thus creating a stay in the proceedings.

Creditors may also appeal from the insolvency order, by presenting elements of fact and law that should have led the Court to a different decision.

On the other hand, if the court decided the insolvency not to have been proved, the insolvent or the petitioner will have the right to appeal from the decision.

3. Lodging and ranking of credits

3.1. Lodging the credits

Creditors who wish to be paid with the proceeds of the sale of the company's assets must lodge their claim and provide evidence for their debts within the timebar set by the Court in the insolvency order. The insolvency administrator must prepare a preliminary list of recognised and non-recognised claims within fifteen days of the lodging of the claims, which may be challenged by any interested party.

Creditors that have not lodged their claim until the expriration of deadline set by the Court may still do so during the year following the issuance of the insolvency order, except for those that have been notified of the list of recognised and non-recognised claims.

3.2. Categories of credits

The Insolvency Code distinguishes four types of debts: (i) secured debts (*créditos garantidos*), which entail a security on any of the company's assets, (ii) preferred debts (*créditos privilegiados*), which entail preference on the company's assets, (iii) common debts (*créditos comuns*), which do not entail

any security or preference but are not deemed as subordinated debts, and (iv) subordinated debts (*créditos subordinados*).

Under the Insolvency Code, the following debts are deemed as subordinated:

- Debts to persons or entities special related with the insolvent company, including but not limited to (i) the shareholders which are personally liable for the company's debts, (ii) the controlling companies which controlled the company during the period of two years prior to the beginning of the insolvency proceedings, or (iii) the company's directors in fact and in law during the two years prior to the insolvency order;
- Interest in respect of unsubordinated credits accrued after the insolvency order, except for the interest accrued on secured debts;
- Debts subordinated by contract;
- Debts that do not involve any consideration payable by the creditor;
- Debts resulting from termination of contracts by the insolvency administrator and owed to creditors deemed to be in bad faith;
- Interest on subordinated credits accrued after the insolvency order; and
- Shareholder loans.

Subordinated creditors may attend but are not entitled to vote at the creditors' meeting.

4. Administration of the insolvency estate

4.1. The powers of the insolvency administrator

The insolvency administrator is appointed by the Court from an official list. Notwithstanding, the creditors may, at the first creditors' meeting, appoint an insolvency administrator of their chosing by a majority of all voting creditors and of all votes present or represented at the meeting.

The Court must accept the appointment of the administrator chosen by the creditors, unless it considers that (i) the appointee cannot perform his/her duties, (ii) the remuneration granted to the administrator is grossly excessive or (iii) there is no circumstance that could justify the appointment of a person not included in the official list.

The insolvency administrator is responsible for:

- Setting the guidelines regarding the management of the company while the proceedings are pending;
- Assessing the financial viability of the company and reviewing the restructuring measures that would best protect the creditors;

- Preparing an inventory of all the assets and rights, indicating the value, nature, characteristics and place where the assets may be found as well as any charges and registration details;
- Preparing a provisional list of the creditors;
- Adopting or proposing the Court to adopt any urgent measures that in his/her opinion may be required to protect the company's assets. The measures that may be adopted by the Court include suspending and/or restricting the management powers of the company's directors or submitting any contracts and other actions to be undertaken by the company to the prior approval of the insolvency administrator;
- Reporting to the creditors' committee the management actions that are undertaken during the administration period as well as any information or documents that may be relevant for the choice of the appropriate restructuring measures; and
- Preparing a report to be presented at the first meeting of the creditors. This report will contain a review of the company's situation and financial viability and a proposal of the restructuring measures that the insolvency administrator considers to be in the best interest of the company and its creditors.

Following the presentation of the insolvency administrator's report, the creditors will decide at the first creditor's meeting to either continue the operation of the business or wind it down. If the creditors' meeting gives powers to the insolvency administrator to present a restructuring plan, it may also create a stay in the liquidation proceedings, which must be submitted in the following sixty days and approved by the creditors.

4.2. The creditors' committee

The creditors' committee (*comissão de credores*) is a supervisory body, composed by three or five members and two alternates, in charge of supervising the management of the company and assisting the insolvency administrator, which is appointed by the Court. As a rule, the creditors' committee is chaired by the largest creditor; however, the Court may appoint another creditor as chairman if it believes that such appointment is preferable having regard to a possible restructuring of the company's business. The composition of the creditors committee must include secured and unsecured creditors.

Its powers include the power to examine the books and documents of the company and, more importantly, to request the insolvency administrator any documents and information regarding the insolvent that it deems necessary.

The decisions of the creditors' committee must be adopted by a majority of the members present at the meetings. The chairman has a casting vote.

4.3. The creditors' meeting

Any creditor of the insolvent has the right to participate in the creditors' meeting. The meeting is chaired by the judge and may be called by the Court or at the request of the insolvency administrator.

The creditors' meeting may (i) dissolve the creditors' committee, (ii) replace any of its members, or (iii) if the Court has not done so, appoint a creditors' committee with three or five members.

Any decision of the creditors' committee may be revoked by the creditors' meeting. The insolvency administrator has the duty to provide any information to the creditors meeting on any matter related with the exercise of its functions of administration if the meeting so requires.

4.4. Administration by the insolvent

Upon the request of the insolvent company, the Court may allow the board of directors to continue managing the insolvency estate provided that:

- The insolvent presented a restructuring plan;
- There are no reasons which may result in a postponing of the proceedings and no disadvantages for the creditors; and
- The petitioner of the insolvency approved the recovery plan presented by the insolvent.

For the Court to entrust the administration of the company to the insolvent, it must consider that it is likely the insolvency was caused by outside factors and that the members of the board of directors were not responsible for the insolvency of the company.

In those cases where the insolvent's board of directors is allowed to continue managing the insolvency estate, the administrator will oversee the management of the company and inform the creditors' committee and the Court if there are any reasons or circumstances that may require changes to the restructuring plan. If there is no creditors' committee, this notice will be made to the creditors that filed their claims in the proceedings.

5. Effects of the declaration of insolvency: stays of proceedings, suspension of payments, etc.

The declaration of insolvency creates a stay on all enforcement actions pending against the debtor and suspends all interest accruing on any debts existing on the date the petition is presented before the Court.

After the issuance of the insolvency order, the administration and disposal of assets will be decided by the insolvency administrator.

The corporate bodies of the insolvent will remain in office during the proceedings but will not be entitled to receive any remuneration. The

insolvency administrator may file lawsuits against any of the members of the corporate bodies for tort or breach of their fiduciary duties and seek damages that might have resulted from the reduction of the insolvent’s assets.

Upon issue of the insolvency order, all agreements that have not been performed in full will be suspended until the insolvency administrator decides to perform the contract or refuse to perform it.

The insolvency administrator may also terminate the following agreements:

- Purchase agreements in which the insolvent is the buyer, if the agreement has not been performed in full and the seller is no longer interested in selling; and
- Purchase agreements in which the insolvent is the seller if the goods have not been delivered, in which case the buyer will be entitled to a compensation ranking as a common creditor.

Contracts whereby the insolvent undertook to transfer certain assets may not be suspended by the insolvency administrator if the transfer of the asset has occurred.

Any transactions or actions undertaken by the insolvent in violation of this rule will be deemed null, save when a consideration was given by third parties acting in good faith.

6. Voidable transactions

6.1. Prejudicial transactions

The insolvency administrator may set aside any transactions which are considered to prejudice the insolvency estate entered upon by the insolvent company within the four years prior to the initiation of the insolvency proceedings.

In the event the insolvency administrator decides to void a transaction, the assets of the debtor that have been transferred or disposed of must be returned to the insolvency estate.

Any actions which cause the reduction, place at risk, or which postpone the exercise of the creditors’ rights are considered to prejudice the insolvency estate.

As a rule, the termination will only be allowed in the event the transaction is entered in bad faith by the counterparty.

Bad faith will be deemed to exist if the creditors knew, at the time the security was given, that (i) the debtor was insolvent, (ii) the granting of the security would be prejudicial to the debtor and (iii) its insolvency was imminent or the insolvency proceedings had already been initiated.

Under the Insolvency Code, bad faith is presumed to exist in any transaction entered upon with or benefiting a related entity in the two years before the initiation of the insolvency proceedings irrespective of whether such relation existed or not on the date the transaction was entered upon.

Other than in these situations, transactions or securities given by the insolvent may only be voided when proved that the beneficiary entered into such transactions or accepted such securities in bad faith with the intent to prejudice the insolvency estate or other creditors.

In the event a transaction or security is voided and the beneficiary wishes to challenge the decision of the administrator to void it, he/she must file a lawsuit against the insolvency estate within six months from the notice issued by the administrator voiding the transaction or the security and present evidence that there was no bad faith.

6.2. Other voidable transactions

Other voidable transactions that do not require the bad faith of the insolvent or its counterparty include, among others:

- Gratuitous acts in the period of two years prior to the insolvency order;
- Securities given in respect of existing obligations or new securities replacing such existing securities within six months prior to the initiation of the insolvency proceedings;
- Personal guarantees granted by the insolvent in the six months prior to the initiation of the insolvency proceeding which are related with transactions which are not in the best interest of the insolvent;
- Securities given to secure obligations undertaken in the sixty days prior to the initiation of the insolvency proceedings;
- Payment or termination of certain obligations which would become due after the initiation of the insolvency proceedings or which are carried out six months prior to the initiation of the insolvency proceedings or after but in any event before the became due;
- Payment or termination of certain obligations performed in the six months before the initiation of the insolvency proceedings which are external to the normal course of the insolvent’s business and that the creditor was not entitled to demand;
- Agreements executed against consideration executed during the year before the insolvency petition is filed, in which the debtor has paid an excessive amount compared with the obligations of the counterparty;
- Repayment of shareholder loans in the year before the initiation of the insolvency proceedings.

7. Restructuring proceedings

7.1. The restructuring plan

The insolvency administrator, the insolvent, persons who are liable for the debts of the insolvent estate and creditors or groups of creditors which represent at least 1/5 of the total credits recognized by the Court may present a restructuring plan.

The restructuring plan must provide that all creditors holding the same category of claims (secured, common and subordinated) are treated equally within their category.

The administrator, in cooperation with the creditors' committee, must specify in the restructuring plan if creditors' rights will be satisfied by (i) using the proceeds of the liquidation of the insolvency estate, (ii) restructuring the business or (iii) selling the company's business to a third party.

The restructuring plan must also (i) specify the changes to the insolvency creditors' categories as well as the purpose of the plan, (ii) describe the measures necessary to its implementation and (iii) contain all the relevant elements to the approval by the creditors and Court, including but not limited to the description of the financial situation of the insolvent.

7.2. Types of reorganisation measures

The restructuring plan may include any of the following measures:

- Reduction in part or in full of the claims, in respect of both principal and interest;
- Payment of all claims subject to the solvability of the company;
- Modification of the term and/or interest rates;
- Creation of new securities;
- Payment in kind of the claims in whole or in part; and
- Transfer of assets to creditors.

Unless otherwise provided in the restructuring plan, the rights arising from secured and privileged claims will not be affected by the restructuring plan, subordinated claims will be deemed remitted and full compliance with the restructuring plan will discharge the company of all recognised claims.

Lastly, the restructuring plan may also contain the following measures:

- Share capital reduction to cover for past losses;
- Share capital increase to be subscribed in cash or in kind by the creditors or by any third parties;
- Amendment to the company's articles of association;
- Change of the company's legal form; or

- Replacement of the company's corporate bodies.

7.3. Voting and approval of the restructuring plan

The restructuring plan must be discussed, voted and approved by the creditors' meeting, which is called by the Court. The plan may be modified at the meeting by the proponent provided that the amendments do not contend with the nature, structure and purposes of the plan.

The plan must be approved by the votes of creditors representing at least one third of the total credits with right to vote and two thirds of the credits present, provided always that one half of the votes cast correspond to unsubordinated credits. The resolution approving the restructuring plan must be published in the Official Gazette.

If the restructuring plan presented by the insolvency administrator is approved the Court will notify the workers' committee and the creditors' committee, the insolvent and the insolvency administrator to present thei objections within the ten days period following the approval of the plan.

The restructuring plan must then be confirmed by the Court. However, the Court may not rule on the merits of such plan, as its powers are limited to assessing the compliance of the approval proceedings with the law.

7.4. Refusal of the restructuring plan

The Court must reject the restructuring plan if the company or any of its creditors provides evidence that:

- The plan is less favourable to the company or to such creditor than the situation would be if the plan was not implemented;
- The plan entitles a given creditor to a consideration that is higher than the amount of his claims; and
- There was a violation of the formal or material requirements regarding the submission of the plan and such violation is not remedied in a reasonable time period.

The Court may also reject the restructuring plan which has been approved by the creditors' meeting if such plan were to violate any procedural rules or other applicable rules, regardless of their nature, or the conditions set out in the plan are not verified and the measures that should have been engaged are not implemented.

8. Liquidation and payment of credits

If the creditors decide to liquidate the insolvency estate, the insolvency administrator shall sell the company's assets and deposit the proceeds of the sale.

Before paying creditors, the insolvency administrator must pay the debts of the insolvent company which were incurred during the insolvency proceedings as well as the court fees and other costs concerning the proceeding.

Once the company's assets have been liquidated in full and proceedings' costs have been satisfied, the insolvency administrator will pay the debts in accordance with the ranking of claims which has been approved by the Court, in the following order:

- Secured and preferred debts;
- Common debts, including the remainder of secured debts in case the proceeds of the sale of the relevant assets have not been sufficient to pay them; and
- Subordinated debts, such as shareholders loans and debts to persons or companies which control or are affiliated with the insolvent company as well as obligations to company's directors created during the two years before the insolvency order.

After all debts have been paid, the remainder of the proceeds of the sale will be distributed among equity holders. For the purposes of liquidation and payment, the Court will only consider the securities and preferences as included in the list presented by the insolvency administrator or in any appeal filed against such list.

9. Closing of the proceedings

Insolvency proceedings are concluded by a formal order of the Court, usually after the plan for liquidation of the company has been fulfilled or when the restructuring measures set in the restructuring plan become effective.

In general, once the Court's final order is given, the company may either be dissolved or carry on its activity if the reorganisation is successful.

The proceedings will be closed by the Court:

- When the final ranking of the claims is completed;
- When the final decision on the restructuring plan becomes definitive and no appeal may be filed against it;
- At the debtor's request, when the situation of insolvency ceases to exist and all the creditors give their approval to the closing of the proceedings; or
- When the insolvency administrator reports the insufficiency of the insolvent assets to pay the costs with the procedures and the remaining debts of the insolvent company.

After the closing of the proceedings, the measures adopted under the restructuring plan will cease, the debtor will regain the right to dispose of its

assets and manage and control the business and the powers of the creditors' committee and the insolvency administrator will be revoked, save for those concerning the filing of the accounts which have been established in the restructuring plan.

As from that date, the creditors may also exercise their rights against the debtor without any restrictions save for those established in the restructuring plan.

Lastly, in case the company is to carry on with its business after the closing of the proceedings, the company may return to its normal activity.

In case of liquidation and sale of the insolvency estate, upon the closing of the proceedings, the company will be considered dissolved after the registration of the dissolution.

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