#BACK TO BUSINESS

Restructuring in Portugal in Covid-19 and beyond

MACEDO VITORINO & ASSOCIADOS
Sociedade de Advogados, RL

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Since the incorporation of the firm we have been involved in several high-profile transactions in all of the firm's practice areas, including banking and finance, capital markets, real estate, M&A, complex disputes, and corporate restructurings.

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Introduction

In the current context of the coronavirus disease 2019 (Covid-19), it is likely that several businesses will be unable to pay outgoings due to severe cash-flow shortages in the coming months. As stated by International Monetary Fund, this crisis is not simply about liquidity, but primarily about solvency at a time when large segments of the global economy have come to a complete stop.

According to official data, the sectors of tourism, non-food retail, automotive and components, textile/clothing, consumer durables and leisure and cultural activities will be the most affected by the crisis caused by Covid-19 in Portugal.

Other sectors that were developing positively in 2020 will suffer a reversal in the upward trend of their activity, standing out, due to their high weight in GDP, those of construction and materials, and real estate activities. In some industries, the consequences will be positive in the very short term, although the sharp deterioration of the economy will probably penalize their activity in the coming months.

Seeking to mitigate the economic impact of Covid-19, the Portuguese Government approved crisis containment measures – legal, financial, and regulatory – to protect businesses and individuals negatively affected by the Covid-19 pandemic. Many of these measures directly or indirectly relate to corporate insolvency. Such measures were essentially designed to support financially distressed companies and preventing the unnecessary insolvency of companies that in the ordinary course would be viable.

As regards insolvency-related matters, the Portuguese Government suspended the obligation of managing directors to file for insolvency, retrospectively from March 9, 2020 (the "suspension period"). Under Portuguese insolvency law (the Insolvency and Recovery Code – *Código de Insolvência e Recuperação de Empresas* – CIRE), directors have an obligation to file for insolvency within 30 days after taking knowledge that the company became either insolvent or over-indebted, as detailed below.

In the Covid-19 context, enforcement proceedings – for example, acts relating to sales, ranking of creditors, judicial deliveries of property, attachments and their preparatory acts – were also suspended, with the exception of those acts that would cause serious harm to the creditor's survival or whose non-performance would cause severe damage (such as pending insolvency proceedings filed prior to the state of emergency). Criminal penalties and civil liabilities for the managing directors breaching of the obligation to file for insolvency were as well put off.

The suspensions on insolvency matters did not however apply to creditors, which remained entitled to file for insolvency. While preferred creditors may be tempted to rush for a company's insolvency, it may be beneficial for all not to put already distressed companies into additional stress without

exhausting all possibilities of an out-of-court arrangement, as a declaration of insolvency will likely have an impact on the regular course of business of the company and it may hinder the chances of credit recovery, compromising the ability of the company of dealing with suppliers and customers.

In these situations, an agreement may be a difficult task as the parties tend to stand rigid in their positions: secured creditors do not want to see equity holders get paid first, unsecured creditors wish to leverage their position and equity holders tend to hold to their entitlement over the course of business.

In the context of Covid-19, it may be even more relevant to use out-of-court remedies. The special recovery proceeding (*Processo Especial de Revitalização* or PER) and the extrajudicial recovery scheme (*Regime Extrajudicial de Recuperação de Empresas* or RERE) allow debtors to start negotiations with their creditors and avoid to increase their distressful financial situation and ultimately the insolvency.

The purpose of this briefing is to provide an overview of insolvency proceedings for Portuguese companies, so that creditors and other stakeholders may understand some of the restructuring and insolvency solutions for facing cash-flow difficulties due to Covid-19 and, particularly, in a scenario beyond Covid-19.

Economic relief measures package

To mitigate the economic effects of the Covid-19 outbreak, the Portuguese Government approved a EUR 9.2 billion incentive package of economic relief measures designed to address future challenges that businesses face.

The relief package includes (i) EUR 5.2 billion euros in fiscal incentives, (ii) EUR 1 billion related to social security payments and a deferral of some tax payments, corporate income tax (CIT) and VAT and (iii) EUR 3 billion in state-backed credit guarantees.

This package aims at supporting businesses' liquidity, but also at keeping employment contracts by companies facing a business crisis, which can be achieved by way of a "simplified lay-off": the suspension of employment contracts or reduction of the normal working period.

Companies that choose the simplified lay-off are entitled to a financial support granted by the Social Security corresponding to 70% per cent of 2/3 of the employee's gross salary up to EUR 1,905, for the duration of 1 month, renewable on a monthly basis up to a maximum of 3 months (the remaining 30% being borne by the employer). An exceptional and temporary regime of exemption from the payment of Social Security contributions is also available during the simplified lay-off period for employers (and self-employed individuals who are employers).

In a normalization phase of the business activity (after the outbreak), companies having used the simplified lay-off mechanism may also benefit from an extraordinary financial support corresponding to a maximum of EUR 635, per employee, to support the payment of salaries.

Other measures already in place include financial incentive measures under QREN or Portugal 2020 incentive programs, including, among others: (i) acceleration of incentives advance payments or reimbursements; (ii) extension of the maturity of the loans and with no interest; (iii) eligibility of the expenses incurred with cancelled or postponed initiatives or events. It was created the "Capitalizar" Financial Facility – Covid-19, worthing EUR 200 million, to support companies affected by the economic effects resulting from the outbreak.

Until 30 September 2020, a moratorium on loans is also in force, allowing: (i) a restriction on lenders' acceleration or termination rights; (ii) an extension of financings with bullet repayments; and (iii) deferral of all payment obligations. Insolvency declaration, the submission to a special revitalization

proceeding or to the extrajudicial company recovery scheme of the borrower shall not affect the lender's rights.

With a view to mitigate the impact of Covid-19, commercial lease tenants are enable to a deferral of rents to be paid in monthly instalments (of not less than 1/12) within the following 12-month period, together with the relevant rents and with no penalties for delay. Moreover, commercial lease agreements may not be terminated on the grounds of business lockdown or due to activity limitations up to 30 September 2020.

In a summary, the measures implemented can be divided into four categories: (i) simplified lay-off and extraordinary training plan; (ii) tax and contributory measures; (iii) economic incentive measures; and (iv) moratorium on loans. An updated summary of the relevant recovery incentive measures is detailed here.

Restructuring procedures

If a company has still a sustainable business, but current creditors and additional losses incurred during the Covid-19 crisis hinder it from continuing to make business as a going concern, there are several options which are available before filing an insolvency proceeding.

Special recovery proceeding (PER)

PER is an out-of-court special conciliation proceeding that enables the recovery of companies in serious financial distress or imminent insolvency, and encourages the restructuring and recovery of viable companies, rather than the liquidation of their assets via an insolvency proceeding.[1]

A debtor is considered in serious financial distress whenever it is unable to fulfil its obligations as they fall due, particularly when it lacks liquidity or credit availability, but also if the circumstances show that it will most likely be unable to do so in the near future.

The company willing to be subject to a PER must file a request before the court together with, at least, one

[1] Natural persons are not eligible for PER but rather for a special payment agreement proceeding (*processo especial para acordo de pagamento*), which closely follows the PER.

creditor, including a statement of intent to enter into negotiations.

After receiving the request and relevant documents[2], the court will appoint an interim administrator. The decision is published online and notified to the debtor and creditors that did not join to the initial request. Creditors that were not part of the initial request are given 20 days to lodge their claims, and within five days the interim administrator issues a provisional list of credits. Any creditor may challenge the provisional list of credits within five business days after publication in the official website. If the provisional list of credits is not challenged, the list will be considered as a final list.

The debtor and its creditors are given two months to close the negotiations that may be extended for an additional period of one month upon prior written agreement entered by the interim administrator and the debtor.

If there is no insolvency decision, all pending enforcement proceedings against the debtor are suspended throughout the PER.

During the PER, the management bodies continue running the business, contrary to the usual procedure under an insolvency proceeding, where the management is normally cast aside. However, relevant actions - for instance, transfer of assets, entry into long-term agreements, assumption of obligations of a third party and provision of guarantee - require the interim administrator's prior approval.

PER may be concluded with or without the approval of a recovery plan. The meeting for the approval of the recovery plan must be attended by at least one third of the total credits with voting rights and it must be approved by at least two thirds of the total credits and at least half the votes correspond to unsubordinated credits. The recovery plan is endorsed by the court within ten days. In turn, if negotiations end without the approval of a recovery plan (or the debtor becomes insolvent), the court must issue an insolvency order within three business days.

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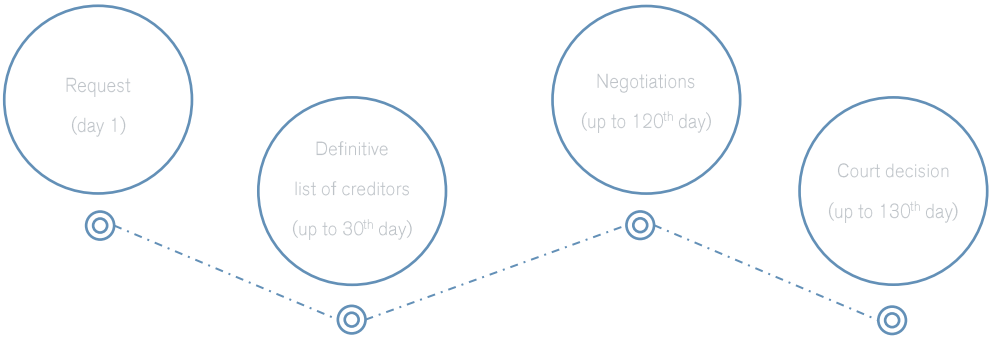
[2] Along with the request, several documents should be presented before the court, namely: (i) list and identification of all creditors, the nature of their credits and guarantees; (ii) a list of all pending claims against the debtor; (iii) a description of the debtor's activity in the past three years and the reason for its distressful financial situation; (iv) a list and identification of all property of the debtor; (v) the financial statements, audit, and management reports of the debtor regarding the past three years, as well as the accounting documents regarding that same time period; and (vi) a list and identification of all employees.



The court may refuse to validate the plan in case the procedural rules set out in CIRE for the approval of the recovery plan were not complied with or in case the debtor directly requests the court not to validate the plan on justified grounds. Regarding the latter case, it may be that the debtor finds itself worse off if the plan is executed or if a creditor is unjustly awarded a more valuable position within the plan.

Once the plan is approved, the recovery measures will apply to all creditors including those which were silent and did not vote the plan.

When a company has been subject to a PER in the last two years it may not, in principle, subject to a new. However, if the company has complied with the recovery plan until the Covid-19 exceptional measures' implementation, it may file for a new PER, as such exceptional circumstances could not have been anticipated at the time the initial PER was approved.

If the recovery plan was sanctioned than two years ago, the company may proceed with a new PER in the current Covid-19 context in those cases where (i) the recovery plan is being complied with or (ii) the current Covid-19 circumstances have promoted the failure of the recovery plan. Otherwise, i.e. if the recovery plan were already being defaulted, the company may already be legally insolvent, and hence the filing of the insolvency should be sought.

Advantages of a PER include:

- Write-downs of debts;
- Leases can be re-negotiated/disclaimed;
- Staffing levels can be reduced in a cost-efficient manner;
- Company continues running business and the directors retain control during the process
- Gives the company time to be restructured;

- Tax benefits;
- Liquidation is avoided.

For a PER to be aligned with the purpose it was designed for, which is to provide a lighter and agile alternative to the insolvency proceeding, the debtor and creditors must act in good faith, in a transparent and prudent manner and within a reasonable schedule.

It is important that companies considering PER as a potential solution start planning now to have a business plan ready to go with a source of new investment identified. The coming weeks can be used to prepare the basis that will ultimately strengthen the relaunch of businesses.

Extrajudicial restructuring scheme (*Regime Extrajudicial de Recuperação de Empresas* - RERE)

RERE is an out-of-court mechanism laid down in Law 8/2018 of 2 March 2018 allowing distressed companies to negotiate with one or more creditors to reach out a restructuring agreement under confidential terms.

Only business entities in a difficult economic situation or in an imminent state of insolvency, but still viable and rearranged, are eligible for RERE.

Unlike in the former *Sistema de Recuperação de Empresas por Via Extrajudicial* (SIREVE), IAPMEI (a State agency, whose purpose is to provide financial support to businesses, particularly to SMEs) is not required to take part in the negotiations. The distressed company may, however, appoint a mediator to assist it in the negotiation with creditors.

Creditors representing at least 15% of the total unsubordinated credits may, together with the debtor, start negotiations and sign a memorandum of understanding (MoU) to be deposited with the Commercial Registry Office.

This MoU must set the key terms of a restructuring agreement to be negotiated and agreed upon within a negotiation period not exceeding three months from the deposit date, unless otherwise agreed (assuming that the debtor has not filed for insolvency or declared insolvent in the meantime). From the MoU deposit date, RERE will grant the debtor the following benefits:

- Suspension of pending seizures and enforcement proceedings filed by creditors taking part of RERE. RERE only binds creditors party to the MoU. The other creditors' claims will remain unchanged, with no waiver towards the debtor;

- The utility services providers (electricity, natural gas, water, telecommunications), regardless of taking part of the MoU, may not suspend the supply of these services on the grounds of non-payment by the debtor;
- If the debtor meanwhile has become insolvent, the time limit for submission of the debtor to insolvency only starts after the end of the negotiation period;
- The debtor stays in possession of its business but is prevented from performing actions of special relevance (as defined in CIRE), unless otherwise provided in the MoU or if previously agreed with all creditors.

The restructuring agreement may, inter alia, provide for an extension of credit conditions, payment arrangements, or even discounts applied to liabilities, to allow for payments to be made from available cash-flows. A declaration from a statutory auditor certifying that the debtor is not the subject of insolvency proceedings, on the date the restructuring agreement is executed, and confirming the total liabilities of the debtor must be attached to the restructuring agreement.

Once approved, the restructuring agreement must be filed with the Commercial Registry Office to produce the following effects:

- Debtors' credit rights and collaterals may be only modified under the restructuring agreement and to the extent that their holders are parties to the restructuring agreement;
- Ending of lawsuits relating to credits included in the restructuring agreement and of insolvency proceedings (if insolvency has not yet been declared) filed by creditors that are parties to the restructuring agreement;
- Any fresh money and attached guarantees explicitly provided for in the MoU or the restructuring agreement (not used by the debtor for the benefit of the relevant financial entity or an entity especially related to it) are ringfenced from clawback actions. For this, it is required a declaration from a statutory auditor declaring that the restructuring agreement includes the restructuring of credit corresponding to at least 30% per cent of the total unsubordinated liabilities of the debtor and that hence the debtor's financial situation is more balanced, due to a proportionate increase in assets over liabilities, and that the debtor's equity capital is higher than the share capital.

If the restructuring agreement is executed by creditors representing the majorities required by the special recovery procedure (PER) (at least 30% of unsubordinated credits), the debtor may eventually start this proceeding in order to obtain the approval of the restructuring agreement by the court.

The advantages of putting at place a RERE include:

- Write-downs of debts;
- Suspension of seizures and enforcement proceedings filed by creditors taking part of the MoU and, after approved the restructuring agreement, the ending of lawsuit relating to the credits covered by the restructuring agreement;

- No appointment of a receiver or liquidator, even though the debtor may appoint a mediator to assist in the negotiation with creditors;
- Moratorium and tax benefits;
- Liquidation is avoided; and
- Confidentiality and no court involvement.

Given the current uncertainty, it is likely that creditors will be open to such confidential discussions as opposed to a formal restructuring process where they are much less likely to get paid at all.

It is very important to keep lines of communications open with creditors, especially with key suppliers and institutional creditors such as banks, Tax Authority and Social Security. While banks and local authorities are agreeable to providing deferral of some payments, the company needs to keep a close review of future cash-flows to ensure the ability remains to clear any liabilities that may accrue.

PER or RERE, which one to choose?

The option between PER or RERE will depend on the debtor's situation at the relevant time. Both PER and RERE have similar requirements, particularly, they are out-of-court instruments through which a debtor in a difficult economic situation or imminent state of insolvency can reach a restructuring agreement with creditors. The range of entities eligible for PER is however broader than those for RERE, which is not, namely, available for State-owned companies and individuals.

The starting of PER and RERE require a joint request of the debtor and creditors representing at least, respectively, 10% and 15% of the total unsubordinated credits. Despite PER being an out-of-court mechanism, the request is filed with the court (the court only intervenes at a later stage to ratify the recovery plan once agreed and approved by creditors). PER is public, which means that it is not under a confidentiality duty. In RERE, the request (the MoU) is filed with the Commercial Registry Office. RERE is a fully out-of-court mechanism and, as a rule, it is confidential.

In both cases, the negotiation period of the restructuring agreement should not exceed three months. In PER, this 3-month deadline is a maximum deadline, after which PER ends if no recovery plan is agreed and a new PER may not, in principle, be submitted within the following two years; in RERE, the 3-month deadline may be extended so that the debtor remains in a difficult economic situation or imminent state of insolvency.

Although the differences between PER and RERE seem not to be very significant, one and other instruments may and should be used in different situations and according to debtor and creditors' goals.

RERE is a better option for businesses aiming to partially restructure their liabilities and keep the restructuring as confidential.

In RERE, the restructuring agreement is freely agreed by the parties, which does not occur under PER, since mandatory rules concerning, inter alia, the principle of equal treatment of creditors of the same ranking will apply.

Businesses that wish to fully restructure their liabilities – imposing on all creditors the solution approved by the majority – and that intend, during the negotiation period, to enjoy a protective shield against enforcement proceedings, must choose PER.

Both out-of-court options suspend the insolvency proceedings filed against the debtor (if the insolvency has not yet been declared) and enforcement proceedings filed against the debtor. However, in RERE, enforcement proceedings are only suspended in relation to creditors that have signed the restructuring agreement and if they request the suspension with the relevant court; the suspension is not automatic. In PER, all enforcement proceedings are automatically suspended during the negotiation period by court's order.

The recovery plan approved in PER binds all creditors, even those which have not approved it; in RERE, the creditors' rights and guarantees are only affected if the creditors are party to the restructuring agreement.

Both PER and RERE allow the financing of the debtor's activity. In PER, creditors, which finance the debtor's activity, enjoy a general preferred credit with prior ranking over general preferred credits granted to employees; no preferred credit is ranked under RERE.

In cases where the restructuring agreement is signed by creditors representing at least 30% of the total of unsubordinated credits, RERE tends to be closer to PER. In this scenario, the debtor under RERE may eventually require the restructuring agreement to be approved by the court, as in PER, with a view to binding all creditors, including those that have not signed the restructuring agreement.

In these cases, the law also provides for the same tax benefits on municipal real estate transfer tax (IMT), stamp duty and corporate income tax (IRC), as those granted under PER. However, while these tax benefits are automatic in PER, the same does not apply in RERE, where the restructuring agreement has to cover at least 30% of the total of unsubordinated credits and be accompanied by a statement issued by a statutory auditor certifying the percentage of the total of unsubordinated credits and the debtor's financial situation. In exceptional cases, local tax authorities may however decide, upon debtor or creditors' request, be the restructuring agreement eligible for tax benefits under RERE, even though the 30% threshold is not fulfilled.

Summing up:

- RERE is a better option for a partial restructuring of liabilities, only binding creditors that are party to the restructuring agreement. RERE is a confidential instrument. No tax benefits are, in principle, eligible, unless the restructuring agreement is covered by at least 30% of the total of unsubordinated credits or in exceptional cases;
- PER is a better option for a total restructuring of liabilities, binding all creditors even those which did not approve the recovery plan, which must be ultimately endorsed by the court, and hence no confidentiality may be ensured. However, tax benefits are automatically applicable.

Before choosing one or other instrument, the debtor and creditors should consider the specifications of each one, and that the choice for one or another could not be indifferent for their specific goals.

Insolvency

Insolvency filings

In general, insolvency is deemed to exist when the company becomes unable to pay its obligations as they fall due but specifically if it has not paid to one of its major creditors or if it defaulted on a contract that would put at risk the continuation of its business.

If directors are aware that the company became unable to comply with its outstanding obligations, they must file for the insolvency of the company within 30 days from the date they acknowledged or should have acknowledged this situation, in which case the proceeding is mandatory.

Due to Covid-19, directors' duty to file for insolvency was suspended with effects from 9 March 2020 (the "suspension period") by the Portuguese Government.

An exemption from director liability may well protect managing directors with genuine short-term issues but long-term viable businesses, but it may also have the effect of artificially supporting companies that would otherwise have been an aspirant for failure regardless of the economic circumstances. The removal of liability can be a shield for those who may be careless as to their directors' duties, adversely impacting the rights of their creditors and employees.

The suspension period did not mean that directors were released from a "business judgment rule" during the Covid-19 pandemic.

Directors continued to be required to act in accordance with statutory and fiduciary duties such as the duty of care and the duty to act in good faith and in the way most likely to promote the success of the company. Directors must prevent any actions that might: (i) damage or endanger the company's assets; (ii) artificially create or worsen liabilities and losses, in particular, by means of damaging transactions; or (iii) manage the company in a way that would foreseeably lead it to insolvency.

Whilst directors owe duties towards shareholders, where the company is in the zone of insolvency, directors are required to act in the best interests of creditors. Consequently, directors are bound on an obligation to avoid any actions that are likely to reduce, frustrate, hinder, jeopardise, or delay payments due to creditors. A failure by directors to comply with their duties will open them up to risks of claims against them.

A company facing an insolvency situation, even though directors do not file for insolvency, is still prevented from using restructuring procedures, such as RERE or PER.

RERE or PER can only be used by a company in a difficult economic situation or imminent insolvency – other than by a company that is already in a current insolvency situation. The company is even obliged to submit a signed statement by a certified accountant or statutory auditor attesting that it is not in a current insolvency situation within the last 30 days. The same is to say: the company that is currently unable to comply with its due obligations is not, however, obliged to file for insolvency, but continues to be prevented from using pre-insolvency mechanisms allowing the company's recovery out-of-court.

Unlike directors, creditors may file for insolvency proceedings during Covid-19, unless the company is benefiting from additional payment deadlines, namely those providing for moratorium on loans. In this situation, the relevant creditor is not entitled to apply for insolvency if the insolvency situation regards to such payment and the payment due date occurs during the extension period. Nevertheless, the company's insolvency declaration (as well as the submission to a RERE or PER) will not affect the lender's rights.

Whenever the debtor voluntarily files for insolvency[3], the court will issue an insolvency order.[4]

If the insolvency request is filed for by any creditor, the court will provide the company 10 days to challenge the initiation of the proceedings. This is the case of an involuntary proceeding.

The debtor must provide a list of its five main creditors and evidence its solvency, otherwise the petition will be regarded as unchallenged and an involuntary insolvency proceeding will commence.

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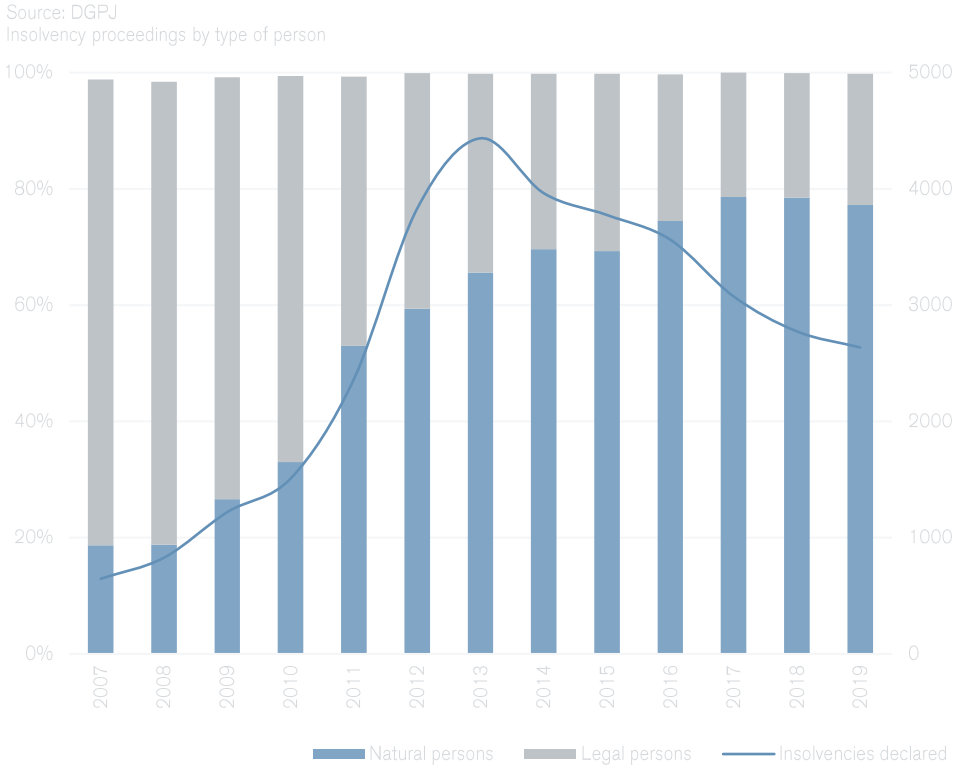
[3] The petition is filed in the commerce court that has jurisdiction where the company is located or has its centre of main interest.

[4] The decision of the court of first instance may be appealed but only if the value of the insolvency proceeding is worth over EUR 5,000.

The court appoints an insolvency administrator[5], requests the debtor to present relevant financial elements concerning its business and sets a deadline for the creditors to file their claims.



The declaration of insolvency prevents any enforcement actions from being filed against the debtor and all pending proceedings are suspended, as well as all accruing interest on any debts existing on the date the petition is presented before the court. This means that after an insolvency order, creditors' claims are not accounted for outside the context of the pending insolvency proceeding.

Creditors who wish to be paid with the proceeds of the sale of the company's assets must lodge their claim and provide evidence of their credits. The court sets a deadline in the insolvency order.

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[5] The insolvency administrator is appointed by the competent court. The creditors may, however, appoint a different administrator if approved by the majority of all voting creditors at the meeting. The insolvency administrator is responsible for: (i) setting the guidelines regarding the management of the company while the proceedings are pending and assessing its financial viability and reviewing the restructuring measures that would best protect the creditors; (ii) preparing an inventory of all the assets and rights and a provisional list of the creditors; (iii) adopting or proposing the court to adopt any measures that may be required to protect the company's assets; and (iv) reporting management during the administration period as well as any information or documents that may be relevant and preparing reports to be presented at the creditors' meeting.

The insolvency administrator must prepare a preliminary list of claims to be accepted within 15 days after the claims are lodged, which may be challenged by any interested party. Creditors who have not lodged their claim because they were not notified of it may still do so during the year following the issuance of the insolvency order.

Following the insolvency order, debtor and creditors will either agree on a recovery plan or the assets of the company will be liquidated to repay the creditors.

The recovery plan

In case the proceeding is filed by the company, the debtor is responsible for proposing a recovery plan for the restructuring of the company, otherwise the court will order the liquidation of the company's assets. Creditors, in their turn, may request the insolvency administrator to prepare a recovery plan at the general meeting, save for a special majority of unsubordinated creditors that may present the plan themselves.

The plan must provide that all creditors holding the same ranking of credits are treated equally within their respective ranking.

Considering that the plan aims at designing the restructuring of a company in financial distress, the plan may:

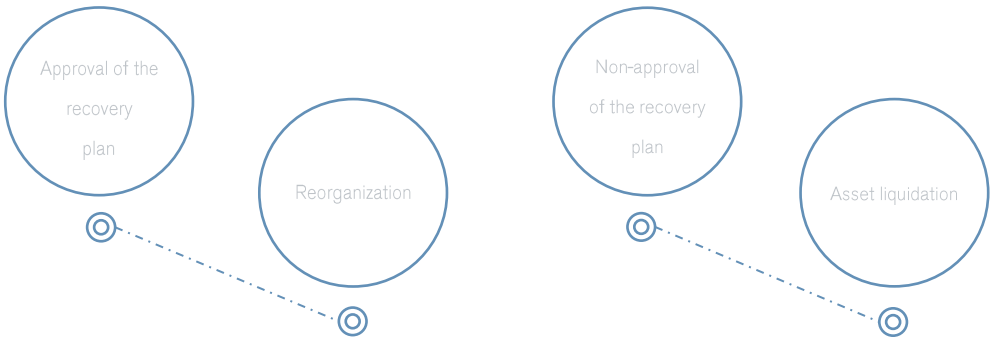
- Provide the full or partial reduction of claims, in respect of both principal and interest, and alter the term of the credit and its interest rates;
- Favour the payment of claims that are subject to the solvability of the company and the full or partial payment in kind;
- Render the creation of securities or the transfer of assets of the company to creditors; and
- Determine an increase or reduction of capital, amendments to the company's articles of association, its legal form, and the composition of its corporate bodies.

The plan is discussed, voted, and approved by the creditors. It must be voted by at least one third of the total credits and have the favourable vote of two thirds of the voting creditors, provided that one half of the votes correspond to unsubordinated credits.

The court will, however, reject the plan if the company or any of its creditors provides evidence that:

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

The court notifies employees, creditors, debtor, and the insolvency administrator to present their objections within the 10 days period following the approval of the plan.



The recovery plan must then be endorsed by the court. However, the court's powers are limited to the assessment of compliance of the approval proceedings with the law. The court will not rule on the merits of the approval.

The voting of a recovery plan may be rejected by the voting parties.

Contrary to a rejection within PER or RERE, after an insolvency order is issued the liquidation of assets of the company is the only possible outcome if the recovery plan is rejected. The assets of the company are seized and sold to settle claims of the creditors.

The business of an insolvent company

The corporate bodies of the insolvent company remain in office during the proceedings. The resignation may only be accepted once the annual accounts are presented. Due to Covid-19, the deadline for the approval of accounts was extended until 30 June 2020. The corporate bodies' power is limited under an insolvency proceeding. It is however expected that the directors of an insolvent company comply with their duty of cooperation with the insolvency administration and it may even be agreed that they continue to actively manage the company.

The court may, upon request, allow the board of directors to continue managing the insolvency estate provided that it was presented a recovery plan that was approved by the petitioner, proceedings are not expected to be postponed and creditors are not put into disadvantage.

For the court to trust the management of the estate to the insolvent company itself, it must consider that it may be that the financial distress was caused by factors other than the

management and that the directors were not responsible for the insolvency of the company.

When directors can continue managing the estate, the insolvency administrator oversees their management and informs the creditors' committee[6] and the court if there are any reasons or circumstances that may require changes to the recovery plan.

Voidable transactions

The insolvency administrator may reverse any transactions considered detrimental to the insolvency estate that were entered upon by debtor within the two years prior to the initiation of the insolvency proceedings. The insolvency administrator will have the power to examine decisions taken by directors prior to its appointment, review transactions entered by directors and take appropriate actions to seek contributions from directors.

All transactions that put at risk, cause a reduction, or postpone the exercise of the creditors' rights are considered detrimental to the insolvency estate.

Despite the generally welcomed relief provided to directors under the now temporarily suspension period, the current changes have not modified the voidable transaction rules under CIRE.

CIRE provides that if a company in financial distress pays its creditors and shortly thereafter the company is declared insolvent, the insolvency administrator may seek to recover those payments from the company's creditors as "voidable transactions". The usual defence to these "clawback" claims is to prove that before a creditor received the payment from the insolvent company that it had no reason to suspect insolvency and a reasonable person would not have so suspected insolvency.

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[6] The creditors' committee is a supervisory body appointed by the court and it oversees the management of the company and assists the insolvency administrator. As a rule, the creditors' committee is composed by three to five members and two alternates and chaired by the largest creditor. The creditors committee must include secured and unsecured creditors. The committee may examine the books and records and documentation of the company and 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.

It is uncertain how creditors carrying out business with distressed companies in the Covid-19 period will be able to successfully make out a defence to a voidable transaction claim brought by an insolvency administrator. The actual effect of this could have severe financial consequences for creditors and for the economy generally. If 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.

The administrator may address a third party within six months following the acknowledgement of the transaction and lawfully terminate any contract satisfying the criteria for prejudicial transactions. As a rule, contractual termination is only allowed where it was evident bad faith by the third party.

A third party is in bad faith if it knew, at the time the security was given, that the debtor was insolvent, or the transaction would be detrimental to the financial situation of the debtor or if insolvency of the debtor was overtly imminent or the insolvency proceedings had already initiated. Bad faith is presumed when the third party is a related entity.

Prejudicial transactions are only voidable within the context of a proper insolvency proceeding and this is not applicable to PER or RERE.

The decision of the insolvency administrator may be challenged within three months from the notice issued by the administrator voiding the transaction or the security.

Some transactions are voidable because of their nature and are not required to have been completed in bad faith. That is, generally, the case of the following:

- Gratuitous acts;
- Securities or personal guarantees that are evidently not in the best interest of the debtor granted within six months – or sixty days, depending on the obligation they are securing – prior to the initiation of the insolvency proceedings;
- Payments, which are carried out six months prior to the initiation of the insolvency proceedings or in any event before they became due, or any payments outside the normal course of business that the creditor was not entitled to demand;
- Agreements executed the year prior to the proceeding, in which the debtor provided an excessive amount compared with the obligations of the counterparty; and
- Repayment of shareholder loans in the year prior to the initiation of the proceedings.

In the current economic environment, the viability of many businesses is a week-by-week or even day-by-day proposition. Whilst the temporary relief measures are a welcome economic incentive at this time, those measures do not currently relieve the risk of an insolvency administrator trying to recover payments a creditor has received from a business in distress. This is not only a major disruption to businesses' cash-flow, but it could, paradoxically, cause creditors' business to suffer an unexpected insolvency event.

Liquidation, ranking and payment of credits

In case of a liquidation of the insolvency estate, the assets of the company are sold to pay the creditors. The payments of credits must follow a priority order.

Credits may be secured (*créditos garantidos*), preferred (*créditos privilegiados*), subordinated (*créditos subordinados*) and unsecured (*créditos comuns*).

The costs incurred with the insolvency proceeding are covered first, as well as court fees and other costs concerning the proceeding. After these are fully covered, the following order of priority applies: secured credits will precede unsecured credits, after which it will follow the subordinated debt. The remainder of the proceeds of the sale will be distributed among equity holders.

Secured credits entail a security on any of the company's assets, such as a mortgage or a pledge. Preferred credits are given preference on the repayment by liquidation of the company's assets. Finally, subordinated credits are those within a special connection between debtor and creditor.

Under CIRE, the following credits are deemed subordinated:

- Credits to entities especially related with the debtor, including shareholders personally liable for the company's debts, controlling companies, and *de facto* and *de jure* directors;
- Interest on subordinated and unsubordinated credit accrued after the insolvency order, save for the interest accrued on secured credit;
- Credits subordinated by contract and credits resulting from termination of contracts by the insolvency administrator;
- Credits that do not required the payment of any consideration by the creditor; and
- Shareholder loans.

For the purposes of liquidation and payment, the court will only consider the priorities that derive from claims included in the definitive list of claims.

Closing of the proceedings

The court is competent to order the conclusion of the proceedings. The closing of an insolvency proceeding may occur whenever:

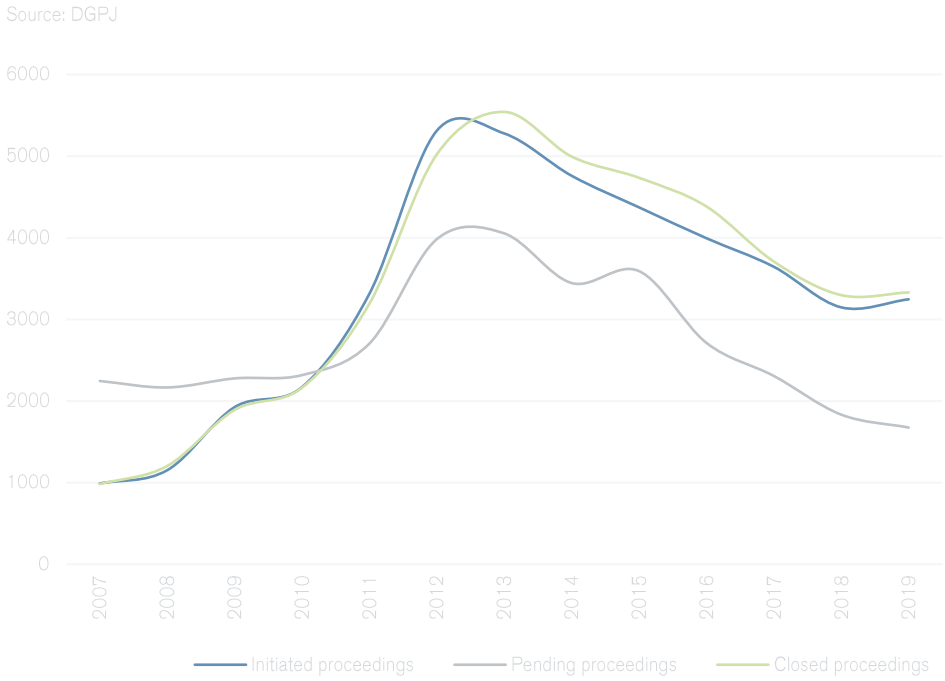
- The final ranking of claims is settled;
- The final decision on the recovery plan becomes definitive and no appeal may be filed against it;
- The debtor so requests, and the creditors approve, in case the insolvency ceases to exist; or
- The insolvency administrator infers from the available estate that it is insufficient to cover the costs of the proceeding and the remaining claims.

In general, once the conclusion is ordered, the company may either be dissolved or carry on its activity in case of a successful reorganisation.

After the closing of the proceedings, the debtor regains control over the business and its assets and the powers of the creditors' committee and the insolvency administrator on the company are cancelled, save for those concerning the filing of the accounts which have been established in the recovery plan.

Final remarks

Due to Covid-19, it is expected a massive increase of insolvency proceedings in the second semester of 2020 (by reference to the same period of 2019), mainly after the end of the economic incentive measures and in case of out-of-court arrangements are not fruitful.



In fact, three stages may be anticipated:

- A first stage, during which companies can take advantage of government support measures to continue to operate during the Covid-19 outbreak;
- A second stage, immediately after lockdown measures are mitigated and economic activity gradually begins to return to normal, where it is likely that companies seek for negotiating with their creditors to prevent immediate defaults by getting waivers and/or other restructurings of liabilities;
- A third stage, where government support measures have not been sufficient to remedy businesses' cash-flow difficulties and the entities are unable to reach immediate agreements with creditors. In this stage, there will be first an increased use of out-of-court recovering mechanisms (RERE and PER) and, if not possible, of insolvency proceedings with investigations into steps taken and transactions entered into, and potentially the use of the insolvency administrator's powers to challenge decisions/transactions and seek to recover value for the benefit of creditors.

Apart from the insolvency-related measures already taken by the Portuguese Government, it could be required to consider additional measures to allow businesses the chance to negotiate with their

creditors and reach arrangements without the risk of litigation, for instance, the suspension of creditors' rights to file for insolvency against companies affected by Covid-19, or, alternatively, to use a more stringent approach to allow insolvency initiated by creditors.

Certain restrictions to terminate contracts, as those applicable to commercial leases, could be eventually extended to other contracts, e.g. contracts for construction contractors and suppliers, tourism-related contracts, in order to provide businesses with relief from immediate cash-flow issues that are at risk of having to pay damages or having their assets seized.

Moreover, it is needed to redefine the voidable transactions regime in times of Covid-19 and include specific rules to be applied in this context in order to avoid the cashback of transaction carried out by businesses, whose financial situation has been deteriorated due to Covid-19, and distinguish this situation from those in which businesses are already insolvent before Covid-19. As this does not reveal an easy task, these measures should be subject to temporal limitations (e.g. three, six months) that can be then adjusted based on the progress of the pandemic.

Although the current and any future measures may provide companies with a valuable breathing space, they do not answer the structural economic challenges actually faced by companies affected by Covid-19: the existence of losses (due to fixed costs and lack of revenues) and lack of cash-flows.

Changes to out-of-courts remedies (possibly together with a more comprehensive package of legal, financial, and economic measures) may reveal crucial to avoid that distressed companies' situation (previously viable) are extended over time and without final creditors arrangements and ultimately leading to insolvency proceedings.

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