IN COVID AND BEYOND

RESTRUCTURING IN PORTUGAL

MACEDO VITORINO

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INTRODUCTION

In the current context of the coronavirus disease 2019 (Covid-19), it is likely that in the coming months several businesses will be unable to pay their debts due to severe cash-flow shortages. 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 are or have recently been in a complete stop.

According to official data, the sectors of tourism, non-food retail, automotive and components, textile/clothing, consumer durables, 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 likely suffer a reversal in the upward trend of their activity. Particularly, due to their high weight in GDP, the sectors 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 affect negatively their activity in the upcoming months.

Seeking to mitigate the economic impact of Covid-19, the Portuguese Government approved various 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 restructuring. Such measures were essentially designed to support financially distressed companies and prevent unnecessary insolvency of companies that in the ordinary course of events would be viable.

Regarding insolvency-related matters, under the 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 thirty days after knowing that the company became either insolvent or over-indebted, as detailed below.

Due to Covid-19, the Portuguese Government suspended temporarily the obligation of managing directors to file for insolvency, retrospectively from March 9, 2020 (the "suspension period"). Criminal penalties and civil liabilities for the managing directors breaching the obligation to file for insolvency were put off as well.

Suspensions on insolvency matters did not, however, apply to creditors, who remained entitled to file for insolvency.

In the Covid-19 pandemic context, enforcement proceedings – for example, acts relating to sales, creditors' ranking, judicial deliveries of property, attachments and their preparatory acts – were also suspended, except for acts that could pose a serious threat to the creditors' survival or whose non-performance could cause severe damage (such as pending insolvency proceedings filed prior to the Presidential Decree of state of emergency).

While preferred creditors might be tempted to file for a company's insolvency right away, it might 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 company's regular course of business and may hinder the chances of credit recovery, compromising the ability of the company to deal with suppliers and customers.

In these situations, an agreement might 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 on to their entitlement over the course of business.

During and in the short-medium term after Covid-19, it may be even more relevant to use out-of-court solutions. 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 increasing their distressful financial situation and ultimately their insolvency.

At the end of 2020, Law no. 75/2020, of 27 November came into force and introduced significant changes to PER, RERE and insolvency proceedings, in order to preserve the companies' viability.

Plus, this law determined that applications for the release of collateral or guarantees provided in the context of insolvency proceedings and PER, both in new and pending cases, have priority over other applications submitted in the context of these proceedings.

Finally, the said law created an Extraordinary Viability Process for Companies affected specifically by the pandemic (*Processo Especial de Viabilização de Empresas* or PEVE).

The purpose of this paper is to provide creditors and other stakeholders essential information about the existing Portuguese extrajudicial and judicial restructuring solutions for companies to face cash-flow difficulties due to Covid-19 and, particularly, after Covid-19.

1. 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 actual and future challenges.

The relief package includes: (i) EUR 5.2 billion euros in fiscal incentives; (ii) EUR 1 billion for 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 includes a procedure called "simplified lay-off", specifically aimed at keeping employment contracts.

The simplified lay-off may involve temporary suspensions of employment contracts or the 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% of 2/3 of the employees' gross salary up to EUR 1,905, for the duration of 1 month, which may be extended monthly for as long as the obligation to close the company remains (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 phase of normalization of the business activity (after the outbreak), companies that 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 salary payments.

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, provided with no interest; (iii) eligibility of the expenses incurred with, cancelled or postponed initiatives or events.

The Program "Capitalizar" Financial Facility – Covid-19 was created and gave EUR 400 million to support companies affected by the economic effects of the outbreak.

Until September 30, 2021, 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) the deferral of all payment obligations. The insolvency declaration of the landlord, the submission to a special revitalization proceeding or to the extrajudicial company recovery scheme shall not affect the lenders' rights.

To sum up, the measures taken 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.

2. RESTRUCTURING PROCEDURES

If a company has a sustainable business still, but current debts and additional losses caused by the Covid-19 crisis are preventing it from working normally, there are several extrajudicial and judicial options available before filing for an insolvency proceeding.

2.1. EXTRAJUDICIAL RESTRUCTURING SCHEME (REGIME EXTRAJUDICIAL DE RECUPERAÇÃO DE EMPRESAS – RERE)

RERE is an out-of-court mechanism laid down in Law 8/2018 of March 2, 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, are eligible for RERE.

Unlike 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 in the negotiation with creditors.

Creditors representing at least 15% of the total unsubordinated credits may, alongside 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 period of no more than three months from the deposit date, unless otherwise is agreed (assuming the debtor has not filed for insolvency or was not 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 the services on grounds of non-payment by the debtor;
- If the debtor meanwhile becomes insolvent, the time limit for the insolvency submission request starts only after the end of the negotiation period;
- The debtor keeps its business, but is prevented from performing acts of special relevance (as defined in CIRE), unless otherwise stated 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 payments to be made from available cash-flows.

A declaration from a statutory auditor, certifying that the debtor is not the subject of an insolvency proceeding 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:

- Debtor's credit rights and collaterals may only be 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 credits corresponding to at least 30% of the total unsubordinated liabilities of the debtor, that 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 seek to obtain the homologation 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 the approval of the restructuring agreement, the ending of lawsuits 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;
- Confidentiality;
- 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 to clear any liabilities that may accrue remains.

Since November 2020, the RERE is applicable to companies that are currently insolvent due to the pandemic.

2.2. 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

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[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.

PER must file a request before the court together with at least one creditor, accompanied by a statement of intent to enter negotiations.

After receiving the request and relevant documents[2], the court appoints a judicial administrator. The decision is published online and the debtor and creditors that did not join the initial request are notified. As from the date of the decision, all pending debt recovery proceedings against the debtor are suspended.

Creditors that were not part of the initial request are given twenty days to lodge their claims, and within five days the interim administrator issues a provisory list of credits. Any creditor may challenge the provisory list of credits within five business days after its publication in the official website. If the provisory list of credits is not challenged, it is considered final.

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

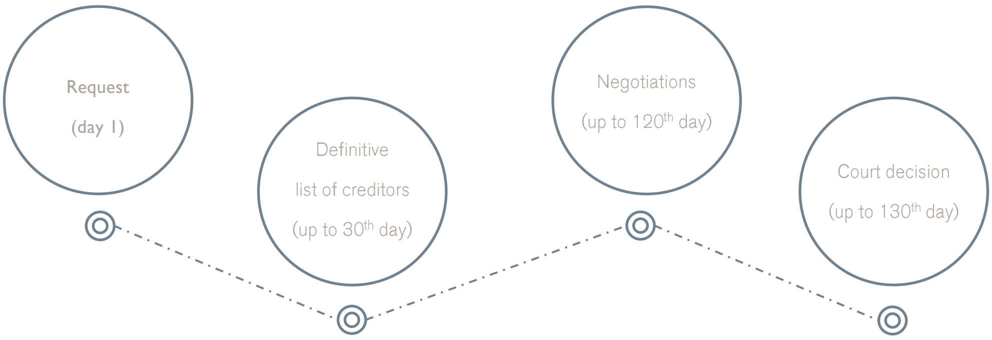
During the PER, the management bodies continue running the business, contrarily to what usually happens under an insolvency proceeding, where the management is normally cast aside. However, acts of special relevance – for instance, transfer of assets, entry into long-term agreements, assumption of obligations of a third party and provision of guarantees – 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 corresponding to unsubordinated credits. The recovery plan is endorsed by the court within ten days.

[2] Along with the request, several documents should be presented before the court, namely: (i) a 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.

In turn, if negotiations end without the approval of a recovery plan, the court may issue an insolvency order within three business days.



The court may refuse to validate the recovery plan in case the procedural rules set out in CIRE for its approval were not complied with or in case the debtor directly requests the court not to validate the plan on justified grounds. For example, if the debtor finds itself worse off if the plan is executed or if a creditor is unfairly 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, as a rule, file a second PER. 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 more than two years before, the company may start a new PER in the current Covid-19 context in 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 was already being defaulted, the company may already have been legally insolvent, and hence the filing of an insolvency proceeding should be sought.

The 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;
- The 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 – provide a lighter and agile alternative to the insolvency proceeding –, the debtor and the creditors must act in good faith, in a transparent and prudent manner and within a reasonable schedule.

It is important that companies considering PER a potential solution start planning immediately 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.

Finally, we highlight that since November 2020 the general privileges over movable property provided in CIRE are now applicable to partners, shareholders or any other specially related persons who finance the company's activity during the PER.

2.3. RERE OR PER, WHICH ONE TO CHOOSE?

The option between RERE or PER will depend on the debtor's situation at the relevant time. Both PER and RERE have similar goals, particularly, they are 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 eligible for RERE, which is namely not available for State-owned companies.

The starting of PER and RERE requires a joint request of the debtor and creditors representing at least, respectively, 10% and 15% of the total unsubordinated credits.

Despite PER being referred to as an out-of-court mechanism, the request is filed with the court, which intervenes at a later stage to ratify the recovery plan once agreed and approved by creditors, and a judicial administrator is appointed. PER is a public procedure, which means that it is not under a confidentiality duty.

Differently, in RERE the MoU is filed with the Commercial Registry Office. RERE is a fully out-of-court mechanism and, as a rule, confidential.

In both cases, the negotiation period of the restructuring agreement does not usually exceed three months, prorogation included. However, in PER this three-month deadline is a maximum deadline, after which PER ends if no recovery plan is agreed and a new PER cannot, as a rule, be submitted within the following two years. Differently in RERE, the three-month deadline may be extended if the debtor and the creditors agree so. If RERE terminates without the successful conclusion of a restructuring agreement, the debtor can initiate a new RERE at any time.

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

RERE is a better option for businesses aiming to partially restructure their liabilities and keep the restructuring confidential. In RERE, the restructuring agreement is freely agreed by the parties, contrarily to PER, where 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 and other debt collection proceedings, must choose PER.

Effectively, both PER and RERE suspend the insolvency proceedings (if the insolvency has not yet been declared) and the debt collection actions filed against the debtor. However, in RERE the debt collection actions 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. Distinctly, in PER all enforcement proceedings are automatically suspended during the negotiation period.

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 who finance the debtor's activity enjoy a general preferential claim with prior ranking over general preferential claims granted to employees; no preferential claims are 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, in order to bind all creditors, including those that have not signed the restructuring agreement.

In both cases, the law also provides for the same tax benefits on municipal real estate transfer tax (IMT), stamp duty and corporate income tax (IRC). However, while these tax benefits are automatic in PER, the same does not apply in RERE, where the restructuring agreement must 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 decide, upon debtor or creditors' request, that the restructuring agreement is 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 if they did not approve the recovery plan, which must be ultimately homologated by the court, and hence no confidentiality may be ensured. However, tax benefits are automatically applicable.

3. PEVE

PEVE is a proceeding that seeks the judicial homologation of an extrajudicial agreement to ensure the viability of a company, established (out of court) between the company and its creditors.

It was specifically created by Law No. 75/2020 of November 27, 2020, to secure the viability of companies affected by the COVID-19 containment measures, and that out of the pandemic scenario would be financially stable.

It is in force at least until December 31, 2021, and its lifetime may be further extended by Decree-Law.

PEVE is applicable:

a) To companies in a difficult economic situation or in imminent or current insolvency, provided that: (i) they are still viable; (ii) their assets exceed their liabilities as of December 31, 2019, and (iii) they are not under PER or insolvency proceedings;

b) To micro or small companies, even if on December 31, 2019, their assets were not in greater number than their liabilities, provided that: (i) they have received State aid funds that have not yet been repaid, or they are in a restructuring plan under the State aid measures; (ii) they are not in a pending PER or insolvency proceeding;

c) To companies that have managed to regularize their financial situation through RERE and filed the restructuring agreement in due time, while not having more assets than liabilities on December 31, 2019.

3.1. RELEVANT PHASES

PEVE begins with the filing of an application to court. This application must be accompanied by a viability agreement – signed by the company and by creditors representing at least the majorities of votes provided for in Article 17-F, paragraph 5 of 'CIRE' – and by a set of documents that are intended to prove the company's economic situation, including the list of the company's creditors and a declaration by the management body attesting that its situation was caused by the crisis brought by the COVID-19 pandemic and that it meets the necessary conditions for viability.

Once the application is received, the judge issues an order appointing the provisional judicial administrator. This order has the following effects:

a) It prevents the filing of judicial actions for debt collection and suspends pending actions with the same purpose. All these actions are extinguished if the viability agreement is homologated by court;

b) The company is no longer allowed to perform acts of special relevance without prior authorization of the judicial administrator;

c) Suspends pending insolvency procedures, which are extinguished with the judicial homologation of the viability agreement;

d) Suspends all prescription and limitation periods until the judicial homologation or refusal of the viability agreement; and

e) Prevents the suspension of essential public services, such as water, electricity, natural gas, or electronic communications.

Once the list of creditors is published, any creditor may challenge it and request the rejection of the viability agreement within fifteen days, based on the undue inclusion or exclusion of claims, incorrectness of the amounts or incorrect legal qualification of the recognized claims.

Upon receipt of the oppositions, the judge decides within ten days: (i) on the objections made; (ii) on the rejection or homologation of the agreement, considering the creditors' statements and the (non-binding) opinion of the provisional administrator.

The agreement must be homologated by the judge only if, cumulatively: (i) it complies with the majorities provided for in CIRE; (ii) presents reasonable prospects of ensuring the viability of the company; (iii) there are no other circumstances that justify a rejection.

The homologation decision is binding for the company, subscribing creditors and creditors included in the definitive list of creditors, even if the latter did not take part in the negotiations, regarding the credits constituted prior to the appointment of the provisional administrator.

Any creditor not included in the definitive list of creditors has thirty days to accede to the homologated agreement. The company is notified and has five days to accept or reject the inclusion of the creditor, the silence corresponding to non-acceptance.

If the court rejects the agreement, PEVE and all its effects are extinguished. This means that all actions against the company may be resumed, including actions that were suspended with the order appointing the provisional administrator.

3.2. DIFFERENCES BETWEEN PER AND PEVE

In comparison with PER, the distinctive notes of PEVE are essentially two:

(i) It is applicable to companies in a current insolvency situation (contrarily to PER, which is reserved to companies in a pre-insolvency situation);

(ii) It only applicable to companies which difficult economic situation, imminent insolvency or actual insolvency where specifically caused by the COVID-19 pandemic.

In what concerns the procedure, PEVE has many similarities with PER, with some differences justified by its own purpose – to avoid mass insolvencies caused by the COVID-19 pandemic – and by its exceptional and temporary nature.

PEVE is an urgent proceeding, with priority over other pre-insolvency and insolvency urgent proceedings, including PER and insolvency proceedings.

After filing the application, the company can request the joinder of other PEVE filed by companies in a parent-subsidiary or group relationship, if their proceedings are also at the preliminary stage. This possibility is not contemplated in PER regime.

Differently from PER, the rejection of the agreement is not subject to appeal and cannot, in any situation, be equivalent to insolvency proceedings application by the company.

3.3. INCENTIVES TO INVEST IN THE RECOVERY OF COMPANIES

Some of PEVE incentives to invest in a company's recovery are particularly interesting:

a) Transactions provided for in the agreement to raise the company's credit availability are not subject to resolution in favour of the insolvent estate, in case the company is declared insolvent after PEVE;

b) Creditors, partners, shareholders or any other persons especially related to the debtor who, in the extraordinary viability process, finance the company's activity shall enjoy a general privilege over movable property, ranked before the general privilege over movable property granted to employees.

4. INSOLVENCY

4.1. INSOLVENCY FILINGS

Broadly, insolvency is deemed to exist when the company becomes unable to fulfil the generality of its obligations as they fall due, does not pay one of its major creditors or defaults on an important contract putting 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 thirty days from the date they acknowledged this situation.

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

The temporary exemption of the duty to file for an insolvency proceeding 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 unable to sustain their business 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 said exemption does not mean that directors were released from a "business judgment rule" during the COVID-19 pandemic.

They remain obliged to act according 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, when the company is insolvent, directors are required to act in the best interests of creditors. Consequently, directors are bound to avoid any actions that are likely to reduce, frustrate, hinder, jeopardise, or delay payments due to creditors. If directors fail to comply with their duties, they will be accountable for any civil and criminal claims against them.

A company in an actual situation of insolvency is not obliged to file for insolvency in COVID-19 context, but continues to be prevented from using the pre-insolvency mechanisms RERE and 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 thirty days.

However, in the COVID-19 context, the company can deploy PEVE, specifically created to face financial difficulties generated by the pandemic containment measures.

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 is related 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 by any creditor, the court will give the company ten days to challenge the proceeding. This is the case for involuntary proceedings.

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

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

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[3] The petition is filed in the commerce court, which 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 only if the value of the insolvency proceeding is worth over EUR 5,000.

[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,

The declaration of insolvency prevents any debt collection actions from being filed against the debtor and suspends all pending proceedings, 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 intend to be paid with the proceeds of the sale of the company's assets must lodge their claims and provide evidence of their credits.

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

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

4.2. THE INSOLVENCY PLAN

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

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

Considering that the plan purpose is restructuring a company in financial distress, it may:

- Provide full or partial reduction of claims, in respect of both principal and interest, and alter the term of the credits and its interest rates;
- Favor the payment of claims that are subject to the solvability of the company and the full or partial payment in kind;

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assessing its financial viability and reviewing the restructuring measures that 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.

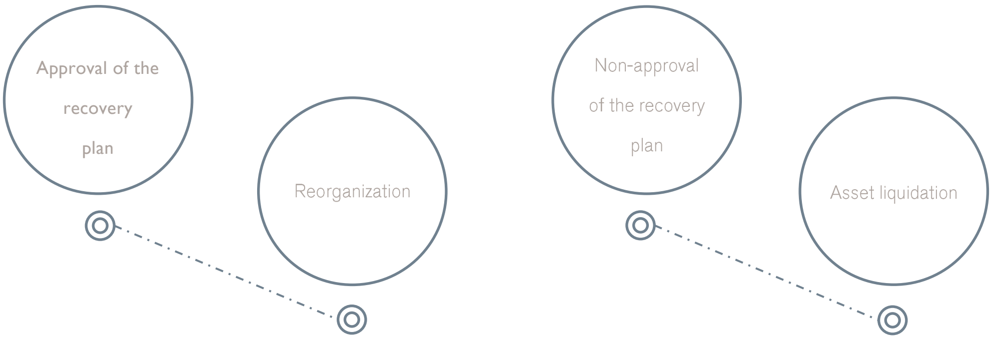
- Render the creation of securities or the transfer of assets of the company to creditors;
- Determine an increase or reduction of capital, amendments to the company's articles of association, its legal form or the composition of its corporate bodies.

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 favorable to the company or to 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/her claims;
- Any requirements regarding the submission of the plan were violated and such violation is not eliminated in a reasonable period.

The court notifies the 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 homologated by the court. However, the court's powers are limited to the assessment of its legal compliance. The court is not entitled to rule on the merits of the plan.

Contrarily to a rejection of a restructuring agreement within PER or RERE, if the recovery plan is rejected the only possible outcome is the liquidation of the company's assets to pay the creditors.

4.3. THE BUSINESS OF AN INSOLVENT COMPANY

The corporate bodies of the insolvent company remain in office during the proceedings. The resignation can only be accepted once the annual accounts are presented. Due to COVID-19, the deadline for the approval of the 2019 accounts was extended until June 30, 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 administrator and they can even continue to actively manage the company.

The court may, upon request, allow the board of directors to continue managing the insolvency estate, if a recovery plan presented by the petitioner is approved, proceedings are not expected to be postponed and no creditors are put into disadvantage.

For the court to trust the management of the estate to the insolvent company itself, it must consider that the financial distress was caused by factors other than the company's management and that the directors were not responsible for the insolvency situation.

When directors are authorized to 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 might require changing the recovery plan.

4.4. VOIDABLE TRANSACTIONS

The insolvency administrator can reverse any transactions considered detrimental to the insolvency estate that were entered upon by the 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.

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[6] The creditors' committee is a supervisory body appointed by the court which 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, records and other documentation of the company and request the insolvency administrator any documents or information regarding the insolvent. 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.

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

CIRE provides that if a company in financial distress pays its creditors and shortly after 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 when the creditor received the payment from the company had no reason to suspect an insolvency situation.

It is uncertain how creditors carrying out business with distressed companies during the COVID-19 pandemic will be able to successfully make out a defence to a voidable transaction claim brought by an insolvency administrator. This could have severe financial consequences for creditors and for the economy in general. If the insolvency administrator decides to void a transaction, the assets of the debtor that have been transferred or disposed 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 in case of clear bad faith by the third party.

A third party is in bad faith if it knew or could not ignore, at the time the contract was celebrated, that the debtor was insolvent, that the transaction would be detrimental to the financial situation of the debtor, or that the insolvency of the debtor was overtly imminent, or the insolvency proceedings were 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, not within 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.

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 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 shareholders' 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 a day-by-day proposition. Whilst the temporary relief measures are a welcome economic incentive at this time, they 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.

4.5. LIQUIDATION, RANKING AND PAYMENT OF CREDITS

In case of 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 can be qualified as secured (*créditos garantidos*), preferred (*créditos privilegiados*), subordinated (*créditos subordinados*) and unsecured (*créditos comuns*).

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 require the payment of any consideration by the creditor;
- Shareholder loans.

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

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.

4.6. CLOSING 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 is filed against it;
- The debtor so requests, and the creditors approve, in case the insolvency situation ceases to exist;
- The insolvency administrator infers that the available estate is insufficient to cover the costs of the proceeding and the remaining claims.

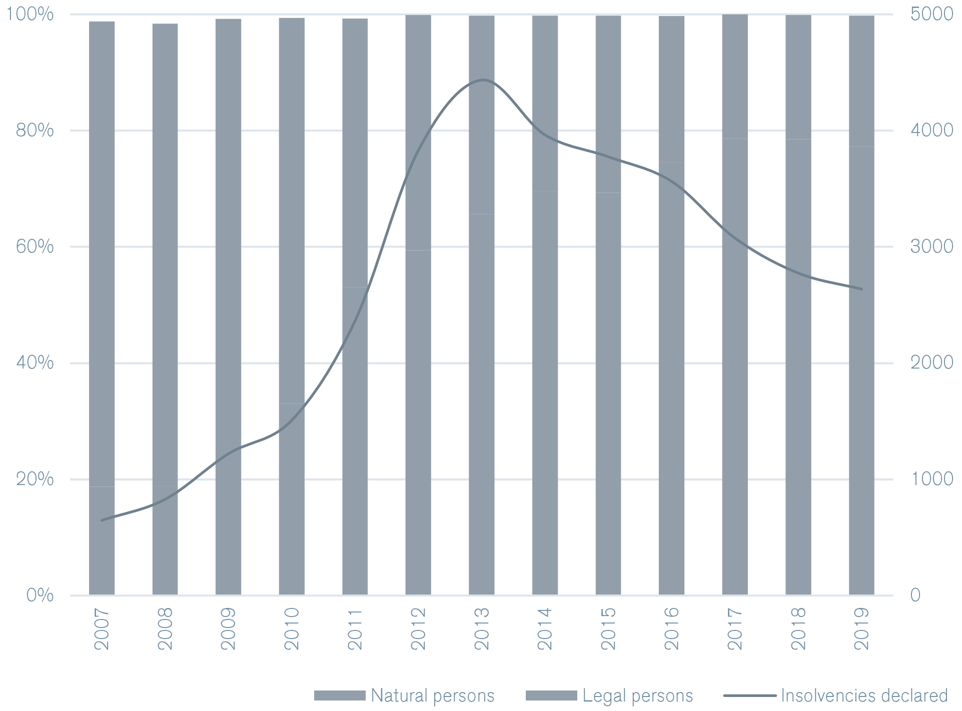
In general, once the closing of the proceeding is ordered, the company may either be dissolved or, in case of a successful restructuring, carry on its activity.

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.

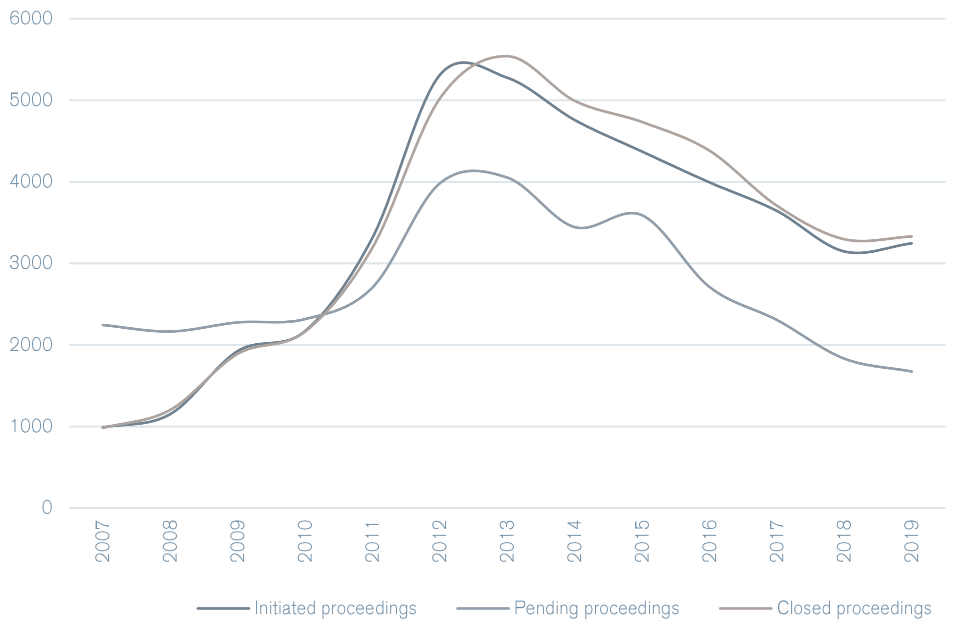
5. FINAL REMARKS

Due to the COVID-19 medium and long-term effects over the economy and companies, a considerable increase of restructuring and insolvency proceedings is expectable along the second semester of 2020, 2021 and 2022, mainly after the end of the economic incentive measures and in case out-of-court arrangements are not fruitful.

Source: DGPJ
Insolvency proceedings by type of person



Source: DGPJ



In fact, there are three stages:

- A first stage, during which companies can take advantage of government support measures to continue operating 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 increase on the 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, 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, the narrowing of the cases they can do so.

Certain restrictions to terminate contracts, as those applicable to commercial leases, could eventually be extended to other contracts, e.g. construction contractors and suppliers or tourism-related contracts, in order to provide businesses with relief from immediate cash-flow issues when at risk of 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 transactions 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 the pandemic. As this does not reveal to be an easy task, these measures should be subject to temporal limitations (e.g. three or six months) that can be adjusted according to the progress of the pandemic.

Although current and future measures may provide companies with a valuable breathing space, they do not answer the structural economic challenges faced by companies affected by COVID-19: the existence of losses (due to fixed costs and lack of revenues) and the 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 distressed companies' situations (previously viable) to be extended over time, ultimately leading to insolvency proceedings.

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