NEGOTIATING A CORPORATE RESTRUCTURING

BE PREPARED. BE INVOLVED. BE RESOLUTE.

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Seven tips for negotiating a corporate restructuring.

The main purposes of Portuguese insolvency are to promote the rehabilitation of insolvent businesses through restructuring and, when that is not possible, to provide the best possible satisfaction of the creditors through the liquidation the company's assets.

The Portuguese insolvency code is among the most advanced insolvency laws in Europe and the world. According to the World Bank's report "Doing Business 2015", Portugal ranks in 10th place in the world (4th in the European Union) on ease of resolving insolvency, which measures the speed, cost and recovery rates in insolvencies in 189 countries.

In this publication we provide practical advice to companies and creditors to help them in a Portuguese corporate insolvency procedure and to negotiate a business restructuring. Here are a seven tips for negotiating a corporate restructuring in Portugal:

1. Before filing to the insolvency always obtain a reliable financial analysis and consider your chances of recovery in a restructuring liquidation proceeding.
2. Be prepared. Be sure to have a reliable resolvability analysis of the company to calculate all the financial repercussions. Be sure that there is a legal basis for having the company declared insolvent.
3. Evaluate your position. Confirm your credit ranking and those of other creditors and try to evaluate your position among the creditors and other stakeholders.
4. Be available for an out-of-court composition. Do not rely on your legal position and do not put a company into insolvency without exhausting all possibilities of an out-of-court arrangement. If an out-of-court arrangement is not possible, try to enter into a Portuguese "revitalization" arrangement.
5. Be involved.. Be involved in the decision-making process, seek to be appointed to the Creditors' Committee, which is in charge of overseeing the restructuring procedure. Be proactive in the restructuring negotiations with the other creditors and the company.
6. Be vigilant.. Create a direct line with the Administrator. Evaluate critically each of the steps taken by the Administrator to ensure that the process is managed in a proper and efficient manner.
7. Follow the liquidation closely. Make sure that assets are sold for fair consideration.

Be prepared.

Be sure to have a reliable resolvability analysis of the company to calculate all the financial repercussions.

It is not possible to draw up a strategy for a restructuring without a reliable resolvability analysis of the insolvent company. To do so, you should review all available information on the company and the current state of the business sector, identify the reasons and nature of the distress situation and try to get an accurate picture as possible of the company's prospects and potential value. Ultimately you will need to answer the question: does the company have inherent value?

This analysis should be made by your financial advisors with the input from lawyers on the legal issues regarding the ranking of creditors and potential pitfalls of an insolvency procedure.

If you conclude that the company does not have inherent value and there is no prospect of emerging from insolvency, the only available option could be to liquidate it. To understand how this affects your options, you will need to know if the company has assets that can be sold in the market and if your chances of recovering all or part of your claim in a liquidation scenario, bearing in mind the ranking of your claim in the event the company is put into insolvency, the size of debt ranking above you and with the same ranking as you and the value of its assets.

Be sure that there is a legal basis for having the company declared insolvent.

Before you decide to petition the insolvency of a debtor, you should bear in mind that mere payment delays may not be enough for a company to be declared insolvent. The court will only declare a company insolvent if it does not own sufficient assets to meet its obligations or is not able to comply with most of its obligations as they fall due.

As a rule, the insolvent company's management must file for insolvency within 60 days from the date it became aware of the insolvency situation but management tries to avoid file for insolvency as much as they can. Many times courts do not pursue management for failing to seek creditor protection in a timely fashion. As a result, the petition for insolvency is delayed to the point when creditors have no other choice than filing for insolvency.

In general, creditors may petition the insolvency if the company has suspended payment of its outstanding obligations, has failed to pay one or more of its main obligations, which evidences that it is no longer able to comply with most of its obligations as they fall due (for instance failure to repay significant loans or one or more of its main suppliers), its tax or social security obligations or to pay its employees' wages for 6 months. Insolvency can also be declared if its debts are manifestly greater than its assets or the company fails to approve and deposit its annual accounts for more than 9 months.

Evaluate your position.

Confirm your credit ranking and try to evaluate your position among the creditors and other stakeholders.

Try to gather all the information about what would be your position in a possible insolvency as well as that of other creditors. This is a key point because it will determine your strategy. In general, creditors are ranked in the following order:

- Secured claims (*créditos garantidos*), which are guaranteed by collateral over some or all of the company's assets;
- Preferred credits (*créditos privilegiados*), which entail a legal preference on the company's assets;
- Unsecured or common credits (*créditos comuns*), which do not benefit from any security or preference; and
- Subordinated credits (*créditos subordinados*), which are legally or contractually subordinated.

Equity holders rank below everyone else but they may have some know-how and inherent value and should be considered.

Secured credits enjoy several privileges: they are paid ahead of other creditors, they can block the restructuring of the company when they are not to be paid in full and they have a right of first refusal in relation to a sale of the company's assets given to them as collateral.

When the number of secured credits and the value of the secured claims is substantial, the possibilities of unsecured creditors recovering their claims are low but they still have an important say in the approval of the restructuring plan.

Subordinated credits have little chances of recovery but they may leverage their rights and try to block a restructuring and force the liquidation. Subordinated claims may only have in nuisance value but sometimes their position may be critical to ensure a successful restructuring. Hence the need to know:

- The number and value of secured claims in relation to unsecured creditors;
- The value of your claim in relation to other secured and unsecured credits; and
- The value of subordinated credits and if they would enjoy any rights in the insolvency.

Be available for an out-of-court composition.

Do not rely on your legal position and do not put a company into insolvency without exhausting all possibilities of an out-of-court arrangement.

If you are a secured creditor you may be tempted to put the company into insolvency relying on your status as a preferred creditor. However, you should be aware that the mere declaration of insolvency will have a negative impact on the business and your ability to recover your credit, as it will demoralise staff, compromise the company's ability to deal with suppliers, who are naturally concerned with the ability to recover past claims and could refuse to pay future orders, and with customers, who fear the company may not deliver in time or not be in business at some point.

For these reasons you should explore all forms of out-of-court arrangements even when to reach an agreement you need to compromise and waive part of your claim or delay payment.

Many times an agreement cannot be reached because the parties stand to their positions. Secured creditors do not want to see equity holders or secured credits receive anything before they are paid. Unsecured creditors want to leverage their rights. Equity holders tend to hold to their "nuisance value" and feel some entitlement to the business which they built over the years and, sometimes, passed on from one generation to another.

If an out-of-court arrangement is not possible, try to enter into a Portuguese "revitalization" arrangement.

The so-called "revitalization procedure" is a form of scheme of arrangement negotiated by the creditors and the company which is sanctioned by the court. The revitalization procedure is faster than a formal insolvency procedure and allows for a majority of the creditors to impose haircuts on all claims.

The procedure is initiated by the company and at least one of its creditors. The remaining creditors have 20 days to file their claims. The company and its creditors will have up to three months to enter into an arrangement.

During this period, the company will continue to be run by its management board, pending court proceedings will be suspended and other creditors will not be allowed to petition the insolvency.

The "revitalization" procedure always requires the intervention of the insolvent company, which will try to use its position to control the outcome of the restructuring. Sometimes expectations of shareholders and managers are too high and no agreement is reached. If an agreement is reached it will bind all creditors, including those who did not sign up to it.

Be involved.

If insolvency has been declared, you should confirm the ranking of your claim and review other claims.

Once the insolvency is declared, creditors have up to 30 days to file their claims. The Administrator will then issue a list of recognised claims and rank all claims. It is important to review the list of recognised claims and all documentation filed by the creditors. A wrong list of credits can seriously damage your position.

You have the opportunity to oppose to claims within 10 days following the term for the Administrator to issue a list of recognised claims to verify and rank credits. This is a very important instrument that should be used to protect your claim by not allowing unsubstantiated claims to dilute valid claims.

The report of the Administrator should also provide sufficient information for you to confirm if the business can survive the insolvency or should be liquidated. The report should contain information regarding: (i) the financial conditions of the company, (ii) the possibilities of continuation of the business, (iii) the feasibility of a restructuring and how each creditor is likely to be affected, (iv) a list of the company's assets and (v) a list of all the creditors who claimed credits. A careful review of the report should allow you to figure out your relative position in the process and your chances of recovery and help you to draw up a strategy.

Be sure to have a clear strategy that suits your goals when participating in the Creditors' Meeting. Seek to be appointed to the Creditors' Committee if you can.

The Creditors' Meeting is of key importance in the insolvency because it is the body that will ultimately decide on whether the company will be restructured or liquidated. The Creditors' Meeting is also called upon by the court to issue its opinion on the main steps of the insolvency and has the power to replace the court appointed Administrator.

All creditors are entitled to attend the Creditors' Meeting, which may be called by the court, the Administrator or at least 1/5 of the unsubordinated credits. The subordinated credits could not however vote in the Creditors' Meeting, except as to the approval of the restructuring plan. The main rule of the vote is one vote for each €.

In many cases, generally for larger insolvencies, the court will invite the Creditors' Meeting to appoint a Creditors' Committee. The main role of the Creditors' Committee is to supervise the actions of the Administrator. The Creditors' Committee will also be called to advise the court in some of the steps of the procedure. Usually, the major creditors will be appointed to the committee.

Whether you are a secured or unsecured creditor, small or large, it usually pays off to be appointed to the Creditors' Committee, as this will give direct access to information and the right to intervene at all the main steps of the procedure.

Be vigilant.

Create a direct line with the Administrator.

This will allow you to follow and influence the process, as the Administrator has a wide range of powers regarding the insolvent company and has a duty to perform its powers with regard to the creditors' interests.

The main role of the Administrator is to assist the company and the creditors to restructure the company or to supervise its liquidation, as the case may be.

The Administrator is empowered to take all actions necessary for the management of the affairs, business and property of the company. Among other things, the administrator may take any urgent measures that are needed to protect the company's assets, including suspending and/or restricting the company's management or submitting any contracts and other actions to his prior approval. The Administrator can cause the company to continue or cancel existing contracts with third parties (e.g. clients and suppliers).

The Administrator is also responsible for presenting a restructuring plan if requested by the Creditors' Meeting (although this does not prevent creditors from proposing alternative plans) and for organizing the liquidation of the company when the restructuring is not possible.

Follow the Administrator's actions closely.

The Administrator must have the requisite skill level and experience needed to preserve the economic value and business of the company, if any.

The Administrator is randomly chosen by the court from a public list, although the court may follow the suggestion of the creditors petitioning the insolvency.

Many administrators do not however have the skills, time or the resources to handle large and complex insolvencies, so creditors should follow his/her actions closely and offer their aid if need be. In most cases, appointing advisors to help the Administrator could be advisable.

In some cases, the dismissal of the Administrator for lack of ability to perform his duties has to be considered. The actions of the Administrator are under control of the court, which may, at any time, require the Administrator to provide information on the company.

The court, upon request of any creditor or group of creditors, may dismiss for cause the Administrator and appoint another.

Consider your options.

Generally the restructuring plan is negotiated by the main creditors of the company with the sufficient votes to impose their will over that of smaller creditors. This is done because the fewer the number of people needed to approve the plan the easier it will be to negotiate it and control the outcome.

The position of each creditor will depend on the value of its claim and its ranking among the creditors. Smaller creditors tend to have little say in the negotiation of the plan but some of their votes may be critical to reach the statutory approval majorities.

This means that larger may need to get the votes of smaller creditors to get the approval of the plan. This may be done by offering the creditors of a particular ranking a better deal or by acquiring some of the smaller claims to reinforce their position.

There are merits and risks involved in any of these options but ultimately this is the critical point when creditors decide if and how they wish to restructure the company or put it into liquidation.

The plan may also be proposed by the insolvent company, but this only happens when the equity holders can contribute to the restructuring of the company through the investment of new money. In most cases, the Administrator is invited by the creditors to present the plan which is negotiated among them.

Any creditor or group of creditors which represent at least 1/5 of the unsubordinated credits may also present a plan but there is no point in doing this if there are no chances of getting such plan approved.

Once the Administrator or leading creditors believe that they have a plan that will be approved they request the court to call a meeting to discuss and vote it. During the meeting the plan may be changed. The final version of the plan will then be put to a vote. To be approved the plan needs to get the votes of at least 1/3 of the total credits with right to vote and 2/3 of the credits present and provided that at least 1/2 of the votes approving the plan are unsubordinated creditors.

Following the approval of the plan, the court will review and confirm that it complies with the law. The court may not, on its own accord, veto a plan on the basis of its merit, as the court only verifies the legality of the plan approved by the Creditors' Meeting, *i.e.* if the plan was approved by the required number of votes and complies with the principle of equal treatment within each ranking, which voids the possibility of offering a better deal to a single or a group of creditors to obtain those votes.

The court may also reject the plan which has been approved by the Creditors' Meeting if such plan violates any procedural rules or other applicable rules, regardless of their nature, or the conditions set out in the plan are not verified and the measures that should have been engaged are not implemented.

Influence and negotiate.

The restructuring plan describes the financial situation of the company and the measures that will be implemented to ensure the recovery of the creditors' claims, which may include the restructuring, the sale of the company as a going concern and the sale of certain assets.

The plan may also contemplate other changes to the organization of the insolvent company to purchase their claims. These changes may include (i) an equity reduction to cover past losses, (ii) equity increases to be subscribed by new investors, (iii) the amendment to the company's articles of association, (iv) the change of the company's legal form and (v) the replacement of the company's corporate bodies.

Specific measures of the plan that affect creditors may include: (i) haircuts to the claims, (ii) the payment of claims subject to the future financial situation of the company, (iii) the modification of the term of loans and other term debt obligations and/or their respective interest rates, (iv) the granting of new securities, (v) the conversion of debt into equity, (vi) the payment in kind of the creditor's claims or (vii) the sale of certain assets to creditors.

It is likely that the plan will not allow you to recover your credit in full unless you are a secured creditor when that is more common but not always the case. A haircut on debts is generally a condition for the restructuring of over-indebted companies.

Haircuts may affect creditors of the same ranking irrespective of whether they are financial creditors or suppliers. The only way to offer a better deal to those suppliers, which the new owners of the company consider essential to ensure the recovery of the company post-insolvency, will be to acquire their claims for a higher consideration than their market value or expected recovery rate.

Of course, such arrangements cannot breach the principle of equal treatment, so they need to be made outside of the insolvency procedure and cannot be tied to conditions in the plan that end up by prejudicing other creditors.

As mentioned above, the court will not rule on the merits of the plan. However, dissatisfied creditors that voted against the plan may seek to block the court's confirmation of the plan if they present evidence that (i) the plan is less favorable to the company and/or its creditors than the situation would be if the plan was not approved, (ii) the plan gives one or more creditors benefits that are higher than the value of their claims, (iii) the plan breaches the principle of equal treatment of creditors and (iv) the plan was approved in breach of the formal or material requirements regarding the submission of the plan.

After the approval and registration of the plan, the company's old debts will be deemed discharged subject only to the terms and conditions of the plan.

Follow the liquidation closely.

If no restructuring plan is approved, the company will be put into liquidation by the Administrator.

Liquidation means converting the company's assets into cash and then distributing the proceeds of the sale to creditors. Then, the company is dissolved and removed from the records.

The liquidation of the company should be concluded within one year from the approval of the Administrator's report detailing the financial situation of the company. This deadline can be extended by the court for further six months if there are reasons to do so (for instance, delay in approving a restructuring plan, provided that this plan is more beneficial to the company than the liquidation).

The liquidation itself is a complex procedure where the Administrator has to take several steps starting with the valuation of the assets and the choice of the method of sale.

The preferred method of liquidation is the sale of the company's estate as a going concern. The sale of individual assets may only be chosen when no satisfactory proposal for the estate has been obtained or can be obtained or such sale of individual asset or assets is more advantageous to the creditors. The sale must be approved by the Creditors' Committee and, when no Creditors' Committee has been appointed, by the Creditors' Meeting.

All secured creditors must be informed about the form of the sale and the base value set for the assets.

As secured creditors enjoy preference rights in relation to the assets that were given as collateral to their claims, they may also force the Administrator to take a third party offer for any of the company's assets if such offer is higher than the price set by the Administrator.

As a secured or common creditor, you should keep up with each step of the liquidation and be prepared to take action when the rules are not complied with and there is a risk of assets being sold below their market price.

After the sale, the Administrator will deposit the proceeds of the sale in a bank account, which may only be moved by the Administrator and/or by a member of the Creditors' Committee specially empowered to do so.

It may be the case that the company will be kept in operation (on a limited basis) during the liquidation procedure. In those cases, consent of the creditors will be needed for the sale of assets or shares in subsidiaries that are essential to the operation of the company as well as for the acquisition of supplies or the entry into new agreements.


ABOUT US
our corporate
restructuring practice

Our corporate restructuring practice.

In today's competitive global market, Macedo Vitorino & Associados can provide a comprehensive commercial and corporate law advice to domestic and foreign clients. We have strong relationships with many of the leading international firms in Europe, the United States and Asia, which enable us to handle effectively cross border transactions.

The international legal directory "The European Legal 500" ranks Macedo Vitorino & Associados among Portugal's leading commercial law firms in thirteen of the eighteen reviewed areas, including in banking and finance, capital markets, project finance, tax, real estate, telecoms and litigation.

IFLR 1000 ranked Macedo Vitorino & Associados in all of its league tables for Portugal, including project finance, corporate finance and mergers & acquisitions. Chambers and Partners mentions us in banking, corporate and dispute resolution among other areas.

Our corporate restructuring practice is well known in the market. We have been involved in several high profile cases and have a deep knowledge of insolvency legislation.

Many times, creditors and distressed companies alike take too long before filing for insolvency from creditors, fearing that procedures are too lengthy, too costly and too unpredictable. To avoid or mitigate these problems, clients need reliable legal advice and a business oriented approach. An informal workout may be preferable to an insolvency procedure but companies must be ready to take speedy and resolute action to protect their interests.

We represent both creditors and distressed companies in:

- Formal and informal workouts
- Restructurings
- Insolvency procedures

If you want to find out more about Macedo Vitorino & Associados please visit our website at **www.macedovitorino.com**

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