

Portugal's restructuring and insolvency paradox

While the economic outlook is a positive one for Portuguese businesses, **Filipa Cotta** and **Catarina Carvalho Cunha** of **Vieira de Almeida** find that pandemic hangovers are contributing to a predicted rise in corporate distress



In a report which was made public in May 2023, the IMF reviewed its 2023 GDP growth predictions for Portugal at 2.6%. This is just after it had predicted a growth rate of 1% in April (in itself, a leap from the projections made in October 2022 which set growth at 0.7%). According to public sources, these predictions are based on an analysis of the country's economic performance in 2022 and the first quarter of 2023.

These economic results are driven by the staggering increase in exports in the services sector (with the tourism sector at the helm). Again, according to publicly available data, in March, exports in the service sector had risen 31%, whilst imports only 14%. Goods exports on the other hand rose by 19%, with the imports growing at a 9% rate.

However, in May, the number of insolvency filings increased by 7% (when compared to the same period last year) and, very recently, Allianz Trade predicted insolvency filings to continue to rise by 19% in 2023. How many of these insolvencies will allow for in-court restructurings and how many in-court restructurings will result liquidation is difficult to forecast yet. Notably, the insolvency and restructuring practice in the country shifted largely from 2011 onwards to meet the Portuguese legislator's strong incentive to restructure companies whilst they are still solvent. Consequently, and whilst the relevant practice is still constantly employed by clients in insolvency-related matters, it has shifted in recent years to focus on assisting clients in



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Catarina's work is focused on civil litigation and international and national commercial arbitration matters, as well as corporate restructuring and insolvency. She advises clients with disputes in Portugal and the Portuguese-speaking jurisdictions Angola, Mozambique, Guinea-Bissau, Cabo Verde, São Tomé and Príncipe, and East Timor. Catarina's work also extends to the countries of the Organization for the Harmonization of Business Law in Africa.

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restructuring their businesses and staying afloat. The result is that companies are nowadays much more aware of the mechanisms available to them to reach these goals and avoid insolvency or liquidation.

While economic difficulty is partly due to the war in Ukraine and the successive lockdowns in China, (which affected supply chains and relevant prices of raw materials and energy and deepened inflationary pressures, causing interest rates to soar) during the pandemic, companies in Portugal were not only granted moratoriums and state aid in other forms, but were also made exempt from the legal duty to file for insolvency when in a de facto insolvent situation.

Under Portuguese insolvency law, management bodies are under a general duty to file for insolvency within a 30-day period from the date they acknowledge (or could not ignore) that the company is legally insolvent. For legal entities there is a presumption that such knowledge exists

when, for three months, the entity has failed to meet certain obligations such as tax or rent.

In fact, statistics show that during the pandemic the number of insolvencies dropped, and companies that would otherwise have been adjudicated insolvent, kept going.

Legislation and policy

The corporate restructuring and insolvency regime in Portugal is framed under the following legal statutes:

- Insolvency and Company Recovery Code: enacted by Decree-Law no. 53/2004, dated March 18 (as amended over time), on recovery and insolvency judicial proceedings, which encompasses the special recovery proceedings (*Processo Especial de Revitalização* – “PER”), established by Law no. 16/2012, dated April 20, 2012;
- Extra-Judicial Regime for Corporate Recovery (“RERE”), enacted by Law no.

8/2018, dated March 2, 2018, providing a specific legal regime for out-of-court recovery agreements;

- Regulation (EU) 2015/848 of the European Parliament and of the Council dated May 20, 2015, on insolvency proceedings;
- Decree-Law no. 199/2006, dated October 25 (as amended over time), governing the liquidation of credit institutions and financing companies with headquarters in Portugal and their subsidiaries incorporated in another member state;
- Decree-Law no. 227/2012, dated October 25 (as amended over time), which
 - a. Foresees principles and rules to be observed by credit institutions when preventing and standardising situations of non-compliance with credit agreements by banking customers; and
 - b. Creates the extra-judicial network to support those customers in the standardisation of those situations;
- Law no. 147/2015, dated September 9 (as amended over time), which sets out a specific regime applicable to the recovery of insurance and reinsurance companies; and
- Commercial Companies Code: enacted by Decree-Law no. 262/86, dated September 2, 1986.

The legislation created for helping companies navigate the Covid-19 pandemic ceased to be in effect via Law no. 31/2023 dated 4th July. This means that the PEVE (*Processo Extraordinário de Viabilização de Empresa*), an extraordinary procedure put in place to enable companies to react to the pandemic, aimed at allowing for a simpler and faster restructuring, is no longer in effect. Recently, at the beginning of July, the suspension of the legal obligation to file for insolvency by companies' management bodies was lifted. Now again, management bodies are under a general duty to file for insolvency within a 30-day period from the date they acknowledge (or could not ignore) that the company is legally insolvent. This should impact the number of in-court restructurings and insolvencies soon.

The proposal for a Directive of the European Parliament and of the Council, harmonising certain aspects of insolvency law, if adopted, will have a major impact on insolvency proceedings in Portugal.

Besides other relevant modifications, the introduction of the pre-pack regime would be significant, as it is generally considered to be effective in recovering value for creditors.

In a pre-pack procedure, the sale of the debtor's company (or part of it) is prepared and negotiated before the formal opening of insolvency proceedings. This allows the sale to be executed and the proceeds to be realised as soon as the formal insolvency proceedings to wind up the company have been opened.

This proposal includes several safeguards to ensure that potential buyers are contacted and that the best possible market value is obtained as a result of a competitive sale process. These safeguards provide member states with a choice between ensuring competition, transparency, and fairness of the sale process in the (generally confidential) "preparation phase" and holding a rapid public auction after the opening of formal proceedings in the "liquidation phase".

Cramdowns

The EU Directive was transposed to Portuguese Law by Law no. 9/2022, in force since the 9th April 2022. One of the mechanisms introduced was the cross-class cramdown, via which a restructuring plan in the context of the special revitalisation proceedings (PER) may, at the court's discretion, be imposed on an entire class of creditors. It is viewed as a key mechanism to allow for the sanctioning of non-consensual plans (plans that are not approved by all creditor classes) by the court.

The rule for these situations, in which creditors have been divided into categories, is that the restructuring plan be voted on favourably, in each category, by at least two thirds of the issued (not considering abstentions), obtaining:

- a. The favourable vote of all formed categories;
- b. The favourable vote of the majority of all categories formed, so long as at least one category comprises secured creditors;

- c. Should there be no categories of secured creditors, the favourable vote of one of the formed categories is accepted, so long as one of the categories pertains to non-subordinated creditors; and

- d. In case of a draw, the favourable vote of at least one category of non-subordinated creditors.

The EU Directive also aims to significantly strengthen asset tracing. This proposal provides insolvency practitioners with the possibility to perform in other member states the powers conferred on them by the law of the member state where the main insolvency proceedings were initiated and where they were appointed.

The specific rules proposed focus on access by insolvency administrators to various registers containing relevant information on assets that belong or should belong to the insolvency estate. Some national electronic registers are public or even accessible through interconnection platforms created by the EU, and member states would be obliged to provide non-domestic insolvency practitioners with direct and quick access to the registers.

To this end, member states designate the insolvency courts in their territory that will have direct access to centralised automated mechanisms, such as centralised bank account registers or electronic data retrieval systems, facilitating the entire process of obtaining information.

While the Directive also provides a strengthening of the representation of creditors' interests in proceedings through creditor committees, this has not yet been implemented in Portugal. But, as a rule in Portugal, the performance of certain acts that are relevant to the insolvency estate requires the consent of the creditors' committee (if it exists) or of the creditors' assembly (i.e. the sale of company). The sale of the company's assets is carried out by the insolvency administrator. However, secured creditors must be heard on the sales covered by their guarantees and may propose that the relevant assets be acquired (for

themselves or a third party) at a price higher than the one set.

Relevant matters

One of the most significant recent restructuring transactions was related to the insolvency proceedings of the main Portuguese handling company, Groundforce (SPdH – Serviços Portugueses de Handling). The company was instituted in 2003 during the privatisation of the land assistance services of the Portuguese airline company TAP Air Portugal, the latter having asked the court to adjudicate Groundforce insolvent in 2021.

After a competitive M&A process with other major international major players, Menzies Aviation succeeded in reaching an agreement to purchase Groundforce. However, the plan's success is highly contingent on Menzies reaching a consensus with the unions representing the company's employees and the approval of all the relevant creditors.

Res judicata of the insolvency decision was finally obtained and the insolvency receivers, with the approval of TAP and Menzies Aviation, can submit a plan to be voted on by the creditors, that will enable the company to resume business.

In terms of key market trends, the strong appetite for foreign investors to come and play a significant role on the market stands out. Due to the lack of liquidity in the Portuguese market, foreign investors are taking advantage and securing an increasingly strong position in the Portuguese economy.

Final thoughts

The most common misconception that we are still faced with as insolvency practitioners in our jurisdiction is the idea that only people who are absolute failures file for insolvency. Although mitigated in the last decade, there is still a considerable stigma linked to insolvency, and often directors would prefer to inject personal money and make emotional decisions to keep going rather than face insolvency.