INSOLVENCY
UNDER THE INSOLVENCY CODE AND CORPORATE RECOVERY ("CIRE")

Background

A company is in a state of insolvency whenever it is unable to meet its obligations ("***cash flow criteria***") or whenever its assets are insufficient to satisfy its liabilities ("***balance sheet or assets criteria***").

The insolvency proceedings runs on a court of law and aims to satisfy, by the most efficient way, creditors' rights. This satisfaction can be reached in the manner provided in an *insolvency plan*, which will be based on the recovery of the debtor one the one hand or, on the other hand, by the liquidation of its assets and the distribution by the creditors.

Under the CIRE:

(i) Any company in distress (the "Insolvent", "Debtor"), i.e., unable to meet its obligations or whenever its assets are insufficient to satisfy its liabilities, must file before the court for the opening of insolvency proceedings within 30 (thirty) days following the date it becomes aware (or should be aware) of the insolvency status.

Failure to comply with this duty may result in penalties. Under the CIRE, there are grounds on which managers or directors (including shadow or "de facto" directors) can face penalties for breaching their legal duties. Under more extreme circumstances, the directors may be subject to criminal penalties if they have, in any way, defrauded creditors and/or fraudulently contributed to the insolvency of the company.

(ii) The opening of insolvency proceedings may also be filed by third parties, notably creditors and the Public Prosecutor (Ministério Público).

(iii) Should the filing be submitted by the Debtor, the insolvency should be immediately declared by the court, within 3 (three) business days from the date in which the procedure is distributed to the judge.

(iv) In case the filing is submitted by a creditor or the Public prosecutor and there is no reason for immediate dismissal, the Debtor is notified in person and shall have a 10 (ten) day period to oppose the insolvency request. Certain protective orders may be approved by the court, including the appointment of a temporary insolvency administrator.

(v) Should the Debtor oppose the filing or in those cases where hearing of the Debtor is waived, the judge will schedule a court hearing, following which he will declare the insolvency or dismiss the filing.

(vi) From the moment in which the insolvency has been declared, the Debtor's powers to manage its own assets are transferred to an insolvency administrator (the "Insolvency Administrator") appointed by the court. The Insolvent directors may continue in office but they will not have, as a general rule, powers to manage the company.

(vii) The Debtor's creditors, including secured creditors, shall claim their credits. The Insolvency Administrator will organize a detailed list of recognized or admitted creditors with their relevant positions. This list can be challenged before the court.

(viii) Subsequently, a creditors meeting would be held to decide whether the Debtor should be put into liquidation or there should be composition (plano de insolvência) with a view to working through the financial issues within the company. In the case of a composition, a second meeting will be held to approve the composition.

(ix) **The detrimental actions - unconditional clawback (*assumption iuris et de iure*)**

The law defines as detrimental, and consequently able of being clawbacked, some acts performed in certain periods of time before the beginning of an insolvency proceedings. Within these detrimental actions are included:

(a) non onerous transactions executed by the debtor during the period of two years prior to the date of beginning of the insolvency proceedings;

(b) granting by the debtor of guarantees in rem in relation to pre-existing obligations or other guarantees which have replaced them, during the period of six months prior to the date of beginning of the insolvency proceedings;

(c) personal guarantees (e.g. sureties) which the debtor has granted during the six months prior to the date that the insolvency proceedings began and which do not relate to transactions with a real interest for the Insolvent;

(d) granting of security "in rem" simultaneously with the constitution of guaranteed obligations within sixty days prior to the opening of the insolvency proceedings

(e) onerous acts carried out by the debtor within the year prior to the beginning of the insolvency proceedings in which the obligations undertaken by the debtor clearly (significantly) exceed those of the counterparty.

There are no further requirements other than the nature of the act, meaning that the good/bad faith of the counterparty or the status of the insolvent on the date the act is performed is irrelevant.

In case of bad faith of the counterparty (as such concept is described below), detrimental actions can be further clawbacked under the general rule (the conditional clawback) even if performed before the above referred periods of time, but no more than two years before the insolvency proceedings had started.

Clawback takes place by means of a recorded delivery letter (carta registada com aviso de recepção) sent by the Insolvency Administrator within 6 (six) months upon becoming aware of the relevant act but in no event after 2 (two) years following the date of the declaration of insolvency by the court. Whilst the transaction is not fully performed clawback can be declared at any time.

Upon clawback being declared by the Insolvency Administrator, the claimant would need to claim his credit against the insolvency estate as an unsecured creditor (credor comum), which shall be satisfied on a pro rata basis. Should the clawback be based on the bad faith of the claimant, the relevant claim is deemed subordinated.

(x) **General rule - the conditional clawback**

Under the general rule the insolvency administrator is entitled to clawback for the benefit of the insolvency estate:

(i) acts prejudicial to the insolvency estate, that were

(ii) performed in the two (2) years preceding the beginning of the insolvency proceedings, provided that

(iii) the counterparty acted with bad-faith.

Prejudicial acts are those that diminish, frustrate, difficult, jeopardize, endanger or delay the satisfaction of the insolvency creditors.

Bad faith, for this purpose, is the knowledge (at the date the action is performed) of any of the following (i) the debtor being insolvent (meaning (a) the inability to comply with its due obligations, or (b) its liabilities clearly exceeding its assets); (ii) the prejudicial nature of the act performed and the imminent insolvency situation; or (iii) the beginning of the insolvency proceedings.

Ranking of Claims (nature of claims and order of priority)

All claims are classified according to specific criteria set out by law (general overview of waterfall on insolvency to be assessed on a case- by- case basis):, as follows:

- **Fees and expenses of the liquidation proceedings** : Court and liquidators fees; and other expenses related to the liquidation proceedings (*pre-deductible claims*).

- **Secured and preferential claims** (*créditos garantidos e privilegiados*): Those that benefit from a security *in rem* arrangement on specific assets of the debtor (these have preference over specific assets of the debtor) and those which hold a general legal preference in respect of the assets of the debtor (e.g. social security contributions or employment-related claims).

- **Subordinated claims**: (i) claims where subordination has been agreed, (ii) interest of any kind to the extent it is unsecured, (iii) claims held by related parties (i.e. directors or shareholders holding, directly or indirectly, a share interest in the debtor in excess of certain thresholds, companies of the same group as the debtor or having dominant influence, etc.), (iv) claims resulting from a clawback by the Insolvency Administrator against bad faith counterparties, and (v) shareholders' loans (*suprimentos*).

- **Ordinary claims**: All claims that are neither secured/preferential nor subordinated.

The shareholders are not a specific class of creditors.

Special Revitalization Process (Processo Especial de Revitalização – PER), which was introduced by Act no. 16/2012, dated 20 April

1. Overview

The PER is a pre-insolvency in-court procedure whereby a financially distressed (or imminently insolvent) debtor (that is not in an actual insolvency situation and that has not yet been declared insolvent) with realistic prospects for revitalization may, under the supervision of a court-appointed administrator (the Provisional Administrator), attempt to establish negotiations for a maximum period of 3 months, intended to devise a restructuring plan, reaching a restructuring agreement with its creditors.

A successful PER would avoid the declaration of insolvency of the debtor and the effects deriving therefrom insolvency statement.

The greatest advantage of this fast-track court approval procedure for restructuring is the ability to carry out a restructuring scheme without the debtor being declared insolvent by the court, preventing the loss of value that such a declaration implies.

2. Starting PER

In order to begin a PER, the debtor together with, at least, one of its creditors shall submit a petition before the court declaring, by means of a written statement, their intention to enter into negotiations leading to the revitalisation of the debtor through the agreement of a plan.

The application should include a statement, issued by the debtor, confirming that it may still be revitalized and is instructed with the following documents:

a) List of all its creditors, including address, amounts of credits, maturity date, nature and underlying guarantees, and, if applicable, its relation with the debtor;
b) List and identification of all pending proceedings (either declarative or enforcement) in which the debtor is defendant;
c) Document describing its activity in the 3 preceding years, list of its business establishments and causes for the current situation;
d) Its shareholders;
e) List of assets leased or owned, together with their identification data, acquisition value and estimated current value;
f) Financial statements for the 3 preceding years, information of the most significant changes to its assets after the closure of the last accounts and transactions conducted beyond its ordinary activity;
g) In case the debtor is required to consolidate accounts, the consolidated accounts for the 3 preceding years;
h) Any other accounts the debtor is required to file under the Portuguese Securities Code and ancillary regulations;
i) Map of employees.

The court immediately issues an order appointing the Provisional Administrator and gives notice thereof to the debtor.
The debtor shall inform the remaining creditors, by means of a letter with acknowledgement of receipt, that it has began the PER, inviting them to participate in the negotiations of a restructuring

agreement and to submit their credit claims to the Provisional Administrator within 20 days from the date in which the appointment of the latter has been published in the official website – Citius.

Any creditor aiming to participate in the negotiations should give notice thereof to the debtor, by registered letter, at any time during the negotiation process.

The PER may be jointly filed by a group of companies.

3. Negotiation Process

Once the time limit for submitting claims has expired, the provisory list of credit claims will be sent to the court by the Provisional Administrator within 5 days and published on the Citius. This list may be challenged within 5 business days by the creditors, such challenging being ruled by the judge within 5 business days.

5 business days after the publication of the provisional list of credits in Citius, the 2 months term for concluding the negotiations start to run. This term may be extended once, by written prior agreement between the debtor and the Provisional Administrator, for another month.

During the negotiations the debtor must provide the creditors and the Provisional Administrator all relevant information to reach a transparent and equitable agreement.

Usually the Provisional Administrator focus the negotiations efforts on the most relevant creditors with a view of ensuring the required majorities for approval.

Upon the conclusion of the negotiations the Provisional Administrator presents the restructuring proposal to all the creditors that have confirmed their intention to participate in the negotiations, which will be entitled to submit their vote in writing. The Provisional Administrator shall then prepare a document with the results of the voting.

4. Liability of the Debtor and Directors

The company or its directors are jointly responsible for any damage caused to creditors due to the lack or inaccuracy of the communications or of the information given to the creditors as part of the negotiation process, under penalty of liability for any losses caused.

Furthermore, under the law directors are required to file for insolvency of a company in distress before the Court within 30 days following the date they become aware (or should be aware) of the insolvency status. Directors which are aware of the imminent insolvency situation of the relevant company and begin a PER will be viewed as compliant with their duties towards the company and its creditors even if the PER ultimately results in the declaration of insolvency.

5. Effects of PER

Once the Provisional Administrator is appointed by the court, no judicial proceedings for the payment of debts (debt collection proceedings) may be filed against the debtor and those which have been already filed shall be stayed during the negotiations of the PER. This stay applies to any and all proceedings, even those that do not have a direct impact on the assets required for the continuation of the debtor's activity.
Pending similar proceedings fall as the restructuring plan is approved and judicially sanctioned, unless the plan sets forth that some proceedings should continue after homologation

During the negotiations period, any insolvency proceedings pending against the debtor shall be suspended. These insolvency proceedings shall fall as the restructuring plan is agreed, approved and judicially sanctioned.

Further, from the appointment of the Provisional Administrator, the debtor shall be prohibited from carrying out acts with a significant importance on its business without the prior authorization of the Provisional Administrator. This applies to the acts listed in the law which include, inter alia, the sale of assets that are relevant for the development of the debtor's activity. Acts performed without the required consent shall not produce effects.

6. Restructuring Agreement

Although case-law is still scarce, legal doctrine and available case-law have stated that restructuring agreements may include any and all measures that allow for the debtor's recovery and provide with the necessary funding for continuing its activity. In particular, the restructuring agreement may provide for debt write-off, haircuts (in some cases the plan has even foreseen a haircut of 95% of the unsecured unsubordinated claims and the judge homologated such plan) and/or debt rescheduling.

As the law does not set forth a catalogue of recovery measures which can be included in the restructuring plan, the latter may have any contents that is not in breach of general principles of law.

Current practice has seen restructuring plans that include (i) sale of assets, either to creditors or third parties; (ii) transfer in lieu of payment; (iii) sale and lease back; (iv) asset contribution to a new co where the creditors hold a stake; (v) creation of investment funds; (vi) granting of security for fresh money

7. Protection against clawback actions

Agreements reached under PER are ring fenced from clawback actions provided that their purpose is to provide the debtor with financial support in order to allow its recovery.

It should be noted that any security agreed during the PER between the company and its creditors with the purpose of granting the necessary financial means for the development of the company's activity will remain in full force and effect even if after the conclusion of the PER the company is declared insolvent within the following two years.

Nevertheless, the fact that new security under PER is protected from clawback actions will not attribute to such security a prevailing ranking over the pre-existing security of an equal or higher ranking.

Protection from clawback shall not extend to other general principles of law such as the paulian action or the act being null and void in case it was aimed at haring the creditors. Nevertheless, challenges based on these grounds are unlikely in case the plan has been approved by the creditors.

8. Fresh money privilege

The creditors which, during the PER, provide the company with the necessary financial means for the continuance of the company's activity will benefit from a general privilege over the company's movable assets, which shall rank before the employee's general privilege over movable assets.

In light of the aforesaid, legal doctrine has sustained that providing the debtor with financing must be broadly interpreted. For instance, creditors who supply new assets or services (employees, suppliers of goods) with the aim of preserving the business as a going concern deserve to be included in the scope of the provision.

In case several creditors grant fresh money to the company's activity they shall be granted equal ranking (i.e., a general privilege over movable assets).

9. Approval and Judicial Sanction of the restructuring plan

In order for the PER to be binding on all creditors of the company (even dissenting or those that did not take part in the negotiations), the minimum threshold of approval a two fold majority of the debtor's creditors[1]: (i) at least 1/3 of all claims with voting rights must be present, and (ii) favorable votes of 2/3 of the total votes issued and more than 1/2 of votes issued corresponding to unsubordinated creditors.

The judge may take into account, for the majorities, credits challenged whenever he deems possible that such credits will later be recognized.

Where a recovery plan has been agreed unanimously during the negotiations, which is highly unlikely, it will be submitted for the immediate homologation of the judge and the plan will take effect once it has been approved by the court.

In case the two fold majority is reached, and notwithstanding what is set out below, the court shall sanction the PER which will be binding to all creditors (including dissenting and non-participating creditors). The judge will decide to approve or reject the PER within 10 days.

The court may refuse to sanction the restructuring plan in the following cases: (i) breach of procedure rules; (ii) breach of the rules applicable to the content of the restructuring plan; (iii) the creditor's situation would be more favorable without the restructuring plan; (iv) the restructuring plan grants to some creditors an economical advantage disproportionate to the value of their claims.

Despite its contractual basis, the restructuring plan enjoys therefore the benefits of a final judicial intervention (the court approval of the plan).

10. Timing

As to the PER, from the date of its submission until the homologation of the agreement, it could be expectable 4 to 6 months[2].

11. Failure to reach a PER

Should the debtor and the creditors be unable to reach agreement or if the time limit for the conclusion of the negotiations (maximum 3 months) expires, the negotiations will be terminated. In this case, the provisory administrator will prepare a reasoned opinion on the solvability of the debtor and in the event that it supports a finding of insolvency, this should be declared by the judge within 3 days.

In cases where the debtor has not yet become insolvent, the PER extinguishes any and all effects, namely those regarding the suspension of debt collection and insolvency proceedings.

[1] Abstain shall not be accounted for.

[2] Apart from other factors, the number of pending proceedings in the competent court is of utmost relevance.

Out-of-Court Companies' Recovery System (Sistema de Recuperação de Empresas por Via Extrajudicial, "SIREVE")

A revised mechanism called SIREVE (*Sistema de Recuperação de Empresas por Via Extrajudicial*) was implemented aiming at enhancing efficiency and speeding up out of court settlements, shortening delays and coordinating official agencies and bodies.

Any company facing a *difficult economic or financial situation, or imminent or actual insolvency*, can also resort to SIREVE, an out-of-court pre-insolvency procedure implemented by Decree Act no. 178/2012, of 3 August 2012, where the company has not yet been declared insolvent by a court.

This procedure is not public. In a SIREVE procedure, the company's administration does not fall to a court-appointed administrator, but the negotiations are conducted and mediated with the intervention of IAPMEI, a governmental agency. SIREVE comprises therefore the participation of IAPMEI, focused on the technical conditions to successfully rescue companies that intend to recover, helping to plan restructuring, facilitate compositions with creditors, gathering (preferential) creditors like the social security or tax authorities.