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Insolvency 2021

Portugal: Trends & Developments

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Trends and Developments

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The State of the Portuguese Insolvency and Restructuring System after COVID-19: Some Indications to Face the Crisis

In early 2020, the Portuguese economy was still slightly expanding, although it had registered a deceleration for the second year running. However, this progress came to an abrupt and unprecedent halt with the beginning of the COVID-19 pandemic in March. The pandemic significantly affected economic activity in Portugal in 2020 and, at the time of writing, its consequences are far from over. The entire business sector has been affected and even viable companies are generally facing enormous difficulties due to a lack of liquidity.

The numbers of restructuring and insolvency procedures are expected to rise in the coming months and years but, so far, the measures enacted to mitigate and contain the economic and financial multiple impacts of the pandemic have been effective in preventing a sudden upsurge in insolvencies.

The lockdown and temporary suspension of the majority of commercial activities between March and May has a direct impact on the tourism and hospitality sectors, creating pressure on the solvency of companies and businesses. Lay-offs, low interest rates, rent moratoriums, deferral of certain taxes and the extension of credit lines with public guarantees and the extension of bank moratoriums helped mitigate – even if only by delaying – the default risk of companies and the subsequent increase in restructuring and insolvency cases.

From 7 April 2020, and as long as the exceptional and temporary legal measures introduced in response to the COVID-19 pandemic remain in force, debtors are not under the obligation to file for insolvency, a legal provision that other EU countries have also adopted in similar terms. The main purpose of this is to stop insolvency numbers from rising. However, this legal provision does removed creditors' right to file for the insolvency of a debtor. Moreover, if the debtor is in a pre-insolvency situation and recovery is still possible, it can begin one of the pre-insolvency procedures at its disposal. These include the Special Revitalisation Process (PER) (Law No 16/2012 of 20 April) and the Extrajudicial Business Recovery Scheme (RERE) (Law No 8/2018 of 2 March). In addition, if the difficulties faced by the company were caused by the COVID-19 pandemic, it can also begin an Extraordinary Recovery Process (PEVE) (Law No 75/2020 of 27 November). This is a special process aimed exclusively at companies that are either in a difficult economic situation or in an insolvency scenario due to the COVID-19 pandemic but are still viable.

New legislation in 2020 relating to insolvency and restructuring

New legislation relating to insolvency and restructuring was introduced in 2020 to support businesses and individuals, and to address the challenges resulting from the impact of the COVID-19 pandemic. These measures were essentially:

- the temporary suspension of the duty to file for insolvency within the legal time limit set for this purpose;

- the adoption of a new extraordinary legal framework aimed at companies facing a difficult economic situation or an insolvency scenario, both imminent and actual; and
- the introduction of one-off amendments to existing pre-insolvency procedures.

The temporary suspension of the duty to file for insolvency within the legal time limit set for this effect

From an insolvency and restructuring standpoint, one of the first reactions to the pandemic was the suspension of the obligation to file for the insolvency of a company based on over-indebtedness or on the inability to pay its debts as they fall due. This suspension took effect from 7 April 2020. However, the creditors continued to be able to file for the insolvency of a debtor.

As COVID-19 continued to weigh on economic activity, liquidity concerns, among other things, became more severe and revealed the need for further legislative responses.

Extraordinary recovery process (PEVE)

Accordingly, the Portuguese government has adopted an economic and social stabilisation plan to respond to the economic and social difficulties caused by the pandemic. One of the measures provided for in this plan was the creation of a new extraordinary process aimed exclusively at companies that are either in a difficult economic situation or in an insolvency scenario owing to the COVID-19 pandemic but are still viable: the PEVE.

The PEVE was first announced by the Portuguese government in June 2020 and, as mentioned above, was later established in Law No 75/2020 of 27 November 2020. This law came into force on 28 November 2020 and is in effect until 31 December 2021, subject to a possible extension.

As a preliminary note, the PEVE provides for shorter time limits than other preventive restructuring frameworks and enjoys a super-urgent nature. This means it takes precedence over any other proceedings of an urgent nature, such as insolvency and PER procedures. The PEVE is also free of court costs.

The PEVE is designed to reach an out-of-court debt restructuring agreement between the company and creditors corresponding to a legally established majority vote and to have it approved by a court (the "viability agreement").

The decision to approve the viability agreement binds the company, the creditors who vote in its favour and the creditors indicated by the company in the list of creditors, even if they did not take part in the out-of-court negotiations or voted against the agreement.

As a general rule, when the initial application for PEVE is filed, the company cannot have any PER procedure pending and needs to prove that it meets the necessary conditions for its viability.

The company must also provide proof that, on 31 December 2019, the company's liabilities were lower than its assets. In other words, the company must provide proof that the difficulties it is facing stem from the pandemic situation.

At the company's request, it is possible for different companies with which the company is in a control or group relationship to also submit to a PEVE and the corresponding proceedings can be joined.

After the initial application is filed, the court is responsible for checking and ensuring that all requirements and preconditions for commencing a PEVE are met. If this is the case, the court will appoint a judicial administrator, who will be responsible for giving an opinion on whether the

proposed viability agreement offers reasonable prospects of ensuring the recovery of the company. This opinion is relevant to the outcome of the PEVE, because it may serve as a basis for the court to decide whether to approve the proposed viability agreement.

Starting a PEVE has both procedural and substantive effects. With regard to procedural effects, the PEVE causes the suspension of any application for insolvency of the company, provided that the insolvency has not yet been declared, and of any debt recovery proceedings. The latter proceedings will be terminated if the viability agreement is approved, unless it provides for their continuation or where the claims in question in those actions are not covered by the viability agreement.

As far as the substantive effects are concerned, the PEVE prevents the suspension of the provision of essential public services to the company. The company is also prevented from performing any acts of relevance, as set forth in the CIRE, without first obtaining authorisation from the administrator to carry out the intended operations.

If the viability agreement is not approved by the court, all effects of the PEVE are extinguished. The ending of the procedure prevents the company from resorting to a new PEVE.

One of the main virtues of the PEVE is that it promotes both financing and self-financing, by its shareholders, to ensure the effective viability of the company. In fact, the guarantees agreed between the company and its creditors will continue even if, at the end of the process, the company is declared insolvent within two years, provided that they are offered for the purpose of providing the company with the financial means it needs to operate. Moreover, the shareholders, or any person related to the company who finances its activities by providing it with funds with a view to making it viable, enjoy privilege in terms of claim classification and ranking. Moreover, if the company is later declared insolvent, legal transactions provided for in the viability agreement that included the provision to the company of new pecuniary claims cannot be clawed back for the benefit of the insolvent estate.

As a rule, tax and social security claims remain unaltered. However, under the PEVE, there is the possibility to reduce interest rates or take advantage of other tax benefits, to achieve the financial viability of the company.

The introduction of one-off amendments to existing pre-insolvency procedures

In addition to establishing the PEVE, Law No 75/2020 of 27 November 2020 also provides for a series of one-off amendments to the preventive restructuring procedures existing in Portuguese law, with a view to adapting them to the pandemic situation. Some of these measures are as follows:

- the three-month maximum deadline for the company to conclude negotiations on a recovery plan or payment agreement within a PER may be extended;
- any proposed insolvency plans may be granted an additional 15 additional working days to be adapted to the context of the COVID-19 pandemic;
- the RERE may be relied upon by companies that are insolvent as a result of the COVID-19 pandemic, provided they are still likely to become viable and certain requirements are met;
- partial prorating becomes mandatory in all pending insolvency proceedings where liquidation proceedings are deposited in excess of EUR10,000 (whenever certain requirements are met);

- applications for release and distribution to creditors of securities or guarantees provided under insolvency proceedings, PER or similar proceedings enjoy priority over any applications pending the decision thereon; and
- if there is a failure to comply with an approved insolvency plan due to events occurring after 7 April 2020, the 15-day time limit for regularisation – after which the moratoriums and waivers provided for in the plan expire – will not begin to run until Law No 75/2020 of 27 November 2020 is no longer in force.

Significant transactions, key developments and most active industries

The year 2020 has, in all respects, been an atypical year, and the fact that the most significant restructuring transactions in Portugal during that period were carried out with state intervention (eg, TAP and EFACEC) demonstrates this fact. In particular, the legislature's successful efforts, especially in the past decade, to create pre-emptive renegotiation tools that debtors can use when they are financially struggling, thus avoiding reaching an insolvency situation. In fact, companies are now acutely aware of these negotiated recovery solutions and filing a PER is usually the first option taken by companies. Furthermore, Portuguese insolvency and restructuring practitioners are first called on to advise on these restructuring solutions, and, in contrast with the situation less than decade ago, insolvency is now a last resort.

Particularly in relation to the judicial approval of recovery plans under a PER, courts hold that the principles of equal treatment of creditors (with no creditors worse off) are not an absolute right of creditors. Consequently, under exceptional circumstances such as the PER, these principles can be limited the different treatment of different creditors allowed.

However, courts have recently questioned the scope of this standard, particularly when there is evidence that the differentiation in treatment between creditors is disproportionate. As a result, the courts have ruled that a recovery plan may not be approved at the expense and sacrifice of a certain class of creditors for the benefit of others. Courts have determined that, in the analysis and weighting of the interest at stake, the review should consider not only the level of haircut but also the percentage that a certain class of credits represents in the overall balance of the debtor, and they have refused to approve of restructuring plans considered unbalanced.

Finally, as a direct consequence of the COVID-19 pandemic, service industries, in particular tourism and hospitality, have been the most affected in terms of insolvency proceedings started in 2020.

New normal developments

Portugal was recently hit hard by a third wave of the pandemic, which took hold in January 2021. At the time of writing, further legislation is pending approval before the Portuguese government and parliament to relieve the burden on businesses and individuals and support economic recovery. According to the legislative texts currently under discussion, new provisional measures suspending certain time limits and procedural acts in the context of insolvency proceedings, among others, are likely to enter into force soon. This will also have an impact on the very activity of the Portuguese courts.

Additional legislation is expected to be enacted in the coming months, as the impacts of the pandemic are far from over, especially those that stem not from COVID-19 directly, but from the consequences of battling it.

A further point to highlight for 2021 is the intended implementation of Directive (EU) 2019/1023

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of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (the Directive on Restructuring and Insolvency).

A number of legal solutions provided for in Directive (EU) 2019/1023 will remain at the discretion of the member states, so we are particularly looking forward to analysing the specific solutions adopted by Portugal when implementing the Directive.

Some of the legislative objectives and instruments set by Directive (EU) 2019/1023 have already materialised in Portuguese legislation, but its incorporation into domestic law may be decisive in preventing and mitigating the impacts of COVID-19 on the Portuguese economy, and in overcoming financial difficulties and avoiding insolvency scenarios. Therefore, the current circumstances only increase the need to incorporate Directive (EU) 2019/1023 into national law within the prescribed deadline in order for Portuguese companies and individual entrepreneurs to benefit from the instruments set out in it to prevent insolvency.

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