DISTRESSED M&A

Portugal

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Getting The Deal Through

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Walder Wyss Ltd

Distressed M&A

Consulting editors

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Quick reference guide enabling side-by-side comparison of local insights, including market climate and legal framework; transaction structures and sale process; due diligence and mitigation of related risks; valuation and financing; documentation; regulatory and judicial approvals; dispute resolution; and recent trends.

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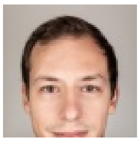

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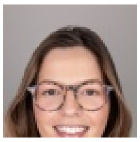

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MARKET CLIMATE AND LEGAL FRAMEWORK

Market climate

How would you describe the general market climate for distressed M&A transactions in your jurisdiction?

Throughout 2021 and the first quarter of 2022, the Portuguese economy was on a steady path of recovery from the covid-19 pandemic crisis. The pace of recovery was, however, hindered by the adverse global macroeconomic scenario caused mainly by the pandemic's lingering effects and the Russian invasion of Ukraine in February 2022.

The industrial sector has been the most seriously affected by the current inflation situation and rising interest rates, in particular, in sectors of machinery and equipment manufacturing, automotive and transport, and industrial feed.

This deterioration of the external global context led to downward revisions in growth rates, especially for 2023. Naturally, this context is adding pressure to companies that could otherwise have healthy balance sheets, and it has a particular impact on those with connections to the industrial sector. As a result, and similarly to 2007–2011, an increase in the number of companies submitting voluntarily to judicial and extrajudicial recovery proceedings is expected in the following years.

Successful implementation of the Recovery and Resilience Plan (the national support programme financed by European Funds that is intended to mitigate the economic and social impacts of the covid-19 pandemic) may, however, alleviate this negative forecast.

This context is prone to creating a rise in distressed M&A transactions and opportunities for investors (mainly in the industrial sector), that have the capacity to invest in and support companies to help them get through the coming months, as companies' access to credit may prove to be more burdensome.

Recent legislative changes resulting from the incorporation into Portuguese law of Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks are also favourable to the M&A distressed transactions sector.

Law stated - 28 October 2022

Legal framework

What legal and regulatory regimes are applicable to distressed M&A transactions in your jurisdiction?

Distressed M&A transactions in Portugal are governed by the Portuguese Companies Code and the Portuguese Securities Code, when carried out out-of-court. In addition, as a significant number of distressed M&A transactions are carried out in a context of pre-insolvency, judicial recovery or liquidation of the company, the Portuguese Companies Insolvency and Restructuring Code is, in these cases, the legislation to be considered in addition to the Companies Code. It is also possible for distressed transactions to be pursued within judicial enforcement proceedings against the assets or shareholdings of the target company. In this case, the Portuguese Civil Procedure Code will also apply.

Over the past decade, the Portuguese legislature has created new pre-insolvency procedures based on out-of-court negotiations with minor court intervention with the aim of reducing the time and costs of judicial restructuring procedures, without compromising their reliance. These include the Special Revitalisation Process and fully out-of-court procedures such as the Out-of-court Business Recovery Scheme in an effort to create effective pre-emptive arrangements that make it possible to restructure the company before it becomes insolvent. In addition, if the difficulties faced by the company were caused by the covid-19 pandemic, it may also begin an Extraordinary Recovery Process, a special process exclusively for companies that, although still viable, are either in a difficult economic situation or in an insolvency scenario due to the pandemic.

Where the distressed company has been declared insolvent or is pursuing its restructuring under court-sanctioned pre-insolvency proceedings, the transaction will, with different levels of intervention, be overseen by a court and the management of the company will be handed over to a court-appointed administrator (also with varying levels of decision-making control).

In addition, distressed M&A transactions may also be subject to merger control by the Portuguese Competition Authority and depending on the target's scope of activities, authorisations from other regulatory bodies may be required.

Law stated - 28 October 2022

Main risk in distressed M&A transactions

Summarise the main risks to all parties involved.

The risks assumed by the parties in distressed M&A vary greatly depending on the structure of each transaction. As the different levels of a company's distress are prone to creating opportunities for a buyer, it is also common for the risks in distressed M&A transactions to be higher on the buyer's side.

From a buyer's perspective, the risks are significantly higher when the transaction involves a company that is on the verge of insolvency but has not yet begun pre-insolvency or insolvency proceedings. In fact, the information disclosed to the buyer is often limited, as is the due diligence review the buyer is allowed to carry out regarding the asset or the target company. Furthermore, there are usually also significant time constraints. In addition, the representations and warranties of the seller are restricted, and the sale is frequently carried out on an 'as is, where is' basis.

Moreover, in these situations, the possibility of a creditor or an insolvency administrator of the company later questioning the conditions and the deal itself also represents a significant risk for the buyer to consider and address. For example, the administrator may challenge the transaction under clawback provisions, reject or confirm the fulfilment of pending agreements or classify the buyer's credits over the company as subordinated debt. This can have a severe impact on the buyer's credit rights and position in restructuring or insolvency proceedings.

Law stated - 28 October 2022

Director and officer liability and duties

What are the primary liabilities, legal duties and responsibilities of directors and officers in the context of distressed M&A transactions in your jurisdiction?

In general terms, under Portuguese law, a director must act in the best interest of the company while also considering the shareholders' and stakeholders' interests. Particularly in distressed situations, the director of a distressed company will have to closely monitor the financial situation of the company, as he or she will have a duty to file for insolvency when the company is near to being or is unable to pay all its debts as they fall due; not increase the potential for insolvency; and not divert corporate assets from the company's creditors. In fact, directors of insolvent companies must be mindful of their actions as they may also be under the obligation to compensate the creditors if their actions lead to a diminishing of the insolvent estate, particularly if the actions occurred within the three years prior to the company being ruled insolvent.

If directors breach their duty to file for insolvency, the court may hold that the insolvency was wrongful and, if so, the directors may be subject to several sanctions. These include a ban on engaging in commerce for a period of up to 10 years, a ban on being appointed to the boards of other companies, the payment of compensation to the creditors and even criminal sanctions, in case of wilful intent to cause damage.

Directors may also be personally liable for the existing tax and social security debts of a distressed company whenever its assets are insufficient to ensure payment.

In addition to the above, the buyer's directors will also have to carry out their due diligence with a more intense duty of care where the seller or target is in a distressed situation and there is a higher risk associated with the investment, being that one of their main duties is to ensure an adequate level of return for shareholders.

Law stated - 28 October 2022

Differences from non-distressed M&A

In general terms, what are the key legal and practical differences between distressed and non-distressed M&A transactions in your jurisdiction?

As a general rule, the first steps of distressed M&A transactions occur prior to the beginning of a formal restructuring of the distressed company. As such, buyers in distressed M&A transactions must, often within constrained timetables, frame their acquisition strategy and plan adequately to ensure that typical distressed M&A risks, such as the risk of equitable subordination or clawback actions, are avoided.

On the other spectrum of the range of distressed M&A transactions, if the transaction is set to be carried out through judicial proceedings, the buyer will have to negotiate with different parties to navigate the often-conflicting interests of all those – company, creditors, shareholders, etc – involved in the restructuring or liquidation of the distressed company. In addition, in these instances, the transaction will be subject to a judicial sanction and the court-appointed administrator will be responsible for managing or supervising the management of the company assets and authorising any acts outside the ordinary course of business.

Law stated - 28 October 2022

Timing of transactions

What key considerations should be borne in mind when deciding when to acquire distressed companies or their assets?

There are numerous factors that should be considered to determine the best timing to pursue an out-of-court distressed M&A transaction or implement such a transaction within formal pre-insolvency or insolvency proceedings.

At the outset, the investor should analyse the pros and cons of each option and take into consideration, in particular:

- the financial situation of the distressed company (in many instances, it is quite challenging to assess the real economic situation of the company);
- if the effects of formal insolvency proceedings are necessary or adequate (eg, stand still or removal of the management) and its impact on the target (eg, reputational effects);
- the number or multiplicity of creditors (multiple creditors may limit coordination, a situation that does not occur when the company has monopolistic creditors, which facilitates out-of-court agreements and negotiations);
- the nature of the creditors and their guarantees or securities over the target's assets (as the restructuring measures will vary depending on the credits being privileged, secured, unsubordinated, subordinated or contingent);
- negotiation level with other relevant parties and the debtor;
- timing issues (the court timings may not be compatible with the debtor's business needs and could result in value erosion);

- lack of unanimity to obtain a creditor's or the debtor's consent; and
- the risk of possible challenge against the transaction by the company's creditors or insolvency administrators.

Law stated - 28 October 2022

TRANSACTION STRUCTURES AND SALE PROCESS

Common structures

What sale structures are commonly used for distressed M&A transactions in your jurisdiction? What are the pros and cons of each, and what procedures and legal requirements apply?

Distressed M&A transactions are most commonly implemented through:

- asset deals and transfers of business as a going concern: these are flexible solutions, as they allow for the separation of the acquired company's assets from identified liabilities;
- share deals, which although simpler and less complex, entail the acquisition from the buyer of all the target's business (including all attached liabilities); or
- loan-to-own purchase, that is, the acquisition of a secured debt (in particular, non-performing loans) which is then exchanged for the target's equity or assets either consensually, through a security enforcement or through a judicial procedure binding all creditors. This last option offers some risk mitigation vis-à-vis an asset or share deal, as a secured creditor will be entitled to access to information of the debtor and may be able to influence the restructuring and insolvency process of the company (depending on their share in the company's debts).

Outside a formal restructuring proceeding, share or asset deals can be implemented through a bilateral agreement or a competitive process, the latter tending to minimise clawback risks.

In formal proceedings, the acquisition is possible:

- in pre-insolvency proceedings (Special Revitalisation Process (PER), Out-of-court Business Recovery Scheme (RERE) or Extraordinary Recovery Process (PEVE));
- under a restructuring plan approved in a company insolvency; or
- in the liquidation phase of insolvency proceedings.

As all these scenarios are possible and potentially successful under Portuguese law, the chosen structure will depend on the specific outline of the transaction, the goals of the parties and the extent of distress of the company.

Law stated - 28 October 2022

Packaging and transferring assets

How are assets commonly packaged and transferred in a distressed M&A transaction in your jurisdiction? What procedural, documentary and other requirements apply?

Where the distressed M&A transaction occurs within formal insolvency proceedings and the creditors do not approve a recovery plan for the company, the transfer of assets often takes place within the liquidation phase, where assets are directly acquired from the debtor, represented by the insolvency administrator, through a competitive process.

Whenever a recovery plan is approved by the creditors (which, in pre-insolvency proceedings must also be accepted by the distressed company) the assets can be transferred through a myriad of different solutions, as the creditors and debtor have ample autonomy to negotiate the terms of the company's recovery. The recovery plan must clearly indicate the measures to be enforced as a means to seek the restructuring of the company. This includes a determination of the assets to be transferred and the appropriate form and timing to execute this. The most common solutions approved in a recovery plan to sell assets are the transfer of assets to creditors in lieu of debt payment and the carve-out of business units of the company, transferred as a going concern to a new company.

Law stated - 28 October 2022

Transfer of liabilities

What legal requirements and practical considerations should be borne in mind regarding the acceptance and transfer of any liabilities attached to the distressed company or assets?

If the transaction is concluded outside formal restructuring or insolvency proceedings, the parties usually decide on the limits and transfer of liabilities between the parties. In asset deals, the buyer should seek provisions excluding specific (or all) liabilities attached to the assets or business that pre-date the transfer (a solution that has been generally approved by the courts). In share deals, the buyer can only seek protection on a contractual basis, as the transfer of liabilities accompanies the sale of the company. In these instances, the buyer should negotiate adequate specific indemnities from the sellers, particularly seeking shielding against tax and social security credits, which have a payment privilege in the case of debtor's insolvency, and request adequate guarantees.

When the transaction occurs within formal restructuring or insolvency proceedings and the company is not liquidated and its assets sold competitively, creditors usually approve a restructuring plan where they set out detailed and extensive provisions on the liabilities of the debtors (typically, setting forth haircuts and moratoriums). They can also limit the liabilities being transferred, subject to the principle of creditors' equality and the 'best interests of creditors test' (also known as the 'no creditor worse off principle'). If approved by the majority of the creditors and homologated by the court, this plan will bind and affect all creditors, including those who have not participated in the proceedings and those who voted against it. The parties can also set certain conditions precedent in the restructuring plan, as long as they are met before the court approves the plan, but no subsequent conditions are admitted.

With few exceptions, extinction of credits by payment in kind (transfer in lieu) requires the consent of the creditor (therefore, no liabilities can be imposed on creditors against their will).

Law stated - 28 October 2022

Consent and involvement of third parties

What third-party consents are required before completion of a distressed M&A transaction? What are the potential consequences of failure to obtain these consents? In what other ways are third parties commonly involved in the transaction?

The consents required for distressed M&A operations depend on whether they are carried out within or outside insolvency or recovery legal proceedings.

If the transaction is carried out outside of insolvency proceedings, the main necessary consent is that of the shareholders (and, depending on the transaction, of the debtor's management). In addition, it is necessary to consider the consents required by change of control clauses in the agreements concluded by the company (here, financing agreements assume special importance). Authorisations from regulatory bodies may also be required, subject to the target's market share and sector.

Moreover, when distressed M&A transactions involve mergers or demergers, additional consents are required, including from the management and supervisory bodies of the company and, in certain cases, from independent auditors. Furthermore, these may be opposed by the creditors if they evidence that the probability of payment of their credits is worsened as a result of the transaction.

When distressed M&A transactions are carried out within insolvency proceedings, the decision to implement them is transferred to the creditors when approved under a recovery plan, which is also subject to court approval. When these operations take place during these proceedings but outside a recovery plan provision, they are subject to shareholder or judicial administrator consent, or both.

Law stated - 28 October 2022

Time frame

How do the time frames and timelines for the various transaction structures differ? Can these be expedited in any way?

Insolvency proceedings are usually quite lengthy and can take years to be concluded. Among the most relevant factors to consider in assessing the time frame of proceedings are the degree of dispersion of the debt of the distressed company, as negotiations will be shortened if the debt is concentrated in a few creditors, and the degree of cooperation of the insolvent.

Pre-insolvency proceedings are, in contrast, mechanisms that are efficient and expeditious. The duration of the phase for the debtor to negotiate the content of the recovery plan with its creditors is limited by law. If the negotiations fail, the judicial administrator is requested by the court to issue an opinion on whether the debtor should be declared insolvent. This makes it possible to implement transactions effectively. The law also allows the debtor to submit a pre-approved and negotiated plan (a version of a pre-packed administration) with the agreement of creditors holding a majority of the credits over the distressed company immediately before the company begins Special Revitalisation Process proceedings to ask for the court's approval of the plan submitted. This solution is particularly fast and, assuming a timely court decision, can be implemented within three months.

Law stated - 28 October 2022

Tax treatment

What tax liabilities and related considerations arise in relation to the various structures for distressed M&A transactions in your jurisdiction?

Distressed M&A transactions are subject to the general tax framework and may raise issues from both direct and indirect tax perspectives.

Nevertheless, there are special tax rules that apply to companies in bankruptcy or subject to special recovery arrangements, and to their creditors. These arrangements allow for:

- a corporate income tax exemption on debt waivers and latent capital gains on the assignment of assets to pay debts in kind;
- stamp duty exemptions on the transfer of business units, renegotiation of existing loans and granting or extension of guarantees; and
- a real estate transfer tax exemption on the transfer of real estate properties in the payment in kind of debts to the creditors.

Creditors may also deduct input VAT on bad debts whenever the insolvency or recovery plan provides for the non-payment of the credit and is approved by a court order.

Law stated - 28 October 2022

Auction versus single-buyer sale process

What are the respective pros and cons of auction sales and single-buyer sales? What rules and common practices apply to each?

The single-buyer process is typically followed under the recovery plan approved within an insolvency or pre-insolvency proceedings, where it is common for the debtor to enclose independent valuation reports as evidence before the creditors that the sale value is at market price so as to persuade them to approve the plan.

In a liquidation scenario, the decision on the value and type of sale of the assets rests with the insolvency administrator, after hearing the debtor and any creditor with an in rem security over the asset to be sold. Secured creditors may propose to purchase the asset for a price higher than the projected sale price and may use their claims to pay the price, provided that no creditors are ranked with a priority over them.

The sale of real estate and movable property is preferably done through an electronic auction. In principle, as potential buyers are encouraged to bid competitively, the proposed base price will be met. In a restructuring scenario, it is up to the company's creditors, through a restructuring plan, to decide which assets should be sold and under which terms (subject to the best interest of creditors test).

However, the seller's assets or business may be unsuitable for an auction sale. In addition, the absence of information about the company or assets may discourage new bidders. These obstacles are more easily overcome through a direct sale process to give bidders more information and adjust the specific terms of the transaction (which could lead to a higher price).

Law stated - 28 October 2022

DUE DILIGENCE

Key areas

What are the most critical areas of due diligence in a distressed M&A transaction?

The focus of the due diligence process should be the same as in traditional M&A transactions. However, the process in distressed transactions tends to have significant time constraints and limited access to information. The scope of review and reliance is usually very limited and focused on financial matters and other key items, such as assessment of liabilities (and value of the debt traded), terms and conditions of financing agreements and the possibility of direct enforcement of guarantees and security. Special attention is usually given to the existing privileged credits (held by tax, social security and employees), as restructuring measures to be carried out over credits of this ranking are limited. When the transaction is structured on a loan-to-own basis, the buyer is often given detailed information on the credits being transferred and very limited information on the debtor, as the distressed company is often not party to the transaction.

Buyers tend to focus on the debt’s characteristics (especially any personal or in rem security that can be used) and the ways it can be restructured with or without the creditors’ consent. They also focus on whether the restructuring can be done through insolvency proceedings or other restructuring proceedings. Nevertheless, depending on the planned acquisition structure, the key areas may vary.

However, during the due diligence process, it is important to understand how the company got into financial distress and to identify where change is required to restructure the company.

Law stated - 28 October 2022

Searches

What searches of public records should be conducted as part of a due diligence exercise in distressed M&A transactions in your jurisdiction?

The following public records must be checked:

- Commercial Registry Office: all relevant corporate acts and company documentation, since incorporation, are filed at the registry and can be consulted for a fee;
- Portal Citius: all restructuring and insolvency proceedings must be registered and published online;
- Land Registry Office: all information regarding real estate, its ownership and any charges over the property is registered here and can be accessed; and
- INPI (Instituto Nacional da Propriedade Industrial): publicly available information regarding trademarks, patents and designs online.

Law stated - 28 October 2022

Contractual protections and risk mitigation

What contractual protections and other strategies are commonly used to mitigate diligence gaps in a distressed M&A transaction?

Standard contractual protections apply but may have limited efficiency in distressed M&A transactions. The granting of broad and general representations and warranties or specific indemnities in the usual terms is normally not accepted by the seller, as the specific terms and conditions of sale and the fact the underlying asset is normally traded at a discount already imply a trade-off where the risk of the transaction is transferred to the buyer.

In addition, granting security by the distressed company may be subject to clawback actions and the solvency of the company may also prevent the company from honouring indemnification undertakings arising from contractual representations. Therefore, the protection that may be granted to the buyer in the transaction is, to a degree, uncertain. In addition, very often, standard mechanisms of protection regarding deferred payment or escrowed instalments of the price are not acceptable to the seller, who is keen to ensure that the completion of the transaction and its gains are swiftly achieved. All these limitations must be considered by the buyer when pricing the transaction.

As a means to mitigate these risks, the seller often requests that the transaction is carried out and concluded within a pre-insolvency proceeding, which will give the seller the comfort of a court sanctioning, confirmation of third-party creditors and assurance that the transaction will not be subject to reversion risk and is enforceable vis-à-vis all other creditors.

Law stated - 28 October 2022

VALUATION AND FINANCING

Pricing mechanisms and adjustments

What pricing methods, adjustments and protections are commonly used in the valuation of distressed M&A transactions in your jurisdiction and what are the pros and cons of each? How are they used to balance the interests of the parties?

Distressed M&A transactions involve specific risks when the transaction is carried out with a solvent company facing financial difficulties, because the possible declaration of its insolvency may make the transaction vulnerable to the scrutiny of third parties and challenges by the insolvency administrator and creditors. Therefore, any determination of the price and of the terms and conditions of the transaction should be carefully reviewed and, if possible, supported by independent valuers.

In out-of-court share deals, the pricing and adjustment methods often also depend on the company's sector, particularly on the seasonality of the activity and the time frame agreed upon to complete the transaction. Typically, although locked-box mechanics are also used and have been more frequent in recent years, prices in M&A transactions are agreed on a cash-free debt-free basis and may also include a working capital adjustment mechanism.

In sales implemented through pre-insolvency or insolvency proceedings, the price is typically fixed.

Law stated - 28 October 2022

Fraudulent conveyance

What rules govern fraudulent conveyance of distressed assets sold undervalue in your jurisdiction? How can clawback risks be mitigated when negotiating the deal price?

As a general rule, any detrimental acts carried out (or omitted) in the two years before the beginning of the insolvency proceedings (ie, the date on which the debtor is declared insolvent) may be clawed back by the insolvency administrator when:

- they diminish, frustrate, hinder, compromise or delay the satisfaction of the creditors' rights; and
- the third party involved acted with wrongful intent.

The law establishes a rebuttable presumption of wrongful intent of the third party when the transactions were carried out less than two years before the declaration of insolvency and the third party is (or becomes) related to the debtor.

The law also identifies certain transactions that may be clawed back without the need to confirm the existence of any of the requirements summarised above. For example:

- granting of in rem security as collateral for obligations that already existed, when created less than six months before the declaration of insolvency;
- gratuitous transactions carried out less than two years before the declaration of insolvency; and
- repayment of shareholder loans made during the year before the declaration of insolvency.

The clawback risk is reduced or mitigated if the sale occurs at a market price and if the debtor's significant creditors are involved in determining the price. To avoid the risk of clawback, the parties may also conclude a pre-packaged plan that provides for the sale of distressed assets approved by the majority of the company's creditors (subject to court approval). This could be very important, particularly when uncertainty remains as to the value of the assets.

Law stated - 28 October 2022

Financing

What forms of financing are available and commonly used in distressed M&A transactions? How can financing be secured?

In distressed M&A transactions, the same forms of financing and security as in common M&A transactions are available. Traditional lenders, such as banks, are, however, less keen on increasing their exposure to a specific distressed company and granting facilities in distressed M&A transactions where clawback risks may be significant. In recent years, the market has also experienced a high level of liquidity and significant activity among private equity funds, which tend to acquire assets exclusively with equity.

Law stated - 28 October 2022

Pre-closing funding

What provisions are typically agreed to secure pre-closing funding of distressed businesses and assets?

The law confers special protection on financing given to a distressed company within the pre-insolvency procedures (Special Revitalisation Process and Extraordinary Recovery Process) to provide the debtor with adequate means to finance its recovery (including the exclusion of clawback risk). In addition, while the restructuring proceedings are ongoing, creditors that finance the activity of the debtor with new credit facilities to help it recover have their new credit facility ranked as a general creditors' privilege, before employment credits (the 'new money' mechanism). In particular, within the Special Revitalisation Process, funding the debtor with new money shall be previously discussed with the judicial administrator and expressly provided in the recovery plan.

This financing can be collateralised with the assets of the company and the security granted in favour of the creditors is also protected against clawback challenges.

Law stated - 28 October 2022

DOCUMENTATION

Closing conditions

What closing conditions are commonly agreed in distressed M&A transactions? How do these differ from non-distressed transactions?

Distressed M&A transactions are usually subject to significant time constraints, so they are often limited to the absolutely essential, such as regulatory approvals (eg, merger control authorisations), shareholders' authorisations and authorisations under change of control provisions. There are no other specific features or material adverse change (MAC) clauses in these transactions, as insolvency is not a MAC trigger under Portuguese law.

Buyers are often also interested in ensuring that the distressed company begins pre-insolvency proceedings and, if the buyer does not acquire control over the distressed company, it may request, as a closing undertaking, that the company begins pre-insolvency proceedings.

Law stated - 28 October 2022

Representations, warranties and indemnities

What representations, warranties and indemnities are commonly given in distressed M&A transactions?

Representations and warranties in distressed M&A transactions are usually restricted and limited to those standardly qualified as 'fundamental warranties' (ie, capacity and title), and sales are often carried out on an 'as is, where is' basis. In transactions carried out under formal proceedings, representations and warranties are usually even more restricted. However, in pre-insolvency proceedings, as one of the relevant aspects of the regime is that the recovery plan may be extensively negotiated with the creditors, the granting of representations and warranties by the seller in the agreements entered into as a result of the recovery plan is not uncommon, although quite limited.

Law stated - 28 October 2022

Remedies for breach

What remedies are available and commonly sought for breaches of closing conditions, representations, warranties and indemnities in distressed M&A transactions?

In distressed M&A transactions, the buyer has the same remedies as it would have in a traditional M&A transaction, although the seller or target company may not have adequate solvency to compensate the buyer for breach of closing conditions, representations, warranties or indemnities.

In the Special Revitalisation Process (PER), in case of breach, the creditors who financed the company so that it could keep operating may enforce the guarantees granted in its benefit. In addition, in a PER procedure, the breach of undertakings set forth under a recovery plan may determine the insolvency of the distressed company and the transaction will then be implemented within insolvency proceedings, which is also considered as a deterrent to the seller and distressed company. If the recovery plan, already approved in insolvency proceedings, is breached by the debtor, the distressed company will be liquidated, which may also have certain advantages to the buyer, as the assets may be valued at lower prices.

The above does not exclude the recourse to common remedies to protect the creditor (eg, impugnação pauliana).

Law stated - 28 October 2022

Insurance

Is warranty and indemnity (W&I) insurance available for distressed M&A transactions in your jurisdiction? If so, what provisions and exclusions are commonly included in W&I policies?

W&I insurance (including synthetic W&I policies) is available for distressed M&A transactions, as it is for traditional M&A deals. However, although quite frequent in traditional M&A transactions, we are yet to see W&I insurance policies frequently used in distressed transactions.

Law stated - 28 October 2022

REGULATORY AND JUDICIAL APPROVALS

Merger control

What merger control rules and filing requirements govern the acquisition of distressed businesses and assets in your jurisdiction? Is the 'failing firm' defence recognised in your jurisdiction?

The general merger control rules apply to the acquisition of distressed businesses and assets in Portugal unless the transaction involves the acquisition of shareholdings or assets by the insolvency administrator and is carried out in insolvency proceedings.

Accordingly, a notification to the Portuguese Competition Authority (PCA) will be required if the acquisition of a distressed asset meets the following thresholds:

- the merger of two or more previously independent companies (or parts of companies);
- the direct or indirect acquisition of control of all or part of a company (which is the case here);
- each party's group, considered together, had an aggregate turnover of €100 million in Portugal in 2020, with each party having €5 million aggregate turnover in Portugal in 2020;
- the transaction creates or increases a market share of over 50 per cent in a potentially relevant market; or
- the transaction creates or increases a market share of over 30 per cent in a potentially relevant market and each party's group had an aggregate turnover of at least €5 million in Portugal in 2020.

The 'failing firm' defence is recognised in merger control proceedings. The PCA will follow the general practice of the EU Commission in applying this defence.

Law stated - 28 October 2022

Foreign investment review

Are distressed M&A transactions subject to foreign investment review in your jurisdiction? What rules, procedures and common practices apply?

Yes, distressed M&A transactions may also be subject to foreign investment review in Portugal, where the Portuguese government may exceptionally oppose investment by entities outside the EU and EEA in certain regulated and sensitive sectors (eg, energy, transport and communications).

There is no mandatory notification procedure. Nonetheless, on a voluntary basis, the prospective purchaser may ask the member of government responsible for the area of the strategic asset to analyse the terms of the transaction and confirm that the government will not oppose it. If the government does not begin any assessment procedure within 30 days of the date of request by the prospective purchaser, a non-opposition decision is deemed to have been tacitly adopted.

If no prior assessment is requested by the prospective purchaser, the Council of Ministers, on a proposal from the member of government responsible for the area of the strategic asset can assess and exceptionally oppose a transaction resulting directly or indirectly in the acquisition of (sole or joint) control, by an investor from a country outside the EU and the EEA. This can happen if it puts at risk, in a real and sufficiently serious way, defence and national security or the security of supply of services that are fundamental to the national interest. The investigation must take place within 30 days of the conclusion of the transaction or from the date it becomes publicly known, if later. A decision must be adopted by the government within 60 days of receiving the complete information and documentation requested. If no decision is issued within that period, a non-opposition decision is deemed to have been tacitly adopted.

We are not aware of any blocked transactions under these rules.

Law stated - 28 October 2022

Bankruptcy court

What rules and procedures govern the bankruptcy court's approval of distressed M&A transactions in your jurisdiction?

Judicial insolvency and restructuring proceedings are mainly governed by the Portuguese Companies Insolvency and Restructuring Code, which allows court approval of distressed M&A transactions provided in a recovery plan approved under insolvency or pre-insolvency proceedings.

The plan negotiated within an insolvency or pre-insolvency proceedings must be approved by the creditors and, after that, it is subject to the court homologation.

A plan is approved:

1. under insolvency proceedings, whenever the creditors attending the relevant meeting represent at least one-third of the total credits (held by creditors with a right) to vote and the plan collects more than two-thirds of the total of votes issued and more than half the votes referred to non-subordinated credits; or
2. under pre-insolvency proceedings, whenever: favourable votes of creditors who represent more than half of the votes, and at least half of these votes must correspond to non-subordinated credits; or the majorities for the approval of the insolvency plan mentioned in (1) are met.

Notwithstanding the approval by the creditors of a recovery plan, the court must refuse its homologation:

- in case of violation of the procedural rules, or of its content applicable rules;
- whenever the conditions precedent provided for in the plan have not been verified within a reasonable period of time; or
- when the acts that should be practised or the measures that should be adopted to proceed with the homologation were not practised or adopted.

The judge may also refuse the insolvency plan's homologation whenever petitioned by an opponent creditor if he or she can duly demonstrate that the position resulting from the insolvency plan is less favourable than the one that would exist if there was no insolvency plan, or that the insolvency plan would provide any creditor with an actual economic value superior to its credit. The decision of homologation may be appealed.

When these operations take place during these proceedings but outside a recovery plan provision, they are subject to shareholder and judicial administrator consent.

Law stated - 28 October 2022

DISPUTE RESOLUTION

Common disputes and settlement

What issues commonly give rise to disputes in the course of distressed M&A transactions and what practical considerations should be borne in mind when seeking to settle such disputes out of court?

The main issues giving rise to dispute resolutions concerning M&A transactions arise from the fact that sales are conducted with limited representations and warranties. This leads to a higher number of disputes between sellers and purchasers relating to the valuation of the target or asset and breaches of the representations and warranties agreed upon by the parties. When these issues are resolved out of court, it is vital to pay attention to collaboration duties between the parties (to maintain the transaction) and confidentiality clauses.

Further, when the distressed company begins insolvency proceedings, some of its creditors may try to challenge the sale and press the insolvency administrator to claw back the deal. In addition, often challenges by other creditors to the approval of recovery plans need to be addressed in court.

Law stated - 28 October 2022

Litigation and alternative dispute resolution

What litigation forums are used to resolve disputes arising from distressed M&A transactions in your jurisdiction and what procedures apply? Is alternative dispute resolution (ADR) commonly used?

Sale agreements are normally subject to Portuguese law and both court jurisdiction and alternative dispute resolution are used, depending on the parties' interests. However, alternative dispute resolution (in particular, arbitration) is more often chosen by the parties because it is confidential, and the final decisions are faster than those of the courts. In addition, the parties usually appoint arbitrators and they feel more comfortable with arbitration because they know that the decision-makers have more experience and sensitivity to this type of dispute.

Law stated - 28 October 2022

UPDATE AND TRENDS

Recent developments and outlook

What have been the most significant recent developments and trends affecting distressed M&A in your jurisdiction, including any notable court decisions, regulatory actions and deals? What is the general outlook for future transactions?

The most significant development was brought by the amendments introduced to the Portuguese Insolvency and Corporate Recovery Code by Law 9/2022 of 11 January, which incorporated into Portuguese law Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019, on preventive restructuring frameworks. This new Law established several measures to support and speed up corporate restructuring processes and payment agreements. The most significant of the various amendments were those introduced to the Special Revitalisation Process (PER) and to insolvency proceedings. It is expected that these measures will have a positive impact on companies undergoing restructuring processes, and also on their creditors and potential investors, thus attracting more investment in distressed companies.

The most important changes were the following:

- a possibility of the company submitting with its PER application a proposal that divides its creditors into distinct categories according to the nature of their credits (this proposal is mandatory for companies other than micro, small, and medium-sized companies), and this allows a more equitable treatment of the different creditors on a case-by-case basis;
- the creation of the concept of 'essential executory contracts', ensuring that, during a critical period of time after submission of the PER, creditors that are parties to contracts with the company and whose performance is essential for the company to continue operating are not allowed, on the sole grounds of breach of repayment of debt, to refuse compliance; terminate; accelerate; or unilaterally amend such contracts to the detriment of the company, in respect of debts created before the beginning of the PER;
- protection and several incentives for the new financing granted during the PER or in the execution of the recovery plan. Creditors that finance the company's activity to provide it with capital for its recovery enjoy a credit over the insolvent estate up to a value corresponding to 25 per cent of the company's non-subordinated liabilities at the date of the declaration of insolvency if the insolvency of the company is declared within two years of the date of the final and unappealable decision approving the recovery plan. The credits made available above this amount will enjoy a general privilege that ranks ahead of the general privilege granted to the employees; and
- financing made available to the company by shareholders and any other persons in a special relationship with the company in connection with the execution of the recovery plan will also enjoy a general privilege that ranks above the one that is granted to employees.

Law stated - 28 October 2022

Jurisdictions

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