INFORMATIVE NOTE

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CORPORATE

THE NEW LEGAL REGIME FOR THE CONVERSION OF UNSUBORDINATED CREDITS INTO CAPITAL

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The new law entered into force on the day after its publication and clearly aims to provide an extrajudicial mechanism for the conversion of credits into capital ("**Conversion**"), enabling, on the one side, the companies that are in a difficult financial situation, but are still economically viable[1], to strengthen their equity and, on the other side, certain of their creditors – unsubordinated – to convert their receivables (unlikely to be recoverable) over these companies into registered capital.

I. THE (LIMITED) SCOPE OF THE NEW REGIME FOR CONVERSION OF CREDITS INTO CAPITAL

The legislator starts by limiting the application of this new regime *"to credits held over a commercial company, or a company adopting a commercial form, incorporated under the Laws of Portugal"*.

In this positive delimitation by our legislator, it results that the regime now created only applies (i) to credits held over a commercial company or company adopting a commercial form, excluding, as such, civil-law partnerships or legal persons of a different nature, and (ii) provided their registered office is located on Portuguese territory, thus excluding all commercial companies established under other jurisdictions.

1 Viability that should be determined in accordance with the (questionable) criterion of turnover.

On the other hand, the following are explicitly excluded from this new Conversion regime:

(i) Credits held over insurance companies, credit institutions, finance companies, investment firms, publicly-traded companies and state-owned companies, as defined under Decree-Law 133/2013, of 3 October, as amended by Laws 75A/2014, of 30 September, and 42/2016, of 28 December;

(ii) Credits held by public entities, with the exception of state owned companies, which for the purposes of using this new conversion mechanism must previously obtain authorisation from the member of Government responsible for the area of finance and comply with the rules and principles applicable to the state owned companies; and

(iii) Credits over companies with a turnover lower than EUR 1,000,000.00 (one million euros), according to the last year-end approved accounts.

This new Conversion regime expressly excludes the credits over companies with a turnover lower than EUR 1,000,000.00, according to the last year-end approved accounts.

II. THE CONVERSION PROCEDURE

(i) Initiative for Conversion – proposal by the company's creditors

Under the new law, the legislator grants creditors the initiative of the Conversion procedure, preventing debtor companies from – at least directly - taking the initiative of proposing to creditors the conversion of their credits into capital.

(ii) Requirements for Conversion – indirect delimitation of the subjective scope of the new law

The possibility of requesting the Conversion is not granted indifferently to all the company's creditors, but only to those which, alone or together with other creditors, hold credits over the debtor company that represent, at least, (i) two thirds of the total liabilities of that company[2] and (ii) the majority of the unsubordinated credits.

In addition to the two aforesaid requirements, concerning the representativity of the credits held by such creditors in the overall liabilities of the debtor company, all the following requirements must also be met:

(i) The equity of the debtor company, as evidenced by the last year-end approved accounts or, if there are any, by the interim accounts drawn up by the board of directors and approved within the last 3 months, is lower than the company's share capital; and

(ii) The unsubordinated credits that are in default for more than 90 days represent more than 10% of the total unsubordinated credits or, in case payments of partial reimbursements of capital or interest are at stake, provided that these represent unsubordinated credits over 25% of the total unsubordinated credits.

Under this new law, the subordinated, common or ranked nature of the credits held over the companies must be determined in accordance with the provisions of articles 47 and 48 of the Code of Insolvency and Corporate Recovery ("**CIRE**"). Therefore, it is not possible the Conversion of (i) credits held by persons specially related to the debtor[3], provided the special relationship already existed at the time of its acquisition, (ii) interests of unsubordinated credits, with the exception of that covered by a real guarantee (guarantee in rem) or by general preferential claims, up to the value of the corresponding assets, (iii) credits subordinated by agreement of the parties, (iv) credits which consist of debtor's obligations free of charge, (v) interest of subordinated credits, and (vi) credits to the reimbursement of shareholder loans (provided that, in any of these cases, such credits do not benefit from general or special preferential claims or legal mortgages).

The purpose of the legislator is clear: while, on the one hand, the intention is to offer creditors out-of-court conversion of credits held over companies that, despite being indebted, have acceptable turnover and well-founded expectations of financial recovery, on the other hand, the range of occasions when these credits can be converted is limited to situations in which this mechanism can simultaneously significantly clear the balance sheet of debtor companies, proportionally reducing their level of indebtness.

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(iii) Details of the proposal for conversion

The proposal for Conversion ("**Proposal**") submitted by creditors must be accompanied by the following:

(i) A report drawn up by Statutory Auditor ("**Statutory Auditor**") that demonstrates the state of thin capitalisation of the company and the delay in payment for more than 90 days of potentially convertible credits;

(ii) A document containing the proposals for the alteration of the company's share capital[4], which must:

(a) Contain a description of the specific content of the corporate operation planned;

(b) If the conversion is preceded by a capital decrease to cover losses[5], provide for the share capital decrease and its justification (which must be determined in the report of the Statutory Auditor referred to in (i) above);

(c) State the amount of the share capital increase to be subscribed by the creditors, through the Conversion, as well as the grounds for the conversion ratio of credit into capital; and

(d) Contain the proposed amendment to the articles of association.

2 Credits held by public entities, save state-owned companies, are expressly excluded for the purposes of determining the company's liabilities.

3 Under article 49(2) of the CIRE, "people specially related to the legal person debtor" are (i) the shareholders, associates or members that are legally liable for its debts, and persons that have had such status in the two years prior to the start of the insolvency proceedings; (ii) people that may have controlled or been in the same group as the insolvent company, under the terms of Article 21 of the Portuguese Securities Code, in a period situated within the two years prior to the beginning of the insolvency proceedings; (iii) the legal or de facto directors of the debtor and those who have been in office at any point within the previous two years; (iv) spouses, former spouses divorced within the 2 prior years, cohabiting partners, ascendants, descendants or siblings of those referred to in the preceding subparagraphs.

4 To which the provisions of article 28 of the Portuguese Companies Code, concerning the occurrence of contributions in kind, shall apply.

5 It is noteworthy that, under this new law, the capital increase resulting from the conversion of credits can be preceded by a share capital decrease with the (sole) purpose of covering losses, even to zero or to an amount lower than the minimum permitted by law for the type of company in question, *if it is to be presumed that, in the event of full liquidation of the company's assets, there would be no remainder to be distributed among the shareholders.*

Also innovative and illustrative of the importance now attributed to creditors in the life of companies is the possibility of a proposal envisaging the transformation of the debtor company into a different type of company and even the exclusion of all its shareholders - which, in certain cases, may not be voluntary -, provided that their shareholdings are of no value.

(iv) The information obligations of the debtor company's board of directors in connection with the Proposal

For creditors to be able to gather the information necessary to exercise their right to submit the Proposal that they are now granted with, the legislator established the duty of the debtor company's directors to provide the information requested for such purpose, within 10 (ten) days after receipt of the corresponding request.

If the information requested is not provided by the company's directors, the Statutory Auditor responsible for the compilation of the assessment report on the financial and accounting situation of the company must (i) verify the maturity of the potentially convertible credits (with a delay of at least 90 days) and the representativity of these credits in light of the information provided by the creditors and, also, (ii) analyse the proportion between the amounts overdue and the liabilities of the debtor company, according to the last accounts approved by the company.

(v) The decision-making stage, the duties of shareholders and the share capital after conversion

Once the Proposal has been received, the general meeting of the debtor company must be immediately convened, to meet within 60 (sixty) days as from the date of receipt of the Proposal, and resolve on its approval or rejection. During this period, the company may reach an agreement with its Creditors on changes to the Proposal, such changes to be made available in advance for analysis by the shareholders, with legal or statutory minimum time for calling general meetings.

In the resolution regarding the share capital increase necessary for the approval of the Proposal, the shareholders will always be granted a pre-emption right. If this pre-emption right is exercised (by all or only some shareholders[6]), the share capital increase will necessarily be in cash, and must be applied to the payment of the credits that would be converted into capital, in accordance with the Proposal.

If the Conversion proposal is approved, the company's equity after the share capital increase must be greater that the value of the share capital at the proposal date.

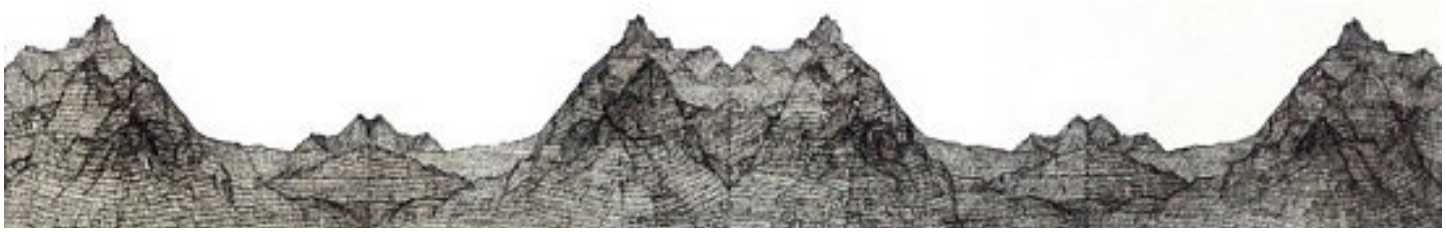
6 If a shareholder does not exercise its pre-emption right, the shareholders who exercise their pre-emption right will be granted the opportunity to subscribe the shares that, in the registered capital increase would be for the shareholder that did not exercise such pre-emption right, pro rata to their shareholdings.

III. THE CONSEQUENCES OF NON-APPROVAL OF THE PROPOSAL FOR CONVERSION AND POTENTIAL LITIGATION

If the Proposal is rejected, whether due to the company's general meeting not being held or the resolutions provided for in the Proposal not being approved or implemented within 90 days as from receipt of the Proposal, the creditors may apply to the court with competence to declare insolvency for replacing the shareholders on the decision of altering the company's corporate structure ("*suprimento judicial*").

The procedings of "suprimento judicial" will be of urgent nature (without suspension of time limits during judicial recesses), and the confirmation judgment rendered will consitute sufficient title for a share capital decrease, share capital increase, amendments to the articles of association, transformation and exclusion of quotaholders of the debtor company, as well as for the purposes of promoting the required commercial registrations.

If the Conversion proposal is approved, the company's equity after the share capital increase must be greater than the value of the share capital at the proposal date.



FUNDAÇÃO PLMJ

SÉRGIO POMBO - S/título, 2003 *(detail)*
Óleo s/papel - 100 x 70 cm
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