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FLASH

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RESTRUCTURING AND INSOLVENCY

AMENDMENTS TO THE PORTUGUESE INSOLVENCY AND COMPANIES RECOVERY CODE

I. INTRODUCTION

There has been recently published in the Portuguese Official Gazette the Law no. 16/2012, of 20 April, which amends the Portuguese Insolvency and Companies Recovery Code (*Código da Insolvência e Recuperação de Empresas*, hereinafter the "**CIRE**") and introduces a special procedure for the recovery of debtors in a difficult economic situation.

In Section II of this Flash, we will analyse in detail the rules applying to the new special rescue procedure.

In Section III, we will summarise the remaining amendments introduced in the CIRE that are relevant for corporate insolvency.

II. THE SPECIAL RESCUE PROCEDURE (PROCESSO ESPECIAL DE REVITALIZAÇÃO)

The implementation of the special rescue procedure is the most innovative measure contained in Law no. 16/2012, which represents an authentic change in the CIRE's underlying principles, in that it gives a priority to the recovery of the company in detriment of its liquidation.

a) Prerequisites

The special rescue procedure is aimed at ensuring the recovery of a debtor that is in a "*difficult economic situation*" or in a "*situation of merely imminent insolvency*" without starting an insolvency procedure, which would otherwise require the declaration by the court of the debtor's insolvency and would lead to a greater time consumption. Also, contrarily to what happens in the insolvency procedure, this procedure may only be initiated at the initiative of the debtor, who may at any moment request it to be dropped.

In order to start this procedure the debtor and, at least, one of its creditors must evidence, *via* a written statement, that they have begun negotiations with a view to rescue the debtor. The latter must state that it is in a "*difficult economic situation*", understood as "*serious difficulties*" of it to timely fulfil its obligations, due to reasons such as lack of liquidity or impossibility of obtaining credit. The debtor must also make available a list of its creditors, its accounts' documents and remaining information and documentation as required under the relevant provisions of the CIRE.

b) Effects on procedures against the debtor

Once the rescue procedure starts, the enforcement and insolvency proceedings that may have been brought against the debtor are suspended (insofar as no decision of insolvency has been declared by the court). In addition, it is not possible to bring enforcement and insolvency proceedings against the debtor for as long as the rescue procedure is running.

Naturally, once the rescue procedure is terminated, regardless of the cause, the procedural situation shall be re-established in accordance with the *status quo* in force at the time before its initiation, being that certain acts performed within it may be employed in the new insolvency proceeding.

c) Effects on the administration of the debtor

During the rescue procedure, and differently from what occurs in an insolvency proceeding, the managers of the debtor shall not be suspended. The management is only bound to request permission from the provisional judicial administrator in order to perform "*particularly relevant acts*".

The qualification of an act as having "*particular relevance*" is made with reference to the several risks involved and the specificities of the procedure. Article 161 of the CIRE provides a list of illustrative examples, such as the transfer of assets required for the exploitation of the debtor's business, the entering into of long term agreements or the assumption of third party's obligations and the granting of security.

In order to ensure a swift communication, the debtor may request permission to practice a "*particular relevant act*" *via* an e-mail sent to the provisional judicial administrator, the latter being under the duty to answer within five days. The request shall be deemed as refused in case of lack of answer within this delay.

d) Credit Verification

Once the application is received, the Court immediately appoints a provisional judicial administrator and issues a judicial order, which is published in the litigation portal run by the Government which is known as "Citius", and, by registered letter, notified to the debtor and to the creditors in accordance with the CIRE's general rules.

The creditors who did not sign the negotiation agreement initially submitted to the Court are granted 20 days as of the publication of the said judicial order to claim their credits and the provisional judicial administrator must prepare a provisory list of credits within 5 days.

This list is published in Citius and it may be challenged within 5 business days, after which term the Judge benefits of the same term to decide on the challenges submitted.

e) Negotiation

Once the term for challenging the credits elapses, the debtor and the creditors have 2 months to conclude the negotiations, being that this deadline may be extended for an additional 1 month period by prior written agreement between the appointed provisional judicial administrator and the debtor.

The provisional judicial administrator participates in the negotiations, guiding and supervising the works and their adequacy, and must ensure that the parties do not adopt any actions in order to delay the negotiations process or that are useless or prejudicial for its progression.

The guiding principles approved by the Resolution of the Council of Ministers no. 43/2011, of 25 October, and available (in Portuguese language) in this link, must be observed during the negotiations.

The debtor must offer all possible cooperation within the scope of the plan negotiation, in particular by providing all information requested by the creditors or by the provisional judicial administrator.

This duty is particularly reinforced to the extent that not only the debtor, but also its legal or *de facto* directors are jointly and severally liable for losses caused to creditors in connection with omissions or inaccuracies in the information supplied. An autonomous suit may be brought in order to condemn the responsible parties to hold the creditors harmless in relation to these losses.

f) Approval and validation of approval of the recovery plan

The recovery plan must be approved by the same majority required for the approval of the insolvency plan: the creditors whose receivables represent at least 1/3 of the total receivables with voting rights must participate in the approval and the approval votes must represent more than 2/3 of the total of the votes cast and more than 1/2 of the votes cast corresponding to non subordinated credits, abstentions not being considered.

The Judge must validate the approval of the plan within 10 days as of receiving the documentation evidencing the respective approval.

The validation of the approval may be refused in accordance to the same rules applicable to the insolvency procedure (Article 215 and 216 of the CIRE).

In summary, the Judge may refuse to validate the approval:

- On his own official initiative, in case of a non-immaterial breach of procedural or substantive rules and whenever the plan's conditions precedent are not verified or other acts or measures which must precede the approval's validation are not carried out;

- Upon request by an interested party, if it shows that its situation under the plan is presumably less favourable than it would be in the absence of it, or if the plan provides a creditor with an economic value higher than the nominal amount of its credits over the insolvency, accrued of the value of any eventual contributions it has to make.

The decision of the Judge to validate the approval binds all creditors, even those which did not participate in the negotiations.

g) Validation of private agreements

In case of approval of a private agreement on the recovery plan by the creditors representing the majority required for such purpose, an even swifter procedure may be put into place, which only entails the receivables verification stage with regard to those which are held by creditors not taking part on the plan's approval, after which the Judge proceeds to the respective validation.

Although during the negotiation of the private agreement it is not possible to block or suspend the enforcement or the insolvency proceedings brought against the debtor, this mechanism allows avoiding the time constraints of the negotiation led within the scope of a pending recovery procedure, and to ensure the effectiveness of the same towards all creditors and the protection of the security provided as described above.

h) Creditor Protection

The creditors who finance the debtor's activity by making capital available for its rescue benefit from a general preferential claim over movable assets, ranking before the preferential claim conferred to the workers.

In addition, and similarly to what has been included in the CIRE's general regime (see below), the security granted within the context of the rescue procedure is not subject to the regime of termination in benefit of the insolvent estate, which removes an important obstacle that existed until this Law in relation to the implementation of financing solutions ensuring an economic viability of the debtor.

i) Implications of the new rescue procedure

The implementation of the rescue procedure is a legislative policy option aiming to favour the recovery of companies that are in a difficult economic situation, in detriment of the satisfaction of the creditors' rights through the product of the liquidation of its assets. In effect, there are several aspects in this regime that clearly favour the debtor's position and stimulate it to initiate this process.

Notwithstanding, it should be noted that this Law also tries, to the extent possible, to protect the creditors' rights and to urge them to cooperate with the debtor in the negotiation of the recovery plan. Certain rules were also established so as to avoid the use of this process for delaying purposes and in order to hold the debtor and its directors liable in case of breach of information duties within the context of the negotiations of the recovery plan.

As it has been shown in other legal systems, the rescue procedures bring both upsides and downsides and may have different effects, depending on several factors.

In Portugal, the Courts' lack of means, a culture which does not rely on entrepreneurial risk, the structure of the business sector – where subsist small or medium companies with little resources to negotiate recovery plans - can hinder the full accomplishment of the objectives underlying the introduction of the rescue procedure.

However, if, as intended, the parties are able to conduct this procedure in a swift way, the same is not used by the debtor as a delaying tactic and a culture of responsibility and cooperation prevails amongst everyone, the rescue procedure may provide a favorable legal framework for the adoption of measures for companies' economic recovery, therefore bringing positive social effects.

III. THE REMANING AMENDMENTS TO THE CIRE'S RULES

The main amendments to the CIRE brought by Law no. 16/2012 are the following:

- The creditors' meeting may be dispensed by the Court, unless the debtor requires the exoneration from the remaining liabilities (*passivo restante*), it is foreseeable that an insolvency plan will be presented or it is determined that the administration of the insolvency will be carried out by the debtor (and without prejudice to any interested party requesting that such meeting takes place);

- Reduction of various procedures time limits:
  - The debtor can now present itself to insolvency within 30 days as of the acknowledgement of such situation, instead of the 60 days period which was previously set out in the CIRE;
  - The creditors' meeting, in case it occurs, must take place within 60 days after the judicial decision of declaration of insolvency, instead of the 75 days which were previously foreseen;
  - In case the creditors' meeting is waived, all procedural deadlines which are to be counted as from such date start to be counted with reference to the 45th day following the date of the pronouncement of the judicial decision of declaration of insolvency;
  - The general term for the termination of acts which are performed in bad faith in detriment of the insolvent estate is reduced from 4 to 2 years;
  - The right to challenge the termination in benefit of the insolvent estate expires after 3 months instead of 6 months;
  - The legal action aimed at the recognition of credits after the end of the term for submitting claims can only be brought in the 6 months following the *res judicata* of the judicial decision of declaration of insolvency, reducing in half the 1 year term which was previously foreseen in the CIRE;

- This legal action now expires if the claimant, with negligence, stops promoting the terms of the proceeding for 1 month, instead of the former 3 months.

- Reinforcement of the rules concerning the liability of all persons affected by the judicial decision which qualifies the insolvency as faulty, which will now, further to the consequences that were already foreseen in the CIRE, have to indemnify the creditors of the debtor declared insolvent in the amount of the unsatisfied credits, up to the possibilities of their respective assets, such liability being joint and several among them;

- Reinforcement of the duties of the "*de facto* directors" (those who, although not having been appointed as directors by the shareholders' meeting of the insolvent companies, actually assume the respective management):
  - Requirement of their immediate identification on the insolvency application;
  - Mandatory attendance by the *de facto* directors in the discussion and trial hearings.

- Mandatory maintenance in office (although with suspension of the exercise of their powers and without remuneration) of the directors of the company, who:
  - Despite before being able of immediately terminating their offices, now can only do it as of when the deposit of the annual accounts with reference to the date of the decision of liquidating the company in an insolvency proceeding;
  - Are liable for the deposit of the accounts at the Commercial Registry Office as well as for the compliance of the company's tax obligations until the eventual closure of the establishment's activity.

- Greater flexibility of the rules concerning the insolvency administrator(s)' appointment:
  - It is now possible to appoint more than one insolvency administrator in the cases where the "*recruitment process assumes a great complexity*", said additional administrators having to be indicated and remunerated by the applicant and being that the standing of the insolvency administrator appointed by the Court shall prevail in case of dissent;
  - Although it was already previously allowed for the majority of creditors to replace the insolvency administrator appointed by the Court for another person who was also part of the official lists (or, in exceptional situations, even if it was not) and who accepted the office, it is now possible to proceed to such replacement not only in the first creditors' meeting but also in any other;
  - The insolvency administrator is now able to delegate, in writing, the performance of specific acts in an insolvency administrator with registration in force in the official lists (further to the possibilities of delegation in reason of legal sponsorship or with the agreement of the creditors' commission, which were already allowed in the CIRE).

- Wider control of the Judge over the incident of insolvency qualification (*incidente de qualificação da insolvência*):
    - The judicial decision of declaration of insolvency can now only declare the incident of insolvency qualification open when there are traces that justify holding the persons involved liable;
    - Possibility of the Judge pursuing the incident of insolvency qualification, even when the insolvency administrator and the Public Prosecutor Office suggest the qualification of the insolvency as random (*i.e.* not faulty), therefore conferring a prevalence to the principle of legality.

- The procedures aimed at providing the debtor with the sufficient financing means to enable its recovery are now unable of being terminated, which is an undeniable incentive to the negotiation of recovery plans, which normally involve the granting of financing and the issuance of securities, acts that are otherwise particularly frail in light of the general regime of termination of acts prejudicial to the insolvent estate;

- Modernisation of the means of communication used within the scope of the insolvency proceeding:
    - Publication of several acts *via* announcements in Citius (in replacement of the publications in the Official Gazette);
    - Summoning of creditors in the legal actions for the subsequent verification of creditors *via* a notice in Citius (in replacement of the former summoning via public notice);
    - Permission of notification concerning several acts *via* electronic mail;

- While in the original version of CIRE, in order to proceed to the anticipated sale of the assets of the insolvent estate that were subject to deterioration or depreciation, the insolvency administrator required the previous authorisation of the creditors' commission or the Judge's, the former is now able to move on with such sale within the minimum term of 2 working days as of the publication of the sale project in Citius, insofar as the Judge does not prohibit so within such term (either officially or in virtue of a grounded request submitted by the debtor, any creditor or the creditors' commission).