

# Portuguese insolvency and restructuring measures during Covid-19

**Eduardo Peixoto Gomes**

*Abreu Advogados, Porto*

eduardo.p.gomes@abreuadvogados.com

## Introduction

Since the beginning of 2020, especially following the Covid-19 pandemic declaration issued by the World Health Organization on 11 March 2020, the world has been haunted by a severe health, social and financial global crisis – with the full extent of its effects still to be ascertained.

In February 2021, the Portuguese National Institute of Statistics announced a decrease of 7.6 per cent in the 2020 gross domestic product (GDP). Considering that we witnessed a growth of 2.2 per cent in the GDP in 2019, this plunge clearly reflects the adverse effects of the pandemic caused by Covid-19 in Portugal's economic activity. At the end of 2019, other benchmarks showed Portugal was following an improving trend, as the budget balance was positive for the first time in the last 50 years, the unemployment rate was the lowest since 2002 and non-performing loans only reached 6.5 per cent.

All over the world, measures have been taken to help businesses cope with the economic crises caused by the Covid-19 pandemic, to try to mitigate the corresponding financial impact. Portugal was no exception. It adopted urgent measures not only to protect Portuguese families, in terms of credit for permanent residence properties, but also companies, to ensure the strengthening of their cash flow and liquidity in order to mitigate the effects of the drastic reduction of economic activity. Individual entrepreneurs, private charities, non-profit associations and other social economy entities were also covered by this protection scheme.

## Key features of insolvency and restructuring measures

Portugal approved an unmatched package of legislation, which included:

- temporary amendments to insolvency rules, such as the special revitalisation procedure (PER), the special payment arrangement procedure (PEAP) and the extra-judicial reorganisation scheme (RERE);
  - special measures such as simplified lay-off, postponement of rent payments, a credit moratorium and supply of credit facilities; and
  - new restructuring mechanisms, such as an extraordinary procedure for companies viability (PEVE), the Action Plan for Default Risk (PARI), the Out-of-Court Procedure for the Regularisation of Defaults (PERSI) and the Public Support System for Conciliation in Over-indebtedness (SISPACSE).
- On 26 March 2020, the Portuguese Government approved Decree-Law 10-J/2020, which established a moratorium that prohibits the revocation of contracted credit lines and the extension and suspension of credits until the end of the applicable period.<sup>1</sup> This measure intended to ensure the continuity of financing and prevent possible defaults resulting from the economic activity reduction. It applies to families, companies, private charities, non-profit associations and other social entities. When contracted by beneficiaries who are natural persons, it only includes the following credit operations: (1) mortgage credits, as well as residential property leasing; and (2) consumer credit for education, including academic and professional training.

The moratorium may be relevant for the purposes of assessing the insolvency of a given debtor if the latter is a beneficiary of the moratorium. It should be noted that Article 6 of Decree-Law 10-J/2020 makes it clear that in the event of a declaration of insolvency or submission to a PER or RERE by the entity benefiting from the moratorium, the financial and credit institutions concerned may exercise all actions inherent to their rights.

Article 18 of the Portuguese Insolvency and Recovery Code (CIRE) stipulates that the board of directors (and each of its members) of a company have the

duty to file for insolvency within 30 days from the date of their knowledge of the insolvency situation. If this obligation is not complied with, serious misconduct may be presumed, which is extremely significant for defining the insolvency as culpable.

Article 20 of CIRE further stipulates that insolvency should be filed if any of the following occurs:

- general suspension of payment of overdue obligations;
- failure to meet one or more obligations which, because of their amount or the circumstances of the failure, shows that it is impossible for the company to meet most of its obligations on time;
- manifest excess of liabilities over assets according to the last approved balance sheet
- insufficiency of seizable assets for payment of a credit verified in executive proceedings brought against the debtor company; or even
- general failure, in the last six months, to meet debts arising from an employment contract, or the breach or termination of that contract.

Considering that, from 2020 onwards, insolvency situations were mostly triggered by the Covid-19 pandemic, the Portuguese Government decided to suspend the abovementioned 30 days deadline for debtors to file for insolvency, with effect from 7 April 2020, as per article 6-A of Law 4-A, of 6 April.<sup>2</sup> In summary, albeit not modifying the grounds for insolvency, nor preventing any creditor from applying for a declaration of insolvency of a debtor, it suspended this legally established obligation regarding voluntary insolvency. This was an attempt to try to minimise inevitable losses and to avoid large-scale stigmatisation and depreciation of company values associated with insolvency.

Nevertheless, considering that companies that were already in a state of insolvency were still prevented from using pre-insolvency instruments to promote their recovery, such as the RERE or PER, Law 75/2020 entered into force on 27 November 2020, which not only established PEVE,<sup>3</sup> but also fine-tuned the aforementioned mechanisms for economic recovery.

PEVE is an extraordinary measure available to companies which are in a difficult economic situation or are insolvent due to Covid-19. It is in force until 31 December 2021<sup>4</sup>. It is a one-time process (in order to avoid abuse), which entails the necessity to prove that the difficult economic situation/insolvency resulted from the Covid-19 pandemic and that the company is still capable of being viable.

It involves a prior voluntary negotiation of a viability agreement between the company and the majority of its creditors and has a minimum judicial intervention: to judicially certify the agreement and make sure it applies to the creditors who are not its signatories.

In addition, it also allows the protection of internal financing (as general movable credit privilege shall apply), provides tax advantages (such as reduction or forgiveness of interest by the Tax Authority or Social Security) and temporarily allows the maintenance of essential public services (eg, electric power, postal services and electronic communications). In fact, this is an extremely urgent procedure which takes precedence over insolvency proceedings and the other pre-insolvency proceedings (PER or PEAP) and does not involve the payment of any court fees.

Furthermore, Law 75/2020 of 27 November also established that internal financing during a PER will no longer qualify as a subordinated credit, but will be identical to one established in CIRE to other creditors. This allows shareholders and directors to grant loans and/or provide guarantees to obtain financing without such onus and facilitate its concession. Additionally, it also provides for the application of RERE to companies that are currently insolvent as a consequence of the Covid-19 pandemic. Moreover, it provides priority to the requests for the release of guarantees provided for in insolvency proceedings, special revitalisation proceedings or special proceedings for settlement of payments.

Finally, on 23 December 2020, Decree-law 105/2020 was published and SISPACSE entered into force.<sup>5</sup> This mechanism is a public support system for conciliation in over-indebtedness situations, the use of which is limited to the time prior to the use of the special revitalisation procedure, the special payment arrangement procedure or the insolvency procedure. Even though it is not a temporary solution, it is only available to debtors who are natural persons.

This public and extrajudicial system (therefore deprived of the court's intervention) is aimed at promoting an alternative dispute resolution between the debtor and their creditors, arising from late payment and non-compliance with pecuniary obligations, supported by the intervention of a conciliator (professionally qualified to use techniques that promote the fair composition of disputes) with the constitutive participation of all interested parties.

Tax and social security outstanding amounts are specifically excluded from this mechanism, as well as outstanding amounts falling under a PARI or PERSI. However, it provides debtors the opportunity to temporarily overcome a situation of non-compliance in an almost cost-free process (the conciliator's fees are paid by a public entity – the General Directorate for Political Justice).

It is important to highlight that this mechanism is voluntary and no creditor is obliged to subscribe to it. However, considering that it will provide the latter with

a swift and economic access to an executive title (the agreement executed), there is a significant cost and time saving.

## Conclusion

Upon a current analysis of the Portuguese legislative activity on insolvency and restructuring in the last year, more precisely between February 2020 and February 2021, we can conclude that initially it was clearly insufficient, even though it gradually remedied, partially, such inadequacy.

For instance, the simple suspension of the debtor's duty to file for insolvency within 30 days from the date of knowledge of the insolvency situation does not prevent any creditor to file it, should one of the events stipulated in article 20 of CIRE be verified.

The effort of creating new restructuring mechanisms, such as PEVE, PARI, PERSI and SISPACSE, is commendable. It not only seeks to prevent future clogging of commercial courts by presenting out-of-court solutions or solutions with a minimum of judicial intervention, but also enhances and adapts already existing recovery processes, providing debtors and creditors a myriad of options.

One may argue, for instance, that the aforementioned mechanisms have a very narrow scope of application. For instance, SISPACSE only covers natural persons and a limited set of debts. Nonetheless, it might

well prove to be extremely useful in the near future, considering that the postponement of rents' payment or moratoriums will soon end.

Finally, with such a wide range of options, special and extraordinary recovery plans and mechanisms, it may be difficult for the target audience to be fully aware of its characteristics and, consequently, difficulties may arise in their use and implementation.

## Notes

- 1 Initially until 30 September 2020; currently for a period up to nine months, subject to a communication of adhesion to be made until 31 March 2021.
- 2 Amended Law 1-A/2020 of 19 March.
- 3 Law 75/2020, of 27 November.
- 4 Its duration may be extended by government decision.
- 5 SISPACSE entered into force on 21 February 2021.

**Eduardo Gomes** is an associated partner at Abreu Advogados, working primarily in corporate restructuring, recovery and insolvency, private investment operations, commercial and real estate contracts.

He focuses particularly on monitoring company mergers and acquisitions operations, in corporate restructuring proceedings, on advising members of the board of large companies and on disagreements between shareholders.

He has extensive experience advising family-owned businesses, including in the transmission from one generation to the next.