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INFORMATIVE NOTE

DISPUTE RESOLUTION

Changes to the Insolvency and Corporate Recovery Code

Law 9/2022 was published in *Diário da República*, the Portuguese official gazette, on 11 January 2022. This new law establishes measures to support and speed up corporate restructuring processes and payment agreements. It is the result of the incorporation into Portuguese law of Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 ("Directive (EU) 2019/1023"). Furthermore, it amends the Insolvency and Corporate Recovery Code ("CIRE"), the Companies Code ("CSC"), the Commercial Registration Code, and other related legislation.

Of the various amendments introduced by Law 9/2022, the most noteworthy are those introduced in relation to the Special Revitalisation Process (*Processo Especial de Revitalização* - "**PER**") and the insolvency process. This is due to the practical impact they will have not only on companies undergoing a restructuring process, but also on their creditors and potential investors. The stated aim of these changes is to streamline recovery and insolvency processes, and to make the judicial system more effective and resilient.

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Dispute Resolution
Restructuring and insolvency

1. Amendments to the PER (Special Revitalisation Process) legislation

The Special Revitalisation Process Evaluation Report dated 8 July 2020 states that, from 2012 until the end of 2019, the PER has enabled "*the recovery of numerous companies that would otherwise not have had at their disposal a mechanism capable of enabling their recovery, better serving the interests of the debtor and the respective creditors, also safeguarding countless jobs. In effect, the number of companies with approved recovery plans which have not resorted to special revitalisation processes or insolvency proceedings is 55.5%. This demonstrates the extent to which the economy has embraced the PER.*

Another not insignificant factor that shows the good performance of the Special Revitalisation Process is the fact that more than 40% of the cases in which companies resorted to this process managed to obtain an agreement in order to continue their activity. This figure shows that the PER has served its purpose of safeguarding jobs and the economic fabric".

Based on these data and in view of the need to incorporate Directive (EU) 2019/1023 into national law, by Law 9/2022 of 11 January, the Portuguese legislature introduced changes to the existing rules to ensure compliance of the PER with the Directive. It also made specific corrections to clarify substantive or procedural aspects.

The main changes are:

- One aim is to ensure, on a case-by-case basis, the most equitable treatment of creditors on whom the effective restructuring of companies will depend. This is to be achieved by making it compulsory for companies other than micro, small and medium-sized enterprises[1] to present, with their PER application, a proposal for the classification of creditors affected by the recovery plan. This proposal must divide the creditors into distinct categories, according to the nature of their credits. The categories are secured, privileged, common and subordinated creditors and these reflect the whole range of creditors of the company according to the existence of sufficient common interests, namely:

  i) Employees, regardless of the type of contract;

  ii) Shareholders;

  iii) Banks that have financed the company;

  iv) Suppliers of goods and service providers;

  v) Public creditors.

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- Any remuneration of the provisional judicial administrator and any expenses he or she has incurred that are not paid constitute claims on the insolvency, if the company is declared insolvent following the non-approval of a recovery plan.

1 The definitions of micro, small and medium enterprises appear in the annex to Decree-Law 372/2007 of 6 November – enterprises that employ less than 250 people and whose annual turnover does not exceed €50 million or whose annual balance sheet total does not exceed €43 million.

- The new law makes it clear that the preliminary order issued in a PER will prevent any enforcement action being brought against the company to recover debts for a maximum period of four months. this order will also cause the suspension of actions that have already been brought against the company for the same purpose. Enforcement actions to recover amounts owed to employee's are excluded from the above rules.

- It is provided that the judge can extend the suspension for one month if one of the following situations occurs: (i) significant progress has been made in the negotiations on the restructuring plan; (ii) the extension is essential to ensure the recovery of the company's activity; or (iii) the continuation of the suspension of the enforcement measures does not unfairly prejudice the rights or interests of the affected parties. However, the judge may order the termination of the suspension if it no longer serves the purpose of supporting the negotiations on the recovery plan or at the request of the company or the provisional judicial administrator.

- The concept of "essential executory contracts" is extended to include not only essential public services but all contracts of continuous performance necessary for the company to pursue its day-to-day activity. It includes any contracts for the supply of goods or services whose suspension would lead to the paralysis of the company's activity. This ensures that, during the period of suspension of the enforcement measures, creditors cannot refuse to perform, terminate, bring forward the maturity, or unilaterally alter essential executory contracts to the detriment of the company, in respect of debts constituted prior to the suspension, where the sole ground is non-payment of such debts. The price of goods or services essential to the company's activity provided during the suspension period that are not paid will be considered a debt of the insolvent estate in any insolvency of the same company declared within two years of the end of the suspension period.

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- Like the pre-existing rule on insolvency, the new law provides for the nullity of any contractual clauses that give the following the value of a resolutive condition of the transaction: (i) the application to open a PER, (ii) the opening of a PER, (iii) the application for an extension of the suspension of enforcement measures or the granting of such a suspension. The same applies if such a clause gives the other party a right to compensation, termination or rescission of the contract.

- Additional protection granted to "financing acts" of the company, with provisions that:

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i) During the course of the PER or in the execution of the recovery plan, creditors may finance the company's activity to provide it with capital for its revitalisation. If they do so, they enjoy a credit over the insolvent estate up to a value corresponding to 25% of the company's non-subordinated liabilities at the date of the declaration of insolvency. If the insolvency 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 preferential credit privilege that ranks ahead of the general preferential credit privilege granted to the employees.

ii) Claims arising out of financing made available to the company by creditors, partners, shareholders and any other persons in a special relationship with the company in implementing the reorganisation plan will enjoy the general preferential privilege that ranks above the general preferential privilege granted to employees.

iii) Credits arising from financing made available to the company in the course of the PER or in implementing the recovery plan may not be subject to Paulian actions, that is, actions by creditors to have certain transactions by their debtors declared void as prejudicial to their interests.

iv) The new financing and the interim financing cannot be declared void, voidable or unenforceable.

v) Anyone granting new financing and mezzanine financing may not incur, by virtue of that financing, civil, administrative or criminal liability on the grounds that the financing is detrimental to the creditors as a whole, except in cases expressly provided for by law.

- The content of the recovery plan is set out in greater detail. Now, among other things, the plan must contain (i) the designation individually and broken down by class - and, if applicable, broken down by the categories into which they have been grouped for the approval of the recovery plan - of the parties affected by the content of the plan and their claims or interests covered by the recovery plan; (ii) the same as just mentioned regarding the parties that are not affected by the recovery plan, together with a description of the reasons why the proposed plan does not affect them (iii) the arrangements for informing and consulting the representatives of the employees, the position of the employees within the company and, where appropriate, the general consequences as regards employment, in particular dismissals, temporary reduction of normal working hours or suspension of employment contracts; (iv) any new financing provided for under the recovery plan and the reasons why such new financing is necessary to implement the plan (v) a statement of reasons containing a description of the causes and extent of the company's difficulties and explaining why there is a reasonable prospect that the recovery plan will prevent the insolvency of the company and ensure its viability, including the preconditions necessary for the plan's success.

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- The rules are defined for the formation of the majorities required to approve the recovery plan, in the case of classification of creditors by categories.

- The new law requires the provisional judicial administrator to send to the court, with the documentation of the result of the creditors' vote, a reasoned opinion on whether the plan has reasonable prospects of avoiding the insolvency of the company or ensuring its viability.

- There are new requirements for the judge to ratify the reorganisation plan or refuse its ratification. The judge must now also assess (i) whether, in the case of classification of creditors in separate categories, creditors in the same category are treated equally and proportionately to their claims and whether the dissenting voting categories of creditors affected receive treatment at least as favourable as that of any other category of the same rank, and more favourable than that of any category of a lower rank (ii) that no class of creditors under the recovery plan receives or retains more than the amount corresponding to the totality of its claims; (iii) that any new financing necessary to implement the restructuring plan does not unfairly prejudice the interests of creditors; (iv) whether the recovery plan has reasonable prospects of preventing the insolvency of the company or ensuring its viability.

Novos requisitos para o juiz homologar o plano de recuperação ou recusar a sua homologação.

- The law allows the judge to order an expert valuation of the company if any creditor ask for the non-ratification of the plan on the grounds that its situation under the plan is less favourable than it would be in a liquidation scenario.

- To overcome issues of unconstitutionality of the rule in article 17-G(4) of the CIRE, the applicable legislation will be amended to ensure that a declaration of insolvency will only be made following the non-approval or non-ratification of the PER if the company, after being heard, does not oppose it. If the company does oppose it, the judge determines the closure and termination of the PER, and this cancels all its effects.

Moreover, changes are also made regarding the PER itself. Most of them are made to provide clarifications, which include:

i) There is no possibility of appeal against the order appointing the provisional judicial administrator.

ii) Any application to join of special revitalisation processes made by commercial companies with which the company is in a control or group relationship, under the Commercial Companies Code, can only be made before the start of the negotiation period in the proceedings to which the others are to be joined.

iii) Credit claims must indicate: a) their origin, maturity date, amount of principal and interest; b) the conditions to which they are subject, both suspensive and resolutive; c) their common, subordinated, privileged or guaranteed nature and, in the latter case, the assets or rights which are the object of the guarantee and their registration identification data, if applicable; d) the existence of any personal guarantees, with identification of the guarantors; e) the applicable default interest rate.

iv) The classification of the related credits, in particular, due to the absence of sufficient common interests, is grounds for challenging the provisional list of credits. The judge must then decide on the conformity of the formation of the categories of credits and can order their modification if they do not reflect all the company's creditors or the existence of sufficient common interests between them.

v) Companies that have filed for insolvency during the period of suspension of enforcement measures are exempt from the obligation to file for insolvency.

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2. The legislative changes regarding insolvency proceedings

When it comes to insolvency proceedings, there is a simple stated intention of aiming "*essentially, to provide the occasional clarification of procedural or substantive issues where there is imprecision in the law, or dissension in legal doctrine or case law*". However, some amendments have been introduced that have an enormous material impact. The most important of them are:

- The requirement for the insolvent to submit with the initial insolvency petition, a document identifying any companies with which it is in a control or group relationship under the CSC or which are considered associated companies[2], and, if applicable, identifying the proceedings in which their insolvency has been requested or declared.

- It is established that compensation claims arising from the termination of employment contracts by the insolvency administrator after the debtor's declaration of insolvency constitute claims on the insolvency.

- The law redefines the provision that the claims held by persons in a special relationship with the debtor are subordinated, provided the special relationship already existed at the time of their constitution (and not acquisition), and by those to whom they were transferred in the two years prior to the start of the insolvency proceedings.

- Clarification of the exhaustive nature of the concept of a person in a special relationship with the debtor as a natural or legal person.

Compensation claims arising from the termination of employment contracts by the insolvency administrator after the debtor's declaration of insolvency constitute claims on the insolvency.

2 "Associated companies" are companies that have one of the following relationships with each other:
a) One company holds a majority of the voting rights of the shareholders of another company;
b) One company has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of another company;
c) One company has the right to exercise a controlling influence over another company pursuant to a contract entered into with it or to a provision in the articles of association of the latter company;
d) One company, which is a shareholder in or associated with another company, controls alone, pursuant to an agreement with other shareholders in that other company, a majority of shareholders' voting rights in that other company.

- A preferential creditor or secured creditor who appoints a natural person to administer the debtor is excluded from the concept of "de facto administrator", provided that such person alone does not have special powers to dispose of the debtor's assets.

- Claims whose recognition or ranking requires the production of evidence are provisionally recognised and ranked, in the preliminary order, for the maximum amount that could result from the recognition of the claims.

- At the meeting to consider the report, if the creditors decide not to oppose it and the decision declaring the insolvency has become final with no further appeal possible, within 10 days of that meeting, the insolvency administrator must present a liquidation plan for the sale of the assets. This plan must contain definite deadlines and a list of the specific steps to be taken. Failure to present the plan will constitute grounds for dismissal of the administrator.

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- Reduction from 20% to 10% of the value of the proposal presented, as the amount to be guaranteed by the secured creditor for the purposes of acquisition of assets, by itself or through a third party, at a price higher than the planned sale price or the established base value.

Partial distributions are mandatory.

- Partial distributions are mandatory whenever EUR 10,000 or more is deposited in the insolvent estate and its ownership is not disputed. However, for this to happen, the judgment declaring the insolvency must have become final and unappealable and the liquidation of the assets must have started. Furthermore, the deadline for challenging the list of creditors must have passed with no challenge being filed, or any challenge filed must already have been decided. Until these conditions have been met, the amounts to be distributed must remain on deposit, taking into account the maximum amount that could result from their recognition if the decision is not definitive. The whole process must also be at a point where the final distribution can be decided.

As is the case with the PER, many of the amendments introduced by Law 9/2022 of 11 January regarding insolvency proceedings are simply to clarify certain points. These include:

i) Registration of the declaration of insolvency in the land, commercial and vehicle registries in relation to the assets or rights comprising the insolvent estate.

ii) Possibility for the insolvency administrator to delegate, in writing, the responsibility for doing specific acts to an insolvency administrator currently registered on the official lists.

iii) Standardisation of some points of the rules applicable to the two restructuring processes, such as the content of the plan and the majority required for its approval.

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iv) Clarification that the measures provided for in the insolvency plan affecting the debtor's liabilities do not affect the existence or the amount of the rights of insolvency creditors, specifically, those voting in favour of the plan, against co-debtors or third-party guarantors of the obligation.

In the insolvency proceedings, it will be necessary to ensure compliance with the new requirements including those relating to the preparation of the plan. These proceedings also have to be more closely monitored in order to promote greater speed, which may have an impact, in particular, on the payment of creditors.

3. Entry into force and transitional arrangements

Law 9/2022 of 11 January will come into force 90 days after its publication. Under the transitional arrangements, the legislature has provided that the law will apply immediately to proceedings pending on the date it comes into force. However, there is an exception regarding the provisions of Articles 17-C to 17-F, 17-I and 18 of the CIRE, as amended by the law now published. These will only apply to special revitalisation proceedings opened after the entry into force of Law 9/2022. ■