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MAJOR DEVELOPMENTS IN WORLWIDE INSOLVENCIES AND REORGANIZATIONS

PORTUGAL

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I. Introduction

Portugal has adopted legislation governing reorganisation and bankruptcy which has been, with minimal changes, in force for the last decade. Several aspects which conform the current Insolvency and Bankruptcy Code have proved to tackle inadequately the issues commonly evolving around any recovery and bankruptcy proceedings. The most negative impact of such unsuccessful results rest in the reasonable number of viable companies which have ended up bankrupt as well as in a significant number of companies clearly unviable which are kept under a recovery procedure all at the sacrifice of the creditors and the good businesses wrongly terminated.

The main negative factors have been consensually identified as being (i) the length of the judicial procedures of recovery and bankruptcy, (ii) the excessive bureaucracy within the preliminary stage of the proceedings, (iii) the lack of transparency of liquidation of the assets of the bankrupt state, (iv) the insufficient economic and financial background of the various entities involved in the proceedings, notably judges, public prosecutors, judicial administrators and liquidators, and (v) the lack of data in the records of the companies before the Companies Registers.

With the above scenario in mind, during the last year new draft legislation has been discussed and prepared, which will provide for a wholly new legal framework. The new legislation named Insolvency Code has been generally approved by the Parliament. It is expected that the different Commissions of the Parliament that will now deal with particular aspects of the draft may approve certain changes to the new law however the general principles and features will almost certainly become law.

The present paper provides for a short description of the new Portuguese Insolvency Code and summarizes the main new features as well as the key factors behind the new law *vis-a-vis* the law soon to be replaced.

II. The New Insolvency Code

(i) General Framework

The new Insolvency Code is particularly focused in the simplification of the court insolvency proceedings as well as in the efficiency of the liquidation of the assets of the insolvent company and the payment of the creditors.

A first important change in that direction is the provision for a more specialised jurisdiction of the commercial courts, which will henceforth concentrate its competence over insolvency proceedings in respect of companies. Insolvency proceedings regarding individuals will be transferred to the civil courts. At present, commercial courts are set up only in Lisbon and Oporto.

The current twofold procedure for recovering the company or for dealing with its bankruptcy will be also replaced by one common procedure which will encompass all aspects of the insolvency. In this respect, the judge will limit its decision to the declaration of insolvency of the company, it being for the creditors to decide whether the debtor company shall be rescued or liquidated. All stages of the proceedings are under the new law held urgent, particularly relevant in respect of claim of credits and the liquidation, currently two of the phases which entail more significant delays.

Instead of providing for a judicial administrator for the recovery of the company and a liquidator when the company is ordered bankrupt, along with the assembly of creditors and the commission of creditors, the new law provides simply for a judicial administrator whether the company will be reorganised or liquidated and the formation of the creditors commission becomes voluntary. The judicial administrator is granted further powers and the respective appointment, based on the recommendation of the creditors, is no longer limited to those persons included in the Official List of Administrators and Liquidators. On the other hand, the judicial administrator may be replaced by the creditors and his liability towards the estate and the creditors as well as his compensation is subject to a more strict regime, the later being based on performance.

The new Code further provides for a simplification of the concept of insolvency, now hold just as the impossibility of complying with the obligations which are due. At present the insolvency of the company is defined as the situation in which the company cannot fulfil its financial obligations because it lacks assets and credit.

(ii) Introductory Stage

The proceedings are commenced upon the filing of a petition of insolvency of the debtor company within 60 days from the inability to comply with obligations which are due. The law provides for a number of incentives for the company to file for insolvency and further encourages the creditors to act accordingly in case the debtor company does not do so. In this connection, the creditor that has the initiative will be reimbursed from the costs incurred in relation thereto and will be granted a creditor privilege in respect of 1/4 of his credits.

One further very important tool to encourage the debtor company to file for insolvency is that failure to do so within 60 days from the inability to comply with obligations which are due, will result in the directors being presumed liable for the insolvency of the company.

The court shall review the petition of insolvency on the day of its receipt and reject it if it does not comply with the legal requirements or promptly declare the insolvency if the petition is filed by the debtor company. In addition, if the applicant is a creditor the court will only serve the company. The current requirement to serve the creditors and/or the debtor through announcements will disappear. The service of the creditors through announcements had the disadvantage of putting the debtor company in a more sensitive position from the outset as well as result in a 30 day delay in the proceedings.

Another innovation to expedite the proceedings is the time period for the debtor company to oppose the petition of insolvency filed by a creditor: this will be 10 days. The more reduced time will allow a more expedite declaration of insolvency if the debtor is not in opposition.

The introductory stage is concluded by the declaration of insolvency of the debtor company. The judge will simply state whether the company is or is not in position to fulfil with its obligations. Under the current Code the court is required to decide at this stage whether the company should be reorganised or declared bankrupt turning this very early stage of the proceedings in a critical and much controversial situation. Furthermore, under the present regime prior to deciding on the insolvency of the company, the court must call on all creditors and have the credits claimed duly listed.

In the decision holding the company insolvent the judge may further decide to close the court file without any further action if the existing assets are not sufficient to cover not even the expenses

with proceedings.

(iii) Liquidation

The assets of the insolvent company shall be seized and the judicial administrator shall make the arrangements for an expedite sale. It is given preference to the sale of the debtor company as whole in order to allow the company to continue its operations and keep its employees or part of it. Under the present regime, the disposal of the company or assets of the company may only occur at a very late stage of the proceedings, were commonly the company or business is no longer attractive.

In either case, the law stipulates a time limit of 1 year to that effect. Failure to do so will result in the administrator being dismissed and loss of his remuneration. This extreme sanction is to avoid that the sale of the assets remain a never-ending process as it is the case at present.

Creditors shall claim its credits subsequently to the debtor company being held insolvent. One feature of the new law concerns the graduation of the credits hold by individuals holding a special relation with the debtor company - e.g. companies of the same group - after the common creditors. The judicial administrator replaces the court in the review, graduation and listing of the credits. Only those credits which have been challenged will be subject to the court review. This will result in a fast track procedure in respect of the court decision regarding the credits, which may inclusively simply refer to the list drafted by the judicial administrator.

For the effect of the composition of the Creditors' Assembly, prior to the definitive listing of the credits, the Court will fix all credits claimed on a provisional basis. Under the present regime, the provisory credits are firmed up by the creditors among themselves at their on discretion, a condition which has resulted many times is a number of unfair situations.

One further relevant innovation of the Insolvency Code law concerns an earlier payment to creditors, in particular employees. As soon as it is hold in deposit monies sufficient to cover 5% of privileged credits payment shall be executed. At present, commonly any payment will be made only at the end of the proceedings.

(iv) Insolvency Plan including the recovery of the company

The debtor company is required to submit a reorganisation plan within 30 days of the insolvency order in case the insolvency petition was not filed by the later and such plan attached to it. Failure to do so will result in the debtor company being deprived from its management powers. The reorganisation plan shall be approved by the Creditors' Assembly.

In case the debtor company does not submit a rescue plan or this is not approved, within the 75 days subsequently to the declaration of insolvency, the Creditors' Assembly shall decide to instruct the Judicial Administrator to draft the insolvency plan under which he shall propose either the reorganisation of the company or its liquidation. The opinions of any interested parties in respect of the plan presented by the Judicial Administrator shall be submitted in 8 days.

The above measures are aimed at allowing that a rescue plan is adopted at a very early stage when the company is held insolvent but also to avoid that the reorganisation of the company is simply applied as a dilatory process as it happens under the current regime.

In contrast with the current law, by which the creditors may only approve for adoption one of the reorganisation devices typified by the law, the new Insolvency Code provides that the creditors have the discretion to adopt the rescue measures which they deem more appropriate. Such flexibility increases the odds of recovery of a debtor company, given that the reorganisation plan will be directed for the company having in mind the concrete circumstances of its insolvency.

The reorganisation plan approved by the Creditors' Assembly shall be homologated by the Court.

One further feature of the new law to sustain the recovery of the insolvent company lies on the general principle of maintenance of the contracts which the later has entered into however are not yet complied or are ongoing. It is for the Judicial Administrator to decide upon which of those contracts shall be executed or not fulfilled. This principle will allow that despite insolvent the company is able to pursue at list part of its business activities. Under the present law, the insolvency order holds automatically ineffective the generality of the contracts with the effect that from that moment on the company is paralysed making it very difficult to be rescued.

In contrast, those deals undertaken by the debtor company in prejudice of the company or the insolvent estate may be resolved. Under the current regime, to that effect it is necessary to prove

that the contracts were performed in bad faith. The change will increase the odds of tackling those deals executed to defraud the creditors.

(v) Action for qualification of the insolvency

Under the Insolvency Code it becomes obligatory to review the conduct of the debtor company and respective directors to assess whether or not they shall be hold liable for the respective insolvency. Upon the declaration of insolvency it shall be commenced an ancillary proceeding to qualify the insolvency. The Judicial Administrator shall draft his opinion holding the insolvency as fortuitous or culpable. In the former case, the Court shall decide for the termination of the procedure; in the later the affected parties shall be served to submit their defence. The action for qualification of the insolvency shall be commenced even if it is approved the reorganisation of the company.

The present law only provides for the possibility of the creditors or the public prosecutor to file a derivative bankruptcy liability action. This places the burden of pursuing the liability of the directors or other persons on the creditors resulting that until now only seldom they are prosecuted for turning a company insolvent despite their culpability.

The Insolvency Code provides for a number of serious consequences on the persons held liable for the insolvency, notably the inability of being directors of another company, the loss of their credits against the company, and the liability for the payment of the losses suffered by the creditors.

III. Conclusion

The new Insolvency Code seeks to tackle part of the main negative aspects of the current insolvency law, in particular its inefficiency as a result of the delay in the adoption of the relevant court decisions and lack of proceeds for the creditors.

As a starting point, it fosters the debtor to file for insolvency by providing serious consequences for not doing so within the legal timetable - presently the vast majority of the debtors file for insolvency some times years after being insolvent.

It provides for a number of fast track procedures, notably the immediate insolvency order if the respective petition is filed by the debtor or the prompt closing of the court file in case the existing

assets are not sufficient to cover the court expenses.

The limitation of the role of the Court to decide simply for the insolvency of the company takes away the controversy at the early stage of the proceedings whether to proceed as a recovery case or bankruptcy.

In respect of the liquidation it is encouraged the due care of the Judicial Administrator to sale the assets, by imposing a timelimit to that effect with consequences on his remuneration.

The new Insolvency law provides for a number of restrictions against deals which might have been executed to the prejudice of creditors, through the stipulation of a category of subordinated credits as well as the resolution of certain contracts in benefit of the insolvency estate, without the need to demonstrate the bad faith of the parties concerned.

The reorganisation process has been turned more flexible, the creditors being now entitled to decide on the adoption of rescue measures which they may deem more appropriate.

Lastly, the provision of a more serious bankruptcy liability procedure will make the persons effectively liable for making a company insolvent with culpability.

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