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MAJOR DEVELOPMENTS AND TRENDS IN INSOLVENCIES AND REORGANIZATIONS WORLDWIDE
PORTUGUESE OVERVIEW

Miguel de Avillez Pereira
and Mafalda Oliveira Monteiro
Abreu, Cardigos & Associados
I. INSOLVENCY AND REORGANIZATIONS PROCEDURES - BRIEF DESCRIPTION

The current regime governing insolvency is contained in the Special Recovery Proceedings and Bankruptcy Code (Recovery and Bankruptcy Code), which was enacted by Decree-Law 132/93, of 23 April 1993, and more recently as altered by Decree-Law 315/98, of 29 October 1998.\(^1\)

According to the last review, the Recovery and Bankruptcy Code provides:

(a) a framework for recovering the company (“recuperação”); and

(b) an ancillary bankruptcy procedure (“falência”).

The concept of company, for the purposes of applying the mentioned code, is defined as an organization of the production factors aiming the exercise of any agricultural, commercial or industrial activity or the rendering of services. The Recovery and Bankruptcy Code does not apply to financial and credit institutions, insurance companies and companies governed by Portuguese public law.\(^2\)

A company is deemed insolvent where is not able to punctually comply its obligations in face of its assets being insufficient to satisfy its liabilities (which is defined as the corporation being unable to fulfill its financial obligations because it lacks assets and credit.). A company is in a difficult financial situation where, not being in a insolvency situation, evidences economic and financial difficulties, including for the non-compliance of its obligations.\(^3\)

Any company with economic difficulties or in a situation of insolvency may be subject to one or more recovery measures or be declared bankrupted, which terminates with the winding up of the company. However, the bankruptcy regime may only be applied where the insolvent company is economically unfeasible or should its financial recovery be, in face of the circumstances, impossible. Thus, the new law is given preference to recovering the company when the corporation

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\(^1\)For certain specific matters, such as jurisdiction and competence, however, the Civil Procedure Code continues to apply.

\(^2\) Article 2º of the Recovery and Bankruptcy Code.

\(^3\) Article 3º of the Recovery and Bankruptcy Code.
is deemed to be economically viable 4.

The above-mentioned amendments to the Recovery and Bankruptcy Code have eliminated the traditional distinction between bankruptcy and insolvency, under which the bankruptcy, focused on traders, was defined as an impossibility of complying with commercial obligations, and insolvency, applicable to non-traders, as the insufficiency of assets to pay its debts, i.e., a deficit patrimonial situation.

Differently, the current Portuguese regime has abolished the insolvency of traders; this concept is now applicable to both, traders and non-traders, in a situation of impossibility to comply with its obligations. Nevertheless, in case of an insolvent debtor not holding a company, this may not be subject to the recovery measures aimed to companies, but only be declared bankrupted or to avoid the bankruptcy statement by the judicial homologation of a private composition.

Insolvency proceedings are deemed urgent procedures, which have precedence over the ordinary court service, and have shorter terms applicable to both creditors and the court5.

Under this new regime, both the recovery and the bankruptcy proceedings involve a court procedure and are subject to a common introductory procedural stage.

The company in a potential state of insolvency has a legal duty to request the competent court to open insolvency proceedings. The appropriate application must be filed within sixty days from the non-completion of one or more financial obligations that by amount or circumstances indicate the debtor’s lack of capacity to comply with most of its financial responsibilities6.

The holder of the company in debt, the board of directors or the General Meeting is responsible for the filling of the recovery request or the bankruptcy statement7. The Portuguese Court, where deciding on this new regime, has held the existence of juridical duty of the manager for the filling of bankruptcy or recovery measures, who is civilly liable for an indemnity payment in case of non-compliance.8.

4 Please see article 1º of the Recovery and Bankruptcy Code.
5 Articles 10º and 26º of the Recovery and Bankruptcy Code.
6 Article 6º of the Recovery and Bankruptcy Code.
7 Articles 6º and 7º of the Recovery and Bankruptcy Code.
8 For such purpose, it is cumulatively demanded:
   (a) that the manager's omission may be understood as a guilty non-compliance of the legal
The proceedings may be commenced either by the debtor, any of its creditors, or the public prosecutor. The bankruptcy may also be officially declared by the Court in the cases provided for in the law.

Where the court does not find any ground for an immediate rejection of the petition, the court will serve the proceedings on (depending on the entity that lodged the application) the company, the public prosecutor and/or the creditors, those listed in the petition personally, and any unknown creditors through an announcement in the official journal and in a newspaper with a wide circulation in the area of the head office of the debtor. The parties served may, within 10 days, not only file opposition or justify its credits, but also file any preliminary measure, enclosing in both cases the available evidence means. The unknown creditors served by announcement are granted an additional 10 days period for that purpose.

Terminated the legal delay to oppose or claim credits, the judge must within the 15 subsequent days carry out all the necessary acts to avail from the existence and enhancement of the alleged legal requirements as well as the other presented elements in order to decide the proceedings furtherance or dismiss. The relevant decision must be taken within the five following days.

Creditors play a decisive role as to the furtherance of the proceedings in recovery or bankruptcy proceedings, and in the former are involved with the specific measure to adopt, so long as certain share requirements of the credits are met.

The administration of an insolvent company differs in accordance with whether the corporation is one that is under recovery proceedings or under bankruptcy proceedings.

In the former, in principle, management keeps its functions without restriction. But during the provisions aimed to protect the creditors’ interests;
(b) that the assets are insufficient to cover the correspondent debits;
(c) that the act/omission of the manager may be deemed as adequate cause of the damage to be caused, including to the creditors.

In case of the debtor’s debt or terminated its activity, the bankruptcy may still be requested by any interested creditor or by the Public Prosecutor within the year following the facts evidencing the insolvency, either this situation has been revealed before or after the death or the termination of the debtor's activity.

Article 8º of the Recovery and Bankruptcy Code.

Article 20º of the Recovery and Bankruptcy Code.

administration the company’s directors perform their duties under the control and supervision of the general assembly of creditors, a body set up from the beginning of the proceedings. The creditors also have the power to indicate the name of the judicial administrator ("gestor judicial") to be appointed by the court, whose main task is to identify the causes of the insolvency and to indicate the appropriate measures to tackle the situation.

In bankruptcy proceedings the court will appoint a judicial liquidator ("liquidatário judicial") whose main function is to arrange for the settlement of debts through the use of existing assets.

The judicial manager and the judicial liquidator play a main role under the scope of the companies recovery and bankruptcy, respectively, in coordination and under the supervision of the creditors commission, being the Court responsible for the inspection of the legality and convenience of the acts. However, the Court is responsible for the supervision of the bankrupt estate assets' management.

II. REORGANISATION MEASURES

The Recovery and Bankruptcy Code provides for several reorganization measures where the company is in an insolvency or economic difficult situation, but economically feasible.

In terms of recovery measures, there is an equality principle between the creditors, which determines that the measures involving the extinction or modification of the credits over the company: (a) are applicable only to common credits or credits with guarantee rendered by a third party, being extended to credits guaranteed by assets of the company in case of agreement with creditor beneficiary of such guarantee (b) impend proportionally over all the credits concerned, unless otherwise expressly agreed by the affected creditors.\(^{13}\)

The General Meeting is the competent corporate body to resolve on the company’s recovery measures, being such resolution subject to judicial homologation. The resolutions aiming the approval of any of the company’s recovery measures should be approved by creditors representing, at least 2/3 of the value of all the credits approved, provided that the creditors, representing 51% or more of credits directly affected by the measure, have not filed opposition.\(^{14}\)

\(^{13}\) Article 62º of the Recovery and Bankruptcy Code.
The decision of non-homologation of the recovery measure approved implies the company's bankruptcy. The Court in the following cases may annul the homologated recovery measure:\textsuperscript{15}

\begin{itemize}
  \item[(a)] upon request of the creditor that, by means of a final decision, proves the existence of a credit prior to the approved recovery measure and which has not been considered in the creditors meeting, provided that such credit may have influence in the necessary quorum and the request is presented within 30 days as of the final decision;
  \item[(b)] where the acceptance of the creditors that had influence in the legal majority had been obtained with fault of the company or of a third party, with 6 months as of the final decision.
\end{itemize}

In above-mentioned cases of annulment, the Court shall call, within 45 days, a new creditors meeting.

It is possible to add to the specific aspects of any of the measures set out below; however the reorganization plan must necessarily include one of the following measures provided by the law:

\begin{itemize}
  \item[(a)] Composition;
  \item[(b)] Company restructuring;
  \item[(c)] Financial restructuring;
  \item[(d)] Controlled management.
\end{itemize}

\textit{(a) Composition ("\textit{concordata}")}

Composition consists in an agreement on the alteration of the company's liabilities, which may result in a reduction or alteration of part or the totality of the credits or consist in a mere delaying of payment\textsuperscript{16}.

The composition is conditioned by a clause, valid for a period of ten years, according to which, as

\textsuperscript{14} Article 56\textsuperscript{0} of the Recovery and Bankruptcy Code.
\textsuperscript{15} Articles 72\textsuperscript{0}, 73\textsuperscript{0}, 82\textsuperscript{0}, 96\textsuperscript{0} and 117\textsuperscript{0} of the Recovery and Bankruptcy Code.
\textsuperscript{16} Article 66\textsuperscript{0} of the Recovery and Bankruptcy Code.
soon as the company’s financial position improves the creditors which agreed to the composition are paid proportionally, although new creditors that conferred credit on the company after the approval of the agreement will be held as preferential creditors\textsuperscript{17}.

The company’s directors may keep the previous management powers during the execution of the composition or being conditioned in the exercise thereof. The execution of the composition may also be subject to inspection by the creditors Commission\textsuperscript{18}.

(b) Company restructuring ("reconstituição empresarial")

Company restructuring involves the incorporation of one or more new companies with the purpose of conducting the company’s business activities, so long as the creditors, or some of them, or third parties are prepared to support and boost the said business activities\textsuperscript{19}.

This measure may be adopted through the approval of the creditors meeting of a proposal subscribed by the creditors or interested third parties, provided that the covered credits represent at least 30\% of all the credits over the debtor\textsuperscript{20}.

The agreement’s homologation determines the conversion of the covered credits into participations with the same nominal value in the capital of the new company and in what concerns the remaining the modification of its object.\textsuperscript{21}.

It is expressly admitted that the creditors’ agreement determines the incorporation of several companies for the exploitation by each one of several parts of the company’s establishment(s)\textsuperscript{22}.

(c) Financial restructuring ("restruturação financeira")

Financial restructuring refers to a wide range of different measures which either deal with covering liabilities - for example, the reduction of credits be it capital or interest, reimbursement of all or part of the credits subject to the financial capacity of the company, extension of the payment term or

\begin{footnotesize}
\begin{itemize}
\item\textsuperscript{17} Article 67º of the Recovery and Bankruptcy Code.
\item\textsuperscript{18} Article 68º of the Recovery and Bankruptcy Code.
\item\textsuperscript{19} Article 78º of the Recovery and Bankruptcy Code.
\item\textsuperscript{20} Article 79º of the Recovery and Bankruptcy Code.
\item\textsuperscript{21} Article 79º of the Recovery and Bankruptcy Code.
\item\textsuperscript{22} Article 86º of the Recovery and Bankruptcy Code.
\end{itemize}
\end{footnotesize}
alteration of the interest rate, total or partial extinction of the liabilities by giving assets of the company in settlement or transferring of assets to creditors - or aiming to providing the company with an adequate net working capital - for example, increasing the company stock capital, conversion of the credits over the company into participation in a stock issue, third party stock capital subscription or reduction of the stock capital in order to cover damages\(^{23}\).

The autonomy of the financial restructure as a recovery measure constitutes the most important alteration introduce by the new regime, as far as the recovery procedure is concerned. And what gives it that autonomy is its particular goal - the superiority of the assets over the liabilities and the disposability of a net working capital. Except for the reduction of the capital stock, all the referred measures were already provided by the former regime, although integrated in the composition or in the controlled management. What is new about those measures is their articulation in order to reach the immediate goal of the financial restructure.

\[(d) \text{ Controlled management ("gestão controlada")}\]

Controlled management, based on the adoption of a complete performance plan for the recovering company, that includes the time period within which it must be completed and the approved measures, the appointment by creditors of a new management, with stipulation of new management rules, to carry out the plan (and then ceasing to act as management on completion of the plan)\(^{24}\).

The new board, appointed by the creditors may include members of the previous board and the judicial manager itself. It is further admitted that the board be appointed to specialized company by means of a management agreement\(^{25}\).

The plan approved by the creditors meeting and homologated by judicial decision should outline the guidelines of the future management of the company, foreseeing its execution in basis of technical, administrative, economic and financial nature, carefully defined. Among other elements, the plan should include the execution term, which shall be more than 2 years, renewable for one

\(^{23}\) Articles 87º and following of the Recovery and Bankruptcy Code.
\(^{24}\) Article 97º of the Recovery and Bankruptcy Code.
\(^{25}\) Article 104º of the Recovery and Bankruptcy Code.
more year\textsuperscript{26}.

Initiatives concerning the company’s management may be included in the resolution of the general meeting as execution means of the plan, including:\textsuperscript{27}

\begin{itemize}
\item[(1)] the launching of new projects comprised in the corporate purpose;
\item[(2)] obtaining credits through the concession of privileges;
\item[(3)] conveyance or temporary assignment of the company’s establishments;
\item[(4)] closing of the establishment or termination of certain activities;
\item[(5)] juridical autonomy of the industrial or commercial establishments, through its transfer for companies dominated by the company;
\item[(6)] sale, permute or assignment of assets;
\item[(7)] leasing of assets;
\item[(8)] termination of bilateral agreements of the debtor.
\end{itemize}

III. BANCKRUPCY PROCEDURES

3.1. General overview

If a company is insolvent or in a difficult financial situation and it is not economically feasible or as shown by the circumstances its financial recovery is not possible, bankruptcy must be adjudged\textsuperscript{28}.

The bankruptcy statement can be pronounced before the proceedings are allowed to continue, when opposition is filed against the continuation of the proceedings by creditors representing 51\% of the known credits who allege that the business is not economically feasible\textsuperscript{29}.

Subsequently, bankruptcy is declared unless any deliberation is approved at the meeting of creditors in 6 months term starting from the publication of the judicial order that determined the creditor's meeting\textsuperscript{30}.

\textsuperscript{26} Article 98\textsuperscript{°} and 103\textsuperscript{°} of the Recovery and Bankruptcy Code.
\textsuperscript{27} Article 101\textsuperscript{°} of the Recovery and Bankruptcy Code.
\textsuperscript{28} Article 1\textsuperscript{°} of the Recovery and Bankruptcy Code.
\textsuperscript{29} Article 23\textsuperscript{°} of the Recovery and Bankruptcy Code.
Bankruptcy can also be declared before the end of this 6 month term if there is (i) a creditor's deliberation rejecting any sort of recovery of the company; (ii) approved by creditors representing 2/3 of the approved credits\textsuperscript{31}.

Bankruptcy declaration also takes place if the measures approved by the creditor's meeting are annulled or not ratified as above referred\textsuperscript{32}.

The bankruptcy statement further occurs in case of bankruptcy proceedings are filled by the debtor or any other creditor, in both cases without opposition; the Court orders the debtor's bankruptcy in the dispatch ordering the prosecution of the proceedings\textsuperscript{33}.

It is appointed a date for the trial session where is filled opposition against the bankruptcy request.

In the final decision ordering the bankruptcy, the Court should fix the bankrupted residence, to appoint the bankruptcy's judicial liquidator and the creditors commission (if not already appointed), to gather the accounting elements of the company to deliver it to the judicial liquidator, to order the Public Prosecutor the delivery of elements evidencing a criminal infringement and to determine a 30 days period for the credits claiming\textsuperscript{34}.

Opposition against the award may be filled where there are factual and legal reasons affecting its regularity and grounds, within the 5 following days of its publication in the Official Journal\textsuperscript{35}.

3.2. Consequences of the bankruptcy regarding the insolvent debtor

(a) Extent Assets

In the Court judgment of bankruptcy is determined the immediate apprehension of all the insolvent debtor accounting elements and assets, including those already seizure or in any other way apprehended or detained by third parties, to be delivered to the appointed judicial liquidator. In this regard, however there are two relevant exceptions to be mentioned, one referred to assets

\textsuperscript{30} Articles 43\textdegree{} and 53\textdegree{} of the Recovery and Bankruptcy Code.

\textsuperscript{31} Article 53\textdegree{} of the Recovery and Bankruptcy Code.

\textsuperscript{32} Articles 56\textdegree{}, 72\textdegree{}, 73\textdegree{}, 76\textdegree{}, 82\textdegree{}, 84\textdegree{}, 96\textdegree{} and 117\textdegree{} of the Recovery and Bankruptcy Code.

\textsuperscript{33} Article 122\textdegree{} of the Recovery and Bankruptcy Code.

\textsuperscript{34} Article 128\textdegree{} of the Recovery and Bankruptcy Code.

\textsuperscript{35} Article 129\textdegree{} of the Recovery and Bankruptcy Code.
apprehended within criminal proceedings and another to non-seized assets, which shall only integrate the bankrupted estate if voluntarily presented by the insolvent debtor\textsuperscript{36}.

(b) Inhibition of managers

Both the insolvent natural person, or in case of collective entities insolvency its managers, are with the bankruptcy order immediately inhibit to perform trading activities, here included the prohibition to take office at any other civil or commercial partnership, private economic activity association, State Companies or cooperatives\textsuperscript{37}.

However, the Court may allow insolvent natural persons to perform such activities, upon their own request or the judicial liquidator proposal, whenever the authorization is addressed to assure indispensable means of subsistence and do not impair with the bankrupted estate liquidation. The permission is also applied to insolvent companies managers within the same terms. Moreover, the law foresees the possibility to assign the bankrupted estate costs, if they absolutely lack means of subsistence and can not obtain by working, depending on the creditors agreement\textsuperscript{38}.

3.3. Consequences of the bankruptcy regarding the insolvent's business\textsuperscript{39}

(a) Existing contracts

Consequences regarding the insolvent debtor existing differ according to the nature of the concerned contract and the judicial liquidator understanding over their relevancy, notably its termination or maintenance in face of the concrete situation all under the creditors agreement. Hence, in this regard there are special provisions referring to:

(i) purchase and sale contracts, namely non accomplished sale and purchase contracts (article 161\textsuperscript{o}), periodical deliveries contracts and furniture contract (article 162\textsuperscript{o}), installment payments and sale contracts or similar (article 163\textsuperscript{o}) and sale of goods already sent to an insolvent purchaser (article 164\textsuperscript{o});

\textsuperscript{36} Articles 128\textsuperscript{o} and 175\textsuperscript{o} and following of the Recovery and Bankruptcy Code.
\textsuperscript{37} Articles 147\textsuperscript{o} and 148\textsuperscript{o} of the Recovery and Bankruptcy Code.
\textsuperscript{38} Respectively article 148\textsuperscript{o} and article 150\textsuperscript{o} of the Recovery and Bankruptcy Code.
\textsuperscript{39} Articles 151\textsuperscript{o} to 171\textsuperscript{o} of the Recovery and Bankruptcy Code.
(ii) procurement contracts (article 167º) and agency contracts (article 168º);

(iii) lease contracts, whether the insolvent is the lesser (article 170º) or the lessee (article 169º).

Additionally some contracts and legal acts specifically foreseen may be terminated in the bankruptcy estate benefit by the judicial liquidator through registered letter with acknowledgment or receipt sent within 3 months from his awareness of those contract or act existence, notably those involving a diminish of the debtor's patrimony which were gratuitously celebrated in the two years prior to the commencement of the proceedings and those celebrated onerously with subsidiary or parent companies as well as with its managers. All other business may be challenge though a special proceeding called Impugnação Pauliana, commenced either by the judicial liquidator or any recognized creditor, which is appended to the insolvency proceeding 40.

(b) Legal capacity to contract

The insolvent is immediately deprived of both administration and disposal powers which are assigned to the judicial liquidator. As a consequence, all business entered into after the court order of bankruptcy, have no effects whatsoever over the bankruptcy estate, regardless the need of a legal action to declare its void nature. However, the judicial liquidator may choose to confirm such business providing that there is a relevant interest for the bankruptcy estate 41.

(c) Preferential creditors

In this regard the Recovery and Bankruptcy Code concerning the State privileged credits as well as those of the Municipalities and Social Security introduced a most relevant alteration. Hence, according to article 152º with the bankruptcy order those entities credit privileges are extinguish and become common credits subject to the same legal terms and constrains, notably to apportionment, as the other.

(d) Procedures by and against the debtor

40 Respectively article 156º and articles 157º to 160º of the Recovery and Bankruptcy Code.
41 Article 155º of the Recovery and Bankruptcy Code.

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With the bankruptcy order all pending actions regarding questions related to assets comprised in the bankruptcy estate, both against the insolvent or third parties but affecting the estate, may be appended to the insolvency proceeding upon a judicial liquidator request. Additionally, the bankruptcy order also prevents the commencement of enforcement proceedings against the bankrupted. As to the insolvent debtor credits, the judicial liquidator with the Committee of Creditors prior agreement must start the relevant debt collection proceedings\(^{42}\).

\[(e)\quad\text{Others}\]

Other consequences specifically related to the immediate maturity of all the debtor's liabilities, the closing up of any existing current accounts and interest cessation in order to establish the concrete amount of the insolvent debtor liabilities to be settle. Additionally creditors loose their right of set-off\(^{43}\).

\[\text{IV. SOME PRACTICAL NOTES}\]

\[4.1.\quad\text{Individual Insolvency. What are the consequences of a declaration of bankruptcy (or equivalent) for an individual who has not been involved in any wrongdoing? How easily and how quickly can that individual become involved in the management of a company's affairs again?}\]

The declaration of bankruptcy immediately deprives the individual of the administration and rights of disposal of his present and future assets, which thereafter shall form part of the bankruptcy state, subject to administration and disposal by the judicial liquidator. In particular, the judicial liquidator holds the power of representation of the bankrupt in any dealings in connection with the assets.

In addition to these restrictions upon the bankrupt, the declaration of bankruptcy entails further immediate consequences. An individual who is declared bankrupt may not continue to conduct any business activities nor be involved in the management of a company's affairs, including associations and foundations, other than companies, which conduct business activities.

\(^{42}\) Respectively article 154º and article 146º of the Recovery and Bankruptcy Code.
\(^{43}\) Please see articles 151º and 153º of the Recovery and Bankruptcy Code
The above restrictions and effects apply irrespective of any wrongdoing by the individual concerned. The court may release the bankrupt from the ban on the exercise of any management activities where he has not been subject to any criminal proceedings within a certain period and the court finds that he has conducted business in a proper and diligent manner.

4.2. Collective Insolvency. What are the consequences for an individual who has been involved in the management of the affairs of a company which has undergone some form of formal insolvency procedure, but who has not himself been guilty of any wrongdoing? How easily and how quickly can that individual again become involved in the management of another company's affairs?

The situation for the management of an insolvent company is different depending on the stage of the proceedings and whether the company is subject to recovery proceedings or has been declared bankrupt. During the common introductory procedural stage if the applicant has a justified fear of wrongdoing by management, it may request the court in the petition to appoint an interim judicial administrator whose approval management will need to seek in respect of any acts other than those concerned with ordinary business.

(a) Recovery

The opening of the reorganisation proceeding will in principle not result in the immediate suspension of the powers of the debtor, or its directors. Generally the directors keep their management functions without restriction including their powers over the company's assets, but under the supervision of the judicial administrator appointed subsequent to the court's decision to further the proceedings. In practice, there will be a division of powers between the management of the company and the judicial administrator. However, the court, bearing in mind both the business of the company and the interests of the creditors, may either restrict or suspend part or all of the powers of the management or require all future acts of the directors to be subject to the prior approval of the judicial administrator.

Subsequent to the adoption of the reorganisation plan and during the course of its implementation, the powers retained by directors will largely depend on the specific measure adopted. Once the reorganisation procedure of the debtor is completed, and as long as this has not resulted in the
business being split into different structures or sold to other entities, in some cases directors can recover the position and authority they used to have before the opening of the insolvency proceedings.

(b) Bankruptcy

The declaration of bankruptcy immediately deprives the company’s management of the administration and right of disposal of its present and future assets, which thereafter shall form part of the bankruptcy estate, subject to administration and disposal by the judicial liquidator. In particular, the judicial liquidator holds the power of representation of the company in any dealings in connection with the assets.

In addition to these restrictions upon the bankrupt, the declaration of bankruptcy entails further immediate consequences. Hence, all the company’s books will be sealed and the company may not continue to conduct any business activities nor be involved in the management of a company’s affairs, including associations and foundations (other than companies) which conduct business activities.

Furthermore, the court may impose a ban on any involvement in management activities on directors and senior officers, subject to having heard the views of the judicial liquidator on this issue.

4.3. Personal Liability. Under what circumstances can the management of an insolvent company become personally liable to creditors? Is it possible for personal liability to arise when the managers have acted entirely properly and innocently?

The directors of a company in a potentially insolvent state must request the competent court to open insolvency proceedings. It is not a right, it is a duty; and if it is not performed, directors may find themselves subject to serious liabilities, particularly if the company would in principle have recovered if it had been placed under insolvency proceedings.

Improper conduct of business without any effect on the solvency of the company is not a ground to request the reorganisation of the company. It might be relevant, however, if as a consequence of such improper conduct the company has been placed in a situation that prevents the company from fulfilling its obligations, in which case its directors may be held civil and criminally liable.
(a) Civil liability

The essential factors that lead to civil liability are behaviour (whether by action or omission), damage, illegality, culpability and the causal link between such behaviour and the damage. There must be damaging, illegal and culpable conduct of the directors concerned. Yet, it is not sufficient to recognise that the director proceeded in an objectively wrong manner. It is also necessary to prove that the illicit infringement was executed with malice (intention of causing damage or knowledge of the likelihood of such a result) or negligence (omission of the normal standard of diligence and care of a director).

A director becomes civilly liable when, due to a culpable failure of fulfilment of his legal and contractual duties, resulting in damage and loss, the corporation’s assets become insufficient to satisfy the credits, be it from the shareholders or third parties such as employees, tax authorities, social security or others.

Culpability means that the director’s conduct deserves the reproach or censure of law. In other words, the director given the specific circumstances could have and should have acted in a different manner. However, it is not sufficient to recognise that the director proceeded in an objectively wrong manner, it being further necessary to establish that the illicit violation was executed with malice or negligence (as described above).

If in the case of bankruptcy, the insolvency of the company has been contributed to, in a significant manner, by any acts of directors during the two years prior to the declaration of bankruptcy, the court can hold those individuals jointly and severally liable for the debts of the company and condemn them to settle the respective liabilities.

The law deems that the directors have contributed, in a significant manner, to the insolvency of the company, when they have done any of the following:

1. destroyed or damaged the assets of the company or made them disappear wholly or in part;
2. hidden or dissimulated the assets;
3. created or aggravated artificially the liabilities and losses, or reduced profits, notably by being involved in crushing deals;
 disposed of the assets for their personal benefit;
(v) conducted business activities under the corporate veil for their personal benefit;
(vi) kept fictitious accountancy records or made accountancy documents disappear or deliberately failed to keep any accountancy records.

Where civil liability of the directors arises under any of the above circumstances the court may at any time impose on the directors a deadline for satisfaction of the liabilities of the bankrupt company.

(b) Criminal Liability

Criminal liability has been separated from the civil matters, and is dealt with by the Penal Code, which contemplates the four following distinct types of criminal conduct of a debtor or its directors:

(i) Fraudulent insolvency - a crime that includes the conduct of a debtor that, with the purpose of prejudicing the creditors, (a) destroys or damages his assets or makes them disappear, (b) promotes or arranges for a fictitious reduction of the assets of the company, and (c) artificially creates or aggravates the losses or reduces the profits of the company - a conviction may lead to the imprisonment of the debtor for up to five years, where the company has actually gone bankrupt;

(ii) Non intentional insolvency - where the negligent conduct of the debtor results in its bankruptcy – a conviction may result in a prison sentence of up to one year or a fine;

(iii) Creditors' facilitation - where the debtor, being aware of or at least being able to anticipate his bankruptcy and having the purpose of benefiting certain creditors in prejudice of the others, arranges for the settlement of debts which it was not bound to settle – a conviction may put the debtor in a prison for up to two years, depending on whether the company has to be placed in bankruptcy.

Please note that Portuguese law does not provide any distinction between a member of the board who is representing investors and not involved in day to day management and a director who is a member of the management team. Therefore, both might be equally liable. The law goes even further and also holds liable those individuals who are not directors but have exercised de facto
management or are senior officers.

4.4. Order of Payment and Security. Do secured creditors get paid out before others? Do the Government, the tax authorities or employees (or any other group) have any preferential rights as creditors? Do such groups rank ahead of secured creditors?

One of the most important changes introduced by the present Recovery and Bankruptcy Code was the extinction of the preferential credits of the State, municipalities and social security, which have become common credits. The current regime says that even when credits of the State, municipalities or Social Security are secured by any guarantee, they will always be treated as common credits. The change is justified because, the main purpose of the law being the rescue of the business in distress, the governmental authorities should be the first to comply with this goal.

Employees are considered preferential creditors according to the general civil law, but not among the secured with real or personal property.

Secured creditors are always considered privileged creditors as they are entitled to be fully paid using the assets on which the security is held.

Apart from the advance fees payable to the administrator, new credit (including finance) provided to a company in a insolvency situation is ranked before any other credit where the court, upon the proposal of the judicial administrator and with the positive opinion of the Creditor's Committee, declares those credits have been provided both in the interests of the company and the new creditors, which means that new investors will qualify as privileged creditors. Those credits can not be retained as guarantee for the payment of any credit belonging to the State or to administrative authorities and confer the right to full payment on the new creditors.

Unsecured creditors will be ranked among themselves on the basis of the debtor's assets over which there are no charges. Apart from this, common creditors will have the same rights as the secured creditors in any decision as to the future of the company. Notably creditors, which have claimed their credits in the terms above mentioned will take place at the Creditors Assembly and will taking into account at the Creditors Commission throughout the implementation of the reorganisation plan.

4.5. Is it possible for banks and other providers of finance to companies to take first
charges over the fixed assets of a company (land, buildings, stock etc)? Is it possible for such providers of finance to take a "floating charge" over the company's assets?

Portuguese law does not provide for any specific regime in which banks and other providers to finance companies can take first charges over the fixed assets of a company (land, buildings, stock, etc). They can do so as generally provided by law, including as a matter of contract. In fact, they have the same rights as the common creditors, unless they have taken security, when they will be considered privileged creditors.

As to the possibility for such providers of finance taking a "floating charge" over the company's assets (cash, stock in trade, etc), it should be noted that the law does not provide any rule in relation thereto. However, a "floating charge" clause can be included in the loan agreement according to the Portuguese Civil Code, which allows atypical contracts.

4.6. Do secured creditors (or persons appointed by them) which enforce their security control the insolvency procedure, or is the emphasis on collective procedures, which aim to maximise the returns to all creditors and/or rescue the business?

As mentioned above, common creditors have the same rights as secured creditors in any decision as to the future of the company, therefore the approval of the recovery measure needs the votes of creditors, both common and preferential, representing at least two thirds of the total amount of the approved claims without the opposition of at least 51% in number of the creditors directly affected by the recovery measure.

4.7. Do secured creditors have an ability to prevent any form of re-organisation or reconstruction from being attempted?

So long as the majority requirements for the approval of the reorganisation plan have been respected, there is little remedy left to the creditors, which did not vote in favor of it. Of course, creditors which did not vote in favor may challenge the approval of a given recovery measure during the necessary court ratification before the High Court; however, this challenge must be restricted to points of law, as the courts may not review the merit of the reorganisation plan. Bearing in mind that the Court has a wide monitoring presence throughout the process of the choice and approval of the plan, it is very rare to find a High Court quashing the judicial decision that approved the measure.