Adjusting a pre-insolvency scheme to respond to the COVID-19 crisis

Nuno Líbano Monteiro and Catarina Guedes de Carvalho report on changes to the Out-of-court Business Recovery Scheme (RERE) in Portugal

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According to the OECD, Portugal is in the top three countries in terms of implementing new measures to face this COVID-19 pandemic.

However, regarding the legal framework of insolvency and restructuring, the only direct, exceptional and temporary measure approved by the Portuguese authorities was to suspend the time limit for the debtor itself to petition for insolvency[1], with effect from 7 April 2020[2]. *No pre-insolvency exceptional measures have been adopted.*

In order to avoid a huge and unprecedented increase in insolvency cases after the end of the current pandemic period – because preventing the insolvency of businesses is also crucial to minimising the impact of COVID-19 in the economy – other urgent measures could be implemented, especially as regards pre-insolvency measures for companies. In fact, we believe a few adjustments to the existing legislation would be enough for this purpose.

In Portugal, the PER (Special Revitalisation Process) and the RERE (Out-of-court Business Recovery Scheme) are the key pre-insolvency measures for companies. If a company is only in a difficult economic situation or facing imminent insolvency, but still capable of recovery, it can use the PER or RERE to try to recover by adopting a recovery/restructuring plan.

As such, the possibility for a company to use the RERE (or the PER), even if it is already in an insolvency situation (at least, if the insolvency situation was originated by COVID-19 crisis[3]) could be an example of an efficient and simple measure to be urgently implemented. In fact, that has already been (successfully) tested, since the RERE could be used by insolvent debtors[4] for an initial transitional period of 18 months (which ended on 2 September 2019).

A couple of days before this article was written, the Government has announced the creation of a new extraordinary process for company viability (**PEVE**). The PEVE is exceptional and temporary in nature. It can be used by any company which, not having a PER pending, is in a difficult economic situation or in a situation of imminent or actual insolvency as a result of the economic crisis caused by the COVID-19 pandemic. However, the company must demonstrate that it is still potentially viable. The objective of this process is to obtain judicial approval of an out-of-court agreement reached between the company and its creditors. It is an urgent process and it takes priority over the processing and judgment of similar processes. We will have to wait for the publication of the legislation that will provide the regulations for this new process, but it already seems certain that the Portuguese legislature's choice was not to use the processes that already existed to respond to the crisis.

Meanwhile, let us now have a brief look at the **RERE's legal framework**[5]:

The RERE is quite a new out-of-court procedure (it has been in place for about two years). It begins with a written agreement (called a Negotiation Protocol), signed by the debtor and by at least 15% of the non-subordinated creditors, stating that the signatories are interested in negotiating a restructuring agreement, which is deposited at the Commercial Registry.

The RERE is voluntary in nature and the parties are free to apply or to sign up for it. As such, the debtor can call on all or only some of the creditors. He/she should call on the ones considered most suitable to achieving the restructuring agreement and its desired viability.

The procedure will be confidential, except where there is an agreement between the parties or a number of exceptions of a legal nature: the Tax Authority, the Social Security and the employees must be informed of the deposit of the negotiation protocol and of its content whenever they are owed money by the debtor.

The deposit of the protocol gives rise to a specific set of obligations for the debtor and the signatory creditors, in particular with respect to (i) the suspension of any judicial proceedings and to (ii) the running of any time limits to petition for insolvency. Essential public utilities, such as electricity, natural gas, water, sewage and electronic communication, cannot be suspended while negotiations continue.

The negotiation period should not take more than three months from the date of deposit of the Negotiation Protocol. The negotiations close with the deposit of the Restructuring Agreement, which takes effect as of this date and only for the future (except if there is a provision to the contrary in the agreement itself), and it only binds the signatories[6]. The parties are free to establish the content of the agreement and it is not subject to the principles that an insolvency plan or PER must respect (equality of the creditors and no creditor worse off). The Restructuring Agreement also allow for tax benefits if the credits restructured represent at least 30% of the total liabilities of the debtor.

If the Restructuring Agreement is subscribed to by creditors that represent the majority as provided for the approval of a plan under the PER (that is, a majority of two thirds), the debtor can obtain the formal judicial approval of the restructuring agreement, with a cramdown effect in relation to the creditors not signing up for the RERE.

The conclusion of the negotiations without the approval of a Restructuring Agreement has no effect for the debtor (specifically, with respect to its potential situation of insolvency).

These proceedings have no fixed costs[7] and can be done in "one shot" (skipping the negotiation period), by presenting the Negotiation Protocol and the Restructuring Agreement at once if all requirements are met.

Probably because it is a recent procedure, it has been little used. However, we can give a good and successful example that PLMJ handled: the RERE of a large company in the motorway concession business. This company benefited from the transitional period (allowing an insolvent debtor to begin a RERE) and ended up with the approval of the restructuring agreement by all the signatory creditors. In this particular case, there was a legal need to obtain the Government's consent to the agreement, so the parties agreed that the restructuring agreement's effects were subject to a condition (since that could not be fulfilled within the 3-month negotiation period): the Government's consent, within a certain period of time. In the meantime, due to the COVID-19 crisis, the Government has focused on the urgently needed response, so all the parties agreed to an extension of the time limit to obtain the consent.

Considering that Portugal already has pre-insolvency procedures and that there is an urgent need for some adjustments in order to respond to the COVID-19 crisis, this could also be the opportunity to bring forward the implementation of the Directive on Preventive Restructuring Frameworks adopted in June 2019.

Indeed, professor and supreme court judge Catarina Serra[8] believes that the RERE corresponds precisely to the type of instrument foreseen in the Directive. However, we fear that the urgency of the current situation is not conducive to its implementation, particularly in view of all the other choices the Directive left to the discretion of the Member States and to the complex and slow work that would imply for the Portuguese legislature. ■

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Footnotes:

1 A company is insolvent when it is not able to pay the debts that have fallen due (under article 3(1) of the Insolvency and Corporate Recovery Code – "CIRE"). Company directors/management have a legal obligation to submit an application for insolvency within 30 days of becoming aware of the insolvency situation (under article 18(1) of the CIRE). Breach of this legal obligation could lead to the insolvency being classified as culpable.

2 The wording of article 7 of Law 1-A/2020, introduced by Law 4-A/2020, suspends the time limit for the debtor to petition for insolvency, with effect from 7 April 2020. Law 16/2020 of 29 May repealed article 7, but it also added a new article 6-A to Law 1-A/2020. This new article provides for the (maintenance) of the time limit for the debtor to petition for insolvency.

3 As in Germany, where the government approved the suspension of the obligation to submit an application for insolvency when it was caused by COVID-19 crisis – and a provision is made for a presumption to facilitate its application: the insolvency is the consequence of the COVID-19 crisis whenever, as at 31 December 2019, the company was not insolvent or had the prospects to avoid it – see § 1 da Gesetz zur Aussetzung der Insolvenzantragspflicht und so weiter, das COVID-19 Insolvenzaussetzungsgesetz (COVInsAG), from 27 March 2020.

4 In this transitional period, the declaration from a certified accountant certifying that the company is not in a current insolvency situation was not required.

5 See Law 8/2018 of 2 March.

6 The main difference to the PER, besides its judicial nature, is the fact that it binds all creditors, even if they have not participated in the negotiations.

7 In this particular respect, much different from the UK's "English Scheme".

8 See Catarina Serra, "A função (alternativa) do RERE como programa extraordinário para o apoio e a reanimação de empresas" in Revista de Direito Comercial (https://www.revistadedireitocomercial.com/a-funcao-alternativa-do-rere).