INSOL INTERNATIONAL

MSMEs – PRACTICAL CHALLENGES AND RISK MITIGATION POST COVID-19

INSOL INTERNATIONAL

International Association of Restructuring,
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PRESIDENT'S INTRODUCTION

The World Bank has estimated that micro, small and medium sized enterprises (MSMEs) represent over 95% of enterprises and account for more than 60% of employment worldwide. With limitations regarding their ability to self-protect against insolvency risk, their susceptibility to systemic demand and supply shocks, their limited capital reserves and their level of debt overhang, MSMEs are in a vulnerable predicament as government fiscal and insolvency relief measures are wound back and the world endures difficult economic circumstances and tightened monetary policy measures.

This new publication from INSOL International, *MSMEs – Practical Challenges and Risk Mitigation Post Covid-19*, provides a timely overview of the informal, hybrid and formal restructuring and insolvency options available to MSMEs in the event of financial distress in 29 jurisdictions across the world. It also outlines the interim measures adopted by governments in those jurisdictions during the pandemic, and assesses the success of those measures in preserving the financial stability of MSMEs and maximising the prospect of a successful restructuring.

Each of the 29 chapters also provides an update on the latest insolvency reform measures either introduced or contemplated to provide streamlined restructuring and insolvency alternatives for MSMEs. This is especially important, with INSOL, the World Bank and UNCITRAL having identified the need for bespoke MSME processes beyond the "one size fits all" formal insolvency alternatives that are generally suited for larger enterprises.

Ultimately, given MSMEs' contribution to domestic, regional and global GDP and employment, creating flexible, efficient and cost-effective restructuring and insolvency alternatives for MSMEs is critical to ensure broader economic and financial stability, job maintenance, innovation and growth in our global economy.

Following the introduction of MSME restructuring and insolvency alternatives in the United States, Myanmar, Singapore, India and Australia in the last several years, it is hoped that similar measures will be introduced in other regions as we continue to navigate current economic conditions.

This book will provide a valuable contribution to our members worldwide, and will serve as a foundation to support ongoing law and policy reform and capacity building in coming years.

INSOL thanks each of the contributors from the 29 jurisdictions covered in this book, as well as the leader of this project, Rocky Gupta, INSOL Fellow, of UNITEDJURIS, India for committing their time, energy and expertise to ensure the completion of this book.

I hope you enjoy reading this excellent resource.

Scott Atkins
INSOL Fellow & President
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December 2022

FOREWORD

This is a special INSOL International publication which explores the insolvency frameworks and special insolvency procedures that exist for MSMEs in 29 jurisdictions worldwide. The publication also provides an overview of the interim fiscal stimulus and insolvency relief measures that were introduced during COVID-19 and the systemic challenges that MSMEs face – such as access to new money and the stigma associated with insolvency – in attempting to restructure their affairs.

Across these 29 jurisdictions, this book concentrates on the diverse tools available to facilitate the reorganisation and restructuring of MSMEs and the possible best solutions and strategies for economic distress alleviation. One of those tools, mediation, is a particular focus point and this book assesses the effectiveness of mediation as a viable restructuring tool.

For each jurisdiction, the book also includes feedback from experienced practitioners on what they see as being the best way to safeguard the interests of MSMEs and whether simplified processes exclusively for MSMEs would enhance the likelihood of a successful restructuring.

The idea of this project came in mid-2020 when the pandemic was at its peak and many businesses and companies had started getting into financial and operational distress. This was not a local phenomenon, but a global one. MSMEs, being one of the major contributors to GDP and collectively constituting almost 90% of the businesses in most jurisdictions, were facing the full impact of the pandemic.

I hope that this book will be a valuable tool for practitioners, academics and the judiciary across the world and may serve as the basis for future law reform locally, regionally and globally.

This project would not have been possible without the help and support of a team of professionals associated with this project. The initial acknowledgement must however go to the Technical Research Committee of INSOL International and Dr Sonali Abeyratne, Dr Kai Luck and Ms Waheeda Lafir in particular for all their assistance throughout the completion of the project, and of course to all the chapter contributors to the book globally for their time, expertise and commitment.

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1. Insolvency Framework – General Overview

1.1 Formal insolvency legislation

MSMEs are defined as enterprises that: (i) do not have more than 250 employees; and (ii) have turnover that does not exceed EUR 43 million. In Portugal, 99.9% of the existing businesses are MSMEs.

Insolvency for both corporations and individual persons in Portugal is regulated by the Insolvency and Corporate Recovery Code (Insolvency Code).

Although in force since September 2004, the Insolvency Code has been subject to several changes throughout the years, among which the inclusion of the multi-creditor workout "Processo Especial de Revitalização" (PER) stands out.

In April 2022, the Insolvency Code was subject to a material change as a result of the transposition of the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

Portuguese courts have jurisdiction to open insolvency proceedings and special restructuring proceedings (i.e. PERs) against debtors having their centre of main interests in Portugal.

Save for certain financial institutions, insurance companies, public undertakings and certain state-owned companies, all debtors with their centre of main interests in Portugal may be subject to the proceedings set out in the Insolvency Code.

The Insolvency Code is divided in two main sections:

- ***Special Restructuring Proceeding (PER)***

  For companies and other businesses (but not consumers) still not insolvent but in a difficult economic condition (that is, with serious difficulties to pay and discharge matured debts due to a liquidity shortfall or lack of access to third party financing), the Insolvency Code lays down a multi-creditor workout tool, the PER. This is fully or partially supervised by a court, whereby such companies or businesses may get a stay for the restructuring of their assets and / or liabilities with the objective of rendering their businesses financially and economically viable.

  The PER, which always presupposes the approval by the court of the agreement reached between the debtor and the majority of its creditors, may unfold in two distinct alternative ways:

  - negotiation of an agreement for the recovery of the company after the PER has been commenced in court, in which case the debtor submits a statement to the court expressing its willingness, together with a creditor or creditors representing at least 10% of non-subordinated claims (which in justified cases may be reduced by the judge), to enter into negotiations leading to recovery. Once started, negotiations must be concluded within

two months, extendable only once by one month, subject to a prior written agreement between the appointed provisional judicial administrator and the debtor.

If approved by the majority of the creditors, the agreement will be submitted to the court for ratification, which will confirm by verifying the required majority of approval; and

- approval of an out-of-court recovery agreement, in which case the debtor files an application with the court seeking approval of the agreement with creditors representing the majority required for approval. In this case, as the negotiation has already been concluded extrajudicially, there is no negotiation stage during the pendency of the process.

This is a significantly faster means of having the recovery plan approved as it does not involve the negotiation stage (which will have been previously established). Furthermore, it restricts the number of creditors that participate in the out-of-court negotiation, as it will be sufficient to involve the majority of the creditors (with limitations in what concerns subordinated credits), which promotes a more efficient and quick negotiation.

Both alternatives have aspects in common, namely:

- they are voluntary, with no obligation deriving from the law for a debtor to file a PER;

- they presuppose the issue of a written and signed statement attesting that the debtor meets the necessary conditions, issued no more than 30 days prior to the beginning of the process by a certified accountant or statutory auditor, whenever the auditing of accounts is legally required, certifying that it is not in a situation of current insolvency; and

- when initiated, the court appoints a provisional judicial administrator, whose functions are different from those of the insolvency administrator (appointed within the insolvency proceedings), to the extent that the debtor retains its administration capacity. However, there are some limitations on the exercise of these administration duties and the debtor cannot perform acts of special importance without the prior consent of the provisional judicial administrator.

A PER has a standstill effect and therefore, while it is pending:

- creditors are prevented from filing debt collection proceedings; and

- ongoing collection proceedings, statute of limitation and prescription periods and insolvency proceedings in which the insolvency of the enterprise has not been declared are suspended.

Depending on the terms and conditions of the restructuring agreement approved during a PER, certain tax benefits from corporate tax, stamp tax, property transfer tax and municipality tax set out in the Insolvency Code may also apply to the agreement. For instance, the positive equity variation

resulting from a debt haircut shall not be treated as taxable income at the level of the debtor for CIT purposes and shall be recognised as a deductible tax loss at the level of the creditors.

- ***Insolvency***

  The Insolvency Code foresees only one type of insolvency proceeding, which encompasses a standard preliminary stage aimed at verifying whether or not a debtor is insolvent and, if so, a subsequent stage aimed at the liquidation of the debtor's assets and the pro rata satisfaction of the creditors' claims via the liquidation proceeds or following approval of an insolvency plan.

  Creditors may nevertheless: (i) propose that the liquidation of the insolvency assets, their distribution among the creditors and the liabilities of the debtor thereafter is governed by an insolvency plan; or (ii) approve a restructuring plan containing the terms and conditions of the recovery and continuity of a company or business in lieu of its liquidation.

  The approval of an insolvency plan or a restructuring plan is not an option for individuals that are not owners of a business or are owners of small businesses (liabilities not exceeding EUR 30,000, no more than 20 creditors and no employee claims). These individuals may, however, propose a payment plan (special payment plan process), which immediately suspends the insolvency proceeding, to be approved by all of the creditors.

  Individual persons also have other particular rules that apply to them only, with relevance to the possibility of discharging their debts in order to allow them to have a fresh start.

  Under the terms of the Insolvency Code, debtors are deemed to be insolvent if they are unable to generally pay and discharge their matured debts (cash-flow test).

  Corporate persons are also considered insolvent when their liabilities manifestly exceed their assets, in accordance with the applicable accounting rules (balance sheet test). However, the insolvency shall not be deemed to occur, provided that the assets of the corporate person are higher than its liabilities, in accordance with the following rules:

  - the identified liabilities and assets will be considered, even if not registered in the accounts, at their fair value.

  - if the debtor owns a business, the value of the assets and liabilities shall be assessed considering a scenario of survival or liquidation (depending on what is the most likely), but always excluding the goodwill account; and

  - the liabilities shall not include debts only payable through distributable funds or the remaining assets debts further to the satisfaction of the remaining common, secured and privileged credits creditors.

1.2 Specific insolvency legislation

The Insolvency Code does not include a specific regime for MSMEs, but rather provides for a general regime with particular rules that only apply to individual persons.

However, during the pandemic period, certain interim measures were introduced to benefit MSMEs (discussed in further detail below).

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

- *Regime on the Extrajudicial Restructuring of Businesses (RERE)*

  With exception to individual persons who do not own a business, other individual persons and corporate persons in a difficult economic condition or in the imminence of insolvency may resort to the out of court workout designated by the Regime on the Extrajudicial Restructuring of Businesses (in Portuguese, *Regime Extrajudicial de Recuperação de Empresas*, commonly and hereinafter abbreviated to RERE).

  The purpose of the RERE is to regulate the terms and effects of the negotiations and the agreements entered into between a debtor and one or more creditors. The object of such agreements is the modification of the structure and conditions of the assets and liabilities of a debtor, or any other part of its capital structure.

  Parties may apply the RERE only to the effects of an executed restructuring agreement or also to the effects of the negotiations leading to the execution of that restructuring agreement. For RERE eligibility, the participating creditors must at least hold 15% of the total unsubordinated liabilities of the debtor.

  If the parties wish to subject the negotiation stage to the RERE, they may prepare and deposit with the commercial registry a negotiation protocol. Upon deposit of the negotiation protocol:

  - unless previously authorised by the creditors, any relevant management decisions (such as the sale of a substantial part of its assets) are subject to the prior consent of the creditors or, if any, the creditors' committee;

  - creditors cannot reject any commitments assumed in the negotiation protocol during the agreed negotiation period, unless there is a serious breach of the debtor's obligations thereunder;

  - any insolvency proceedings filed by a participating creditor or party to the negotiation protocol are immediately suspended, if insolvency has not yet been declared;

  - unless otherwise provided in the negotiation protocol, any proceedings aimed at forcing performance of payment obligations initiated by participating or acceding creditors shall be closed (in case of enforcement proceedings) or suspended (in case of any other proceedings); and

- essential service providers (i.e. water, electricity, natural gas and electronic communications, among others) cannot terminate or suspend the delivery of such services;

- if the parties successfully close the negotiation stage and execute a restructuring agreement or if they simply subject it to the RERE, such agreement must also be deposited at the registry office, upon which:

  (i) the restructuring agreement is fully effective between the debtor and (only) each creditor party thereto as of the date of the deposit (no retrospective effect being permitted) and shall be characterised as an enforceable instrument, while a restructuring agreement subject to a RERE shall not be effective against creditors that are not party thereto; and

  (ii) any declaratory, enforcement or injunction proceedings in respect of claims comprised in such restructuring agreement shall be immediately closed, the same occurring in relation to insolvency proceedings filed against the debtor by a creditor party to such agreement, if no insolvency has been declared yet.

  There is a principle of confidentiality applicable to the negotiations and to the resulting restructuring agreement, which is viewed as a great advantage of the RERE as compared with the PER. Moreover, there is no need to involve a court, which also brings benefits in terms of timing.

▪ *Regime on the Conversion of Debts into Capital (RCCC)*

The RCCC is applicable to the conversion of debts into capital occurring in commercial companies with head offices in Portugal whose turnover is equal to or higher than EUR 1 million.

However, the RCCC cannot apply to the indebtedness of insurance companies, credit institutions, financial companies, investment companies, public listed companies or claims held by public entities (except public sector companies).

For the application of the RCCC, the following conditions must be satisfied:

- the net assets of the company must be lower than its equity; and

- there must be a delay over 90 days in the payment of unsubordinated claims over the company whose value exceeds 10% of the total amount of unsubordinated claims, or, in the case of payments to reimburse partially capital or interest, provided that these relate to non-subordinated claims of more than 25% of total non-subordinated claims.

The proposal for the conversion of debt into capital must be signed by creditors whose claims represent at least two thirds of the company's total liabilities and the majority of the unsubordinated claims.

Once the proposal is received, a general meeting of the company must be convened within 60 days to approve or reject the resolutions required to

implement the proposal. Within that period, the relevant company may negotiate and agree with the creditors any modifications to the original proposal, which must be communicated to the shareholders within the time limits provided for by law.

The shareholders of the company always hold a pre-emption right in respect of any share capital increase, which shall be paid in cash, such cash then being applied in the discharge of the debts of the company. If not all the shareholders exercise their pre-emption right, it may be exercised by the remaining shareholders on a pro rata basis.

In the event that (i) the creditors' proposal is rejected; (ii) the meeting is not held; or (iii) for any reason, the resolutions taken therein are not implemented within 90 days of their approval, creditors may then apply for a judicial ruling in lieu of the required resolutions. Once the application is received, the court shall appoint an interim judicial administrator and shall notify the other creditors of the existence of the proposal and shall publish the list of claims.

After the determination of the final list of claims, the court will review the proposal and approve it if all the conditions provided by law are met. The ruling issued by the court constitutes a sufficient instrument for the share capital reduction, the share capital increase, the modification of the company's bylaws, the conversion of the company and the exclusion of shareholders and required registrations.

No later than 30 days of the final ruling, shareholders may still acquire or cause the acquisition by third parties of any shares resulting from the changes approved by the court, at their nominal value, provided that they also acquire or pay the total outstanding amount of the remaining claims of the proposing creditors against the company.

If the company is declared insolvent:

- any debt conversion proposal or any resolutions taken by the company shall be of no effect; and

- if an application has already been filed for a ruling in lieu of the required resolutions, the proceedings are closed.

If any share capital modifications have already been registered and the insolvency has not yet been declared in pending insolvency proceedings, the modifications must be immediately communicated to the court and pending court proceedings shall be closed.

1.3.2 Informal framework

Portugal formally adopted in 2011 a set of principles closely inspired by INSOL's Statement of Principles for a Global Approach to Multi-Creditor Workouts for application to all court or out of court workouts and / or restructuring proceedings (Restructuring Principles). Creditors and debtors are required to comply with the Restructuring Principles in connection with formal workout proceedings, such the

PER and the RERE but, aside from those proceedings, adhesion to the Restructuring Principles is voluntary.

However, the Restructuring Principles have been approved for general application and therefore are capable of applying to both MSMEs and non-MSMEs. Generally, the Restructuring Principles and the formal restructuring proceedings are not specifically designed for MSMEs.

That said, the Portuguese banking system is usually accessible to companies undergoing out of court restructuring, usually by way of an extension of the maturity of existing loans and other forms of financing and a payment plan. However, for tax reasons, a restructuring involving a write-down of the debt is normally conducted in formal restructuring proceedings, because otherwise a haircut may not be recognised as a loss for tax purposes at the creditor level and may be taxable as a capital gain at the debtor level.

We have also seen in certain instances the conversion of existing debt in hybrid (convertible debt) or equity instruments. However, these types of restructuring options are only available to large debtors and not to MSMEs.

1.4 Accelerated restructuring or liquidation of MSMEs

The PER, described above as a judicial multi-creditor workout tool, is an urgent proceeding, which means that it should be prioritised in relation to other non-urgent proceedings and completed in a short timeframe.

In the scenario where the restructuring agreement is negotiated after the proceeding is filed, those negotiations should not take longer than three months, which means that the proceeding is usually concluded five months after being filed in court. If the agreement is already approved when the PER is filed in court, the duration is normally no longer than three months.

PER is quite an efficient tool which has indeed helped MSMEs in Portugal, in particular those that actually have access to investors and new money and where the recovery relies on a solid restructuring plan (usually encompassing structured financial and corporate restructurings).

As for insolvency, although it is also an urgent proceeding, the complexity that it can assume is not always compatible with the possibility of avoiding liquidation. Usually the debtor and / or the creditors take a while before managing to file an insolvency plan aimed at recovery, which still may be subject to amendments and finally to its approval by the majority of creditors and by the court.

In any case, whenever the insolvent assets are presumably insufficient to pay for the judicial costs (i.e. are under EUR 5,000) and the presumable debts of the insolvency estate (e.g. remuneration of the insolvency administrator), the insolvency proceeding is closed. In this case, corporate persons will be liquidated in accordance with the regular administrative proceeding aimed at the liquidation of companies.

1.5 Discharge of debts for natural persons

One of the specific provisions that only applies to natural persons under the insolvency regime is the possibility of having an effective discharge of debts. For that purpose, the natural person must request thr discharge, which will only occur three years after the insolvency proceeding is closed (fresh start).

The discharge of debts is not granted by the court if:

- the application is not filed on time by the insolvent;
- the insolvent, with intent or gross negligence, within the three years prior to the commencement of the insolvency proceedings, provided wrongful or incomplete information about his / her financial circumstances aimed at obtaining credit or subsidies from public institutions or in order to avoid payments to such institutions;
- the insolvent already benefited from the discharge of debts within the 10 years prior to the date of the commencement of the insolvency proceedings;
- the insolvent has failed to comply with the duty to file for insolvency or, not being under an obligation to do so, has failed to do so within six months following the onset of the insolvency, with prejudice, in either case, to the creditors, and knowing, or being unable to ignore without serious fault, that there is no serious prospect of improvement of the economic situation;
- there is already evidence in the proceedings, or is provided until the time of the decision by the creditors or the insolvency administrator, which indicates with all probability the existence of guilt on the part of the insolvent in creating or worsening the insolvency situation;
- the insolvent has been convicted by a final decision of any of the insolvency related crimes provided and punished under the Portuguese Criminal Code in the 10 years prior to the date of filing the application for declaration of insolvency or after that date; or
- the debtor, with intent or gross negligence, has violated the duties of information, presentation and collaboration arising from the Insolvency Code during the insolvency proceeding.

During the three year period before the discharge of debt, the insolvent must deposit in favour of an Insolvency Administrator the available income – with exception to the amount necessary:

- to secure a minimum dignified support for the debtor and his / her family, which shall not be over three times the minimum wage;
- to perform his / her professional activity; and
- to pay other specific expenditure determined by the court – so that it can be distributed to the creditors during that period.

This discharge of debts is commonly requested by the insolvent individual and, as a general rule, granted by the courts.

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

During COVID-19, the Portuguese Government approved a statutory moratorium in the payment of principal and interest under existing credit agreements, a measure applicable to individuals and companies and businesses. It is generally accepted that the moratorium has contributed to the survival of companies that would otherwise be unable to overcome the pandemic. However, an assessment is still to be made on whether a proper screening of viable businesses has been made prior to the application of the statutory moratorium.

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

The Portuguese legislator implemented specific restructuring and insolvency measures aimed at supporting insolvent or struggling corporate and individuals in general, some of which lifted on 31 December 2021.

Besides the suspension of the duty to initiate insolvency (discussed below), the following measures were implemented with the intention of mitigating the impact of the pandemic:

- ***Special Business Recovery Process (PEVE) – the new restructuring multi-creditor workout tool***

  The Special Business Recovery Process (in Portuguese, Processo Extraordinário de Recuperação de Empresas, or PEVE), is a new multi-creditor workout tool that was implemented due to the pandemic.

  The PEVE is a judicial process available to businesses that are proven to be in a difficult economic situation or in a situation of imminent or current insolvency due to the pandemic, but which are susceptible to recovery.

  Micro and small businesses may resort to the PEVE even if on 31 December 2019 their assets did not exceed their liabilities provided that:

  - there are no pending insolvency proceedings, PERs or a special payment plan process at the date of submission of the court application for a PEVE;

  - the business received rescue aid under the temporary State aid measures to support the economy during COVID-19 and it has not been reimbursed in accordance with the law; or

  - it is covered by a restructuring plan under the State aid measures.

  The purpose of the PEVE is to allow the debtor, even if already in a current insolvency situation, to enter into a restructuring plan approved by the majority of its non-subordinated creditors, aimed at recovery. This agreement approved

by the required majority and subsequently ratified by the court is binding on all creditors, even those that voted against the restructuring plan.

While the process is underway, the debtor is prevented from performing acts of particular importance without the prior authorisation of a provisional judicial administrator.

This process has a standstill effect. Therefore, during a PEVE:

- creditors are prevented from filing debt collection proceedings; and

- pending collection proceedings, statute of limitation and prescription periods and insolvency proceedings in which the insolvency of the enterprise has not been declared are suspended.

The PEVE has been available since 28 November 2020 and will remain in force until 30 July 2023.

- ***Failure to comply with the approved insolvency plan due to an event occurring after 7 April 2020***

The law foresees that any creditor that has not been paid in accordance with the approved insolvency plan or recovery plan approved under a PER may demand from the debtor the payment of the amounts that are due, plus default interest granting the debtor a period of 15 days to do so. If the debtor fails to make the payment within the given 15 days, the moratorium or write-down provided in the insolvency plan / recovery plan becomes ineffective.

However, pursuant to Law No. 75/2020 of 27 November 2020, the 15 day period was suspended until 31 December 2021, provided that non-compliance resulted from an event, whether or not related to the pandemic, occurring after 7 April 2020.

This suspension therefore prevented corporate or individual persons that were unable to comply with the insolvency plan / restructuring plan from seeing the credits that have been waived being revived and / or having to pay, immediately, the full amount of the credits due which possibly would be incompatible with a recovery.

- ***Mandatory partial payments in relation to insolvency proceedings***

Pursuant to Law No. 75/2020 of 27 November 2020, in all the insolvency proceedings that were pending on 28 November 2020, it became mandatory to distribute to creditors a part of the amount deposited in favour of the insolvency estate, provided the amount was over EUR 10,000.

This measure was particularly important considering that many creditors are also MSMEs, usually ranked as common creditors. Before this measure, unsecured creditors had to wait for the liquidation of the entire insolvency assets before receiving any amount, which may take several years to occur. Thus, this partial distribution of the proceeds of the sale of the insolvency

assets allowed an earlier reimbursement of unsecured creditors, namely MSMEs.

The importance of this measure led to its introduction in the Insolvency Code with effect since 11 April 2022 and therefore partial payments in insolvency proceedings are now mandatory.

- ***Extension of time for negotiations under a PER***

  Law No. 75/2020 of 27 November 2020 also established the possibility of obtaining an extraordinary one-month extension of the deadline to conclude the negotiations for the approval of the recovery plan.

  This measure aimed precisely at countering the difficulties, in the context of the pandemic, of communication between the various interlocutors in the negotiation process and understanding the real effects of a possible reduction of the debtor's activity, essential to define the necessary steps for restructuring.

  This extension also applied to the special payment process accessible to individuals, as described above.

  This temporary measure was revoked on 31 December 2021.

- ***Incentive of financing by shareholders and other persons especially related to the corporate person in relation to PER proceedings***

  Law No. 75/2020 of 27 November 2020 determined that shareholders and any other persons especially related to the corporate person that, between 28 November 2020 and 31 December 2021, financed the company's activity would, in case of insolvency, be ranked as a preferred creditor in relation to the debtor's movable assets.

  This is a deviation from the general rule, which was at that time in force, that provided shareholders and other persons especially related to the corporate person would be ranked as subordinated, thus serving as an important incentive for these persons to directly invest in the company without the need to resort to external funding, which is not always easy to obtain for corporate persons in financial difficulties.

  This temporary measure was introduced with permanent effect in the Insolvency Code as of 11 April 2022 and currently shareholders and any other persons especially related to the corporate person that financed the company's activity during the PER benefit from the preferred ranking in relation to the debtor's movable assets (ranking before employees).

- ***RERE proceedings***

  As regards the RERE, the Portuguese legislator provided that corporate persons that were actually in an insolvency situation – and not only those in a difficult economic situation or in a situation of imminent insolvency – but which were still susceptible to recovery, could also resort to this restructuring workout tool.

However, only corporate persons that were in an insolvency situation due to COVID-19 could benefit from this measure. Thus, it was necessary to demonstrate, in accordance with the applicable accounting standards, that the corporate person, on 31 December 2019, had assets in excess of liabilities.

This temporary measure was revoked on 31 December 2021.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

Under the insolvency law, a person is obliged to apply for their own insolvency within 30 days of the date of knowledge of the insolvency situation in accordance with the tests referred to in section 1.1 above.

Indeed, the breach of the duty to file for insolvency may even lead to the insolvency being declared by the court as being culpable, which may entail serious consequences for the corporate person's directors, and may also constitute the commission of a crime of negligent insolvency.

However, Law 4-A/2020 of 6 April 2020 provided for the suspension of the debtor's duty to file for insolvency of the debtor with retroactive effects as of 9 March 2020, regardless of whether the situation of insolvency was motivated by the pandemic.

In any case, the suspension of the duty to file for insolvency does not prevent any corporate or individual person from doing so, nor does it prevent any creditor or whoever is legally liable for the debts from requesting it.

The aforementioned law does not provide a deadline for this exceptional measure to be lifted, which means that the duty to file for insolvency still remains suspended. However, when the suspension is lifted, the duty to file for insolvency will again require a filing within 30 days of acquiring knowledge of the insolvency situation, which may be insufficient to initiate and implement the necessary restructuring measures with a view to recovery. Therefore, it is important that those affected by the pandemic adopt recovery measures in a timely manner in order to avoid insolvency.

This suspension of the duty to file for insolvency should therefore be interpreted as an opportunity to act in order to implement the necessary measures for recovery, avoiding subjecting the corporate or individual person in distress to insolvency proceedings and the upheavals, limitations and risks that this entails.

2.3 Insolvency procedural deadlines

Although not introduced for MSMEs in particular, besides the suspension of the debtor's duty to initiate insolvency (a measure that remains to be lifted), the legislator extended for an additional period of 15 days the deadline to file the insolvency plan proposal in order to grant additional time to adjust it to the pandemic context. This latest measure was targeted at assisting the insolvency plan proposed within the insolvency proceeding in view of the recovery, and not for the insolvency plan aimed at the liquidation of the insolvent.

The 15 day extension measure aimed at adjusting an insolvency plan to the pandemic context. However, it had a very limited beneficial effect, not only because it was only introduced by the end of 2020, but also since it remained hard to accurately predict the actual effects of the pandemic and how they would be an obstacle to the recovery of an insolvent person.

2.4 Minimum debt requirements to initiate insolvency proceedings

The requirements to initiate an insolvency proceeding remained unchanged and in fact, although the duty of the debtor to initiate insolvency was and still is suspended, any creditor could during COVID-19 initiate insolvency procedures against a certain debtor provided the insolvency requirements (failure of the cash-flow and / or balance sheet test) were met.

The courts are sensitive to the COVID-19 temporary effects argument if an insolvent person is able to present evidence of the casual link between the pandemic and the insolvency. The courts are also sensitive of the recovery should the restriction measures imposed due to the pandemic be lifted.

2.5 Suspending specific creditors' rights

Although the debtor's duty to file for insolvency was suspended, any creditor was and is still allowed to initiate insolvency procedures during COVID-19 against any of her / his / its debtor based on the failure of the latter to pass the cash-flow and / or the balance sheet tests.

In fact, creditors' rights were only affected until 31 December 2021 in the terms mentioned in section 2.1 above.

2.6 Mediation and / or debt counselling

Mediation and debt counselling are available in Portugal for corporate persons that under the Insolvency Code are in a difficult economic situation or are insolvent, in order to give the necessary advice in negotiations with creditors with a view to reaching a restructuring agreement aimed at recovery.

Although mediation is not referred to in the Insolvency Code, the RERE regime (the out of court workout tool described above) specifically foresees the possibility of the debtor appointing a mediator to provide the necessary support and advice during the negotiation stage.

Mediation, debt counselling and financial education is not mandatory for any type of rescue, restructuring or rehabilitation.

An experienced, reputable and independent mediator may theoretically have an essential role in the designing a workout solution that aligns the interests of a debtor and its creditors, mainly in instances where the debtor is a MSME or has no experience in financial matters. We have nevertheless seen that role in pre-insolvency scenarios being performed by corporate advisors engaged by debtors or increasingly by servicing providers engaged by lenders. A cost sensitive debtor may also hesitate if it has to bear the mediation costs.

In out of court proceedings, we see potential in the appointment of a mediator in the reduction of cots and the length of a restructuring proceedings insofar as the mediator has the expertise, the drive and the knowledge required to strike the best solutions. However, as referred to above, the appointment of a mediator is not mandatory in form.

3. Challenges Faced

3.1 Stigma associated with insolvency

Form a cultural perspective, the insolvency of an entrepreneur or promotor is generally viewed as a sign of personal inability to pursue a business or professional activity. The insolvency is registered in the personal public records of a person (public civil registry) for at least five years and it may determine a prohibition to carry a professional or commercial activity or the ineligibility for certain functions in the administration or supervision of legal entities. The insolvency of an individual may also be relevant in the assessment of the suitability as prospective directors and senior officers of regulated entities (mainly in the financial sector) carried out by supervisory authorities.

3.2 Availability of financial information

Although it is possible to have access to information on whether a natural person is party to a recovery, insolvency or enforcement proceeding, other types of information – namely in relation to the existing assets – may be difficult to obtain.

If the creditor has an enforceable instrument (a document which foresees and confirms the existence of a credit) against the debtor (e.g. a judgment, a certified document by a competent authority or a negotiable instrument), it is possible to initiate a Pre-Enforcement Out-of-Court proceeding (in Portuguese Procedimento Extrajudicial Pré-executivo, or PEPEX). Within PEPEX, and subject to the payment of EUR 51, an enforcement agent is appointed to research on the available public data of a certain debtor to verify if there are any assets (properties, vehicles, shares, bank accounts and any income / salary).

The goal of this procedure is not to attach any assets but only to verify if it is worth starting an enforcement proceeding. This can also be helpful for insolvency as it is a way of anticipating the outcome of such proceeding: recovery or liquidation. Either way, since PEPEX may be used only by creditors that have an enforcement title and the debtor is notified whenever such proceeding is initiated, the instrument is not used very often. The instrument may not always be an advantage for creditors if they do not want the debtor to have advance knowledge of potential actions which may in turn lead to the dissipation of any assets.

It is therefore common that creditors resort to specialised asset tracing companies that usually have the means to obtain more information, namely by researching public information.

Due to data protection measures, it is difficult to put in place other measures allowing creditors to have access to financial information of a natural person. The creditors, in particular financial institutions, should therefore – as is common –

obtain as much information as possible on the financial information, including about the existing assets, when financing a natural person.

3.3 Access to new money

There is no new money with a preferred status post filing or post commencing of an insolvency proceeding. The protection to new money is only afforded in a PER or a PEVE by way of a general statutory preference to other unsecured liabilities of a debtor, such that new money will not rank senior to exiting secured creditors. Security interests provided as security to the obligations in respect of new money are also protected from "hardening period" rules.

3.4 Secured creditors *vis-a-vis* unsecured creditors

Secured creditors, which rank above common creditors but may rank below specific preferred creditors include, for example, creditors holding mortgages, pledges, rights of retention over assets and general or specific statutory liens over movable property or real estate.

Secured creditors may propose to the insolvency administrator the acquisition of the secured asset for the amount of its projected sale price or fixed sale price. Plus, secured creditors are mandatorily consulted by the insolvency administrator regarding the secured asset's sale method that should be chosen and are also informed about the projected sale price of the asset to a certain entity or about what its fixed sale price should be.

In addition, after the secured asset is sold, secured creditors are immediately paid (after deduction of the estimated insolvency estate expenses and in accordance with their ranking), whereas other creditors usually have to wait before the entire insolvency estate is liquidated in order to receive any amount.

3.5 Insufficient asset base

A formal insolvency proceeding makes third party new financing less likely. A low asset base makes also financing more difficult. In any case, whether a low asset based companies are liquidated or restructured may depend on other factors other than its assets, mainly if the business of a MSME requires certain types of assets or the feasibility of a prospective business plan proposed by, or to, the investors.

3.6 Personal guarantees (PGs)

PGs are quite prevalent in MSMEs where there is a corporate structure and are usually required by financial institutions when entering in financing agreements. Promissory notes signed by a MSME and guaranteed by shareholders (usually the Ultimate Beneficial Owners (UBOs) or mortgages granted by a third party (also usually shareholders / UBOs) are still the most common PGs.

PGs are – unless otherwise agreed with creditors – not affected by any haircut or moratorium foreseen under the insolvency plan aimed at the recovery of a debtor.

As PGs are usually enforcement titles, under Portuguese law, creditors may file enforcement proceedings against the guarantor, in each case upon occurrence of a failure to pay or any other event of default. Save for certain exceptions, and unless otherwise agreed with one or more creditors, all the assets of a guarantor may be enforced to discharge the debtor's liabilities. Enforcement proceeds deriving from the enforcement of the guarantor's assets are rateably distributable among creditors, unless there are any lawful causes of preference among the creditors (assets separation, subordination or secured claims).

There is no required protocol or structure, and enforcement is generally carried out depending on the specific circumstances of the MSME involved.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Insolvency should clearly be avoided if the intention to the create the condition for the restructuring of MSMEs. Although some improvements have been made, there is still some room to improve efficiency and ensure that experienced and reputable insolvency professionals are designated to handle matters more efficiently.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Insolvency proceedings are still regarded as a process that negatively impacts the reputation of MSMEs (and other companies, for that matter) and their directors. Hence, for viable MSMEs in financial stress, it is more beneficial to seek a restructuring out of an insolvency proceeding.

The suspension of the duty to file for insolvency and statutory moratorium have certainly benefitted MSMEs as, according to the latest available statistics, insolvency proceedings have not increased substantially as it would be expected due to the financial distress caused by COVID-19.

This allowed many corporate and individual persons to recover a certain economic stability while avoiding going through an insolvency proceeding.

Some of the temporary measures introduced by COVID-19 legislation were included in the Insolvency Code, thus revealing their importance. In particular, the incentive for shareholders and other related persons to finance the company in distress during a PER and the obligation to proceed to a partial reimbursement of creditors (including, therefore, unsecured creditors) within the insolvency proceeding even when the liquidation of the insolvency assets is not concluded are important measures that will continue.

However, the suspension of the duty to file for insolvency is a measure that should be lifted as the effects from COVID-19 have become clearer and debtors are already capable of measuring the odds of recovering.

4.3 Simplified insolvency proceedings

Although the restructuring workout tools foreseen under Portuguese law are already quite straightforward and allow a simple restructuring, there is still some

work to be done in relation to the duration of the insolvency proceeding.

As mentioned in section 1.4 above, the Portuguese Insolvency Code already foresees a simplified liquidation mechanism whenever the insolvency estate is presumably insufficient to pay for the judicial costs associated to the proceeding.

However, whenever this is not the case, an insolvency proceeding still takes a while before being concluded which may be detrimental to many creditors.

With the transposition of the EU Directive, which is quite recent, it is expected that the PER and also insolvency proceedings will move faster and allow a swifter liquidation and discharge of the insolvent persons.

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