**A picture containing drawing

Description automatically generated**

**Inside Story – May 2021**

**For Great Ills, Great Remedies! The New Extraordinary Proceedings for the Economic Sustainability of Businesses**

*Catarina Serra, Justice of the Supreme Court, Professor, University of Minho (Braga), Portugal; Email: <cssserra@gmail.com>.*

*Introduction*

Since the early days of the pandemic, the Portuguese legislator has taken several extraordinary measures to help businesses: the deferral of specific obligations, namely tax obligations and social security contributions, bank loans, performance in lease contracts; a furlough scheme for employees; the opening of lines of credit, just to name a few. As far as insolvency law is concerned, the only measure for a long time has been the suspension of the duty to file for insolvency. The usefulness of such a measure is, however, limited, given the fact that, to begin with, the creditors and the debtor itself retains the right to request the opening of the insolvency proceedings.[[1]](#footnote-1)

More recently, Law No. 75/2020 of 27 November 2020 introduced additional measures, from which stand out the new extraordinary proceedings designed to allow the swift restructuring of businesses affected by the COVID-19 crisis (Articles 6 to 15).[[2]](#footnote-2) The national legislator has put into practice the old saying “for great ills, great remedies” and created extraordinary proceedings for an extraordinary crisis. But are these proceedings the (most) appropriate tool to meet the actual needs of the businesses (companies and entrepreneurs)?

*Extraordinary Proceedings?*

Despite being extraordinary, the new proceedings – the extraordinary proceedings for the economic sustainability of businesses, as they are called[[3]](#footnote-3) – are very similar to other proceedings available in Portuguese law since 2012 called “Special Revitalisation Proceedings”.[[4]](#footnote-4) They both fall into the category of the proceedings known as “fast-track-court-approval-procedures” (accelerated procedures aimed at the judicial confirmation of a restructuring plan) and serve to overcome the limits of contractual relativity, to enable out-of-court agreements to become binding on all creditors, including the dissenting creditors and the creditors who have not even participated in the negotiations.

Naturally, there are differences. First of all, the new proceedings are temporary, meaning the tool is in force for a limited period (until 31 December 2021, although with the possibility of extension) (Article 18, 1/2). Then, they are more urgent than the other proceedings that are also insolvency and pre-insolvency related (Article 6, 6). Lastly, they are free of costs to the debtor (Article 15). Lastly, they are single use, that is, they are usable only once (Article 9, 15).

It is, however, on the substantive level that the real differences (and, consequently, the peculiarities of the new proceedings) unveil. While the other are typical pre-insolvency proceedings, the new proceedings are applicable both when there is a likelihood of insolvency[[5]](#footnote-5) and where there is actual insolvency. In either case, this is provided the situation is caused by the COVID-19 crisis (Article 6, 1). In accordance with Article 6, 3, it is necessary to demonstrate that, by 31 December 2019, the business had a positive balance sheet, i.e., the value of the assets exceeded the liabilities.

Supposedly, a positive balance sheet at that point demonstrates the causal link between the current situation of the business and the COVID-19 crisis. As a matter of fact, this is not completely true: according to Portuguese law, actual insolvency is the inability to pay debts as they fall due (Article 3, 1, of the Insolvency Act), therefore it is possible that the business is insolvent, even though the assets exceed the liabilities and vice-versa. The bottom line is: the new proceedings are accessible to businesses whose insolvency is not COVID-19-related and may be prohibited to others which are not and have never been insolvent.

Another – a second – relevant difference between the new proceedings and the others is the total absence, in the former, of a procedural stage for the lodging of claims. The new proceedings are, naturally, opened at the request of the debtor. This request is instructed with multiple documents, namely the restructuring plan, which must have been adopted by the legally required majority (Article 7, 1, *d*), and the alphabetical list of creditors, drawn up by the debtor (Article 7, 1, *c*). It is this list which, at first, serves as the basis for the court to verify the adoption of the plan for the purpose of opening the proceedings.

At a later stage, this list is challenged by the creditors and becomes final. It will then serve as the basis for the court to confirm, for the second time, the adoption of the plan for the purpose of its judicial confirmation. This is to say: it all revolves around the list of creditors submitted by the debtor, contrary to what usually happens (the list is submitted to the court by the insolvency practitioner after the spontaneous lodging of the claims by the creditors). This certainly undermines or, in the least, reduces the possibility to determine with precision the definitive universe of creditors, but it is what allows the proceedings to be (more) accelerated.

An ultimate difference lies on the fact that, in the new proceedings, the court has the power/the duty to analyse the plan with a view to verify that it presents a reasonable prospect of ensuring the restructuring of the business (Article 9, 4, (b) *(ii)*). This means that the court has the power/the duty to refuse the confirmation of the restructuring plan if it lacks a reasonable prospect of ensuring the (economic) viability of the business.[[6]](#footnote-6) Let us have a closer look at this feature and the difficulties that may arise.

*Verifying Viability and Plan Feasibility*

In this regard, it should be said that it is the first time that the Portuguese law gives the court powers/duties to verify the feasibility of the plan.[[7]](#footnote-7) The legislator was certainly trying to introduce something new in the proceedings or, more than that, something that evokes the Preventive Restructuring Directive (PRD).[[8]](#footnote-8) As a matter of fact, Article 10(3) of the PRD provides that “Member States shall ensure that judicial or administrative authorities are able to refuse to confirm a restructuring plan where that plan would not have a reasonable prospect of preventing the insolvency of the debtor or ensuring the viability of the business.”

The desire to anticipate the accommodation of some of the measures laid down in the PRD is quite understandable, considering that Portugal will not, contrary to what was expected, have implemented it by the end of the deadline (17 July 2021).[[9]](#footnote-9) Still, it may not have been the smartest move since the application of this particular measure faces several difficulties.[[10]](#footnote-10)

To cut a long story short, the control of the feasibility of the restructuring plan is confronted with three fundamental obstacles. The first is the alleged lack of legitimacy of the judicial authority to replace the creditors or, more precisely, to substitute their will with his/her own.[[11]](#footnote-11). Put in other words: every plan implies a certain degree of risk which the creditors assume whenever the plan is adopted by the required majority; on what grounds might the judge ultimately contradict the will of the majority of the creditors?

The two other objections are of a practical nature and concern the costs (time and money) that such a control of the plan entails. To be sure, neither the judge nor the insolvency practitioner is adequately equipped to make a prognosis about the future viability of the business. In order to have a rigorous assessment, the task must be assigned to external experts/independent professionals.[[12]](#footnote-12) When this is not the case (when it is not possible to spend enough time and money), it is inevitable that the results are very modest, hence deprived of utility.[[13]](#footnote-13)

Coming back to the Portuguese law, despite the above-mentioned difficulties, the court is required to verify that the restructuring plan presents a reasonable prospect for ensuring the viability of the business for the purpose of confirming or refusing the confirmation of the plan (Article 9, 4, (b) *(ii)*).[[14]](#footnote-14) Bearing in mind that the new proceedings are (superlatively) urgent as well as free of costs for the debtor, it is understandable that such an assessment must be performed in the same time frame as the assessment of the other prerequisites for the confirmation of the plan (i.e., ten days) and on the sole basis of the opinion of the insolvency practitioner (Article 9, 3). Still, it is possible to wonder if such an assessment (i.e., obtained in such a way) is of any worth.

*Potential Structural Weaknesses*

In addition to the points already mentioned, it may be argued that the new proceedings suffer from two congenital and structural weaknesses. In the first place, being a procedural tool as they are, they do not contribute to alleviating the burden on the courts (the number of lawsuits pending). Furthermore: given that the new proceedings are more urgent than the other pre-insolvency and insolvency proceedings, they inevitably imply the delay of the latter.

In the second place, and more importantly, the new proceedings are not aimed at promoting negotiations between the debtor and his creditors. In the aftermath of the COVID-19 crisis, it is possible to argue that the most pressing need of the debtor is to be granted a breathing space so that he can negotiate more easily with his creditors and persuade the majority to accept the debt restructuring. Yet, this is precisely what the new proceedings do not ensure since the adoption of the restructuring plan by the required majority is a prerequisite/a premise for the opening of the proceedings.

If the mentioned shortcomings actually hinder or prevent the success of the new proceedings or not, one thing is for certain: the number of proceedings opened so far is completely insignificant. All things considered, it may just be the case that the new proceedings are not appealing, as designed, to companies and entrepreneurs, and therefore will not be used.

*Summary*

A legislative review aimed at introducing amendments where needed appears as a reasonable solution and, for certain, is a better attitude than just to sit and wait for the proceedings to fall out of use. For sure, the work is not stimulating since the proceedings are supposed to be in force only until the end of the year. Then again, for great ills, great remedies…

1. See on the topic Catarina Serra, “Directors’ duties under COVID-19 legislation – A comparative perspective”, in: *Eurofenix – The Journal of INSOL Europe*, 2020, 80, 20 ff. [↑](#footnote-ref-1)
2. Unless otherwise stated, references to articles are to those of Law no. 75/2020 of 27 November 2020. [↑](#footnote-ref-2)
3. The proceedings are called, in Portuguese, “Processo Extraordinário de Viabilização de Empresas” (acronym: “PEVE”. For a first look at them, see Catarina Guedes de Carvalho, “Portugal’s Extraordinary Business Viability Process”, in: *Eurofenix – The Journal of INSOL Europe*, 2020-2021, 82, 36 ff. [↑](#footnote-ref-3)
4. They are called, in Portuguese, “Processo Especial de Revitalização” (acronym: “PER”). For a quick look at them, see Catarina Serra, “Reforms in Adverse Economic Climates: How Reforms Take Place in the Eurozone – Part I: Portugal”, in: Paul Omar/Jennifer Gant (editors), *Research Handbook on Corporate Restructuring*, Cheltenham, Edward Elgar Publishing, 2021 (forthcoming). [↑](#footnote-ref-4)
5. The Portuguese doctrine speaks rather of pre-insolvency, while the Insolvency Act refers to two different, despite close, situations: the situation of economic difficulties and the imminent insolvency. [↑](#footnote-ref-5)
6. “In economic terms, viability implies the ability of the business to provide an appropriate projected return on capital after having covered the operation costs”. See Francisco Garcimartin, in: Paulus/Dammann (editors), *European Preventive Restructuring – Article-by-Article Commentary*, Munich/Oxford/Baden-Baden, Beck/Hart/Nomos, 2021, 92. [↑](#footnote-ref-6)
7. It is interesting to know that, according to the tenth guiding principle of out-of-court restructuring (“princípios orientadores da recuperação extrajudicial de devedores”, approved by the Resolution of the Council of Ministers No. 43 of 25 October 2011), the proposals for debt restructuring shall be based on a feasible and crediblebusiness plan. Feasibility and credibility imply that the plan contain, firstly, information on all the steps that the business must take in order to overcome its financial problems, secondly, the demonstration of the debtor's ability to generate the financial flows necessary for debt restructuring and, thirdly, proof that the plan is not simply a means of delaying the opening of insolvency proceedings (i.e., delaying tactics). [↑](#footnote-ref-7)
8. On the foreseeable effects of the Directive on the Portuguese restructuring framework, see Catarina Serra, “The Directive on restructuring and insolvency from a Portuguese Perspective – A brief approach to preventive restructuring frameworks”, in: María Isabel Candelario Macias/Stefania Pacchi (Dir.), *La Directiva de la UE 1023/2019 sobre insolvencia (Estudios desde diferentes ordenamientos)*, Valencia, Tirant Lo Blanch, 2021 (forthcoming). [↑](#footnote-ref-8)
9. As provided in Article 34(2) of the PRD, Portugal has notified to the Commission the need to make use of the option to extend the implementation period. [↑](#footnote-ref-9)
10. See on the topic Catarina Serra, “The new extraordinary proceedings for the economic sustainability of businesses: the viability or feasibility test”, in: *PoLaR – Portuguese Law Review*, 2021, vol. 5, 1, 1 ff. [↑](#footnote-ref-10)
11. See Lorenzo Stanghellini/Riz Mokal/Christoph Paulus/Ignacio Tirado (editors), *Best Practices in European Restructuring – Contractualised Distress Resolution in the Shadow of the Law*, Milano, Wolters Kluwer / CEDAM, 2018, 202. [↑](#footnote-ref-11)
12. See Francisco Garcimartin, in: Paulus/Dammann (editors), *European Preventive Restructuring – Article-by-Article Commentary*, cit., 175. [↑](#footnote-ref-12)
13. See Nicolaes Tollenaar, *Pre-insolvency Proceedings – A Normative Foundation and Framework*, Oxford, Oxford University Press, 2019, 229-230. [↑](#footnote-ref-13)
14. There are other examples among European jurisdictions, such as the Italian, in which, for the purpose of confirming a *concordato preventivo* or an *accordo di ristrutturazione dei debiti*, the court shall verify the economic feasibility of the plan (Article 48, 3, *Codice della Crisi d’Impresa e dell’Insolvenza*). [↑](#footnote-ref-14)