The influence of the Preventive Restructuring Directive in Portugal

Catarina Serra writes on the Discharge of Debts in the Portuguese Insolvency Act 20 years on

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The Portuguese Insolvency Act

20 years after the enactment of the Portuguese Insolvency Act, it is interesting to take a look at the one of the greatest novelties that was introduced back then: the discharge of debts.

In the design of the Portuguese law, the discharge, applicable to all natural persons, implies the allocation of the insolvent's disposal income, during a certain period ("assignment period", which lasts, in principle, three years), to the payment of the outstanding debts (i.e., debts left unpaid throughout the insolvency proceedings), leading to their cancellation.

The main advantage is clearly for the debtor: the discharge allows him to reset his liabilities to zero and make a fresh start. The truth is that the discharge cannot be taken for granted; it must be earned (it is a privilege reserved for "honest and unfortunate debtors") and it must be conquered (only debtors who fulfil certain obligations during the assignment period are able to get it), which is why it is more correct to speak of an earned (fresh) start.

The Preventive Restructuring Directive

The regime was recently amended by Law No. 9/2022, of 11 January, aimed at transposing the Preventive Restructuring Directive (**PRD**). The two most significant changes concern the discharge period, or rather the assignment period (reduced from five to three years), and the possibility of extending this period (up to a maximum of three years). It is worth noting that, in the case of an extension, the assignment period amounts to six years, which paradoxically means an increase of the previous deadline.

At this point, however, rather than looking back or criticising the recent amendments, it might be appropriate to look ahead to the next 20 years and ask two or three questions.

1. Why not a discharge without asset liquidation?

According to the PRD, a discharge of debt should be available in proceedings that include a repayment plan, a realisation of assets, or a combination of both.[1]

The Portuguese Insolvency

Act provides a repayment plan. The instrument avoids the typical course of insolvency proceedings, that is, asset liquidation, and is accessible to natural persons who are not entrepreneurs or who are small entrepreneurs and, while the discharge is an *additional* measure to liquidation – as a rule, it presupposes liquidation - the payment plan is an *alternative* measure to liquidation – it avoids liquidation. In the end, however, the debtor is only released from his debts whose payment is made or whose discharge is specifically included in the payment plan.

If the payment plan could ensure a discharge of debts, it would have an additional appeal for the debtor. And if the discharge could be obtained without asset liquidation, the debtor would be able to keep his assets, which are usually necessary for him to carry out his activity. This possibility would therefore be useful not only for the debtor but also for creditors and the public interest.

2. Why not differentiate between entrepreneurs and non-entrepreneurs?

The PRD lays down rules on procedures leading to a discharge of debt incurred by insolvent entrepreneurs,[2] but does not prevent, in other words allows, Member States to extend the application of these procedures to insolvent natural persons who are not entrepreneurs.[3]

The discharge of the debt incurred by entrepreneurs is, in principle, more necessary (entrepreneurial activity is a risky activity) and more justified (entrepreneurial activity aims to create value), but it must be more demanding (entrepreneurs are professionals and supposed to be better prepared).

On the other hand, the discharge of debt incurred by non-entrepreneurs/consumers must take into account that they are strangers to the professional credit market and are very sensitive to the solicitations to take credit. The regime should thus include specific measures, such as an assessment of the credit grantor's behaviour.

The need for this assessment is, not only justified by the risk of an incomplete or incorrect assessment of the debtor's behaviour for the purpose of obtaining discharge, but, in most cases, corresponds to the monitoring of creditors' compliance with legal duties (creditors have the obligation to assess the debtor's credit-worthiness before providing a credit). The problem is that non-compliance is not sanctioned or, at least, is not sanctioned in a dissuasive manner. If it was, lending would be more responsible and the problem of over-indebtedness would be tackled *ex ante*, what would, presumably, be more effective.

3. Why are tax and social security debts not dischargeable?

The PRD list six categories of debts that Member States can exclude from discharge.[4] Those categories are: secured debts; debts arising from or in connection with criminal penalties; debts arising from tortious liability; maintenance debts; debts incurred after the application for or opening of the procedure leading to a discharge of debt; and debts relating to the cost of that procedure.

Although it could be argued that the list is non-exhaustive and may be supplemented by Member States,[5] the fact is that it is quite extensive, suggesting, at the very least, that the exclusion of tax and social security debts is not, in the European Union's legislator's view, the most obvious or justified.

Currently, despite widespread criticism, under the Portuguese law tax and social security debts are (still) excluded from discharge. The proviso considerably reduces the scope of discharge as an instrument for the cancellation of the debtor's liabilities. It also puts Portuguese entrepreneurs at a disadvantage compared to their competitors in other member states, since most foreign laws do not include such a proviso.

Most of all, in light of all the interests at stake in discharge, it is difficult to understand what justifies such a privilege to public creditors. It may be argued that it is convenient to ensure the general sustainability of the tax system but this cannot be achieved at all costs and, most of all, does not override all other interests in specific contexts such as this.

Strangely, it is in the chapter dedicated to discharge that we may find one of the two norms in all the Insolvency Act that enshrine the *pari passu principle*. As it is widely known, according to this principle, no discrimination without objective reasons may take place. Is the exclusion of tax and social security debts indeed justified?

This and the preceding are a few of the doubts to which the Portuguese discharge gives rise considering the PRD and are sufficient to show that the regime is not perfect.

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Summary

It is difficult to achieve the right balance between all the conflicting interests. But it is indisputable that, at present, beyond the familiar liquidation and rescue/restructuring functions, insolvency law fulfils a discharge function, from which it will no longer be able to resile. Every endeavour to make the regime better will be worthwhile. ■

Footnotes:

1 Article 21(1)(a) and (b) and Recital 75, PRD.
2 Ibid., Article 1(1)(b).
3 Ibid., Article 1(4).
4 Ibid., Article 23(4).
5 See ECJ Cases C-687/22 – Opinion of Advocate General Richard de la Tour, delivered on 14 December 2023, and C-20/23 – Opinion of Advocate General Richard de la Tour, delivered on 11 January 2024).