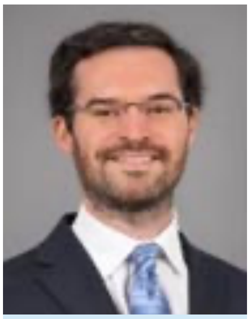
Sustainable insolvency: A green turning point in corporate restructuring

Francisco da Cunha Matos and Carolina Rodrigues Fontes discuss corporate restructuring in the context of the European Green Deal



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The debate on insolvency has undergone a profound transformation in recent years. For decades, insolvency was regarded primarily as a mechanism for addressing economic and financial distress, focused on restoring liquidity, restructuring debt, or liquidating non-viable companies. Today, however, a broader paradigm is taking shape – one that embeds environmental and social responsibilities into the very notion of corporate viability.

This shift is not accidental. It stems from increasing regulatory pressure at the European level, evolving expectations among institutional creditors, and the gradual adaptation of market practices. The concept of *sustainable insolvency* – a green turn in corporate restructuring – captures this emerging reality. It reflects a fundamental rethinking of how companies in distress are assessed, and of the role played by all actors involved in insolvency and restructuring proceedings.

The driving force behind this transformation lies largely in the European regulatory framework. The European Green Deal set an ambitious transition agenda, reinforced by green taxation policies and sector-specific environmental legislation. Among the most relevant instruments is Directive (EU) 2024/1760, widely known as the Corporate Sustainability Due Diligence Directive (CSDDD), which imposes corporate due-diligence obligations in environmental and social matters and requires companies to systematically integrate ESG criteria into their operations.

Although Directive (EU) 2025/794 recently adjusted the transposition timetable, it preserved the core principle: companies operating within the European Union must demonstrate compliance with environmental and social standards, even when facing severe financial distress. Insolvency no longer suspends these duties; if anything, it reinforces them. Decisions taken during restructuring have direct consequences for the company's future, its employees and directors, the environment, and its creditors. As a result, sustainability considerations are becoming inseparable from corporate rescue frameworks.

Redefining corporate viability: New challenges and expectations

Against this backdrop, the notion of what constitutes a viable company is undergoing substantial change. Traditionally, viability was assessed almost exclusively through financial criteria -specifically, whether the restructured company would be capable of generating profit again. Today, economic viability must coexist with the need to demonstrate environmental compliance and social legitimacy.

Across several European markets, institutional creditors (including banks, investment funds, and public financing entities) are increasingly integrating ESG risk factors into their credit decisions. Recent academic studies, such as those developed at Ghent University[1] on the integration of ESG goals in restructuring distressed firms, highlight clear trend: financiers increasingly favour companies that present credible sustainable-transition plans, even when the immediate financial returns are less compelling. In practice, this means that companies that neglect or underestimate environmental risks may face significantly greater difficulty in securing new financing or obtaining support for their restructuring efforts.

> *Institutional creditors are increasingly integrating ESG risk factors into their credit decisions*

This evolution introduces new challenges, particularly for insolvency practitioners. One of the most pressing dilemmas arises in cases involving companies operating in sectors with significant environmental impact. Should an insolvency administrator immediately suspend polluting activities to ensure compliance with environmental standards, even if doing so risks job losses and reduction in the value of the insolvent estate? Or should operations be allowed to continue temporarily in order to preserve employment and facilitate the sale of the business to buyers better equipped to implement a sustainable transition?

A second critical dilemma arises in asset or business units during insolvency proceedings. Should insolvency administrators and courts prioritise bidders offering stronger ESG credentials or more robust environmental transition plans, even when their financial offer is slightly lower? This question goes to the core of how value ought to be assessed in contemporary insolvency practice.

Increasingly, scholars argue that the insolvency administrators may be subject to a new duty of diligence: to evaluate the environmental and social impact of decisions made during the proceedings. While Portuguese legislation does not yet expressly impose such an obligation, European regulatory convergence and evolving market practice strongly suggest that these factors should be taken into account. Moreover, as courts become more attuned to sustainability requirements, they may progressively require clearer evidence of environmental and social compliance when approving restructuring plans.

Even in the absence of immediate legislative reform, best practices are emerging. Conducting environmental audits, incorporating ESG objectives into restructuring plans, and justifying decisions with reference to non-financial impacts are becoming essential elements in managing insolvency proceedings with this evolving paradigm.

Green financing instruments: Green loans and sustainability-linked loans

One of the most tangible developments in this field is the expansion of green financing within restructuring processes. *Green loans* – dedicated exclusively to projects that generate clear environmental benefits, such as replacing polluting machinery, improving energy efficiency, or adapting facilities to comply with environmental regulations – are expanding significantly across Europe. For companies undergoing insolvency, they offer a potentially decisive tool for restoring long-term viability.

In parallel, *sustainability-linked loans* (SLLs) have gained prominence. Unlike green loans, SLLs do not require funds to be allocated to specifically environmental projects. Instead, the cost of financing is linked to the borrower's ESG performance, assessed through predefined sustainability indicators. International frameworks such as the *Green Loan Principles* and the *Sustainability-Linked Loan Principles* provide clear standards to guide structuring and ensure transparency.

The application of these instruments in insolvency contexts raises particularly relevant legal and economic questions. Many distressed companies require substantial investment to achieve compliance with environmental standards, without which they cannot legally continue to operating. In such cases, green financing directed toward environmental compliance or conversion may be essential to implementing a restructuring plan.

This gives rise to a key issue: should these forms of financing receive priority ranking over other claims? A strong argument can be made in favour of granting priority. These loans contribute directly to maximising the company's future economic value, mitigating environmental liability risks, and aligning corporate recovery with the European Union's climate-transition agenda. Although Portuguese law does not yet provide for this type of priority, it is reasonable to anticipate that market practice and future legislative reforms may evolve in this direction over the medium term.

Implications for insolvency and restructuring practice

The impact of this transformation on insolvency and restructuring practice is significant. Lawyers can no longer focus exclusively on financial engineering, debt negotiation, and traditional legal structuring. Expertise in environmental compliance, sustainability reporting, climate-transition planning, ESG metrics, and decarbonization-related technologies is becoming increasingly relevant.

Insolvency practice is therefore evolving into a multidisciplinary field, one situated at the intersection of corporate law, insolvency law, environmental regulation, and sustainable finance. This interdisciplinary approach is essential for effectively safeguarding clients' interests in a context where creditors and investors seek companies that are not only profitable but also responsible and aligned with long-term sustainability objectives.

The integration of sustainability into insolvency does not abolish the principle of maximising the value of the insolvent estate or the creditors' right to repayment. Rather, it broadens the notion of value. Instead of focusing solely on immediate financial returns, it incorporates long-term economic value, mitigates regulatory and environmental risks, and enhances the social legitimacy of the restructured company.

A company that disregards environmental obligations or overlooks social impacts may achieve short-term profitability, but it is unlikely to remain viable in the long term. By contrast, a company aligned with ESG standards is better positioned to secure financing, attract investors, and maintain sustainable commercial relationships.

Conclusion

The green turn in corporate restructuring represents a genuine paradigm shift. Corporate viability is increasingly understood as resting on three core pillars: economic profitability, legal compliance, and social legitimacy. Insolvency is no longer merely a mechanism to protecting creditors; it is also becoming an instrument for advancing environmental and social public policy objectives.

The challenge for lawyers, insolvency practitioners, and courts is to integrate this new paradigm in a balanced manner - ensuring that sustainability strengthens, rather than undermines, the effectiveness of restructuring procedures.

The future of insolvency will inevitably be greener. The question is no longer *whether* this transformation will take place, but *how* and at *what pace* it will be fully realised. ■

Footnote:

1 See Diederik Bruloot, 'ESG-Concerns in the Restructuring of Financially Distressed Companies', paper given at the INSOL Europe Academic Forum Conference (Dubrovnik, 2022), available at: <https://www.insol-europe.org/download/documents/2372>.

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