

# Portugal

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## MARKET AND INCENTIVES

### 1. Please describe briefly the private equity market in your jurisdiction, in particular:

- The sources from which funds established to invest in private equity transactions (private equity funds) obtain their funding, such as institutional investors (for example, pension funds, insurance companies and banks), companies, individuals and government agencies.
- Market trends (for example, the role of hedge funds in private equity).
- Any proposed or pending regulatory changes.

### Sources of funding

In 2007 the predominant investors in private equity vehicles (PEVs) were:

- Banks, representing 55% of the total funds raised.
- Government agencies, representing 17%.
- Private companies, representing 12%.
- Pension funds, representing 9%.

Pension funds, funds of funds and insurance companies do not play a large role in the Portuguese private equity (PE) market when compared with the rest of Europe (where these sources represent about 40% of the funds raised).

### Market trends

Investment by PEVs increased to EUR396 million (about US\$579 million) in 2008, against the trend in the European market, and up by 134% from 2007.

The sectors raising the most investments were:

- Energy and environment: 52%.
- Services and products: 20%.

Consumer services, which represented 28% of total investment in 2007, decreased to 4%. The energy and environment sector registered 27 transactions, representing a total investment of EUR204 million (about US\$298 million). This increase was due to a single major private equity transaction, the purchase of an energy company's assets, one of the largest private equity transactions in Europe in 2008.

Portugal has not been greatly affected by the global credit crunch and the volume of transactions has increased. More than 80% of private equity operations made in Portugal are internal, while the volume of investments by PEVs in toxic products was not significant and did not affect investment volume. However, the volume of capital released through exits was relatively low in 2009 (although it had increased in 2008).

### Regulatory changes

Law 28/2009 (19 June 2009) introduced an obligation for PEVs to communicate their statutory members' (directors and auditors) remuneration policy to the market.

There were also new requirements for communications to the market to be made by entities placing and trading complex financial products, which may indirectly affect PEVs.

There are also proposed regulatory changes increasing market transparency by giving an obligation to communicate to the market any agreements that are similar in economic effect to holding listed companies' shares, for example cash-settled call options and return equity swap agreements. This would be in line with the recent regulatory measures adopted in the rest of Europe to avoid cases such as Porsche/VW in Germany, Implenia/Laxey Partners in Switzerland or CSX/TCI (Children's Investment Fund) in the US.

### 2. Please summarise any changes in the level of activity in recent years in relation to:

- Fundraising by private equity funds and hedge funds.
- Private equity investment in established, early stage and start-up businesses.
- Private equity financed transactions (for example, management buyouts (MBOs), management buy-ins (MBIs), leveraged buyouts and public to private transactions).
- Exits from private equity funds (that is, the realisations of the investments).

### Fundraising

Fundraising reached EUR15 million (about US\$23 million) in 2008, which represents a huge decrease when compared to 2007, when fundraising peaked at EUR452 million (about US\$661 million). However, funds raised by two companies in particular made 2007 an outstanding year, and 2005 and 2006, when fundraising reached EUR298 million (about US\$436 million) and EUR81 million (about US\$118 million) respectively, are a better reference.

Hedge funds (both multi-manager and multi-strategy) are not allowed to operate in Portugal. However, it is possible to incorporate funds of hedge funds (*fundos especiais de investimento*) as a vehicle to support investment in hedge funds by Portuguese PEVs.

### Investment

In 2008 the investment average per portfolio company was EUR2.8 million (about US\$4.1 million), which represents an increase from 2007 when the investment average per portfolio company was EUR1.8 million (about US\$2.6 million). The number of invested companies also increased from 93 in 2007 to 141 in 2008 (which is close to the 2006 number of 143).

### Transactions

In 2008 PEVs invested in:

- Buyouts. These represented 72% of registered operations in 2008. This represents an increase of EUR189 million (about US\$276 million) from 2007. In 2006 and 2005 buyout operations only represented 4% of investments made. The increase that occurred in 2007 of 143% in relation to the two previous years was therefore confirmed in 2008.
- Expansion capital represented 10%. This increased 34% from 2007.
- Start-up investments represented 14%. This increased 104% from 2007.
- Replacement equity represented 4%.

There were no seed capital investments in 2008, which confirms the market trend in 2007 when only one investment in seed capital was made of EUR200,000 (about US\$292,000).

No public to private transactions have ever been made in Portugal and no information is available on LBOs, MBOs or MBIs made in Portugal.

### Exits

The capital divested in 2008 increased from EUR86 million (about US\$126 million), in 2007, to EUR135 million (about US\$197 million), which represents an increase of 57%. Exits included:

- Trade sales, representing 74% of capital released by exits in 2008.
- Management buyouts, representing 10%.
- Sales to silent partnerships, representing 7%.

### 3. What tax incentive schemes exist to encourage investment in unlisted companies? At whom are the schemes directed? What conditions must be met?

There are no tax incentive schemes specifically applicable to investments in unlisted companies. However, there are some tax benefits applicable to general investment in companies (either listed or unlisted):

- The positive difference between capital gains and capital losses obtained from disposing shares in companies by resident transferrable securities investment funds, resident funds of funds and resident individuals is generally subject to a 10% tax rate. However, capital gains obtained from disposing shares held for more than 12 months in companies

that do not have directly or indirectly more than 50% of its assets in real estate located in Portugal are tax exempt.

- Non-resident individuals and companies are generally tax exempt in relation to capital gains obtained by disposing shares, if:
    - these individuals and companies are not resident in blacklisted jurisdictions;
    - the shares are not in companies that have directly or indirectly more than 50% of its assets in real estate located in Portugal.
- This exemption does not apply to non-resident companies either:
- with permanent establishments in Portugal to which these capital gains are attributable; or
  - held, directly or indirectly, in more than 25% by resident entities.
- Holding companies, venture capital companies (*Sociedades de Capital de Risco*) (SCRs) and venture capital sole shareholder private limited liability companies (*Investidores em capital de Risco*) (ICRs) are generally tax exempt in respect of:
    - dividends distributed by resident companies and EU companies that fulfil the conditions set out in Directive 90/435/EEC on the taxation of parent companies and subsidiaries (Parent-Subsidiary Directive);
    - capital gains from the sale of shares in companies, provided such shares were held for at least one year.

However, these capital gains exemptions only apply where shares are held for at least three years and are acquired from related entities, entities resident in blacklisted jurisdictions or resident entities subject to special tax regimes. In addition, when the holding company, SCR or ICR had a previous legal structure that did not qualify for the exemption, the exemption only applies after three years from the change of the structure.

- SCRs and ICRs can also receive a special tax credit in respect of the amount invested in companies with growth and valorisation potential.
- Venture capital funds (*Fundos de Capital de Risco*) (FCRs), stock investment savings funds, pension funds and retirement savings funds are tax exempt, although income paid to unitholders by these funds is taxed under certain favourable tax rules.

## FUND FORMATION

### 4. What legal structure(s) (domestic or foreign) are most commonly used as a vehicle for private equity funds in your jurisdiction?

The most common PEVs in Portugal are SCRs and FCRs:

- FCRs are the most common PEV operating in Portugal. There are 52 FCRs registered (ten more than in 2007). According to the information made available by the Portuguese securities market regulator, the *Comissão do Mercado de Valores Mobiliários* (CMVM) (see box, *Private equity/venture capital organisations*), in 2007, FCRs have a market share greater than 80%.

- SCRs are the second most common PEV operating in Portugal.

Since November 2007, business angels are also regulated and must operate in the Portuguese market through a sole shareholder private limited liability company (ICR). However, there are currently no registrations at CMVM for this type of PEV.

Private equity activity in Portugal is not restricted to PEVs, as envisaged in the relevant legislation. In practice, PE operations (in particular venture capital operations) are also developed by standard companies. PE is assumed to be a main financing instrument for medium-sized companies, whose structure and financing capacity does not allow the incorporation of an SCR or FCR, in lieu of the traditional financing means (for example, banks).

**5. For each structure identified in Question 4, identify whether it is taxed, tax exempt or fiscally transparent (that is, tax is levied on the individual investors rather than the fund itself):**

- So far as domestic investors are concerned.
- So far as foreign investors are concerned.

#### FCR

FCRs are tax exempt.

**Domestic investors.** Tax-resident individuals generally benefit from a 10% definitive withholding tax rate on income paid by FCRs or through redemption of units and a 10% tax rate on capital gains made with the disposal of FCR participation units. Tax-resident companies do not benefit from any advantageous regime in respect of investments in FCRs.

**Foreign investors.** Foreign individuals or companies (if 25% or more of them are not ultimately held by residents and not resident for tax purposes in blacklisted jurisdictions) are generally exempt from income paid by FCRs and, if not exempt from taxation of capital gains made with the disposal of FCR participation units, benefit from a 10% tax rate on these capital gains.

#### SCR

SCRs are taxed but benefit from significant exemptions in respect of some dividends and capital gains irrespective of the residence of the investors (see Question 3).

#### ICR

ICRs are taxed but benefit from significant exemptions in respect of some dividends and capital gains irrespective of the residence of the investor (see Question 3).

**6. What (if any) structures commonly used for private equity funds in other jurisdictions are regarded in your jurisdiction as not being tax transparent (in so far as they invest in companies in your jurisdiction)? What parallel domestic structures are typically used in these circumstances?**

Tax transparency applies to a relatively small and specific number of entities. Therefore, generally, funds in other jurisdictions are not regarded as tax transparent.

As an alternative, investment in Portugal is commonly made through other EU companies from jurisdictions that recognise tax transparency from private equity funds of other jurisdictions.

**7. Are a private equity fund's promoter, principals and manager required to be licensed?**

FCRs must be managed by any of the following:

- SCRs.
- Companies of regional development (*Sociedades de Desenvolvimento Regional*) (SDRs).
- Entities with legal capacity to manage close-end funds, that is:
  - banks;
  - mutual building societies (*instituições de crédito hipotecário*);
  - mutual agricultural societies (*caixas de crédito agrícola mútuo*);
  - financial credit institutions (*instituições financeiras de crédito*).

All these entities must be licensed by the competent regulators. SCRs are subject to prior registration with the CMVM or to a mere communication if they are addressed only to institutional investors or the minimum capital investment per investor is higher than EUR500,000 (about US\$731,000). SDRs must be incorporated under the joint dispatch of the Minister of Finance and Minister for Territorial Planning and Management, and their incorporation is subject to the approval of the Portuguese Central Bank (*Banco de Portugal*). Entities with legal capacity to manage closed-ended funds must be also incorporated under the authorisation of the Portuguese Central Bank.

Promoters of FCRs are not subject to any specific licence.

To pre-register an SCR, the CMVM must be provided with certain information, including the identification of qualified shareholders and the corporate bodies. On the satisfaction of certain objective criteria of good character of the qualified shareholders (promoters) and the corporate bodies, the CMVM will approve the appointed entities. Therefore, promoters of SCRs and their corporate bodies must also be licensed to develop their activity and functions.

ICRs are not subject to any pre-registration, but must inform the CMVM before starting to operate in the Portuguese market.

**8. Are private equity funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?**

#### Regulation

SCRs are not regulated as investment companies (*sociedades de investimento*). Therefore, they do not need to be incorporated under the authorisation of the Banco de Portugal and are not subject to its supervision. SCRs are public limited liability companies (*sociedades anónimas*), although they have some additional requirements in relation to the minimum amount of share capital (EUR750,000 (about US\$1.1 million)). However, if its corporate object is restricted to managing FCRs, the minimum share capital is EUR250,000 (about US\$366,000).

FCRs are not investment companies as they are autonomous collective schemes with no legal capacity.

ICRs are not deemed to be investment companies, but standard sole shareholder (single person) companies.

### Marketing and advertising

Units in FCRs can be subscribed under a private offer or a public offer depending on whether or not they are addressed to more than 100 persons resident in Portugal and which are not institutional investors. When the placement is addressed to fewer than 100 persons or to institutional investors only, they are deemed private offers.

Public offers of units in FCR are not common and there are no listed FCRs in Portugal. However, in theory, FCRs for which subscription is made through a public offer require the preparation of a prospectus (prepared in accordance with local requirements) and must be registered and approved by the CMVM.

Private funds, due to their nature, are not marketed or advertised to the general public.

Shares in SCRs can also be subscribed under an initial public offering (IPO), in which case a prospectus must be prepared and registered with the CMVM. However, in Portugal, there are no SCRs subscribed to the public.

## 9. Are there any restrictions (for example, nationality, age and number) on investors in private equity funds?

There are no specific restrictions on investing in a PEV and general rules relating to the legal capacity of persons or entities apply.

## 10. How is the relationship between the investor and the fund governed? What protections do investors typically seek?

FCRs are governed by their bye-laws (*regulamento de gestão*), which are contained in a comprehensive document establishing, among other things:

- The fund's corporate governance.
- The fund's duration.
- The capital subscribed.
- The categories of units and their subscription prices.
- Debt limits.
- Investment policy.
- Distribution of dividends policy.
- The calculation method of the value of the units.

Any change to the FCR's bye-laws requires a majority of two-thirds of the unitholders. In addition, if the change specifically refers to a particular category of units, a meeting must be held by the holders of the affected category of units to approve the change (a qualified majority of two-thirds of the unitholders is also required).

In addition, several of the following protections are typically sought:

- Negotiations between FCRs, and funds or companies related to the management entity require the approval of the unitholders.
- FCRs are not liable for the debt of the management entity or of any of its unitholders.
- Unitholders are entitled to access the yearly accounting documents of the FCRs.
- Unitholders are entitled to be fully informed about the issues to be resolved by the participants.
- Management entities cannot deal with third parties that are in conflict of interests with the unitholders.
- Unitholders are entitled to be informed of the value of the units, at least once every 12 months.

In SCRs, the investors do not seek any specific protections in relation to standard public limited liability companies.

## 11. Are there any statutory or other limits on maximum or minimum investment periods, amounts or transfers of investments in private equity funds?

In addition to a PEV's bye-laws, there are several mandatory limits on maximum or minimum investment periods, amounts or transfers of investments, as follows:

- FCRs cannot:
  - have more than 50% of their assets invested in securities listed in a regulated market;
  - have more than 33% of their assets invested in a company or group of companies for more than two years or until two years before the end of the FCR;
  - have more than 33% of their assets invested in other funds;
  - invest in companies that control the management entity of the FCR or in any company that has a group relationship with the management entity before the investment in PE is made;
  - make loans or provide guarantees for the purpose of financing the acquisition of treasury units; or
  - make loans or provide guarantees in favour of any company that controls the management entity of the FCR or to any company that has a group relationship with the management entity before the investment in PE is made.
- SCRs cannot:
  - have more than 50% of their assets invested in securities listed in a regulated market;
  - hold securities for more than ten years;
  - own real estate assets, other than their own offices;
  - have more than 33% of their assets invested in a sole company or in the same group of companies for more than two years;

- have more than 33% of their assets invested in funds managed by other entities;
  - invest in companies that control the management entity of the SCR or in any company that has a group relationship with the management entity before the investment in PE is made; and
  - make loans or provide guarantees within the purpose of financing the acquisition of treasury shares.
- ICRs cannot:
- have more than 50% of their assets invested in securities listed in a regulated market;
  - hold securities for more than five years; and
  - own real estate assets, other than their own offices.

## INVESTMENTS

### 12. What are the most common investment objectives of private equity funds?

As a consequence of the international market crisis, PEVs are avoiding large investments and medium-sized companies are now their main targets. However, investments in medium-sized companies seek capital gains in the medium and long term, which require PEVs to assume longer positions in the portfolio companies. There is no available information relating to the period in which equity is held by PEVs, however, it is estimated that it can vary between three and seven years. These periods are quite significant, especially taking into account that the average life of an FCR is ten years.

The average return rate in recent years was around 30%. However, it is estimated that in 2008 the average return rate was between 16% to 18%.

The average rate return of investments in PE is around 5% over the normal investment return in listed securities.

### 13. What forms of equity and debt interest are commonly taken by a private equity fund in a portfolio company? What are the relative advantages and disadvantages of each? Are there any restrictions on the issue or transfer of shares by law?

The normal forms of equity taken by a PEV in a portfolio company are common shares in the share capital. The most common forms of debt interest held are bonds (*obrigações*), shareholder loans (*suprimentos*) and equity contributions (*prestações suplementares*).

When share capital is transferred, equity contributions are automatically transferred together with the shares. As shareholder loans are not transferred automatically, the normal practice is to include them in the package to be transferred.

The main advantages of shares are that an actual stake in the company is obtained which allows the buyer to take control of the portfolio company's management and business direction. Bonds do not generally grant holders voting rights (and would only serve as a control tool if they were convertible into common shares). The advantage of shareholder loans is that, as a financing tool, they are exempt from stamp tax. While equity contributions are

not actual share capital, they are also not treated as debt, which allows the equity of the company to increase without the commitment of a share capital increase. Equity contributions are not subject to stamp tax, but redemption is not as simple as the reimbursement of shareholder loans.

## BUYOUTS

### 14. Is it common for buyouts of private companies to take place by auction? If so, which legislation and rules apply?

It is not common for buyouts of private companies take place by auction.

### 15. Are buyouts of listed companies common (public to private transactions)? If so, which legislation and rules apply?

Public to private transactions are not common in Portugal.

### 16. What are the principal documents produced in a buyout?

The documents produced in a buyout can be split into three stages.

#### Pre-transaction documents

At this stage, two key documents are normally produced:

- The binding proposal.
- The due diligence report.

If any clearance from market regulators (that is, anti-trust) is necessary, a notification must also be prepared.

#### Transaction documents

Commonly, at this stage, three documents are produced:

- The share purchase agreement.
- The shareholders' agreement.
- The credit facility agreement and related security documents (if any).

Sometimes the transaction is made under conditions precedent, therefore, an additional document should also be prepared when these conditions are met in order to make the transaction effective.

#### Post-transaction documents

This may depend on what was agreed in the transaction documents. However the most common are:

- The minutes resolving on the appointment of the new corporate bodies.
- The updates to the commercial registry and land registry.
- Amendments to the bye-laws.
- The completion certificate.

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**17. What forms of contractual buyer protection are commonly requested by private equity funds from sellers and/or management?**


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Buyer protections are normally divided into two different fields:

- **Corporate governance protections.** This type of protection is normally foreseen in the shareholders' agreement. The most common protections are:

- the submission of certain matters to the buyer's approval (both at general meeting or board level);
- appointment of directors by the buyer;
- establishment of call and put options.

Tag along and drag along provisions often exist if the buyout is not of 100% of the share capital.

- **Representations and warranties.** These are normally set out in the share purchase agreement. The representations and warranties that are commonly provided are quite comprehensive and vary from case-to-case, but normally they refer to:

- employment, tax and social security issues;
- accounting policies;
- regulatory issues;
- environmental issues.

When the transaction is made including conditions precedent, the conditions that must be met by the vendor in the period between the signature date and the date on which the transaction will be effective (completion date) are normally locked to a certain category of acts to guarantee that no extraordinary acts with relevance to the value of the company are taken by the management. This also generally avoids having to prepare further balance sheets and other accounting documentation for completion purposes.

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**18. What non-contractual duties (for example, of confidentiality and employment) do the portfolio company managers owe and to whom (for example, when approaching possible investors in relation to an MBO)?**


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Management agreements are not common in the majority of Portuguese companies (that is, medium-sized companies) because the relationship between statutory directors and the company is set out quite comprehensively by statute, namely in relation to non-competition and confidentiality duties. However, in certain cases, management agreements are executed when the company or shareholders intend to govern the relationship with their directors beyond what is established by law.

Company directors have a number of duties to the portfolio company implied by law. These duties cannot be waived by contract and should be enforced by the company's shareholders general meeting. Principally, these duties are:

- To act diligently.
- To provide information and accounts.
- Not to compete with the company.

- Not to enter into contracts with the company (except in very limited circumstances).
- To endeavour to fulfil the company's corporate object.

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**19. What terms of employment are typically imposed on management by the private equity investor in an MBO?**


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Statutory directors of companies have no employment agreements as such. Directors are appointed by the general meeting of the company for a certain term of office and no further act or document is required.

However, in some cases, a management agreement is executed to govern the conditions in which the director will act during his term of office on some specific issues not covered by law (that is, confidentiality and non-competition duties) and compensation on termination of the term of office (*see Question 18*).

Matters typically governed by these agreements tend to be termination obligations and compensation, and post-termination non-competition and confidentiality. Directors' salary, benefits and pension arrangement tend to be covered in management agreements.

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**20. What measures are commonly used to give a private equity fund a level of management control over the activities of the portfolio company (for example, representation at board level)? Are such protections more likely to be given in the shareholders' agreement or company bye-laws?**


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Management control over the activities of the portfolio companies are normally set out in the shareholders' agreement. The most common measures used to grant a private equity fund control over management are requirements for a majority number of members of the board and special voting majorities for certain matters.

Although these types of protection can also be governed by the company's bye-laws, this is often avoided as this is a publicly accessible document. In addition, references to the identification of shareholders are also avoided in company's bye-laws in order to avoid disclosing who they are and the need to amend the companies' bye-laws each time there is a change in the capital structure of the portfolio companies. However, if the shareholders' agreement is in contradiction with the bye-laws, the latter prevails, even though there may be a right to compensation (not enforcement) in the case of breach of the shareholders' agreement.

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**21. What percentage of finance is typically provided by debt and what form does that debt financing usually take (for example, term loans, working capital facilities, convertible loans and bonds)?**


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The form by which the investment structure is split depends on the transaction. However, term loans and working capital facilities are the most common, but there is no typical percentage.

## 22. What forms of protection do debt providers typically use to protect their investments, in particular through what types of:

- **Security?**
- **Contractual and structural mechanisms (for example, covenants or subordination)?**

### Security

Normally debt providers are protected with several types of securities:

- Share pledges.
- Credit pledges.
- Mortgages over real estate.
- Guarantees (for example, guarantees provided by parent companies).

Only fixed charges are accepted in Portugal. Floating charges are not generally admissible.

### Contractual and structural mechanisms

Two different types of transactions must be distinguished:

- **Transaction over a group.** This is when the target company is a subsidiary and the object of the transaction is a group of companies. In this type of transaction different levels of documents are prepared. Generally, an umbrella loan agreement (inter-creditor agreement or senior facility agreement) is executed between the debt provider and the parent company, and all subsidiaries accede to the agreement by mere statement (for example, accession letter). Subsidiaries normally do not participate in the negotiation of this type of agreement.

With the accession to the umbrella loan agreement, subsidiaries are requested to provide guarantees, of the loaned amount in favour of the debt provider or any local subsidiary of the debt provider.

- **Individual transaction.** When the transaction relates to an individual company a standard loan agreement guarantees reimbursement or payment of the loan, guarantees or securities to the debt provider (namely, credit pledges, share pledges and mortgages over real estate). With the share pledges all rights inherent to the shares, that is, the right to receive dividends and voting rights, are assigned to the debt provider.

## 23. Are there rules preventing a company from giving financial assistance for the purpose of assisting a purchase of shares in the company? If so, how does this affect the ability of a target company in a buyout to give security to lenders? Are there exemptions and, if so, which are most commonly used in the context of private equity transactions?

Security, guarantees or loan facilities cannot be used to finance a third party in subscribing or in any other way acquiring shares of its capital.

Therefore, some solutions are engineered to overcome financial assistance prohibitions. The most typical adopted solutions are:

### PRIVATE EQUITY/VENTURE CAPITAL ASSOCIATIONS

#### *Comissão do Mercado de Valores Mobiliários (CMVM)*

**Head.** Carlos Tavares (Chairman)

**Address.** Avenida da Liberdade, 252  
1056-801  
Lisbon  
Portugal  
**T** +351 213 177 000  
**F** +351 213 537 077  
**E** [cmvm@cmvm.pt](mailto:cmvm@cmvm.pt)  
**W** [www.cmvm.pt](http://www.cmvm.pt)

**Status.** The CMVM is a governmental organisation and is the securities market regulator.

**Membership.** Not applicable.

**Principal activities.** The CMVM principally supervises the securities regulated market and private equity activities.

**Published guidelines.** Reporting and public registrations related to securities regulated market and private equity vehicles.

**Information sources.** See website above.

#### *Associação Portuguesa de Capital de Risco e Desenvolvimento (APCRI)*

**Head.** Afonso Oliveira Barros (Chairman)

**Address.** Rua Tierno Galvan, Torre 3, 10th floor  
1070-274  
Lisbon  
**T** +351 21 382 67 16  
**F** +351 21 382 67 19  
**E** [geral@apcri.pt](mailto:geral@apcri.pt)  
**W** [www.apcri.pt](http://www.apcri.pt)

**Status.** APCRI is a non governmental organisation.

**Membership.** Information not disclosed.

**Principal activities.** Reporting on the private equity industry.

**Published guidelines.** Annual reporting on private equity activities.

**Information sources.** See website above.

- **Forward merger.** A holding company is incorporated to hold the capital in the target or operational company. The holding company is the beneficiary of the loan facility and assigns the loaned amount to the operational company through a shareholder loan. To guarantee the payment of the loaned amount, the holding company pledges the shares held in the operational company in favour of the debt provider. After completion, the operational company is merged into the holding company. This solution does not allow securities over real estate; therefore, an option is that the target company delivers irrevocable powers of attorney regarding the sale of its real estate assets.

- **Limitation language.** Another option is to include limitation language in the guarantees and pledges granted by the target, stating that the financing that it is guaranteeing cannot be used to acquire its own shares. This is a common mechanism, but is not 100% risk free.
- **Promissory security agreement.** A third option is to execute a promissory agreement between a holding company and the debt provider regarding the grant of securities over the target's assets after the target is merged into the holding company.

In this scenario, the holding company undertakes to grant an all-asset pledge of the target or operational company's assets after the merger, when those assets have become, by virtue of the merger, its own assets.

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**24. What is the order of priority on insolvent liquidation? Are certain debt providers given priority over other debt providers? Are debt providers given priority over other stakeholders by law or is priority purely a matter of contract and company constitution?**

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Debt providers have priority over equity holders on an insolvent liquidation, who are paid after all other creditors have been paid. The priority order of payments is as follows:

- Liquidators fees.
- Secured creditors.
- Preferential creditors (for example, credits held by the state and employees).
- Remaining creditors.
- Equity holders.

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**25. Is it possible for a debt holder to achieve equity appreciation through conversion features such as rights, warrants or options?**

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This approach is not common in Portugal. However, debt holders can achieve equity appreciation if they hold convertible bonds (*obrigações convertíveis*) or warrants.

## PORTFOLIO COMPANY MANAGEMENT

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**26. What management incentives are most commonly used (for example, shares, options and ratchets) to encourage portfolio company management to produce healthy income returns and facilitate a successful exit from a private equity transaction?**

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The following forms of management incentives are commonly used to encourage management to produce healthy income returns and facilitate a successful exit from a private equity transaction:

- Share plans.
- Establishment of put and call options at a pre-determined fixed price (only in buyout transactions).

Ratchets are not common in Portugal.

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**27. Are any tax reliefs or incentives available to portfolio company managers investing in their company?**

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There are no tax reliefs or incentives available to portfolio company managers investing in their company. Additionally, general investment made by managers and other employees in the employee company may result in employment income, for example, share plans, which, as a general rule, do not benefit from a more favourable tax regime when compared with the tax regime applicable to investment income and capital gains.

## EXIT

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**28. What forms of exit are typically used to realise a private equity fund's investment in a successful company (for example, trade sale, initial public offering (IPO) and secondary buyout)? What are the relative advantages and disadvantages of each?**

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The typical forms of exit used to realise a PEV investment are:

- **Trade sale.** This type of exit is quite attractive because the payment is made in cash (or equivalent) and the exit is made 100%. However, this is not the most profitable means of exit. In addition, this form of exit is not always very attractive, as the invested company loses autonomy and independence on merger with another company or another group of companies.
- **IPOs.** IPOs are the most profitable exit. However, due to low Euronext market liquidity IPOs are not common in Portugal.
- **Sale to management.** This has the convenience of having a fast exit from the portfolio company, as the conditions of sale are normally pre-determined. However, the exit is normally below market price.

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**29. What forms of exit are typically used to end the private equity fund's investment in an unsuccessful company? What are the relative advantages and disadvantages of each?**

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The forms of exit typically used to end the private equity fund's investment in an unsuccessful company are the secondary buyout and write off:

- **Secondary buyout.** This is not a profitable exit. The sale to another PEV means that the company's potential was not fully explored and the new PEV is unlikely to offer a good price.
- **Write off.** The sale is made at cost and no material profits are made with the investment. This is quick exit to avoid further losses.

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