



PORTUGAL

In May this year Portugal became the second Eurozone state to exit its €78bn rescue program assembled by the EU and the International Monetary

Fund in 2011.

However, over that last few months, investors have raised concerns over the health of Portugal's largest listed bank, **Banco Espirito Santo SA** ("BES"). Shares in both BES and its 20.1% shareholder **Espirito Santo Financial Group SA** ("ESFG") were suspended from trading on 10 July 2014 amid reports of accounting irregularities and following **Espirito Santo International SA** ("ESI") (which has an indirect stake in BES), delaying coupon payments on some of its short term debt. ESI has an indirect interest in the Lisbon-listed ESFG (through **Rioforte Investments S.A** ("Rioforte") and **Espirito Santo Irmaos SGPS**), which in turn owns shares in BES. BES has stated that it does not have direct exposure to ESI's debt, but confirmed it has exposure of €927 million to ESFG and its subsidiaries, and €271 million to Rioforte and its subsidiaries.

Each of ESI, Rioforte and ESFG have applied to the court in Luxembourg to be placed in "controlled management" (gestion contrôlée) under Luxembourg law (see below) and have been admitted. We wait to see whether any other BES entities file for creditor protection in the coming days.

On **30 July 2014**, BES published its half year 2014 Financial Statements disclosing a **net loss of EUR3.5 billion** in part caused by its exposure to the ES Group. The financial statements also show **Common Equity Tier 1 capital of only 5%** (2% below the Bank of Portugal's minimum requirement). Mr Bento, who took over as CEO, said BES would immediately advance with a "[comprehensive capitalisation plan](#)" that would include a capital buffer as well as meeting minimum regulatory requirements.

GESTION CONTRÔLÉE / CONTROLLED MANAGEMENT PROCEDURE - F.A.Q [Click here](#)

Trading Q&A for entities in Controlled Management (Gestion Contrôlée) under Luxembourg law:

Q.1 What is Gestion Contrôlée? Controlled Management is a Luxembourg insolvency process that is available if a company could potentially recover from its financial difficulties. Initially directors or managers will file for controlled management with the Luxembourg District Court. There is a private hearing and a judge is appointed. From the date of judgment, there is a

BANCO ESPIRITO SANTO S.A.

Simplified Structure Chart
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Financial Statements 1H14
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A number of investors are interested in exposure to BES through secondary purchases of bonds or loans, some of which are structured/repackaged. Each of those assets requires careful analysis of the applicable insolvency and failure to pay triggers, and of any mandatory redemption events.

BES Group Entities in *Gestion Contrôlée* (Luxembourg) at 31 July 2014:

Issuer	Date of request	Date admitted
Espirito Santo International S.A.	18 July 2014	22 July 2014
Rio Forte Investments S.A.	22 July 2014	29 July 2014
Espirito Santo Financial Group S.A.	24 July 2014	29 July 2014

In addition, **CDS investors** are considering the potential restructuring scenarios with respect to BES and how those may affect their CDS pay-outs (if any). Existing CDS are traded on the 2003 Credit Derivatives Definitions (as amended by the "Big Bang" and "Small Bang" protocols). In recent years, the limits of the **Restructuring Credit Event** have been tested by governmental interventions, such as the **expropriation** of the subordinated bonds in **SNS Bank NV**, the restructuring of **Bankia S.A.** and the exchange, coupled with a change of terms, of the subordinated notes issued by **Anglo-Irish Bank**. Therefore, on the current CDS definitions, the precise method of bail-out of BES or bail-in by investors may or may not trigger a Restructuring Credit Event, depending on the facts of the intervention.

moratorium on enforcement of debts by unsecured creditors (save for collateral falling within the Directive on Financial Collateral Arrangements).

Q.2 Do I need to file a claim? It is not necessary to file a proof of claim against a company in controlled management, however, if controlled management is followed by bankruptcy proceedings, a proof of claim may be required.

Q.3 What public information is available or likely to become available? Controlled Management is a private process and only a limited amount of information is required to be made available to creditors. The Judge's reports and excerpts of the reorganization plan will be sent to creditors and published in the Luxembourg legal gazette. The court appointed officials may provide for a process for creditors to notify them of their claims.

Q.4 Is Controlled Management an insolvency process? Yes and it may trigger certain events of default depending on the wording of the underlying debt documentation.

Q.5 Are claims transferable? Yes, claims are transferable under Luxembourg law (in whole or in part) and may be acquired using a tailored form of LMA English law trade confirmation (claims) with local law assignment agreement, with notification to the court appointed representatives. **Please note that claims trading documentation is recommended for bond or debt transactions which settle on or after 18 July 2014 (ESI), 22 July 2014 (Rioforte) 24 July ESFG** or the relevant date of request for controlled management by any other filing entity.

For a more detailed summary and further questions and answers on the Gestion Contrôlée process, please [click here](#).

LOAN TRADING RISKS IN PORTUGAL

Equitable subordination: shareholder loans or payment deferrals with a maturity of over one year qualify as "suprimentos" and are subordinated on insolvency. Additionally, shareholder loans that do not qualify as *suprimentos* but are granted by entities in a group or control relationship are also subordinated. Portuguese Insolvency Law defines control with reference to the Portuguese Securities Code, which provides that control is deemed to exist between a legal entity and a company when, regardless of whether the domicile or headquarters is located in Portugal or abroad, such legal entity is capable of exercising, directly or indirectly, a dominant influence over the borrower. "Control" will always exist when a legal entity: (i) *holds* the majority of voting rights; (ii) *may* exercise the majority of voting rights, according to the terms of the shareholders' agreement; or (iii) *may* appoint or dismiss the majority of the members of the board of directors or supervisory board. **If you acquire a loan from a person that exercises control, it will be equitably subordinated on insolvency of the Portuguese debtor.**

Bonds convertible into equity, or core Tier 1 or Tier 2 instruments are contractually subordinated on insolvency.

An additional consideration when taking CDS positions on BES is the imminent introduction of the **2014 ISDA Credit Derivatives Definitions**. Of note in this context is the introduction of a new credit event - **Governmental Intervention**, which is wider than Restructuring and will cover the change of terms of the relevant obligations resulting from the action of a Governmental Authority pursuant to an applicable restructuring and resolution law.

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JULY UPDATE

1. **SANCTIONS:** On **29 July 2014**, both the **United States and Europe** announced additional sanctions against **Russia**, including sectoral sanctions designed to target companies in the Russian financial, energy and arms industries. Under Directive 1, U.S. persons are **prohibited** from transacting in, providing financing for, or otherwise dealing in new equity or new debt of longer than **90 days** maturity for sanctioned companies, as well as their property or interests in property. Click [here](#) for further information.

A European Council Background Note further explains that, with respect to the restriction on access to EU capital markets, "EU nationals and companies may no more buy or sell new bonds, equity or similar financial instruments with a maturity exceeding 90 days, issued by major state-owned Russian banks, development banks, their

Banking licence: a licence from the Bank of Portugal is required for the origination of any loan (whether to an individual or a corporate borrower), but the assignment of fully funded receivables is not a licenced activity. A licence will be required for any revolving loan as it constitutes the granting of credit which is regulated under the **Credit Institutions and Financial Companies: Legal Framework**. There may be exceptions where lending is on a one-off basis.

Tax: Payments of interest on a loan by a Portuguese resident company to a foreign lender will be subject to withholding tax, currently at a rate of **25%** (or **35%** where payments are to an entity in a tax haven) or such other rate as determined by an applicable Double Taxation Treaty. **Stamp duty: 0.6%** stamp duty applies to mortgage security. The transfer or amendment of loans does not trigger Portuguese Stamp Duty, unless: (i) the transfer is not a "true sale" (i.e., if the acquirer has recourse against the transferor in case of default by the debtors of the corresponding credits); (ii) if the amendment gives rise to a novation (i.e., termination of the original obligation and its replacement by a new one).

Commercial Paper or Bonds traded on Euroclear or Interbolsa are generally not subject to withholding taxes or require an investor to hold a banking licence.

Transfers of loans: may be made by (i) assignment of rights (*cessão da Crédito*), (ii) assignment of rights and obligations (*cessão da posição contratual*) (with Borrower consent) or (iii) novation (*novação*), whereby the debtor is discharged of its rights and obligations under a specific agreement by entering into a new contract that replaces the first contract. **Assignment** of rights, or assignment of rights and obligations is recommended to preserve security in favour of the new lender and to avoid a novation creating a new loan that may require a banking licence in Portugal.

Security: Portugal **does not recognise the concept of a trust**. Where security is granted in favour of an agent it is possible to contractually provide, for the purpose of enforcement in Portugal, for the security agent to be considered a joint and several creditor (*credor solidário*) in relation to any and all liabilities of the other secured parties (in accordance with, inter alia, articles 528 et seq. of the Portuguese Civil Code). For this to be effective, it may be a requirement that the security agent is also a lender of record for it to be able to claim the whole debt in its own name. As far as we are aware, the Portuguese courts have not addressed the validity of 'parallel debt structures'.

Post Transfer Requirements: It is **mandatory to register the transfer of mortgages** (real estate, vehicles, aircraft) in the central Portuguese registry for the transfer of the security to be valid. Notarisation of the transfer may be required depending on the nature of the security and whether the credit agreement has been raised to public status, therefore it is important to check such requirements with local counsel prior to completion of the transfer.

Thank you to the various Portuguese and Luxembourg counsel who assisted us with this Trade Alert.

subsidiaries and those acting on their behalf. Services related to the issuing of such financial instruments, e.g. brokering, are also prohibited." [Click here](#) for EC Background Note. Please contact [Dale Turza](#) for any Sanctions related queries.

- US FOREIGN ACCOUNTS TAX COMPLIANCE ACT ("FATCA"):** FATCA withholding could now apply to secondary loan trades on interest, breakfunding, fees and delayed settlement compensation from **1 July 2014**, and on the Settlement Amount from 2017. Therefore, LMA trades settling **on or after 1 July 2014** should incorporate the appropriate **LMA FATCA riders** to the trading documentation to ensure that a party is entitled to withhold on account of FATCA if required to do so and not gross up, and request information from the other party concerning its FATCA status, and where relevant to request information from a Grantor concerning an underlying Obligors' FATCA status. Please contact [Adam Blakemore](#) with any FATCA queries.
- ICELAND:** On **9 July 2014** the Icelandic Ministry of Finance and Economic Affairs announced the appointment of various specialist advisers to assist in negotiations with the banks' creditors **with a view to the removal of capital controls**, which were introduced following the collapse of the country's three largest banks Glitnir, Kaupthing and Landsbanki in 2008.
- CYPRUS:** On **28 July 2014** Bank of Cyprus successfully placed **EUR 1 billion** new shares at a price of **EUR 0.24** per share by open offer as part of its restructuring plan and is now proceeding with its offer to existing shareholders to subscribe for up to 20% of the new shares (open for 15 business days starting **31 July 2014**).

The new shares will be unlisted but the bank's intention is to list on the Cyprus Stock Exchange and Athens Stock Exchange before the end of 2014. The bank also expects to offer up to EUR 100 million additional new shares to retail shareholders (excluding those who became shareholders for the first time as part of the EUR 1 billion

USEFUL LINKS

[Sanctions](#)
[BES Financials](#)
[BES Simplified Structure Chart](#)
[Gestion Contrôlée Q&A](#)
[CEO Statement dated 30 July 2014](#)

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placing) prior to any listing. [Click here](#).

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