The new Portuguese Framework of Participative Loans – some questions and perplexities[1]

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Abstract

In this article we have analyzed the very recent Portuguese framework about participative loans, introduced by the Decree-Law n. 11/2022, of 12th of January, trying to identify its core problems and shortcomings.

Keywords

Equity; Net Assets; Share Capital; Liability; Participative Loans

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Background[2]

The Portuguese Government approved, last January, a framework for participative loans[3]. According to the recitals of the Decree-Law n. 11/2022, of the 12th of January, the Government decided to introduce a set of rules aiming to promote the capitalization of companies via special loans that may increase the amount of *net assets*[4].

We endorse said goal.

In fact, the numbers reported by the Bank of Portugal are very clear. As per the last report[5], 25% of the Portuguese companies have a negative net assets amount[6] what shows how important it is to increase the level of net assets of the Portuguese companies.

Moreover, giving additional options and flexibility both to prospective creditors and debtors is also a positive aspect.

Since the publication of said Decree-Law, there are already some published short analyses of said framework, mostly made by Law firms[7], that briefly explain the main characteristics of said framework. It is not our intention to provide a repeated general/broad overview of this new framework, but rather to address some issues that, so far, we have not seen discussed: The accounting treatment of said loans and the *silent revolution* of a new *equity concept for commercial law purposes*.

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[2] The author would like to thank Professors Rui Pinto Duarte and Evaristo Mendes, from Portugal, and Professor Gregorio Labatut Serer, from Spain, for the discussion in the context of some parts of this article. This article, however, reflects only the opinion of the author and any mistake or misconception is only attributable to him.

[3] These loans may also take place under the *legal form* of debt securities.

[4] For the purposes of this article, and for simplification purposes, we will use the terms "equity" and "net assets" to refer to the same reality – the accounting concept that, together with liabilities and assets, are the main parts of the balance sheet.

[5] BANK OF PORTUGAL, *Sectorial analysis of the non-financial companies in Portugal*, 2019, https://www.bportugal.pt/publications/banco-de-portugal/all/124 , p. 27.

[6] Please keep in mind that, according to the prevailing doctrine, under the Portuguese Insolvency Code, *over-indebtedness* does not give rise to any duty to file for insolvency.

[7] https://www.servulo.com/en/knowledge/Between-equity-and-debt-the-Legal-Framework-for-Participative-Loans/7802/ ; https://cms.law/en/prt/publication/meet-the-law-profit-participation-loan ; https://www.cuatrecasas.com/en/global/article/portugal-legal-flash-legal-framework-for-participative-loans

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General overview

These new participative loans, in a very brief description[8], are loans that can only have, as creditors, some institutions, investment entities, funds or other specific entities identified by the legislator. On the debtor side, we may find all non-financial companies, meaning that the framework is much more restrictive when it comes to the creditor side, when compared to the debtor one.

The main characteristic of this framework is, in our opinion, that the reimbursement of these loans and the payment of the remuneration (that needs to be indexed to the company's results and may be - but does not need to - complemented with a *fixed* remuneration, i.e. interests) is contingent on the company's results, when it comes to remuneration, and, in general, i.e. also the reimbursement, on the existence of amounts that may be paid out to shareholders (in synthetic terms, balance sheet surplus, i.e. equity > share capital + non-distributable reserves)[9]. The outflow of cash is, therefore, contingent on the general requirements that the law imposes to allow the payment of profits to shareholders (foreseen in the articles 32.º and 33.º of the Portuguese Commercial Companies Code, that implement in the Portuguese Law part of the capital maintenance framework, as required by the former Second Directive on Corporate Law and that can now be found in the Directive 2017/1132, of 14th of June).

If, on the relevant due dates, these requirements are not met, the company may not pay the due amounts, and the creditor has the right to convert the credits into share capital.

This being said, the most *polemical* and important part of this framework is, in our opinion, its article 2.º, no. 2, where it is said: *The participative loans shall be considered as equity for the purposes of the commercial legislation if the remuneration is contingent on the results of the debtor and the reimbursement/amortization is contingent on the*

[8] For further details, please refer to the abovementioned *newsletters*.

[9] In fact, the only requirement, when it comes to the remuneration, is that (at least part of) it needs to be contingent on the existence and amount of the company's results, but the law also foresees, in general, that no payment can be made if there are no distributable profits. However, one disturbing element exists. Article 11.º, a) says that no payment or reimbursement can be made if, after such payment, the equity falls below the sum of share capital plus reserves. A question arises. Which reserves? All of them? If so, why? Or just the non-distributable reserves? Why can't the reimbursement be paid at the cost of free reserves? We think that the only logical interpretation requires a restrictive understanding, therefore reading non-distributable reserves.

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criteria set forth by the articles 32.º and 33.º of the Portuguese Commercial Companies Code (…).[10]

This reference, is, from a Portuguese perspective, puzzling.

In fact, it was not clear what was the legislator's intention with *purposes of the commercial legislation*. What is the commercial legislation?

In fact, one must keep in mind that, in the PCCC, the references to the concept of equity are (with very few exceptions) a way of sending the reader to the accounting concept. Let us take as an example the relevant provision for ascertaining balance sheet surplus: it uses the concept: *equity, including the annual profit, as it stems from the accounts drafted and approved as per the law*. The same happens with the framework that implemented, in the Portuguese Law, the European rules on the serious loss of capital. In fact, article 35.º says that if it stems from the annual accounts or from in-between-accounts, as drafted by the management body, that half of the share capital is lost, then (…).

It is therefore clear that the concept of equity is, for the purposes of the PCCC, a concept that must be imported from the relevant accounting provisions[11].

Under this light, the first and the most obvious outcome of this provision, saying that these new loans should be deemed as equity, would be that the legislator wanted these loans to be treated, from an accounting perspective, as equity. In fact, shouldn't accounting principles and rules be considered as part of *commercial legislation*?

This is not, however, the case.

First of all, because in the recitals of the Decree-Law the legislator said that these loans are a quasi-equity instrument that may be, totally or partially, treated, for accounting

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[10] "Os empréstimos participativos são considerados capital próprio para efeitos da legislação comercial, sempre que a respetiva remuneração dependa dos resultados do mutuário e o respetivo reembolso ou amortização dependa do cumprimento dos critérios previstos nos artigos 32.º e 33.º do Código das Sociedades Comerciais, aprovado pelo Decreto -Lei no. 262/86, de 2 de setembro, na sua redação atual, nos termos previstos no presente decreto -lei". From now on, the Portuguese Commercial Companies Code will be referred to as PCCC. For abbreviation purposes, we will also use the expression "for commercial purposes" as identical to "for the purposes of the commercial legislation".

[11] The only exception to this is the article 349.º that defines what should be understood by equity for the purposes of complying with the requirements applicable to the issuance of bonds. It is our opinion, however, that said definition may only be used for this very purpose and, in addition to this, it is outdated because the legislator of the PCCC forgot to adapt the article to the amendments of the relevant accounting framework. We will, however, not go deeper on the analysis of this topic, as it would require a profound historical analysis of the Portuguese accounting framework, what does not fit into the purpose of this article.

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purposes, as equity. Therefore, as the requirements set forth in this framework to give rise to any cash outflow are the same that the legislator uses in the provision that says that these loans are to be considered, for commercial purposes, as equity, then the only logical conclusion would be that said loans should always be accounted for as equity, what would contradict the recitals. This is a first clear sign that the *commercial purposes* might not include accounting.

However, and more important than this, the accounting framework, not only the national one but, crystal clear, the international one, would never allow such a result. Let us see why.

The Accounting Framework in Portugal

Portugal, as one of the 27 European Member States, has two systems of accounting: a national and a European one. The national system, called *Sistema de Normalização Contabilística*, was approved by the Decree-Law no. 158/2009, of the 13th of July, already amended. It comprises several different parts, being, for this purpose, relevant both the *Estrutura Conceptual* and the *Normas Contabilísticas e de Relato Financeiro*.

The European Union Member States, on their turn, have a common accounting[12] framework that can be partially found in the Regulation 1126/2008, of the 3rd of November. Said regulation endorses, to make them applicable in the EU, some International Accounting Standards and International Financial Reporting Standards.

According to the Regulation no. 1606/2002, the 19th of July, and the article 4.º of the Decree Law approving the *Sistema de Normalização Contabilística*, in synthetic terms, only the listed companies must adopt the international accounting rules when drafting their consolidated accounts. However, the Portuguese law also allows the adoption of the international accounting rules in some other cases, both for consolidated and individual accounts[13].

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[12] It is noteworthy, however, that the national standards also present a certain degree of harmonization, as there are Directives aiming to achieve some harmonization and that have to be implemented by the member states on their national frameworks, e.g., Directive 2013/34/EU, of 26th of June.

[13] For further details, please refer to HELENA ISIDRO / CLÁUDIO PAIS, «The Role and Current Status of IFRS in the Completion of National Accounting Rules – Evidence from Portugal» in *Accounting in Europe*, Vol. 14, Issue 1-2, 2017.

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The accounting treatment of the participative loans

When analyzing this topic under the national accounting rules, one should start by the paragraph 49 of the *Estrutura Conceptual*, that only says that *net assets* are the *residual interest on the entity's assets, after deducting all the liabilities*. Moreover, the *Norma Contabilística e de Relato Financeiro 27*, that deals with financial instruments, repeats the same definition of net assets, but also adds that a *financial liability* is any liability that is, in a loose translation:

a) A contractual obligation:
    i) Requiring the entity to deliver money or another financial asset to another entity, or
    ii) Of exchanging financial assets or liabilities with another entity in terms that might be potential unfavorable to the entity, or
b) An agreement that is or might be settled with equity instruments of the entity and that is:
    i) A non-derivative according to which the entity is or might be obliged to deliver a variable number of its own equity instruments; or
    ii) A derivative that is or might be settled in a way different than the delivery of a fixed amount of money or other financial asset against the delivery of a fixed amount of equity instruments of the entity. (…)

The situation with IAS 32 is a bit different. In fact, the definitions themselves are rather similar:

"A financial liability is any liability that is:

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

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(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D".

On the contrary, "An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities"[14].

However, and in addition to this, IAS 32 provided further details on what "No contractual obligation to deliver cash or another financial asset" means.

"With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions of equity, the issuer does not have a contractual obligation to make such

[14] Paragraph 11.

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distributions because it cannot be required to deliver cash or another financial asset to another party"[15].

And also foresees the specific case of a contingent settlement:

"A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

(a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;

(b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or

(c) the instrument has all the features and meets the conditions in paragraphs 16A and 16B"[16].

Moreover, IAS 32 also contains an application guide.

In paragraph AG 25 it may be read that:

"Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential

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[15] Paragraph 17.
[16] Paragraph 25.

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inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation. An option of the issuer to redeem the shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. In this case, redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares".

On the other hand, in AG 26:

"When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments (…)".

Under this light, let us analyze the new Portuguese framework.

The features of the participative loans

These participative loans grant the parties a great deal of autonomy when negotiating the terms of the agreements. However, as said, the legislator decided to classify said loans as equity, for commercial purposes, (and these requirements are necessary but also enough) if the remuneration is contingent on the existence of results and the remuneration and the reimbursement on articles 32.º and 33.º of the PCCC.

Let us analyze both of these requirements.

The remuneration

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Regarding the payment of the remuneration, the only criteria that the legislator requires in order to classify said loans as equity is the indexation to the company's results and the existence of distributable profits. In addition to this, however, the legislator foresees two types of *remuneration*.

One that must be indexed to the results of the debtor, another one, that might not exist, that is a fixed interest.

Regarding the remuneration indexed to the results, it might seem strange that the legal provision foresees that, for this purpose, the participation in the results may be indexed to several indicators, for example, says the law, the turnover. It is indeed surprising, as the turnover is not the same as distributable profits. The possible difficulties arising from this problem are, however, as mentioned, solved by article 11.º that foresees that no payment (as remuneration or reimbursement) can be made if said amount does not meet the criteria required to pay dividends to the shareholders (i.e., annual profit and balance sheet surplus, as already defined). As a consequence, if the company has a positive turnover, but no distributable profits, no remuneration can be paid.

The legal framework is, however, unclear in one key aspect. In fact, article 9.º, no. 2 provides that should the debtor not pay the remuneration agreed, the creditor has the right to enforce the security rights provided to secure his loan or the right to convert the credit into share capital, as per article 14.º, according to which we then see that such a conversion right only arises after 12 months without being paid. It is therefore unclear whether if, should the company have distributable profits that allow it to pay the agreed remuneration, the creditor has an enforceable right to receive such an amount or if, on the contrary, the creditor must wait, as the only remedy, until being able to convert the credit into equity.

It is our opinion that there are two great arguments to say that the remuneration, should the profits exist, must be mandatorily paid.

The first is that the law gives the creditor the right to enforce the security rights provided (which security rights these might be the law does not detail. One should not forget, however, that, in case of insolvency, this credit is mandatorily subordinated). The second, the fact that article 9.º, no. 4 states that the parties may agree that such a payment is contingent on a previous resolution of the shareholders of the debtor company. If this is only a possibility, it means, as we see it, that if this possibility was not agreed on, the

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debtor must pay the remuneration. The consequence of this is, therefore, very clear: the company has as an enforceable duty to pay the remuneration, should the distributable profits allow such a payment.

This being said, there is a distinction to be made. The part of the remuneration that is calculated based on a percentage of the profits is, by its own nature, not a present liability, as its value would be impossible to ascertain. On the contrary, when it comes to the fixed part of the remuneration, its amount is known beforehand. The perspective of the legislator seems to be that as long as said amount may only be paid should the company have distributable profits, it is not a liability, what seems to us the very contrary of what IAS 32 says. In fact, it seems to us that at least the future fixed remuneration should be treated as a liability. The only possibility of avoiding such a result would be to give the company an unconditional right to refuse to pay the remuneration (without giving rise to the conversion right foreseen in the law). This is, however, not the case[17] and, therefore, this duty to pay this fixed remuneration should always give rise to a liability component, even if the instrument could only be reimbursed in a scenario of liquidation of the company.

The reimbursement

As seen, the relevant provisions, here, are the articles 32.º and 33.º of the PCCC. In a summarized description, they foresee what the Portuguese Legal Doctrine describes as the balance sheet and the financial year surpluses. In simplified terms, the company may only reimburse this loan if, after such a payment, the net assets amount of the company does not become lower than the amount of subscribed capital +legal reserves[18].

Once again, article 10.º, no. 5 allows the parties to foresee that the reimbursement must be preceded by a resolution of the debtor's shareholders, what is therefore a possibility,

[17] One thing should also be mentioned. None of these types of remuneration is a true right to participate in the profits of the company. First of all because, as said, the relevant index might not even be the distributable profits. Secondly, and more importantly, because this right might be enforced without the need of any resolution of the company regarding the use of the annual profits. It truly is a liability, as it is nothing more than a credit right whose amount is indexed to the existence and quantity of profits, but is not, in anyway, a right to receive a share in the profits.

[18] It is however noteworthy to mention that, according to these articles, there are some elements of net assets that cannot be considered for this purpose, due to the realization principle.

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not a mandatory requirement. For the same reason as explained above, the reimbursement in itself is also a liability. The only way to avoid such a scenario, once again, would be to foresee that said reimbursement could only happen if and when the debtor wishes to do so or in the liquidation of the company. This would exclude the right to convert the credit into share capital, what seems to us[19] (but is not clear, as the wording is not clear in this regard) to violate the rules set forth by this framework.

Preliminary Conclusion

Based on what we have seen so far, the Portuguese Legislator seems to follow a different understanding (when compared to IAS, and the SNC) when it comes to contractual duties to pay an amount of money contingent on the existence of distributable profits. In fact, as IAS 32 clearly states, the fact that a duty to pay is contingent on the existence of profits does not exclude the treatment as a liability, for the simple reason that the company itself does not control whether it will or will not have profits and, therefore, does not have an unconditional right to refuse the delivery of cash.

Let us imagine, however, that the parties agree that both the payment of the remuneration and the reimbursement need to be approved by the general meeting of the debtor. Even this would not mean that, from an accounting perspective, said loans could be treated as equity. The key to understand why is in the conversion right.

The Conversion of the Loan

As already mentioned, there are situations in which the creditor may demand the conversion of its credit into share capital, becoming, therefore, a shareholder by receiving equity instruments of the company[20].

[19] In fact, article 14.º of the Decree-Law sets forth the scenarios in which a conversion right may arise but starts by saying: “Subject to more demanding requirements that might be agreed upon in the loan agreement”. Does this mean that said more demanding requirements can, in practice, exclude the right to convert? It does not seem so.

[20] It seems that, if nothing something is foreseen in the agreement between the parties, the shareholders of the debtor need to approve said conversion. However, it seems to us that the law allows the creditor, should the debtor’s shareholders refuse to approve the share capital increase, to go to court and ask the judge to

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Such situations are, focusing on what is now relevant, the non-payment of the retribution for more than 12 months and the non-reimbursement of the loan.

The conversion of the loan is, in this context, problematic. While also relying on a great extent on the agreement between the parties, the number of financial instruments that needs to be delivered in order to settle this conversion may be calculated only when the settlement occurs. In fact, article 21.º says that: The shareholding given as a consequence of the conversion is the result of the proportion of the non-reimbursed value of the credit plus the non-paid remunerations in the equity of the company. This being said, if the net assets of the company are 10.000.000 EUR, and the non-paid loan is 1.000.000 EUR, the issued shares should, if we understood it correctly, represent 10% of the share capital. Moreover, if it is necessary, the law foresees the possibility of a previous share capital reduction.

Having this in mind, it is also our perspective that such a framework does not comply with the fixed-for-fixed requirement set forth in the accounting rules. In fact, the number of shares to be given to the creditor is contingent on the equity value of the company as per the last approved accounts before the conversion, which, therefore, also speaks in favor of an accounting treatment as liability according to IAS 32.

The Portuguese accounting standards committee decision

This being said, the Portuguese interpreter would be facing a difficult situation.

On one side, one faces a clear rule saying that "for the purposes of commercial law" these loans are to be deemed as equity, reference that, considering the PCCC, does not make sense if it does not imply that said treatment should also be given by the accounting. On the other side, however, the IAS is, in this regard, very clear. Therefore, the only logical conclusion seemed to be that the Portuguese legislator decided to implement different accounting criteria in this case, therefore allowing companies that follow the SNC to treat these loans as equity, what could not, however, happen with the companies that follow the IAS, as these rules cannot be amended by the Portuguese Legislator.

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approve the conversion, therefore replacing the approval of the shareholders. In practice, and despite the need to go to court, the conversion might take place without or against the will of the company.

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This conclusion seems to be, however, wrong.

In fact, the Portuguese accounting standards committee ("PASC") published a technical orientation[21] regarding the accounting treatment of these loans. Under said technical orientation, and despite some too generic terms, it seems that the PASC recognizes that a liability component typically exists in these loans. In fact, the PASC says that said loans should be treated as foreseen by NCRF 27, and also added: *For example, considering the eventual option for a conversion into share capital, paragraph 21 shall be applicable*. The outcome of that would be that the entity needs to ascertain the fair value of the liability component without the equity component, and the residual amount should be treated as equity.

However, it is not our main concern to address the accounting treatment of this *conversion into equity* component, as there is already vast literature on the accounting treatment of convertible bonds and other similar instruments. What results crystal clear is that, despite complying with the requirements imposed by the legislator, these loans can (and, we would add, it seems to us that they must[22]) be treated, at least in part, as a liability.

If so, what does "for the purposes of the commercial legislation" mean?

If these loans are not to be treated, from an accounting perspective, as equity just because they meet the requirements foreseen by this new Decree-law, then what does "for the purposes of the commercial legislation" mean?

The first certainty is that, in a somehow *disruptive* solution, the accounting treatment, the rules governing the *duty to keep the books in order*, following the relevant reporting criteria, are, it seems, not under the scope of the commercial legislation. How to understand such a strange outcome?

[21] http://www.cnc.min-financas.pt/pdf/Orientacoes_tecnicas/OT_4.pdf

[22] Again, the reason to say this is that it seems to us that both the right to convert and the criteria of the conversion seem not to be in the disposition of the parties. If this is not the case, and if the duty to deliver cash can be excluded and the conversion right too, the outcome would be different. The compliance with the fixed-for-fixed requirement could also change our conclusion.

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The Spanish framework

We were not inside the head of the legislator, when drafting this framework. We know, however, that the Portuguese legislator was aware of the existence of the legal solutions in other countries, as this is mentioned in the recitals. It is therefore possible that, due to the similarities of the wording, the Portuguese legislator followed the Spanish wording.

In fact, the framework of the *préstamos participativos*, in Spain, was approved by the *Real Decreto-ley 7/1996, de 7 de junio, sobre medidas urgentes de carácter fiscal y de fomento y liberalización de la actividad económica*. In its article 20[23] we can find said framework. For what is now relevant, one can read there that "Los préstamos participativos tendrán la consideración de fondos propios a los efectos de la legislación mercantil". The Portuguese wording is the very translation into Portuguese. However, the *Ley 10/1996, de 18 de diciembre, de Medidas fiscales urgentes sobre corrección de la doble imposición interna intersocietaria y sobre incentivos a la internacionalización de las empresas*[24] has amended said wording, in the Spanish law. It is now: "*Los préstamos participativos se considerarán patrimonio contable a los efectos de reducción del capital y liquidación de sociedades previstas en la legislación mercantil"*. In fact, following the information provided by Professor Gregorio Labatut Serer[25], and while considering that,

[23] "Artículo 20. Préstamos participativos.
Uno. Se considerarán préstamos participativos aquéllos que tengan las siguientes características:
a) La entidad prestamista percibirá un interés variable que se determinará en función de la evolución de la actividad de la empresa prestataria. El criterio para determinar dicha evolución podrá ser: el beneficio neto, el volumen de negocio, el patrimonio total o cualquier otro que libremente acuerden las partes contratantes. Además, podrán acordar un interés fijo con independencia de la evolución de la actividad.
b) Las partes contratantes podrán acordar una cláusula penalizadora para el caso de amortización anticipada. En todo caso, el prestatario sólo podrá amortizar anticipadamente el préstamo participativo si dicha amortización se compensa con una ampliación de igual cuantía de sus fondos propios y siempre que éste no provenga de la actualización de activos.
c) Los préstamos participativos en orden a la prelación de créditos, se situarán después de los acreedores comunes.
d) Los préstamos participativos tendrán la consideración de fondos propios a los efectos de la legislación mercantil.
Dos. Los intereses devengados tanto fijos como variables de un préstamo participativo se considerarán partida deducible a efectos de la base imponible del Impuesto de Sociedades del prestatario". This Law can be found at: BOE.es - BOE-A-1996-13002 Real Decreto-ley 7/1996, de 7 de junio, sobre medidas urgentes de carácter fiscal y de fomento y liberalización de la actividad económica.

[24]Available at https://www.boe.es/buscar/doc.php?id=BOE-A-1996-28330. In general, about *préstamos participativos* in Spain, VIÑUELAS SANZ, MARGARITA, "Los Préstamos Participativos", in *Revista de Derecho Mercantil*, 305, pp. 305 ss.

[25] LABATUT SERER, GREGORIO, "Caso práctico sobre el tratamiento del préstamo participativo

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in Spain, said loans are, from an accounting perspective, a liability, the treatment as equity is relevant for the purposes of articles 327.º[26] and 363.º[27] of the *Ley de Sociedades de Capital*[28].

These articles of the *Ley de Sociedades de Capital* are part of the financial structuring of the Spanish companies and are a clear manifestation of the relevance that share capital still has in the 27 EU member states. In synthetic terms, these articles impose a reduction of share capital or even the wind-up of the company should the equity fall below a certain amount, when considered together with the amount of the share capital.

This outcome, however, does not make sense in a Portuguese perspective. In fact, the rules governing the financial structure of the Portuguese Companies are very different from the Spanish ones[29].

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según el proyecto del ICAC de modificación del PGC" in *Economistas*, available at https://ec.economistas.es/wp-content/uploads/sites/5/2019/09/13_09_2019_Caso-pr%C3%A1ctico-sobre-prestamos-participativos.pdf

[26] "Artículo 327. Carácter obligatorio de la reducción.
En la sociedad anónima, la reducción del capital tendrá carácter obligatorio cuando las pérdidas hayan disminuido su patrimonio neto por debajo de las dos terceras partes de la cifra del capital y hubiere transcurrido un ejercicio social sin haberse recuperado el patrimonio neto" . This Law may be found at: BOE.es - BOE-A-2010-10544 Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital.

[27] "Artículo 363. Causas de disolución.
1. La sociedad de capital deberá disolverse:
a) Por el cese en el ejercicio de la actividad o actividades que constituyan el objeto social. En particular, se entenderá que se ha producido el cese tras un período de inactividad superior a un año.
b) Por la conclusión de la empresa que constituya su objeto.
c) Por la imposibilidad manifiesta de conseguir el fin social.
d) Por la paralización de los órganos sociales de modo que resulte imposible su funcionamiento.
e) Por pérdidas que dejen reducido el patrimonio neto a una cantidad inferior a la mitad del capital social, a no ser que éste se aumente o se reduzca en la medida suficiente, y siempre que no sea procedente solicitar la declaración de concurso.
f) Por reducción del capital social por debajo del mínimo legal, que no sea consecuencia del cumplimiento de una ley.
g) Porque el valor nominal de las participaciones sociales sin voto o de las acciones sin voto excediera de la mitad del capital social desembolsado y no se restableciera la proporción en el plazo de dos años.
h) Por cualquier otra causa establecida en los estatutos" This Law may be found at: BOE.es - BOE-A-2010-10544 Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital.
2. La sociedad comanditaria por acciones deberá disolverse también por fallecimiento, cese, incapacidad o apertura de la fase de liquidación en el concurso de acreedores de todos los socios colectivos, salvo que en el plazo de seis meses y mediante modificación de los estatutos se incorpore algún socio colectivo o se acuerde la transformación de la sociedad en otro tipo social.

[28] It seems that also for the purposes of transformation of companies, said loans should be added to the equity.

[29] The corresponding French wording is: "Ils sont, au regard de l'appréciation de la situation financière des entreprises qui en bénéficient, assimilés à des fonds propres", article L313-14 of the Code monétaire et financier. This code may be found at: https://www.legifrance.gouv.fr/codes/id/LEGITEXT000006072026/

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The importance of the concept of equity in the PCCC

As stated above, the PCCC does not define equity. However, it uses this concept in several provisions. None of those is, however, comparable to the Spanish ones.

First of all, because, according to the Portuguese legal system, the serious loss of share capital does not give rise to a liquidation or share capital reduction duty. In fact, when half of the share capital is lost, article 35.º of the PCCC, following a purely informative model[30], only requires the Board of Directors to summon the shareholders, and to present alternatives to handle the situation. According to the prevailing opinion, however, the shareholders have no duty to adopt any of those measures.

In fact, the loss of half of the share capital do not give rise to any *capitalize or liquidate* duty. It does not even give rise to any duty to reduce the share capital. The only consequence is that, should the balance sheet show that half of the share capital is lost, the company must also make reference, in its *external* documents, to the amount of equity as approved in the last balance sheet. If the purpose of the legislator is to prevent this scenario, it is our opinion that it was simply too much work for a very, very limited outcome.

The concept of equity is also relevant for other purposes, notably in mergers and divisions. However, it does not seem to us that, having the goal of increasing the capitalization of the companies, said provisions were what the legislator had in mind.

The concept of equity is, however, relevant for the purposes of distributions to shareholders. By allowing the company to increase the equity amounts, without increasing the share capital or the legal reserves, there is not a specific legal duty forbidding the company to use, in a *commercial law* perspective, the amount of the loan to make possible a distribution to the shareholders. In fact, the legislator has decided to forbid, in this Decree-Law, some corporate operations when the company still is a debtor of participative loans, such as the amortization of shares, or the amendment of the rules on distribution of profits. It did not however, at least explicitly[31], restricted the ability to

[30] In this regard, and in Portuguese, please refer to DOMINGUES, PAULO TARSO, *O Financiamento Societário pelos Sócios*, Almedina, Coimbra, 2021, pp. 230 ss.

[31] We need to add this *cautious addition* as the article 13.º has some parts that escape our comprehension. In fact, the legislator says things like: The prohibition of reducing the share capital set forth in the previous

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pay dividends. In fact, the legislator did not say that the amount of those loans could not be considered for the purposes of distributing profits, when ascertaining balance sheet surplus.

Is the Insolvency Law "Commercial Law" for these purposes?

As we have seen, accounting rules do not seem to be "commercial law". Is insolvency law commercial law? Let us assume so, in order to try to obtain any useful effect of this treatment as equity for commercial purposes.

If these loans are to be treated as equity, then someone not used to deal with the Portuguese Insolvency legislation might think that it can be useful in the scenario of Insolvency. In fact, having read that Portugal gives no *significant relevance* to the loss of half of the share capital (i.e., the scenario of serious loss of capital), one would expect to find, at least in the insolvency law, a strong reaction to the loss of 100% of equity[32]. This is not the case. In fact, the loss of 100% of the equity does not give rise, by itself, in the Portuguese legal system, to any reaction[33]. *Over-indebtedness* is only foreseen if the liabilities *significantly exceed* the assets. Moreover, we are not aware of any insolvency declared only for this reason (i.e., without meeting also the *cash-flow criterion* for insolvency).

In addition, it must be said that if this was the outcome foreseen by the Portuguese legislator, then there was no need to consider these loans as equity, as the article 3.º. no. 3, c) of the Portuguese Insolvency Code deals with another concept, relevant for insolvency purposes. In fact, it says – in simplified and not 100% exact terms - that, for the purposes of insolvency due to over-indebtedness, *liabilities should not include debts*

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number comprises the share capital, eventual treasury stock and other equity instruments as well as *shares issuance premiums*. How cannot understand the meaning of this provision.

[32] This was the case of the German Federal Republic. In fact, and despite having a purely informative model when it comes to the serious loss of share capital, the over-indebtedness - *Überschuldung* - was, as per paragraph 19 of the *Insolvenzordnung*, a cause of *Antragspflicht*, i.e., the management of the company needed to start an insolvency proceeding. However, in 2008 (first temporarily, then on a definitive basis), the legislator decided that over-indebtedness should only mean insolvency if the company could not predominantly foresee that it would be able to pay its debts in a certain period of time, which was then decided to be 12 months. We should, in addition, mention that the *partiarische Darlehen* are also know in Germany. In this regard, please refer to BRAUER, BJORN, *Das partiarische Darlehen als Instrument der Unternehmensfinanzierung*, Peter Lang, 2019.

[33] What explains, in our perspective, the fact that 25% of the Portuguese companies may simply remain operating with negative net assets.

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that may only be paid should distributable funds exist or at the cost of the remaining assets, after having paid the other creditors of the debtor. For clarity purposes, it would have been better if the legislator had just said: these loans fall withing the scope of article 3.º, no. 3, c) of the Insolvency Code.

Final Conclusions and unanswered questions

As stated, the Portuguese Legislator decided to follow a criterion, for *commercial purposes,* that is not compatible with the accounting rules. In fact, under this new framework the legislator decided that the contingency on the existence of distributable profits is enough in itself to grant the treatment of equity for commercial purposes. The goal of doing so is not understandable, as we cannot find any real utility in said outcome. We foresee that these loans will not change the accounting over-indebtedness of the companies, and this was the goal that should have been pursued. In fact, from a purely commercial perspective, the consequences of over-indebtedness clearly did not justify the introduction of this new concept of *equity for commercial purposes*.

Moreover, we would like to point a theoretical consequence and raise three additional questions.

From a theoretical perspective, it does not seem a good concept of equity, as it makes the classification as equity contingent on one article (32.º of the PCCC) that relies on the concept of share capital. The basic idea is that, from a commercial perspective, an instrument is equity if it fulfills the function of *protecting* share capital. Indeed, the instrument is equity because it cannot be paid back at the cost of the nominal value of share capital. This is very questionable, from a theoretical perspective, because it causes a conceptual subordination of equity to share capital. The equity concept exists *per se* regardless of share capital. The bullet proof evidence is that there are countries in which there is no share capital, and equity still exists. Equity needs to be defined for itself and not under the light of share capital.

Regarding the questions, we would like to add the following: if this remuneration is in itself not a true participation in the profits, from a corporate law perspective, but rather a credit right whose amount is indexed to the profits (or other financial indicator, as the

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turnover), we would like to ask: should the company have book profits that allow such a payment, but, due to cash-flow reasons, such a payment would render the company in the vicinity of insolvency, should the company make the payment?

In fact, the Portuguese legal framework regarding payment of dividends is based only on a balance sheet perspective, without having a generic prohibition of payments that would make the company insolvent (see, as an example of a different solution, paragraph 15b of the German Insolvency Law). One thing, however, is the payment of dividends, with its own characteristics that allow a solution for this purpose that, however, does not fall within the scope of this paper. A different thing are credit rights of a creditor, for which the rules on dividend payment are only relevant for the purpose of ascertaining the amount to be paid. One can always argue that these loans are, by law, subordinated, but subordination is, in this context, a concept that is only relevant in the context of insolvency. When dealing with payments that are to be made to third parties, i.e., non-shareholders of the company, should book value give rise to a duty that will render the company almost insolvent if the purpose of the framework is to capitalize the companies?

The second one: Should the general meeting of these companies now approve two different balance sheets, one for accounting purposes, another for commercial ones?

The third: what is the impact of this new commercial concept of equity? Does it mean that, from now on, any type of instrument/agreement that fulfills these two requirements should be qualified as equity, even if it is a liability from an accounting perspective[34]?

To sum up, this new framework seems to have potential scarce impact and to be problematic. In fact, its biggest merit would be to allow the companies to have additional financing that would increase their net assets, what seems not to be the case.

We would like to end this short paper as it begun. The goal of increasing the average level of net assets of the Portuguese companies seems to be some sort of national goal, and we share that view. However, the correct path should be somewhere else, rather than in coming up with *new equity concepts* that clearly introduce a blatant and puzzling distortion between corporate law and accounting.

[34] Even here the wording of the Portuguese legislator was unhappy, even if compared with the former Spanish one, because the Spanish legislator said that these loans are deemed as equity for commercial purposes. The Portuguese one, redundantly, said that these loans shall be deemed as equity if they fulfill two characteristics. Do these characteristics have a qualifying relevance outside this decree-law?

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