# THE PRIVATE EQUITY REVIEW

ELEVENTH EDITION

**Editor**
Stephen L Ritchie

THE LAWREVIEWS

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# PREFACE

The 11th edition of *The Private Equity Review* comes on the heels of a record-breaking year for dealmakers in 2021. Despite the continued impact of the global covid-19 pandemic, the volume and value of both US and global buyouts soared to all-time highs in 2021, with more than US$1 trillion of global activity attributed to private equity sponsors – at roughly 25 per cent of global deal value, the highest share ever. Deal activity was propelled by a confluence of factors, including favourable macroeconomic conditions leading to increased confidence in boardrooms, accommodating central bank policies, an abundance of cheap financing, robust stock markets, substantial corporate cash and the pace of innovation across industries. IPO and merger and acquisition activity by special purpose acquisition corporations (SPACs), skyrocketed to unprecedented levels, with more than 300 de-SPAC transactions announced in 2021 for a total of over US$600 billion. Private equity (PE) sponsors also sought out larger public targets in record numbers, with overall take-private value eclipsing that of previous years. In keeping with the theme, sponsor-backed leveraged buyouts above US$1 billion peaked in 2021, as did exits above US$1 billion, in part due to more public exits with higher multiples fuelled by the boom in de-SPAC transactions and IPOs. With continued confidence in the performance of PE as an asset class, fundraising activity remained strong, with PE funds amassing aggregate capital of over US$1.3 trillion raised and record amounts of available capital ('dry powder') (one estimate puts the latter at over US$1.6 trillion).

In 2021, PE's enormous impact and the continuing creativity of PE dealmakers was demonstrated. Given PE funds' success, creativity and available capital, we are confident that PE's role in the global economy will continue to grow, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa, notwithstanding ongoing and potential political, regulatory and economic challenges.

PE professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. *The Private Equity Review* has been prepared with this need in mind. It contains contributions from leading PE practitioners in 16 different countries, with observations and advice on PE deal-making and fundraising in each.

As PE has grown, it has also faced increased regulatory scrutiny throughout the world. Adding to this complexity, regulation of PE is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this 11th edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their scarce and valuable time to share their expertise.

**Stephen L Ritchie**
Kirkland & Ellis LLP
Chicago, Illinois
March 2022

Part II

# Investing

Chapter 21

# PORTUGAL

*Mariana Norton dos Reis and Miguel Lencastre Monteiro*[1]

## I OVERVIEW

### i Deal activity

The serious uncertainty and instability caused by the covid-19 pandemic affected the European and the Portuguese private equity markets, similarly to other markets worldwide, notably the levels of total investment and the most targeted sectors of investment, in particular in the first half of 2020.

According to the 2020 European Private Equity Activity Report,[2] approximately €88 billion of equity was invested in European companies in 2020, which represents a 12 per cent decrease in relation with 2019, yet still 18 per cent above the average of the previous five years. Buyout investment, despite still representing 68 per cent of the total investment, suffered a decrease in relation with the previous year, reaching approximately the amount of €60 billion. Growth investment, which is typically a minority investment in mature companies that are seeking primary capital to expand and improve operations or enter new markets to accelerate the growth of business, suffered a 26 per cent year-on-year decrease in 2020 to €14 billion. Venture capital, in turn, recorded a 7 per cent growth in relation to the year of 2019, reaching an amount of €12 billion and, thus, not interrupting the positive trajectory of growth it has seen since 2012. In terms of geographical investment flows, the largest part of capital circulated inside the European territory, with €56.1 billion capital investment made domestically within European countries and €25.7 billion made in cross-border investments within Europe. The most targeted sectors were ICT (communications, computing and electronics) (37 per cent), consumer goods and services (19 per cent) and biotech and healthcare (15 per cent), with a combined share of approximately 71 per cent of all private equity investment made in Europe.

This conjuncture was, naturally, reflected in Portugal's private equity market. Although net investment of €239.3 million made in Portugal was recorded in 2020, transactions involving equity and private equity funds units in the same year amounted to a net divestment of €1.8 million.[3] Furthermore, assets under management (sum of equity, financing, liquidity, options on derivatives and other private equity assets) recorded a decrease, in the first half of 2020, of €273 million; however, this negative trajectory was then counterbalanced by the

1 Mariana Norton dos Reis is a partner and Miguel Lencastre Monteiro is an associate at Cuatrecasas.

2 Published by Invest Europe and available at https://www.investeurope.eu/media/4004/investing-in-europe_private-equity-activity_2020_invest-europe_final.pdf.

3 https://www.cmvm.pt/pt/EstatisticasEstudosEPublicacoes/Publicacoes/CapitaldeRisco/Documents/CMVM-Relat%C3%B3rio%20Anual%20de%20Capital%20de%20Risco-2020.pdf.

economic recovery of the second half of the year, registering a significant increase of €776 million in the assets under management, which reached €5.6 billion by the end of 2020, with 9.8 per cent more than in the previous year.

Equity only accounted for 22.2 per cent (€1.3 billion) of the total amount invested in the national private equity sector, while other investments (i.e., supplementary contributions, ancillary capital contributions, shareholders' loans, bonds and other loans) appear as the major target in 2020 (albeit with a decrease of 6.4 per cent in comparison with 2020), amounting to up to 35.6 per cent (€2 billion). In comparison with the previous year, investments through deposits and other liquid means and investments in other assets held the largest increases in 2020, with, respectively, 20.4 per cent (€210.7 million) and 56.6 per cent (€367.3 million), in relation to 2019.

Currently, there are 61 private equity companies and 202 private equity funds operating in the Portuguese private equity sector.[4] By the end of 2020, investments of these private equity funds totalled €5.4 billion, while investments of private equity companies amounted to €283.9 million. This shows that investment via private equity funds in Portugal is staggeringly more significant than via direct investment through private equity companies.

There continues to be a significant concentration of the Portuguese market, with 11 private equity funds representing around 46.9 per cent of total assets above €100 million under management.

By the end of 2020, there were 1,028 equity participations, of which 29.9 per cent comprised 96.1 per cent of the global value of all equity participations and only 12 equity participations had a value above €20 million each. Conversely, 70.1 per cent of all equity participations – with a value below €500,000 each, largely related to targets in the seed, start-up and growth investment stages – solely amounted to 3.9 per cent of the global value of all equity participations. There is only one equity participation exceeding €100 million.

As for the targets that private equity agents generally envisage, holding companies that manage non-financial corporations acting as vehicles for investments in other companies continued to be quite popular in 2020 (despite a slight decrease), as they allow end investments not to be disclosed. Excluding such holding companies (whose investment amounted to €776.5 million), the activities that captured the largest amounts of private equity investment in 2020 were the ICT (€568.4 million), real estate (€415.7 million) and manufacturing industry (€340 million) sectors, which jointly represent close to 40 per cent of the total investment in private equity in Portugal. Conversely, there was a decrease in investment in accommodation and restaurant services, a sector that was severely affected by the restrictions put in place against the covid-19 pandemic. On the other hand, financial and insurance companies continue to gather the clear majority of investment made by private equity companies (approximately 82.6 per cent).

In respect of the stages of private equity investment, the amount invested in both the expansion and the replacement capital stages increased, with the latter even registering the largest increase in 2020 of any of the stages of investment (32.5 per cent), while the investment in the turnaround stage suffered a decrease of 16.2 per cent. As a result, levels of investment in the expansion stage surpassed in 2020 the turnaround (with 24.7 per cent), as the largest branch of private equity investment. Venture capital evidenced a slight increase in the investment amount (up to €665.7 million in 2020). At any rate, and contrary to

4 https://web3.cmvm.pt/sdi/capitalrisco/index_cr.cfm.

the expectations occasioned by the multiple measures and incentives implemented by the Portuguese state, the start-up stage holds at 7.5 per cent of the total amount invested, having suffered an 8.6 per cent decrease in relation to 2019.

Private equity investments differ in terms of management approaches between hands-on (technical supervision and management involvement) and hands-off (restricted to the allocation of funds). This distinction is also related to the level of control that the investor intends to exercise. By the end of 2020, 62.6 per cent of all investments concerned shareholdings under 30 per cent of the total share capital of the targets.

Concerning the duration of investments, nearly 30.6 per cent of private equity investment had a term of less than four years and 37.2 per cent were kept for more than eight years.

At the time of writing, and although the lasting repercussions of the covid-19 pandemic in 2021 remain unclear, the prospects for the European private equity market behaviour in the first half of last year appear to be encouraging. According to the available data, most notably the H1 2021 European Private Equity Activity Report,[5] the first half of 2021 was marked by a noticeable recovery in investments (38 per cent compared to the same period of 2020), thus reaching the highest level of investment ever seen in any half year period to date. In this context, venture capital recorded a surge in investments of 85 per cent (in relation to the same period of 2019), reaching an amount of €10.2 billion, and growth investments seeing their highest levels ever recorded (€17.5 billion), which more than doubled the level of investment registered in the corresponding period of the previous year. However, in contrast with such positive trajectory, buyout investments saw a slight reduction in the first half of 2021 (7 per cent, when compared with the same period of 2020, and 6 per cent, compared to the average of the past five years).

### ii Operation of the market

***Management incentive arrangements***

Management incentives may be structured as compensation schemes linked to predetermined performance thresholds, equity-linked participation programmes, granting managers the option to acquire shares at a discount or vesting mechanisms where shares are gradually 'unlocked' and offered to managers at a discount. Furthermore, exit bonuses are standard market practice for almost any private equity entity in Portugal. From a strategic point of view, equity incentives are a reliable source of interest alignment between the management and the company, constricting both parties to equal goals and targets.

Because management incentive arrangements are designed to intersect interests of both the management and the investors, general prohibitions (or severe restrictions) on the transferability of equity or the incentive itself are used to ensure that it is exclusively held for the benefit of management. This kind of mechanism is complemented by the fact that, in the event of change of management, the interest may be transferred back to the company or to the majority shareholder. For this purpose, 'good-leaver' and 'bad-leaver' provisions are used to adjust the vested equity accordingly.

Ratchet arrangements are mechanisms designed to align the amount of equity held by owner managers with the performance of the company after the initial investment. However,

5 Published by Invest Europe and available at https://www.investeurope.eu/news-opinion/publications/?keyword=H1%202021%20European%20Private%20Equity%20Activity.

ratchet arrangements are not regulated under Portuguese law, and the question of whether the gains obtained from such arrangements are taxed as labour remuneration (and consequently subject to personal income tax and social security) or as capital gains is currently still under discussion and may vary according to the particular structure implemented.

## II LEGAL FRAMEWORK

### i Acquisition of control and minority interests

Portuguese law sets no restrictions – neither legal nor regulatory in nature – on the ownership of companies and assets by foreign entities or individuals, except for a foreign investment control screening (approved by Decree-Law No. 138/2014 of 15 September 2014) over particularly sensitive industry sectors, based on reasons of national defence and security and/or security of supply of services fundamental to the national interest. Indeed, the acquisition of direct or indirect control over main infrastructures and assets related to (1) national defence and security and/or (2) the supply of essential services in the energy, transport and telecommunications sectors, by nationals of a non-European Economic Area country, either an individual or legal entity, may trigger an investigation procedure by the cabinet member overseeing the relevant sector. Should the government ultimately determine that the acquisition might harm national interest by threatening either the country's security or its provision of fundamental services, the transaction may be deemed null and void. Even though this screening mechanism has been in place since 2014, to our knowledge it has not been enforced to date. Also, contrarily to what happened in other European jurisdictions, no 'covid-19 specific' foreign investment control legislation has been enacted to date.

Even though the national regime seems to be compatible with the Regulation (EU) No. 2019/452 of the European Parliament and of the Council dated 19 March 2019, which establishes a framework for the screening of foreign direct investments into the Union and which came into force on 11 October 2020 (the FDI Regulation), it is clearly less restrictive. It is possible that the screening mechanisms in Portugal will be amended to accommodate the EU's recent guidance on this matter, although it is unlikely as Portuguese governments have historically been very supportive of foreign investment.

In fact, it is already apparent that players involved in M&A transactions show an increasing concern about this type of screening when selecting bidders or preparing a bid for assets in strategic sectors.

Portuguese law sets some rules on group companies, which are relevant for the acquisition of minority and control interests. Indeed, according to the provisions of the Portuguese Companies Code, whenever a simple interest relationship is established (i.e., a company holds an interest equal to or greater than 10 per cent in another company), the acquirer company must notify the acquired company, in writing, of all acquisitions and divestments in the latter's equity.

In the case of a company that establishes a relationship of control in another company, which is presumed after the acquisition of a majority stake, if the acquirer has more than half of the voting rights or if it has the possibility of appointing more than half of the members of the board of directors or of the supervisory board, the dependent company may not purchase shares of the former company.

Pursuant to the Portuguese Companies Code, if a company acquires 100 per cent of the share capital of another company, a general shareholders' meeting must be convened by the board of directors of the dominant company within six months, to decide whether to dissolve the dependent company, transfer the shares of the dependent company or maintain the existing situation.

Portuguese law also contains squeeze-out and sell-out rules applicable as follows: if a company acquires, directly or indirectly (by means of a company in the same group, or through a dependent company), an interest greater than 90 per cent in another company, the acquiring company must notify the latter of this fact within 30 days of the moment that this amount of interest was achieved. A squeeze-out mechanism is available within six months of the notification, whereby the dominant company may secure the remaining equity from the other shareholders. Similarly, if the dominant company does not squeeze out the remaining shareholders, any minority shareholder may, at any time, demand in writing that the majority shareholder purchases the remaining shares from it, within a time limit of not less than 30 days. In the absence of said purchase, or it being considered unsatisfactory, the minority shareholder may request a judicial purchase from a court of law.

Particularly relevant to private equity investors that do not acquire large interests in their targets, the Portuguese Company Codes ensures, through multiple provisions, that minority shareholders are protected from certain abuses.

First, in public limited liability companies (SAs), although the general shareholders' meeting must be convened according to the law or when any of the boards (board of directors, audit commission, executive management council, audit committee, general and supervisory council) deem it necessary, it will also be convened when one or more shareholders with an interest exceeding 5 per cent requires it. As for private limited liability companies (Ldas), all shareholders may request the managers to convene a general shareholders' meeting or include items in the agenda, and no shareholder may be restricted from participating in the general shareholders' meeting, even if it is prevented from exercising its voting rights.

For a public or private limited liability company to decide on matters such as changes to the company's by-laws, mergers, demergers, transformations or dissolution, a qualified majority is required.

Regarding information rights, public and private limited liability companies operate under different frameworks. Any shareholder of a public limited liability company that holds an interest equal to or greater than 1 per cent of the share capital may, on the basis of justified grounds, consult (1) management reports, accounts, supervisory boards and certified public accountants' reports for the previous three years; (2) convening notices, minutes and attendance lists of the general or special shareholders' meetings or bondholders' meetings for the previous three years; (3) the global remuneration amounts paid to members of the company bodies for the previous three years; (4) the global remuneration amounts paid to the highest-paid employees; and (5) share registry documents. In private limited liability companies, managers must provide true, complete and clear information on the company's management and ensure that inspection of books and documents can be made by any shareholder that so requests it. Although this information right may be further developed in the company's by-laws, its effective exercise may not be prevented or unjustifiably limited in the by-laws.

To prevent abuses by majority shareholders, resolutions approving the non-distribution of profit with the intent to pressure minority shareholders into relinquishing their shares, the increase of share capital with the intention of rendering minority shareholders unable to partake in such an increase, or the change of company headquarters may be annulled if the court finds that the resolution was intended to harm the interests of the company or some of its shareholders.

On the other hand, like majority shareholders, minority shareholders are also subject to the provisions of the Portuguese Companies Code, which may prevent improper conduct such as the abuse of judicial opposition to corporate resolutions with the intent of forcing the company to carry out a transaction that specifically benefits the objector, or even the withholding of votes in favour of a proposed change of the by-laws that is essential to preserving the corporate interests, when those votes are essential for the approval of the relevant resolution.

### ii Fiduciary duties and liabilities

Pursuant to the Portuguese Companies Code, directors are subject to fiduciary duties, namely the general duties of care and of loyalty. The duty of care is defined as the standard of a diligent and responsible businessperson and requires directors to have the availability and willingness to carry out the company's management, the proper technical capacity and skills for the performance of the relevant functions and an understanding of the company's business, appropriate for the due performance of the role.

Directors are also bound by a duty of loyalty according to which they must exclusively act in the best interests of the company and of the stakeholders who are relevant for its sustainability, in particular employees, customers and creditors. In addition, the duty of loyalty also comprises three fundamental principles, namely: (1) a non-competition obligation towards the company; (2) a prohibition on taking advantage of corporate opportunities; and (3) a prohibition on trading with the company, except in specific, legally established, situations.

Furthermore, rules set out in the Portuguese Company's Code establish that directors must avoid any activity that can result in a conflict of interest with the company unless express consent has been granted by the general meeting of the shareholders and may not vote on resolutions of the board of directors if they are conflicted in any way (for example, if they are involved in a management buyout). Directors may only enter into agreements with the company in the situations strictly set out in law, may never use the company's assets for their own benefit or the unlawful benefit of third parties and are bound by a duty of confidentiality in respect of information related to the company that is not available to the public.

The duties directors are bound to may be further expanded by means of management agreements and in the by-laws of the company.

Managing entities of private equity funds are subject to specific provisions, established in Law No. 18/2015.[6] The managing entity, in the exercise of its functions, acts on behalf of the investors, independently and in their exclusive interest, with the obligation to perform all acts necessary for a diligent and responsible administration of the private equity fund, according to high levels of integrity, diligence and professional ability. In the performance of its duties, a managing entity shall safeguard the legitimate interests of the investors, refrain from entering into arrangements that may lead to a conflict of interests with investors and set up an organisational structure and internal procedures proportional to the size and complexity

6 Law No. 18/2015 of 4 March 2015, as amended by Decree-Law No. 56/2018 of 9 July 2018, by Decree-Law No. 144/2019 of 23 September 2019, by Decree-Law No. 25/2020 of 7 July 2020, and, more recently, Decree-Law No. 72/2021 of 16 August 2021, transposed Directives Nos. 2011/61/EU and 2013/14/EU of the European Parliament and of the Council and executed Regulations Nos. 345/2013 and 346/2013 of the European Parliament and of the Council, developing the legal framework applicable to private equity investment activities.

of their activity. Apart from being bound to the duties of care and loyalty set out above, directors of managing entities must satisfy demanding fit-and-proper criteria established by the Portuguese Securities Market Commission (CMVM).

In accordance with general principles governing civil liability, any director that wilfully or negligently infringes another person's right, or a legal provision designed to protect the interests of others, is obliged to indemnify the aggrieved party for the damage arising from the infringement. Damage caused to the company, shareholders or third parties may arise from an action or omission in breach of the legal or contractual duties of a director. In respect of damage caused to the company, Portuguese law lays down a rule of fault-based liability, albeit with a presumption of guilt, rather than one of strict liability. Therefore, directors are liable for the damage caused to the company, unless they prove that they did not act with fault. Directors are also liable for damage directly caused to shareholders and third parties to the extent that the aggrieved parties provide evidence of unlawful or negligent conduct on the part of the relevant director that resulted in the damage; furthermore, the director's liability is joint and several with the other directors. Furthermore, directors can be held responsible for damage to creditors of the company, and the applicable rules in this case do not differ significantly from those regarding damage caused to shareholders and third parties, with the single difference that the aggrieved party bears the burden of proving that the non-payment of the claims is because of the insufficiency of assets of the company and that the insufficiency arises from the director's fault and the breach of the legal provisions designed to protect creditors of the company. The insufficiency of assets alone is not enough to establish the directors' liability.

One or more shareholders holding a minimum share quota of 5 per cent of the company (2 per cent in listed companies) may, in the name and on behalf of the company, file a lawsuit against a director with the intention of receiving compensation for the damage suffered, without prejudice to other lawsuits for compensation in respect of individual damage caused to that same shareholder.

## III YEAR IN REVIEW

### i Recent deal activity

In 2020, according to public information, the covid-19 pandemic negatively impacted the number of private equity deals that occurred in Portugal, with 39 deals recorded in that year (a 17 per cent decrease in relation to 2019), and yet in the same year a significant increase was registered in the value of such deals, with an aggregate amount of €6.7 billion (representing a 62 per cent increase with reference to the previous year). Similarly, with regard to venture capital transactions, although the amount recorded dropped (decreasing 28 per cent to 61 transactions), the value of such deals increased exponentially (recording a 119 per cent increase to €889 million).[7] Additionally, the amount of assets under management registered an increase of 9.8 per cent in comparison with 2019, reaching a total of €5.6 billion by the end of the year. Similarly to 2019, this was accompanied by an increase in the value of local private equity investment (of approximately 7.1 per cent).

Turning now to 2021, according to publicly available data until November 2021 private equity deals continued to suffer the lasting repercussions of the pandemic, with both

7 Transactional Track Record's Iberian Report, of November 2021, available at https://www.ttrecord.com/pt/publicacoes/relatorio-por-mercado/relatorio-mensal-peninsula-iberica/Mercado-Iberico-Novembro-2021/2067/ a.

their value and volume suffering a decline. Indeed, in 2021, the value of such deals amounted to €2.2 billion, recording a 68 per cent decrease when compared with the previous year, while the number of deals decreased 2.78 per cent, amounting to 35 deals. Conversely, venture capital recorded significant increases both in the number (103 transactions, with an 87.27 per cent increase) and the total value of transactions (with an aggregate amount of €1.5 billion, 87.6 per cent more than in 2020). The ICT sector was the most active sector with 42 transactions, followed by real estate with 41 operations and financial and insurance with 29 transactions. There were also some exceptionally high-value private equity deals in Portugal, including the acquisition for €528 million by CVC Advisers Company (Luxembourg) S.á.r.l. of a minority equity stake in Sonae MC, SGPS, SA, a leading provider in the food retail sector that owns the Continente hypermarkets chain.

In addition, in the current year, sovereign wealth funds have become important players in the Portuguese private equity market. In this sense, one of 2021's most significant deals was the acquisition of Carlyle's majority stake (i.e., 60 per cent) in Logoplaste, SA by Ontario Teachers' Pension Plan, Canada's largest occupational pension plan.

### ii Financing

Private equity transactions are generally carried out with resort to the equity raised by the private equity entity, but also with support in external financing.

Debt financing structures include senior term facilities, senior revolving facilities and mezzanine facilities, which usually require security packages, including pledges over shares, receivables and credit rights under the transaction documents, subject to financial assistance rules.

An important restriction that private equity entities face when resorting to leveraged acquisitions is the prohibition against financial assistance (financing or securing the acquisition of a public limited liability company's own shares). However, there are mechanisms to mitigate the effects of this prohibition, namely the granting of pledges over the target's shares by its shareholders or the tranching of facility agreements to segregate amounts that may be secured by the target company (for example, in respect of working capital requirements) from those that may not (namely, those raised for the acquisition of the target's shares) and resorting to distributions of free reserves or reduction of share capital.

### iii Key terms of recent control transactions

Private equity transactions each have their own characteristics, their terms depending on a number of factors, including, but not limited to, the quality and quantity of information disclosed by the seller, the timeline of the transaction taking place and whether due diligence is carried out beforehand.

To mitigate risk, a contractual framework of representations and warranties is usually negotiated between the buyer and seller (more or less robust depending on the profile of the parties, the assurance provided during the due diligence process and the negotiation phase of the transaction) that, if breached, may lead to a number of consequences, typically an indemnity in respect of a claim for damages subject to *de minimis*, thresholds and caps. Contingencies identified in the due diligence process are either addressed as a price reduction or a specific indemnity. In private equity deals, parties tend to resort to warranty and indemnity insurance (generally purchaser insurance) to cover the purchaser against a breach of the representations and warranties, subject to certain limitations, excluding the contingencies known by the purchaser (revealed in the disclosed information) and certain uninsurable matters.

Risk can also be mitigated by means of purchase price structure or adjustment clauses. The most common mechanisms for structuring the purchase price are the locked-box mechanism and a purchase price adjustment based on completion accounts, which are essentially distinguished by the date of transfer of economic risk. With the locked-box system, the valuation of an invested company is based on a historical set of reference accounts (the locked-box accounts), usually dated before the closing of the transaction. This mechanism is the most commonly used in private equity deals and particularly favourable to the seller as there will be no subsequent purchase price adjustment and it results in a swifter, simpler and more cost-friendly deal, as both parties will know the amounts each party has to receive or concede at a specific moment of the transaction. The locked-box system may have variables, namely by setting an interest in favour of the seller to compensate it for the earnings until closing. Recent deals bring more complexity to the locked-box system with 'hybrid' solutions as to the cash produced or date of valuation of the company. Under the completion accounts clause, the definition of the final price is deferred until the moment of the closing of the transaction, with the investor disbursing the purchase price in accordance with the real level of assets and liabilities of the target at closing. The parameters according to which the adjustments of the final value of the purchase price are calculated are usually contractually established in the share sale and purchase agreement.

Conditions precedent are also frequent and standard market practice in almost any private equity transaction, their terms and scope depending on, among other factors, the sector and industry of the target and the need to obtain any regulatory authorisations or third-party waivers or approvals.

As a general standard, the fulfilment of conditions precedent may include both best effort and cooperative obligations. The former determines the amount of effort expected and required of the buyer to satisfy the conditions precedent. The level typically agreed regarding the accomplishment of conditions precedent related to merger control or regulatory authorisations is that of 'commercially reasonable efforts'. On the other hand, cooperative obligations set both parties' mutual duties to cooperate in the attainment of the conditions precedent (e.g., reciprocally providing sensitive information and reviewing filings to regulatory authorities). 'Hell-or-high-water' clauses, imposing upon buyers the obligation to do all that is necessary (as required by the relevant regulatory authorities) to satisfy the conditions precedent, are not common, because of their potential to harm the buyer or the target.

Considering the difficulties in ensuring the investor's willingness to obtain financing for the transaction between the signing and closing, there is usually some reluctance on the part of the seller to include related conditions precedent. Should a special purpose company be incorporated by the buyer to acquire the target shares upon the closing, it is common for the seller to ask for an equity commitment letter to be provided. This letter is only to be effective when the transaction's conditions precedent, as set out in the sale and purchase agreement, are fulfilled.

The exceptional circumstances brought by the covid-19 pandemic were also reflected in the contractual conditions, namely with more complex price structures including some seller financing mechanisms (e.g., deferred purchase price, earn-out mechanisms, among others).

While the legal system in place in Portugal is grounded in civil law, the importance of major common law jurisdictions such as the United Kingdom and the United States in international business has significantly shaped the framework for cross-border deals. Even though Portuguese law governs the overwhelming bulk of transactions involving Portuguese companies, it is within the parties' powers to freely choose a different governing law for the transaction documents. This is more common when one of the parties is a foreign investor. Accordingly, as long as Portuguese law's mandatory rules (such as governing provisions on the transfer of shares, assignment of credits and obligation, among others) are abided by, parties to contracts of either a civil or commercial nature have the right to determine the governing law as provided for in the Rome I Regulation,[8] which is in force in Portugal.

### iv Exits

Overall divestment experienced a significant increase in 2020, totalling €369.2 million (from €51.3 million in the previous year). In 2020, divestments were in large part made through third-party sales, which amounted to 63.5 per cent of the total divestment in private equity assets and are mainly concentrated in companies in the expansion, seed capital and start-up stages.

Following the trend of previous years, no divestments were made through an initial public offering.

## IV REGULATORY DEVELOPMENTS

Pursuant to the Portuguese Securities Code and Law No. 18/2015 (the Legal Framework for Private Equity), prudential and market conduct supervision of private equity entities in Portugal is carried out by the CMVM.[9] As regulator, the CMVM has legislative competencies and sets out the rules on, but not limited to, asset and debt valuation, accounting organisation, duties of information and fit-and-proper requirements of the members of the corporate bodies and holders of qualified shareholdings of and in private equity entities.[10]

With the introduction of the Legal Framework for Private Equity, private equity entities may be subject to one of two legal regimes, depending on the value of their assets under management. If the asset value under management of a private equity entity is greater than €100 million (in respect of portfolios containing assets acquired with recourse to leverage) or €500 million (in respect of portfolios not containing assets acquired with recourse to leverage and in respect of which there are no redemption rights for an initial five-year period), private equity entities are considered to be above a relevant, legally established threshold, and are subject to a more demanding legal framework than entities that do not have assets under management that cross any of these two thresholds. Private equity entities that fall under the more demanding framework are subject to, among other things, the following rights and obligations:

*a* the prior authorisation of the regulator for their incorporation;

*b* the EU passporting system for banks and financial services applicable to the private equity fund participation units concerned;

8 Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

9 Regarding the supervision of managing entities of private equity investment undertakings, the CMVM may cooperate with the Portuguese Central Bank and the European Securities Market Authority.

10 CMVM Regulations Nos. 3/2015 (as amended by Regulations Nos. 5/2020 and 6/2020) and 12/2005.

*c* disclosure to the regulator of outsourcing of management and other services; and
*d* a requirement for the implementation and maintenance of conflict-of-interest policies to avoid, identify and manage potential conflicts.

In 2018, Decree-Law No. 56/2018 of 9 July 2018 amended the Legal Framework for Private Equity. Among other changes, the Decree-Law (1) removed the 10-year time limit on the qualification of private equity investments, allowing private equity companies and funds to manage their portfolio in a more flexible way; (2) introduced further clarification of the calculation methodology to be followed to determine the legal framework applicable to private equity entities; and (3) extended the scope of private equity investments aimed at promoting social entrepreneurship to include entities other than companies, such as associations and foundations.

In 2019, Decree-Law No. 144/2019 of 23 September 2019 also amended the Legal Framework for Private Equity, which provides for the transfer to the CMVM of the powers and competences relating to the prudential supervision of investment fund management companies and securitisation fund management companies, which was previously carried out by the Bank of Portugal. This legal act incorporated credit funds (loan funds) in the Portuguese legal system and qualified them as specialised alternative investment schemes of credit, with a view to fostering the capital market and diversifying companies' sources of funding, providing financing. These funds are committed to financing the economy directly through the granting of credit to companies and indirectly through the acquisition of credits, including non-performing loans held by banks. Notwithstanding, these funds are not allowed to carry out certain operations, such as short sales of securities; securities financing transactions, including securities lending; or derivatives, except for the purpose of risk coverage. Additionally, these funds are not allowed to lend money to natural persons or financial institutions.

In 2020, the Legal Framework for Private Equity was once again amended by Law No. 25/2020 of 7 July 2020, which introduced slight adjustments to the terms and conditions of the administrative offences foreseen for the breach of the obligations set out in this legal regime.

In 2021, this legal framework was amended by Decree-Law No. 72/2021 of 16 August 2021 pursuant to which securities investment companies for the promotion of the economy, a special vehicle whose purpose is to acquire debt issued by small or medium-sized enterprises (SMEs) and the placement of such debt in the securities market, through the issue of bonds, with the possibility of associating a mutual guarantee, created by the Council of Ministers Resolution No. 41/2020 of 6 June 2020, would be regulated by special legal framework, to be approved in the future.

Furthermore, within the scope of its legislative competencies, the CMVM has recently enacted new regulations, among which we can highlight: (1) CMVM Regulation No. 1/2020, defining the form and content of the transparency obligations of collective investment scheme management companies and credit securitisation fund management companies, to inform the CMVM on a quarterly basis of their economic and financial situation; as well as (2) CMVM Regulation No. 5/2020, which amends CMVM Regulation No. 3/2015 to set up the legal framework applicable to loan funds, as provided for in Decree-Law No. 144/2019, of 23 September 2019.

In light of the covid-19 pandemic, the Development Finance Institution has also approved solutions aimed at facilitating the execution of financing operations through private equity funds (e.g., until 31 December 2020, private equity funds were entitled to carry out investment rounds without the mandatory entry of new independent investors).[11] Additionally, Decree-Law No. 63/2021 of 28 July 2021 proceeded to the incorporation of the Companies Capitalisation Fund, with an initial funding of €320 million, aimed at (1) reinforcing the solvency of commercial companies that develop their activity in Portugal and that have been affected by the covid-19 pandemic, and (2) providing injections of capital in commercial companies in an initial stage of activity or in the process of growth and consolidation.

## V OUTLOOK

By the end of 2020, despite the impacts of the covid-19 pandemic, the total amount of assets under management in the private equity sector maintained the growth trend of previous years.

However, although turnaround transactions still represented a large part of private equity deals in Portugal in 2020, the continued decrease in this type of transaction remains, while being replaced by a trend for growth investment and management buyouts. This rebalancing of private equity, undertaken by more speculative participants through more conservative transactions, indicates that the market has matured and traditional investors are becoming more confident in the domestic business fabric.

While the trend of systematic growth of investment that had been experienced in previous years was interrupted, mainly, in the first half of 2020, the recovery evidenced in the latter half of that year and the resilience of private equity activity in 2021, together with several factors as detailed below, can lead the sector to a swift recovery, reinstating 'pre-pandemic' standards.

For one, the Portuguese state made, and continues to make, significant efforts aimed at economic recovery, enacting remedies aimed at mitigating the economic impacts of this exceptional situation (e.g., credit lines, subsidies and the Companies Capitalisation Fund). Such solutions have also been complemented by an exceptional stimulus package from the European Union.

Besides this, the increased adaptation of companies to this 'new normal' and the emergence of new sectors of activity could open the door to new investment opportunities. Other aspects, such as new private equity firms becoming active in the domestic market, the continued appetite of global private equity firms in the Iberian and Portuguese markets, low interest rates, and an increase in financial fund willingness to invest in certain transactions may also prove crucial for the development of the private equity sector in Portugal in the coming years. In fact, it is possible that we will continue to see a recovery in deal volume in the post-pandemic context, including transactions that started to be prepared last year but were delayed because of the unfavourable economic environment caused by the covid-19 pandemic, as well as some opportunities for distressed investments in companies that performed badly during this period.

11 www.ifd.pt/pt/medidas-de-flexibilizacao/.

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