

SCHEDULE 2

PORTUGAL

COUNTRY ANALYSIS

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1. General

1.1 Pledge – General Characteristics

- Under Portuguese law, a pledge (penho) may be created over cash or fungible securities. There are two types of pledge, namely civil and commercial. The latter is a pledge entered into between entities or individuals subject to the regulations of the Commercial Code. These will be individuals with capacity to carry out commercial acts and other entities which engage in commercial activities. The requirements for a civil pledge will be stricter than those for the commercial pledge. The kind of pledge used depends on the parties' status, although we can say that in practice, a civil pledge will be more likely to be used.
- The difficulties associated with pledge, whether civil or commercial, have to do with the nature of the registration requirements. It may be impracticable in the financial markets for a pledgee to be able to register each transfer of collateral in the records of the relevant custodian. Furthermore a security interest in after-acquired property is not enforceable against third parties.
- The prohibition on use by a pledgee of collateral in the form of fungible securities is also an impediment to efficient collateralisation. As regards fungible securities registered in the records of the local securities central clearing house, the collateral receiver would not be permitted to sell, lend or re-pledge rehypothecate the collateral because registration of the pledge in the records of the local custodian is required. This registration effectively blocks such use, even if permitted under the express terms of the security agreement.
- The fact that the obligations guaranteed by the pledge have not yet matured does not prejudice the validity and enforceability of the pledge provided such obligations are nevertheless identifiable and result from a framework which is already known. However, assets which do not yet exist or which are not yet in the pledgor's estate may not be subject to a security interest and instead are subject only to contractual undertakings to create a pledge over them. These undertakings will not be effective against third parties.
- The relevant deposit/custody relationship should provide for duties of care and diligent conduct applicable in the discharge of the pledgee's obligations (eg. duties to collect interest, dividend payments).

Type of investments which can be pledged include:

- Certificated shares: in relation to shares represented by certificates, there is a distinction between registered and deposited shares.
 - (a) for registered shares the pledge will be subject to contractual agreement, delivery of certificates to pledgee, notation of pledge in official form and in the certificates (if nominal shares), company's certification of pledge (official form, which may require notarised signatures).

- (b) for deposited shares the pledge is created by a contractual agreement (which may require notarised signatures if bearer shares) and notation of pledge in official form may also be required.
 - Dematerialised securities: a pledge over dematerialised shares is constituted by a contractual agreement on the basis that the financial institution where the shares are registered shall effect the corresponding registration.
 - Other securities: may be subject to different/additional requirements, for example, bearer shares not deposited or registered require a pledge agreement plus delivery of certificates and shares represented by certificates which are under the system of control and deposit of the “Securities Central” (mandatory for listed shares but which may be voluntarily adopted for unquoted shares) are subject to the regime applicable to dematerialised shares.
- The creation of security interests in Portugal attracts stamp duty of 0.04% per month (for obligations having a maturity of less than 1 year), 0.5% for obligations having a maturity of between 1 year and 5 years and 0.6% (for obligations having a maturity of more than 5 years). However, stamp tax is generally not applicable in relation to transactions concluded between two financial institutions and for credit provided in respect of transactions executed through a stock exchange.

1.2 Transfer of Title – General Characteristics

- Transfer of title, although not expressly sanctioned under Portuguese law, should in principle be accepted if allowed under the law applicable to the relevant agreement. If Portuguese law is deemed to apply, then re-characterisation risk is low and limited to tax considerations.
- Explicit protection of transfer of title arrangements from prohibition on insolvency set-off would be desirable, perhaps via clarification of Portuguese netting legislation to cover such arrangements.
- Although set-off is prohibited after a declaration of insolvency there is normally a considerable delay between commencement of the insolvency proceedings and any declaration. Set-off is permitted during this period and during reorganisation proceedings up until a declaration of insolvency (if one occurs at the end of such proceedings).
- Under the Portuguese netting legislation, enacted in 1997, close-out netting under a Master Agreement (such as the 1992 ISDA Master Agreement) is enforceable against a third party subject to Portuguese bankruptcy proceedings (whether re-organisation or liquidation proceedings) in relation to “financial investments”. The Portuguese entity subject to bankruptcy proceedings must be a corporation or a bank.

2. Private International Law and Domestic Law Aspects of Collateral

Validity of the Contract/Attachment

Portuguese private international law:

- There is no particular provision of Portuguese Private International Law dealing with the creation of security interests over securities currently in force. The general rule of conflicts of law which is therefore currently applicable is that all rights existing over assets should be governed by the law where such assets are located, ie. the “lex rei sitae”, pursuant to Art. 46 of the Portuguese Civil Code.
- Current Portuguese practice would appear to be that pledges and other security interests over securities issued by Portuguese entities are created in compliance with Portuguese law (even if the relevant securities are held outside Portugal and if the law governing the relevant contract is not Portuguese).
- Additionally, a new Securities Market Code entered into force in March 2000, and article 41. of this new code provides that (i) the creation of security interests on securities integrated in a centralised system should be governed by the law applicable to the jurisdiction of such system; (ii) the creation of security interests to securities held or registered outside such a system should be governed by the law of the jurisdiction where the securities are held/registered; and that (iii) the creation of security interests on securities not so integrated, held or registered shall be governed by the law of incorporation of the relevant issuer.
- The parties are free to decide on the law governing the relevant contract and its substantive effects, provided there is a relevant element of connection with the law ultimately selected (without prejudice to the provisions of International Conventions or Treaties that Portugal has ratified and which may soften these requirements).
- Provided that the applicable law is that under which the relevant security interests were actually created and that under such law the relevant security interests are valid and fully enforceable, Portuguese courts would also recognise their validity and give them effect.

Portuguese domestic law:

- Liens, pledges and other security interests and charges on registered securities (in case of dematerialised securities) or on securities represented by certificates which are deposited with duly authorised financial operators (either nominative or bearer), are created by means of registration of the creation of the relevant security interest on the bank accounts where the relevant securities are held.

- Creation of liens, pledges and other security interests and charges on certificates not deposited under the above system, depend on the nature of the underlying securities, so:
 - a) liens on nominative shares must be registered in the relevant company's ledger book;
 - b) liens on bearer securities depend on physical delivery of the certificates to the respective beneficiary (or to a commonly appointed third party).

In general, the creation of security interests over securities follows formal requirements similar to those that apply to the transfer of same securities.

Perfection:

Portuguese private international law:

- To the extent that perfection relates to the proprietary aspects of the security agreement between two parties and the rights of third parties in relation to the assets subject to the security interest, the law of the place where the relevant collateral is located will apply.
- For reasons of perfection of the relevant security interest and in order to make sure that *erga omnes* effects are produced (and therefore that priority over third party entitlements is obtained) the requirements of the law under which the relevant securities have been issued must also be complied with.

Portuguese domestic law:

- [Described as above.]

Priorities:

Portuguese private international law:

- Priority aspects will be governed by “lex rei sitae”.

Portuguese domestic law:

- Priority over third party entitlements is determined by registration of the security interests that have been created in the relevant issuer's ledger book or bank account.
- For bearer securities which are not dematerialised or deposited at a bank account, the relevant element in determining priority over third party entitlements is physical (*bona fide*) possession.
- Portuguese law awards first priority to certain creditors, namely to court and other enforcement proceedings fees and costs, certain credits of the

defaulting party's employees for unpaid salaries and, on certain occasions, to tax and social security debts.

These creditors take precedence over those of the beneficiary of security interests being enforced. The tax and social security credits for unpaid taxes and contributions lose automatically their higher ranking with the declaration of bankruptcy and should, from then onwards (but only in the event bankruptcy has been declared) be regarded as debts with no particular priority.

Enforcement:

Portuguese private international law:

- “Lex rei sitae” is the law governing enforcement

Portuguese domestic law:

- Court enforcement of pledges and other securities is conducted by means of special legal remedies extensively governed by civil procedure laws.
- Pledges entitle their beneficiaries to obtain payment of their credits through the proceeds of the forced sale or execution of the pledged assets, such forced sale to be conducted by the court where the proceedings have been initiated (namely by means of a public auction or by a direct sale organised by the court).
- Portuguese law generally does not allow the foreclosure of pledged assets. The appropriation to the creditor of the assets is only permitted when expressly provided in the applicable security contract and after being individually allowed by a court of law.
- To a limited extent and when that is expressly authorised by the relevant contractual instrument and provided the pledge is enforced by a special procedure entitling the court to determine the value for which the pledged assets are transferred to the pledge beneficiary, a somewhat similar effect may be obtained, but always requiring a court intervention.

Insolvency:

Portuguese private international law:

- The bankruptcy of Portuguese companies is governed by Portuguese law, irrespective of the location of the bankrupt company's assets.

Portuguese domestic law:

- Bankruptcy of a Portuguese debtor has various consequences regarding the taking/creation/enforcement of security interests.

Generally speaking, all acts of the bankrupt company after the declaration of bankruptcy are illegal (except when performed on limited circumstances by the bankruptcy administrator).

Also for a period of 5 years counting from the dates of the constitution of the security interest, the other creditors of the bankrupt company are entitled to challenge such constitution made by such company which were prejudicial to the creditors' interests in case of bad faith of the relevant counterpart. These include: (i) set-offs applied in the 2 years prior to the proceedings that lead to bankruptcy were initiated, if funds not commonly used for such purposes were consumed; (ii) security interests created after the relevant obligations having been undertaken, in the 12 months prior to the proceedings that lead to bankruptcy were initiated, or created in the 90 days prior to same moment, in case of security interests perfected simultaneously with the guaranteed obligations; (iii) acts and contracts of the bankrupt company conducted in the same 2 years where the obligations undertaken are substantially greater than those of the relevant counterpart; and to (iv) credit mandates granted in the same 2 years which were not granted with real interest for the bankrupt company).

- Under Portuguese law all creditors are forced to present their claims on a given debtor's insolvency/bankruptcy proceedings (even those merely directed to a re-organisation of the debtor) once such proceedings are initiated.

All other enforcement actions against the insolvent debtor that may be impending when the bankruptcy proceedings are initiated are legally suspended after the first court decision to accept such proceedings.

Credits guaranteed by security interests may not be reduced or waived without the relevant creditor's authorisation.

3. Miscellaneous

3.1 Cross-border transactions in multi-tiered holding systems

Portuguese conflicts of law rules determine that holding of assets, property rights and other related rights such as those arising from the creation of a security interest, are governed by the law of the place where the relevant assets are located.

In addition, to the extent these issues are subject of the parties' agreement the law chosen by the parties as the governing law of that agreement will be respected so long as there is a connection between the governing law and any of the elements of the contract, or where there is no direct connection, so long as the choice of law corresponds to a serious commercial concern of one of the parties. In the absence of any choice of express governing law, the law of agreement will be deemed to be that of the parties domicile, if this is the same for both and if it is not, the law of the place in which the parties entered into the agreement.

Also a specific conflicts of law rule also requires that a foreign law otherwise applicable in accordance with these rules will not apply if it involves the violation of fundamental

principles of Portuguese public order and that no equivalent remedy applies under the foreign law.

In short:

- the interest of an owner of a share in a pool of fungible securities will depend on the value of the arrangements.
- the “lex loci” of fungible securities held through an account in a clearing system is the place where the clearing system is located.
- Art. 41 of the Securities Market Code approved by Decree Law 486/99 of 13th November, provides that:
 - (i) “the creation of a security interest on securities integrated in a centralised system should be governed by the law applicable to the jurisdiction of such system;
 - (ii) the creation of security interests to securities held or registered outside a centralised system should be governed by the law of the jurisdiction where the securities are held/registered; and that
 - (iii) the creation of security interests on securities not so integrated, held or registered shall be governed by the law of incorporation of the relevant issuer”.

3.2 Implementation of the Settlement Finality Directive

No specific legislation for the implementation of this Directive has been passed.

The new Securities Market Code (in force from March 2000 onwards) contains many rules implementing the provisions of this Directive.

The purpose of these provisions is to protect Central Banks and other participants in a given system from any legal uncertainty as to the law that would govern the enforcement of existing pledges in a bankruptcy scenario.

The concept is to place securities held in a given jurisdiction under the law of that jurisdiction, in order to facilitate and to speed up all possible court procedures applicable for continuation of normal trade in case a given party fails to perform its obligations.