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Barros, Sobral, G.Gomes & Associados R.L. is one of Portugal's leading legal firms and the sole Portuguese member of the Euro-American Lawyers Group (EALG). Our main offices are in Lisbon and Funchal (Madeira) from which we provide a full range of business legal services, specialising in Tax Law, Corporate and Commercial Law, Litigation, Criminal Law and ITT. We have representation in Oporto and Vilamoura (Algarve) and correspondent and associate offices in the Portuguese speaking countries of Angola, Mozambique and Sao Tome e Principe.

Our Tax Department has formed strong links with an extensive network of leading tax law firms across Europe. Close professional contacts with all major off-shore jurisdictions enable us to provide a wholly integrated and inclusive international tax service, and assists in successful implementation of client arrangements whose development we have partnered. Our membership of the Committee of Arbitrators of the American Chamber of Commerce in Portugal is reinforced by membership of the Euro-American Lawyers Group.

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legalinterview

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THE NEW SPANISH INSOLVENCY LAW Dangers & pitfalls for directors & group companies

Before the enactment of the 2004 Insolvency Law ("LC") the rules governing bankruptcies and insolvencies in Spain were contained in the 'modern' Suspension of Payments Act of 1920, and earlier nineteenth century enactments. One of the principal aims of the 2004 law was to put an end to the perpetuation of the very obvious examples of abuse of the law under the old regulations. Possibly the most striking aspect of the LC is the introduction of an inclusive definition of third party liability in insolvency where liability is automatic except in very narrowly defined defence circumstances.

Fundamental to the new system is the basic concept of "Persons specially related to the insolvent party", who fall into two categories –

(first) **luris et de iure (without possibility of evidence to the contrary)**

- Any partner responsible for the company's debts.
- Any shareholder with a shareholding of 5% or more if the insolvent company is publicly quoted, or 10% or more if not.
- Any Board member or Manager with general powers, any *de facto* Manager of the insolvent entity (i.e. controlling individuals or corporations taking the relevant decisions, or who have done so at any time in the previous two years) any liquidator, and *any person who has held any of the foregoing positions in the previous two years.*
- Associated companies forming part of the same Group as the insolvent company. (Under Spanish law the definition of 'Group of Companies' is dealt with differently by the Civil and/or Commercial Courts and the Labour Courts, the latter applying much more rigorous standards when interpreting Group companies' responsibilities).

Group companies, and in particular parent companies, can be held responsible for their Spanish insolvent associate company's debts either under the concept of 'de facto manager' or the wider 'company of the same Group' concept.

(second) **luris tantum (evidence to the contrary is admitted)**

Assignees to whom credits owned by any of the persons or corporate bodies defined in the previous category have been transferred under any title.

An innovation in section 166 of the LC is the introduction of 'Accomplice' (which can include lawyer, auditor or other professional adviser) as a new classification of personal liability in insolvency proceedings. Accomplices are persons who, wilfully or by gross negligence, cooperate with the insolvent entity in the performance of any act (and, by assumption, any omission) which the court decides has contributed to the insolvency.

Depending on the relationship with the insolvent entity, the effect of being associated, in whatever capacity, in a corporate insolvency can be threefold –

- Forfeiture of any claim against the insolvency (creditor's mass) if the claimant falls into either of the above categories.
- Liability for all or part of the corporate debts of any *de facto* or *de jure* manager or liquidator, or any person who has carried out these functions in the two years preceding the declaration of insolvency.
- Obligation to refund or return to the creditor any asset received from the insolvent entity with damages, compensation and forfeiture of any claims against the insolvency (i.e. professional fees received or accrued) of persons declared accomplices.

The worst case scenario is obviously liability for all or part of the insolvency debts, but the law only applies such liability (Section 164.1) when "there has been an element of wilfulness or gross negligence in the generation or aggravation of the insolvency situation".

The 'no hope' scenario

The "element of wilfulness or gross negligence" will be deemed to exist in an insolvency *iuris et de iure* (that is to say, *without possibility of evidence to the contrary*) when there is –

- Significant disregard of accounting obligations; evidence of double accounting or irregularities in the presentation of the financial position or assets of the insolvent.
- Filing false documents or serious inaccuracies in documents filed.
- When liquidation proceedings are commenced due



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- to failure, attributable to management, to adhere to the terms of any agreement reached with creditors.
- Disappearance of the debtor's assets causing loss to the creditors, and delaying, impeding or preventing the seizure, actual or foreseeable, of any asset.
- When within two years prior to the declaration of insolvency, assets are removed causing loss to the creditors.
- Creation of fictitious assets before the insolvency is declared.

The **'some hope'** scenario

Allowing for evidence to the contrary by way of a defence, the law will deem the element of wilfulness or gross negligence to be present whenever the insolvent entity has –

- Failed to apply for insolvency in a timely manner.
- Failed to cooperate with the Court or the AC (Receivers); failed to produce all 'necessary or appropriate' information; or failed to attend the creditors' meeting.
- Failed to timeously meet the compliance obligations with regard to approval, auditing and filing of accounts with the Register of Companies in any of the three years preceding the declaration of insolvency.

Third party liability can be enforced in two ways –

1. By way of Mareva injunctions (or cautionary measures) according to section 48.3 of the LC, applied for by the AC (Receivers) or declared at the court's discretion at any time during the insolvency procedure when –
 - The receivers' report shows the company's assets to be less than its liabilities.
 - There are 'reasonable grounds' (fumus boni iuris) that the Court's finding of insolvency will include a declaration implying liability, or 'guilt'.
2. By way of the so-called qualification piece in the insolvency procedure where a report of the AC (Receivers) supporting the declaration of liability (guilt) is an essential prerequisite.

Spanish law has now firmly established that corporate control can be deemed to extend to shareholders and "de facto" management, and that 'control' implies potential liability in the event of insolvency. While this is undoubtedly a beneficial step forward, it may prove to have been an over-correction enabling the regulations to be applied with undue harshness to otherwise *bona fide* transactions. The highest risk situation being, for a Group with a subsidiary in Spain, to be subject to a Mareva injunction 'inaudita parte'.

One positive thought, however, is that the LC may have established the basis for having clear and binding Court precedents to determine extra-corporate liability which has hitherto operated under a series of different and sometimes contradictory positive enactments.

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INTERNATIONAL ARBITRATION - The American Perspective For or Against?

As communication, in particular, speeds up the pace of all aspects of our lives, the desire to find ways to speed up resolution of corporate disputes and seek quicker, more (legal) costs-effective settlements becomes more compelling. Increased cross-border trade and investment has seen a significant preference – up to forty percent growth in caseload over recent years, according to one commentator – for election for international arbitration as opposed to reliance on dispute resolution through the courts.

From a U.S. company's perspective, international arbitration can be both advantageous and unwelcome, depending on the nature of the dispute. Although domestic arbitration is frequently seen as being simpler, faster and less expensive than traditional judicial litigation, it is not always the case with international arbitration.

U.S. companies frequently find that the cost of an international arbitration in Europe involves substantial cost. On occasions they discover that international arbitration lacks some of the familiar procedural regularities which exist in judicial and, sometimes, also in arbitration proceedings in the United States. U.S. clients are frequently surprised to discover that arbitration in some European countries have procedural rules that prevent contact with witnesses prior to arbitration or, alternatively, may not permit the principal of a party to testify.

Specific concerns that U.S. companies may have regarding international arbitration include – (1) the location of the arbitration forum; (2) the costs of the arbitration; (3) perceived bias of the arbitrators if the arbitration takes place in a foreign jurisdiction which is the home of the other party; (4) the law to be applied in the arbitration, i.e. U.S. law, foreign law, or some mix thereof; (5) the discovery and evidentiary rules that may or may not apply, for example, the right to obtain copies of the opponent's documents prior to the proceeding; for counsel to determine which questions will be asked of the opposing party; or whether counsel will be allowed to directly question witnesses; (6) whether a written opinion will be issued; (7) whether the arbitration is binding and will be subject to judicial review and/or enforcement, both in the country where the arbitration proceedings were conducted and in the United States.

Notwithstanding the pitfalls that can occur in international arbitrations, companies frequently prefer this route. First, international arbitration can be faster and less expensive than complex litigation, especially certain types of litigation in the United States. Second, international arbitrations can act independently of differing legal cultures. A panel of international arbitrators may be perceived as more neutral and fairer by parties from separate countries, than a court or arbitrator based in the country of one of the parties. Third, depending on circumstances, international arbitration can be more predictable than judicial resolution of disputes.

In this last-mentioned context the United State Supreme Court has ruled under the Federal Arbitration Act that federal courts are required, under most circumstances, to enforce mandatory arbitration provisions contained in contracts. So, as a matter

of policy many companies include mandatory arbitration provisions in their standardized form contracts.

Frequently these provisions require arbitration in locations convenient to the party using the form contract and requisitioning the use of arbitration proceedings favoured by it. There have been allegations that such mandatory arbitration provisions are used either to dissuade the filing of litigation, or to ensure more favourable rulings for the party issuing the standard form contract. While studies have indicated that this may be true in a consumer context, from a commercial perspective companies requiring such standardized contractual arbitration provisions may be reflecting a desire for uniformity of forum in the resolution of disputes.

Perhaps the most important thing to note about international arbitration is that with regard to contract negotiation it can be a method of entering a commercial relationship on a positive rather than a negative note. All well drafted contracts should contain provisions for dispute resolution, especially if the contract is between parties from different countries.

Voluntarily negotiating a contract providing for international arbitration, rather than litigation, can frequently signal to the other party that while it is prudent to recognize that disputes can arise, the parties will agree to an impartial resolution of that dispute. This is especially true for U.S. companies, since their foreign counterparts frequently are concerned about the cost of litigation in the United States.

To avoid the pitfalls that can arise from an international arbitration, contracting parties should thus draft contracts that very specifically address the issues (1) to (5) set forth above. In addition, it is increasingly common for contracts in the United States to include a provision requiring the mandatory mediation of contractual disputes prior to a dispute being referred to arbitration or judicial litigation.

There are a number of commercial mediation organizations that will provide trained mediators – at a fee – to assist the parties to reach a negotiated resolution of a commercial dispute. Time is money, and as arbitration becomes more formalized and expensive, companies are increasingly seeking recourse to the flexibility of mediation services as an alternative, or an initial first step, in resolving commercial disputes.

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Eric-Jean Thomas, President of the Euro-American Lawyers Group welcomes members and guests to the Group's 20th anniversary dinner in Paris – May 2006

INTERNATIONAL ARBITRATION Selecting the Best Venue for International Arbitration

When companies or organizations enter into a commercial relationship, the furthest thing from the parties' minds tends to be disputes. Nobody wants to think about problems at the outset of what they hope will be a mutually beneficial and profitable relationship. This tendency leads to situations where dispute resolution is often the very last item considered in contract negotiations.

Nevertheless, experienced business people know that unforeseen problems can arise even in situations where the contracting parties enter into a relationship with the best of intentions and in complete good faith. Unexpected changes in market conditions, breaches by suppliers or other third parties, and a host of other events can quickly engender disputes between formerly loyal and satisfied business partners. Where the parties are located in different countries, the stress and expense of enforcing a contract is magnified because one of the parties will have to submit to the jurisdiction of an unfamiliar and sometimes unsympathetic judicial system.

To avoid that dilemma, the parties to a contract will often agree in advance to submit their dispute to arbitration. Arbitration is a process in which each side puts its arguments, claims and counter claims to an independent and impartial arbitrator or panel of arbitrators for decision. The decision reached by the arbitrator is legally binding and enforceable. However, in comparison with litigation, arbitration has the advantage of being private, less formal and adversarial, and it can be conducted in a place that is mutually convenient to both parties.

For these reasons, international business people are increasingly choosing to include arbitration clauses in the contracts they negotiate. Indeed, a recent survey of companies conducting business abroad found that they view arbitration and other forms of alternative dispute resolution as among the top trends of the future. A study published recently by a U.S. based firm, Fulbright & Jaworski L.L.P, found the most frequently used venues for arbitration to be (in order of preference): London, New York City, and Paris, with Singapore and Geneva tied for fourth place.

While the foregoing cities are traditional international arbitration hubs, they may not be ideal in every situation. With respect to the critical matter of arbitration venue selection, rather than accept one of the major "default" cities, the parties to a contract should carefully consider the following factors before specifying the location of a potential arbitration.

- the location of the parties,
- the location of witnesses and documents,
- the location of sites or the place of materials,
- the relative costs to the parties,
- the place of performance of the contract,
- the law applicable to the contract, and
- the place of previous court actions, if any.

In sum, arbitration can significantly reduce the expense, inconvenience and disruption that attends litigation in civil court. However, much of that advantage can be lost if the parties select an inappropriate venue for the arbitration. Giving thoughtful consideration to the proper venue when drafting the arbitration clause will help insure that the parties achieve the full benefits of arbitration.

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