

New York International Chapter News

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Message from the Chair

As I write this message on my plane back to New York from our remarkable Panama Seasonal Meeting, I am struck by what an extraordinary group our Section has become over the last twenty-plus years. The quality and breadth of our programs and activities, which we sometimes take for granted, are brought home when viewed through the eyes of newcomers to our work, like many of the attendees at the Panama meeting, who repeatedly told me it was the best legal conference that they had ever attended.



Andre R. Jaglom

The success of the meeting can be attributed in large part to the contributions of our Program Co-Chairs, Alvaro Aguilar and Juan Francisco Pardini in Panama and Alyssa Grikscheit in New York. Their efforts in recruiting speakers and sponsors, identifying venues and assisting in meeting logistics were critical. Alvaro also provided an intern to coordinate with Linda Castilla and help with translation and venue communications. Perhaps most important, Alvaro's service as Program Co-Chair also resulted in his wife, Pamela Oakes, serving as a "minster without portfolio." Pam was virtually another Program Co-Chair, helping with protocol issues, serving as official photographer (photos can be viewed at <http://www.facebook.com/media/albums/?id=142136312535240>), and acting as emergency interpreter, chauffeur and gener-

Inside

A Word from the Editor3

A Tribute to Linda Castilla.....4

NYSBA International's First UNCITRAL Experience (June-July, 2011).....5

Of International Interest

Introduction: Panels Discussions at the 2011 Annual Meeting.....15

 Europe Panel—Spain15

 Europe Panel—Czech Republic.....17

 Europe Panel—Sweden.....20

 Questions for the Americas Panel—Argentina22

 Introductions to the CISG for the Practitioners.....25

Legal and Investment Updates

 Corporate Governance in Ecuador28

 Issues That U.S. Corporate Counsel Should Consider When Doing Business in Guatemala31

 Is This the Right Time to Sell? Legal Issues and Considerations Regarding the Upcoming Privatizations in Portugal.....36

 Private Limited Liability Company in Italy.....38

Insurance Arbitration in France and Belgium: Bitter Rivals or Simple Differences?42

Use "Adequate Protection," Avoid I(legally)T(ransmitting)D(ata)44

New European Union Directive Calls for Greater Transparency on the Internet48

Public Company Takeovers in the U.K.—Recent Amendments to the Takeover Code.....49

The Introduction of Punitive Damages in French Law: One Step Forward, Two Steps Back.....52

Reduction of Corruption in the European Union: Czech Republic Perspective.....56

Spotlight on Aruba's Thriving Aircraft Financing Industry.....58

Chapter News

 Straddling the Gateway between South and Central America61

 Join Us for the European Regional Meeting in the Beautiful City of Prague.....61

 An Annual Update from the Brazil Chapter.....62



Is This the Right Time to Sell? Legal Issues and Considerations Regarding the Upcoming Privatizations in Portugal

I. Introduction

In the context of the global economic crisis, and due to the accumulation of public debt by Portugal and the bailout negotiated with the IMF, the European Central Bank and the European Commission, Portugal is now required to adopt significant austerity measures in order to alleviate its public finance problems. Several drastic economic, tax, and policy measures are being implemented, one of them being the privatization of multiple State-Owned Companies (SOEs) by 2013.

The purpose of this article is to provide an analysis of the legal issues related to the privatizations to be undertaken in Portugal in the near future, as well as to explore other relevant considerations related to this hot topic. This article will cover: (i) the privatization plan for Portugal; (ii) the novelties of the newly amended Privatization Law; (iii) the legal issues related to the considered privatizations; and (iv) provide insight into the recent intention to suspend shareholder vote caps.

II. Portugal's Privatization plan

In order to stabilize European economies, the European Commission's Eurogroup and ECOFIN Ministers have declared that financial aid would be provided to Portugal, subject to a strict austerity plan, negotiated by the Portuguese authorities, the European Commission, the European Central Bank and the International Monetary Fund. The austerity measures to be adopted by Portugal as a condition for obtaining the financial aid are contained in the Troika Memorandum of Understanding¹ and its first update,² and cover the issue of privatizations. Indeed, the MoU describes two privatization waves, the first to be concluded before the end of 2011 and the second to take place during 2012-2013, resulting in the privatization of close to 20 companies, and estimated proceeds of about € 5 billion. The MoU provides that State participation in EDP—the Portuguese electricity company, REN—the Portuguese gas and electricity Network Company and GALP is to be divested in 2011. In addition, should market conditions permit, state participation in TAP—the Portuguese airline company—market is to be divested conditions permitting. The second wave

will concern Águas de Portugal—the water management company, RTP—the media network company, ANA—the Portuguese company for the development and management of airports, the freight branch of CP—the railroad transportation company, Correios de Portugal—the public postal company, and Caixa Seguros—the insurance branch of CGD Bank, to mention some of the most significant.

III. Novelties of the Newly Amended Privatization Law

On September 13th, the Portuguese Parliament adopted Law 50/2011, an amendment to the Portuguese Privatization Law, in preparation for the numerous privatizations that will take place. Certain points are worth noting regarding the new wording of this law, as they touch on some fundamental elements of the privatization process in general.

The first element, reworded in the update of the law, is found in article 6. Public companies to be privatized, which are not already in the form of a Limited Company,³ are to be transformed into such a type of company by way of Decree-Law. Such a corporate transformation is necessary to facilitate the sale of shares and for a public offering procedure.

Secondly, the amendment to the Law also modifies the wording pertaining to the method of privatization. Indeed, article 6 now states that the privatizations shall be carried out, as a rule and preferably, through a public tender or public offering process, in accordance with the Portuguese Securities Code. This does not exclude that the State can also opt for a trade sale or a limited public tender by pre-qualification if a national interest, a sector strategy, or the economic and financial state of the company should require it. Should the State opt for a public tender or a trade sale, it will be the competence of the Cabinet of Ministers to select the candidates, as well as to define the specific terms of the share acquisition. In both of the above cases, it is most probable that the Government of Portugal will consider each operation on a case-by-case basis. This flexibility will allow the Government to adapt the privatization procedure to the market

offer and the players at stake in the respective sectors of activity.

The final point amended by Law 50/2011 is the definition of the competence and function of the Privatization Commission. Indeed, the new wording of the law provides that such a commission will be created for the sole purpose of each privatization procedure, and would terminate upon the conclusion of the operation. The role of the Commission is to provide technical support to the process, and to ensure the full observance of the principles of transparency, rigor, impartiality and the defence of public interest. The commissions would, independently from the privatization mechanism selected for each operation, carry out the following:

- a) Assess strict observance of the statutory rules and principles, as well as of the rigorous transparency in each process;
- b) Draft legal opinions and reports that the Government deems necessary on matters related to the process;
- c) Verify compliance with the restrictions and rules established in relation to voting rights and the acquisition of a limited percentage of participation;
- d) Evaluate and submit to the competent entities or bodies any claims they are presented with; and
- e) Draft a final report regarding its activity.

Each member of the Privatization Commission will be nominated by implementing order of the Prime-Minister, upon proposal by the Finance Minister, and a summary of their curriculum will be published in the Official Gazette. Moreover, they are held to the strictest duty of confidentiality, impartiality and will not be authorized to acquire any shares of the company their Privatization Commission is assigned to.

IV. Legal Issues Related to the Portuguese Privatizations

Several key issues must be identified when considering the privatizations. The first is predicting the Government of Portugal's decision concerning the sale mechanism of its participation in the State-Owned Companies. Here, the Government of Portugal will have to choose between a trade sale (through a public tender or a limited tender) or a flotation, as per the methods identified in the Privatization Law. Thus, other uncommon mechanisms such as auctions, voucher sales, or management buyouts seem legally excluded from consideration. Other issues could include how to carry out the pre-sale valuation, and finally, how the bid-criteria will be defined.

A. The Implications of Opting for a Trade Sale

The Government of Portugal may choose to sell its participation through the means of a trade sale, mean-

ing that the buyers will be clearly identified and in direct negotiation with the Government in order to set the terms and conditions of the sale. Such a mechanism can be carried out in the form of a public tender, for which an invitation to tender is made public and any investor can present his or her bid, or through a limited public tender with pre-qualification, hence guaranteeing that potential bidders are selected individually by the Government of Portugal.

This mechanism can usually be completed more quickly than a public offering, and is particularly relevant if Portugal wishes to bring in a strategic investor, usually specialized in the sector of activity of the privatized company, to further a predefined or jointly defined future policy in that sector. For example, it would be plausible to imagine that an investor with significant experience in energy distribution and management be selected as an acquirer of a share in REN—the Portuguese gas and electricity Network Company—through a trade sale, under the negotiated conditions that certain specific investments be made for an innovative energy policy. An issue to point out in the case of a trade sale is the valuation of the shares, which will be discussed below.

B. The Implications of Opting for a Flotation

The Portuguese Government may also choose to carry out the sale of its participation in State-Owned Companies through a flotation, or public offering on the national or international stock markets. Such a sale mechanism is not new to Portugal, as EDP and REN, two of the major State-Owned energy Companies in Portugal, have already been the object of one or more public offerings after their nationalization in 1974. As a modern and well-established market economy, such a mechanism would definitely be a viable option for Portugal. Moreover, despite the fact that public offerings tend to be more costly, complicated, technical, and riskier than trade sales, the flotation on a stock market of the shares to be sold can sometimes provide greater returns, depending on the conditions of the stock market conditions.

As mentioned above, the sale of publicly held shares must comply with the Portuguese Securities Code, which leads to the issue of company structure and management prior to the offering. It will indeed be necessary, prior to the flotation date, to ensure that the corporate and management structure are not only aligned with this code but also with current European Regulations concerning securities trading.

The ultimate goal of the State of Portugal is to perceive as high a return as possible during these privatization operations, hence it is likely that Portugal will adopt a combination of the above described mechanisms in order to increase the price of the sale. One such strategy to adopt would be to have trade sales and public offerings simultaneously in order to create greater competition among the buyer groups, which may be individuals, insti-

tutions or national and foreign investors, thus increasing the odds of a higher share price. Also, the Portuguese Government may decide to carry out multiple waves of public offerings, divesting its ownership progressively while hoping that share price will increase with each wave.

No one can yet be certain what sale mechanisms and strategies the Government of Portugal will adopt. However, it would not be surprising for the privatizations to be carried out through the use of both mechanisms, thus permitting a concomitant control as to who some of the acquirers would be, how the risk associated with the sale would be controlled, and how the State could perceive the maximum possible return from the sale.

C. Pre-Sale Valuation

One of the other key issues of the privatizations in Portugal is the valuation of the shares to be sold before they are actually put up for sale. This valuation must be carried out by independent financial analysts to assess the market value of the shares so that the Portuguese Government can adequately evaluate any offers and bids it receives from interested buyers. Also, the valuation will be a key piece of information for it to set a floor price for the shares in the case of a public offering. As the companies to be privatized are likely to maintain their activity, the “ongoing concern” valuation method seems a probable method to be used, which is not uncommon for privatizations.

D. Defining the Bid Criteria

In the case of trade sales, through public tenders or limited public tenders by pre-qualification, the definition of the bid criteria will be a significant issue. As certain sectors of activity in which the companies that are to be privatized operate, there may well be a national strategic interest at stake, such as in the areas of transportation, energy or postal services for example. Therefore, the Government of Portugal and its financial advisors will have to define the bid criteria in such a way as to secure national interests without keeping a share participation

in the company. This can be achieved mainly through engagements from the bidders regarding these interests in response to the criteria set by the State.

V. The End of Shareholder Vote Caps in Takeovers

Various companies in Portugal that are to be privatized, including EDP—the Portuguese electricity company—have rules which allow them to limit voting rights of shareholders regardless of how much capital they own. Indeed, some of these companies have ceilings set between 5 and 20 percent of voting rights for each shareholder, thus limiting their power within the company. With these existing limits and the risk that they fragment voting on acquisition bids at general meetings, the privatization process by way of public offering could be hindered. On August 17, 2011, the Portuguese Securities Authority (CMVM) announced its intention to suspend the shareholder vote cap in the context of acquisitions. The voting right cap would therefore be suspended during the acquisition process and thus boost the interest of foreign entities to invest in Portuguese listed companies.

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Endnotes

1. Memorandum of Understanding on Specific Economic Policy Conditionality of May 3rd 2011 entered into between the State of Portugal and Troika (European Commission, European Central Bank and International Monetary Fund).
2. Memorandum of Understanding on Specific Economic Policy Conditionality—First Update, of September 1st 2011 entered into between the State of Portugal and Troika (European Commission, European Central Bank and International Monetary Fund).
3. The corporate structure to be adopted by the public companies is that of a “Sociedade Anónima,” a type of Limited Company.

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