Region Focus: Spain & Portugal

Rivals in crisis

As the weight of insolvency becomes unbearable, the courts in Spain and Portugal are experiencing a crisis within a crisis. Their responses show the old imperial rivals share plenty of common ground – and not just physically. *Ben Lewis* reports from Madrid and Lisbon.

Iberia. It's not a word to be uttered lightly. Even after 350 years, the spectre of the "captivity" – a sixty-year period of Spanish rule – still lingers over Portugal.

As recently as the First World War, the fear of reintegration was a central part of Portuguese politics and culture.

This threat is gone for now at least, but the rivalry between Spain and Portugal is undiminished. The two countries have bitterly competed over the centuries to assert their dominance, each amassing a sprawling empire.

Nowadays the empire-building is economic: both countries have fiercely independent business communities with legal markets to match.

Nevertheless, through a cautious series of associations, mergers and new offices, the Spanish law firms have crept west.

The integration of Spain's Cuatrecasas with Portugal's Gonçalves Pereira Castelo Branco is a case in point. Tabled in 1996, the merger was signed four years later and became reality in 2003. Last year the two firms finally came to share a name, Cuatrecasas Gonçalves Pereira.

This February, Uría Menéndez consolidated its presence in Lisbon by merging with Proença de Carvalho, a prestigious Portuguese firm – a dramatic vote of local confidence after last year's loss of office head Francisco Sá Carneiro.

Garrigues and Gómez-Acebo & Pombo are thriving in Portugal too. All of them are determined to transform into that most elusive thing: the Iberian law firm.

For those without such ambitions, of course, this is nonsense. How can you have an Iberian law firm, they ask, when the countries in question are so defiantly separate?

It is true that Spain and Portugal have very different legal systems, not to mention culture, language and politics.

But even the most established lawyers admit that the global age has brought with it some blurring of the borders. After all, the divisions mean little to foreign clients, as long as they don't obstruct good business, and this is having a local effect.

"What I see in the future is the integration of the two economies. Not the integration of the two jurisdictions, but the integration of the economies is a given," says António Pinto Leite of Morais Leitão Galvão Teles Soares da Silva & Associados.

The extent of this integration – and how it affects law firms – will become evident over time. As it does, the two legal communities must grapple with a common crisis: a rising tide of insolvency, which threatens to engulf their courts.

How each country is meeting this challenge is a window into their fundamental similarities – and differences.

Spain

Spanish lawyers will tell you their courts are *colapsados*. That is not to say they have collapsed – the word roughly translates as "congested" – but the reality isn't far off.

In a typical year around 1,000 Spanish companies declare themselves bankrupt. But in 2008 something snapped.

"I remember the month of August 2008," says Vicente Sierra of Freshfields Bruckhaus Deringer.

"In places like Barcelona everyone was planning their insolvencies. In the first days of September everyone was queuing outside the filing office to ask for suspension of payments."

Last year the number of insolvency declarations soared to nearly 6,000, and this year has so far been similar. The nature of the insolvent companies is also changing, as the fallout spreads away from property, the once-rigid backbone of Spain's economy.

"Last year was the real-estate sector," says Juan Ignacio Fernández, a partner at CMS Albiñana & Suárez de Lezo. "This year there are other sectors that have increased in insolvencies, such as the automotive sector and retail."

As a result the courts are creaking under the pressure.

It's not a problem of quality. As David Arias of Pérez-Llorca says: "Although the Spanish courts aren't bad, they are terribly, terribly slow."

But according to some, the inefficiency undermines the quality of the judgments. Sierra is among them.

"This produces delays and prevents defendants from having their case properly explored, and prevents judges from properly considering the merits of the case," he says.

For him, the creation of specialised commercial courts (*juzgados de lo mercantil*) in 2004 has failed to alleviate the glut of cases in the country's court system.

"It's a patchwork," he says. "It's trying to have a quick and fast solution for a very big problem."

Other reform efforts have included an update to Spain's Insolvency Act. The legislation, in effect since 2003 and further amended last year, is quite progressive.

Its most distinguishing feature is that it combines the previously separate procedures for suspension of payments (*suspensión de pagos*) and insolvency (*quiebra*) into a single process (*concurso*).

Nevertheless there is still ample room for improvement.

Luis Divar of Diaz-Bastien & Truan identifies three problem areas the Law has failed to properly address in commercial insolvency:

- high costs arising from receiver and lawyer fees;
- slowness (due to the volume of cases, as well as delaying tactics); and
- logical inconsistencies (in particular the lack of incentive for a creditor to reach an agreement where the insolvent company has more assets than liabilities, but lacks liquidity).

Divar hopes a further round of reforms, under discussion and due early next year, will take these issues into account.

Sierra's partner at Freshfields Bruckhaus Deringer, Rafael Murillo, has further advice for the committee.

"Try to reinforce the number of judges and amend the law in a way that really makes an impact on the way these cases are handled," says Murillo.

He would like to see more innovations of the types regularly used in Anglo-Saxon countries, such as the introduction of schemes of arrangement, under which a majority agreement among creditors can force the hand of lesser stakeholders and thus limit the squabbling over assets.

"We have to bring in solutions that are totally away from the systems and traditions that have existed in Spain previously," he adds.

Spanish lawyers can't seem to agree what's going to happen next.

"Insolvency filings have peaked," predicts Daniel Jiménez. "I don't think we're going to see increases of 300% to 400%. I think it's going to be steady.

Divar has a far less optimistic outlook. Insolvencies will continue to rise,

"We have to bring in solutions that are totally away from the systems and traditions that have existed in Spain previously"

Rafael Murillo

he believes: there is more drama to come out of the collapse of property giant Martinsa-Fadesa, Spain's largest-ever corporate default.

Now that the ratings company Fitch has stripped Spain of its AAA credit rating, further turbulence is assured.

More than ever, the country's courts need a saviour.

Great expectations

There is a hint of evangelism in the way the Spanish talk about arbitration. Bring up the subject and you'll hear hope and excitement that hasn't been heard in common-law countries for decades.

The Arbitration Act of 2003 was a long-overdue update of legislation dating back to 1988. The Law reinvigorated a practice that was in danger of going stale.

"Thirty years ago our Supreme Court didn't apply the New York Convention," says Juan Viaño of Gómez-Acebo & Pombo.

"I can't remember having spent any time in arbitration 20 years ago. Ten years ago, when I joined this firm, we had an eye on arbitration but it wasn't an important part of dispute resolution.

"Today I work significantly more in arbitration than in litigation. This tendency increases every month and every year. Now the question is: where are we going to be in another 10 years?"

One hint of things to come lies overseas. Every major Spanish law firm is heavily targeting Latin American business, and a part of this drive is offering a viable Spanish-speaking arbitration seat in Madrid.

At least one recent arbitration in Madrid involved no Spanish parties at all.

One experience recounted by David Arias of Pérez-Llorca reflects a growing recognition of Spanish arbitration overseas: "Last year I was in Miami attending an ICC Congress. At a mostly Spanish-speaking conference I met Julian Lew QC, who doesn't speak Spanish.

"I asked him: 'What are you doing here?' He replied: 'You know, international arbitration now speaks Spanish. Here is where a lot of the interesting cases are taking place.'"

Nevertheless, arbitration's popularity at home is mainly restricted to blue-chip businesses with complex commercial disputes. Domestic parties remain wary.

Even some of the blue-chips are still unconvinced. "We have a client – one of Spain's 35 biggest companies," says Daniel Jiménez of Ashurst. "They said: 'We are sceptical of arbitration and we don't include arbitration clauses in our contracts.'"

> "If a client loses a lawsuit, the reading is: 'very bad judge'. If a client loses an arbitration, the reading is: 'something very strong has happened'"
> Juan Viaño, Gómez-Acebo & Pombo

One of the main reasons for the scepticism is concern about the independence of practitioners. Whereas judges are seen by Spanish clients as separate from the business community, arbitrators frequently mingle with businesspeople. This is hard to stomach for those who are unused to it.

"If a client loses a lawsuit, the reading is: 'very bad judge'," says Viaño. "If a client loses an arbitration, the reading isn't 'what a bad arbitral tribunal'. It's: 'something very strong has happened'."

Since arbitrators have a vested interest in being independent, the challenge is addressing perceptions.

"It is not only that they are impartial but that they are seen as impartial," says Miguel Virgós, a partner at Uría Menéndez.

In his view the route to success is not promoting arbitration as cheaper or faster, but emphasising the fact that since arbitrators are closer to the business community they are better placed to judge a dispute – particularly as parties are able to select them.

"Judges tend to apply the law, while arbitrators tend to apply the contract," says Virgós. "If the contract is complex, in the face of difficulty a judge will tend to go to see what the codes say, whereas an arbitrator will try to see what answers are in the contract. So in a way arbitration gives you more control over your transaction."

The mission of convincing their countrymen of arbitration's merits falls to the Club Español del Arbitraje. The club was formed in 2005 as a vehicle for Spain's dispute resolution lawyers to establish best practice, lobby the country's government, and promote

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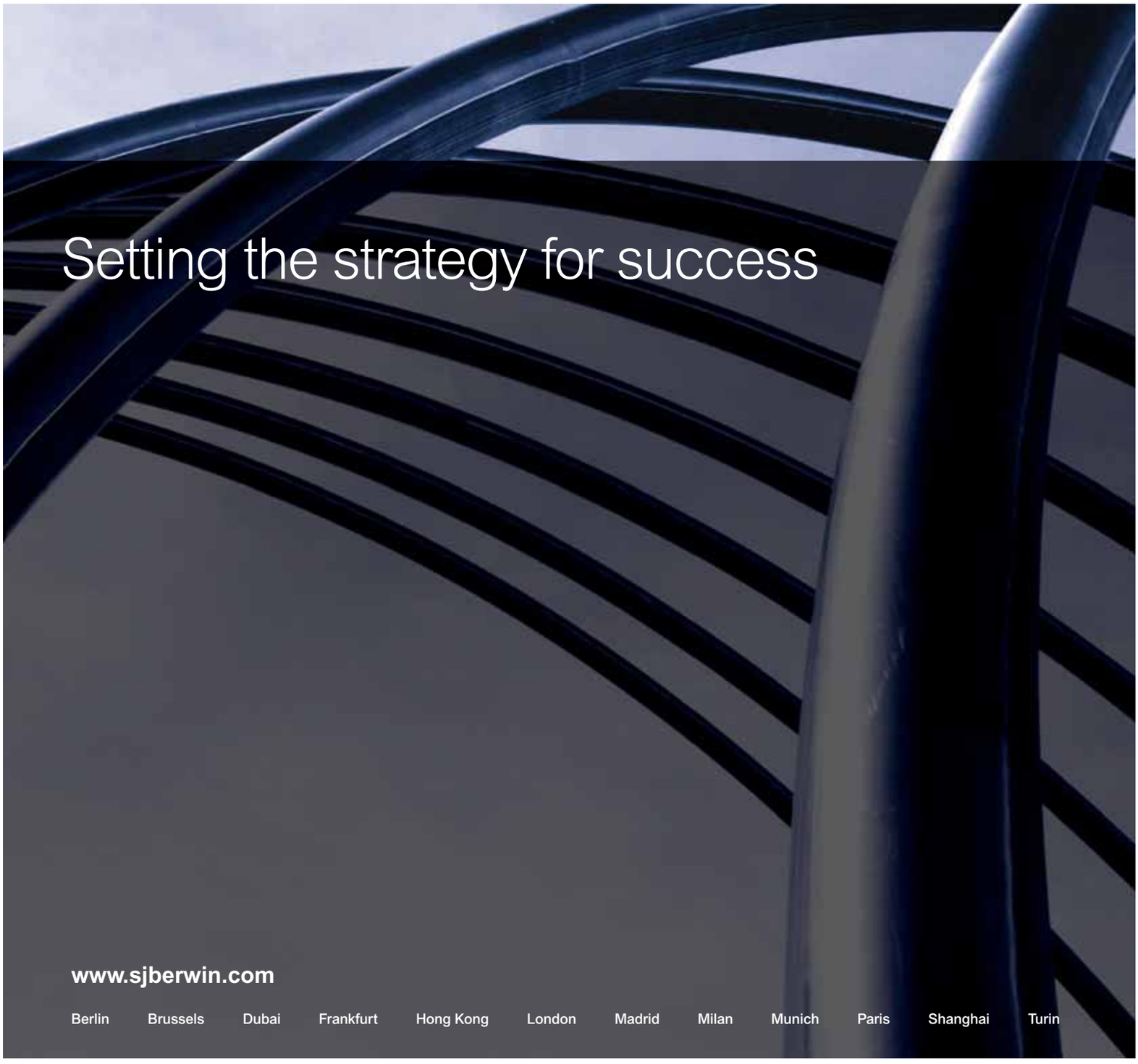

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Alvaro Mendiola

"We can't just take the benefits of our home jurisdiction when we want to be a global player" Alvaro Mendiola, Cuatrecasas Gonçalves Pereira

arbitration among the Spanish business community.

The charm offensive appears to be bearing fruit. "I'm beginning to see that smaller companies and businesses are willing to agree to arbitration clauses," says Carlos de los Santos of Garrigues.

"Those arbitration clauses are usually attributed to institutions, particularly the Corte de Arbitraje de Madrid, which I think is doing a very good job. At least they're beginning to look at the possibility of including an arbitration clause."

Virgós is even more optimistic. In his view economic recovery should act as a catalyst for arbitration's development in Spain, perhaps eventually putting it on a par with the UK.

And herein lies an opportunity. The scourge of UK and US arbitration is the excessive discovery requirements. But in Spain, discovery is very limited – it can't be used as a fishing expedition.

A Latinised version of arbitration, lighter on discovery and expense, could become Spain's trump card.

For Arias, the ideal situation is a compromise between common-law and civil-law values. "*In medio stat virtus*: virtue lies in the centre," he says.

But how do you achieve an effective judgment in an intricate dispute without extensive discovery? "It's a vicious circle," says Arias. "But in the end, the core of the dispute can be summarised with reference to the original agreement and to the contemporary records. Anyhow, it is a fact that civil-law systems have successfully dealt with complex cases for decades without any need for extensive discovery.

"As clients increasingly demand flat rather than hourly fees, arbitration will naturally become lighter because lawyers have less interest in prolonging a dispute," he adds.

Other lawyers seem to welcome the prospect of wider discovery.

"The real issue in discovery is the obligation you have in the US to show every single thing in the courts in the presence of the other party, which we don't have here. It's a real substantive change in mentality," says Álvaro Mendiola, a partner at Cuatrecasas Gonçalves Pereira.

But he adds: "I wouldn't oppose having it. I think the discovery system is a very good one. It encourages parties to come to an agreement."

Mendiola recognises full discovery would be unwelcome among Spanish parties, perhaps even more than punitive damages. The answer? Get with the times.

"We can't just take the benefits of our home jurisdiction when we want to be a global player," he says.

Gómez-Acebo & Pombo's Francisco Peña also sees heavier discovery as an evolutionary step for Spanish arbitration.

"We welcome any modification of the law," he says. "It's an aspiration."

Mediation: a cultural unknown

Mediation is another aspiration that could clear up the courts even more effectively, but lies maddeningly out of grasp. The problem is that it isn't a very Spanish thing to do.

"It's not embedded in our way of thinking," says Carlos de los Santos of Garrigues. "When you have a client that doesn't like you to say 'good morning' to the other party's counsel, how can you mediate?"

The consensus among Spanish lawyers is that Latin clients feel once a third party has been brought into a dispute then the time for conciliation is over. Nothing short of a binding judgment will do.

There are also problems in legal culture. "Trying to persuade less sophisticated litigators to use what is essentially the most sophisticated form of dispute resolution is very difficult," says De los Santos.

In part, scepticism about mediation comes from prior experience. For many years Spanish court procedure has used a similar process: the *acto de conciliación*.

At a case's first hearing, the judge asks the parties if there is any chance

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Garrigues

of reaching an agreement before the proceedings begin. To which the answer is invariably: no.

This mechanism has had a spectacular lack of success – most lawyers view it as little more than a formality, or a delaying tactic at best. "No-one takes it seriously," says Sierra.

Nevertheless in 2008 the European Commission published a Directive requiring member states to put in place a framework for mediation.

The government dutifully responded with a draft Law to implement the directive: the Civil and Commercial Mediation Bill.

But the country's lawmakers also did something quite unexpected. Instead of adopting an international standard, as they had done so successfully with the Uncitral Model Law, they opted to start from scratch.

Thus the Spanish version of mediation will be compulsory and massively bureaucratised. If the Bill is passed in its current form (as seems likely), mediators will be required to register with the justice ministry, and must take out professional insurance policies.

There will be no right to waive agreements, which will have an enforceable status akin to *res judicata*. "There's nothing else like this in the world," says David Arias.

In general, lawyers praise the confidentiality provisions. But everything else seems to miss the point of mediation, which is by nature an organic, informal process.

So why reinvent the wheel if mediation is so alien to the Latin mentality? Some blame political arrogance. Among them is Jose Antonio Caínzos of Clifford Chance. "The ministry of justice and the government are always saying justice in Spain is slow. For politicians – especially with relation to elections – it's very attractive to say to voters: 'I am changing justice to make it quicker.'"

But if that is the government's motive, it could backfire, says Caínzos. Mediation may alleviate pressure on the courts by removing the need to hear disputes under €6,000 – but the resulting improvement in access to justice could limit the effect as more disputes arise.

There even seems to be an air of enigma about precisely who is responsible for the notorious Bill. Many Spanish lawyers are annoyed that they were not consulted.

"My personal thought," says Juan Ignacio Fernández of CMS Albiñana & Suárez de Lezo, "is that it is being done by people who haven't ever been to court."

But the Bill does have a small core of supporters in the Spanish legal market. Daniel Jiménez of Ashurst says the Bill's critics must accept that mediation is a fledgling practice in Spain. Only once a culture is in place can it start to improve, he argues.

"In my opinion since mediation is unknown in Spain there is very little to criticise. You can't just impose mediation: you have to take things step by step," he says.

"Cases below €6,000 are not going to be the ones that drive forward mediation in Spain. There is a huge ignorance in Spain of what mediation is and the Law helps to explain what mediation is.

"For Jiménez, the Bill's critics may have another agenda: "I understand that some arbitrators can be worried about mediation because they can lose work."

Whatever their motivations, the message from Spain's arbitration lawyers is clear: if the government wishes to regulate mediation it should not interfere with the runaway success of Spanish arbitration.

Arias believes the Bill will be passed unchanged into law – and ignored. "I

will be happy," he says, "if at least it doesn't interfere with arbitration."

Portugal

It's Saturday afternoon. Down a side-street on the fringes of Lisbon's trendy Bairro Alto, scores of middle-class Portuguese are taking shelter in one of the city's coffee shops.

There's something quintessentially Portuguese about the scene. And it's not the egg custard pastries.

The room is littered with gadgets: Apple laptops, BlackBerries, Bluetooth headsets and other hi-tech gizmos punctuate the view. It's a stark contrast with the ancient cobbled streets outside.

Technology is central to the country's mission to disprove its sunny, laid-back Mediterranean stereotype. And one of the most fervent fronts is the legal sector.

Unlike in Spain, where the experience of technology differ wildly (one lawyer describes local attitudes as being "at the end of the nineteenth century"), the Portuguese legal market is unanimous in praising the uptake of digita methods.

The jewel in the crown is Citius, a case management system run by the government.

Lawyers and their clients log in each morning and check if any documents have been served by the court, without the need for paper or cross-country travel.

Everything is encrypted, and the Portuguese Bar association regulates access. It is possible to liaise with the courts almost exclusively online in the run-up to litigation. Judges can even rule via Citius.

Practitioners are delighted. "There are some critics that say this is just a façade that the government is making. But as lawyers this has been a great help," says João Maria Pimentel of Uría Menéndez.

He adds: "Normal mail is disappearing. Nowadays we receive it all by email – paper is disappearing from our desks. Not only are the lawyers using the internet but also the judges and bailiffs."

Portugal's digital revolution is also finding a foothold in the law firms' own systems. One firm has taken this further than any other.

Abreu Advogados has a separate division which only practises mass debt recovery. The service depends on volume, so efficient, modern technology is essential for it to be profitable.

Although the service pre-dates Citius, the system's introduction has been a massive boost, says the partner in charge of the project, Natália Garcia Alves. Clients are able to follow the progress of every case, even down to tracking the relevant phone calls made by Abreu's lawyers.

"It is great because we can know what is going on at any time," she says. "Before Citius even existed we already did this kind of practice but we had to go to courts with documents."

Rescue and restructure

If only this celebration of efficiency extended to court procedure. Like its easterly neighbour, Portugal suffers from a cripplingly slow judicial system, particularly when it comes to liquidating a company, which can take up to four years.

Some respite came in the form of a new Insolvency Law in 2004. The legislation consolidated the processes of restructuring and insolvency, and gave rise to new opportunities to effect a corporate rescue, even during the liquidation process.

Meanwhile the company enjoys court protection similar to that of Chapter 11 proceedings in the US.

But it wasn't until 2006 that any change was seen in practice. "Now there is clearly a different movement," says Nuno Líbano Monteiro of PLMJ. "The banks are clearly interested in rescuing the company."

And what a difference it makes.

"The probable speed of the insolvency process has a lot to do with the ability of the courts to deliver," says Frederico Gonçalves Pereira of Vieira de Almeida.

"When there's a will to restructure – when there's an attractive project – the courts are not a problem. The problems come with the liquidation of the company.

"The legislative change of 2004 is clearly helpful because it gives the creditors the opportunity to intervene more. My experience is that this intervention by the creditors has been more effective in the past two-and-a-half

years because the importance of the credit is a lot bigger and with higher credit we have the will to find a recovery solution."

This epiphany has come at the right time. Stricken by losses totalling €700 million, Banco Português de Negócios (BPN) collapsed in late 2008, swiftly followed by accusations of fraud.

The government had little choice but to bail out the bank, but the real damage was collateral: a host of companies connected with BPN, most of them in real estate, now face the threat of insolvency.

"It was like a house of cards," recalls Líbano Monteiro.

Small industrial producers of textiles, cork and sunflower seeds are also under pressure.

Many will be saved; some will not.

Attempts to save the Portuguese arm of German shoemaker Rohde went awry as creditors lost faith in the company's management, which was hugely dependent on the company's German parent.

Where recovery fails, companies drop into the tortuous process of insolvency.

António Pinto Leite of Morais Leitão Galvão Teles Soares da Silva & Associados, is succinct: "In Portugal it's difficult for a company to die."

As the firm's managing partner he believes the issue is entirely down to poor management – of personnel, of cases and of bureaucracy.

"When you have a high pressure of bureaucratic issues, those are the issues that you have to deal with first in the morning, because if you wait two days or three days they become huge issues," he says.

In Pinto Leite's view the courts have much to learn from law firms. (After all, he says, "we were all colleagues back in university".)

The best judges should focus on the complex cases; those with management skills should manage; and the rest should concentrate on clearing the litigation backlog, hearing cases on which they are actually suited to rule.

Suspicious minds

If arbitration is characterised by evangelism in Spain, in Portugal it is stuck in a crisis of faith.

Despite having legislation in place since 1986, providing for ad hoc arbitration, companies remain unconvinced about the merits of the process. Manuel Cavaleiro Brandão of PLMJ says the lack of belief is particularly pronounced among smaller companies.

"They like to see things in court," he says. "It's a kind of private vice of many of our clients!"

Addressing suspicion about arbitration is difficult, particularly as the Portuguese Arbitration Association lacks the impact of its Spanish equivalent (which launched a Portuguese chapter in 2006).

Cavaleiro Brandão blames a lack of international networking by the associ-

ation. And on the domestic front, the government has offered little support.

Says Cavaleiro Brandão: "In the past, the government was accepting arbitration but not pushing it. We are now promoting arbitration, but I must admit in not as strong and systematic a way as the Spanish are doing it. We are trying to do it but much more from the universities and law firms, not the government."

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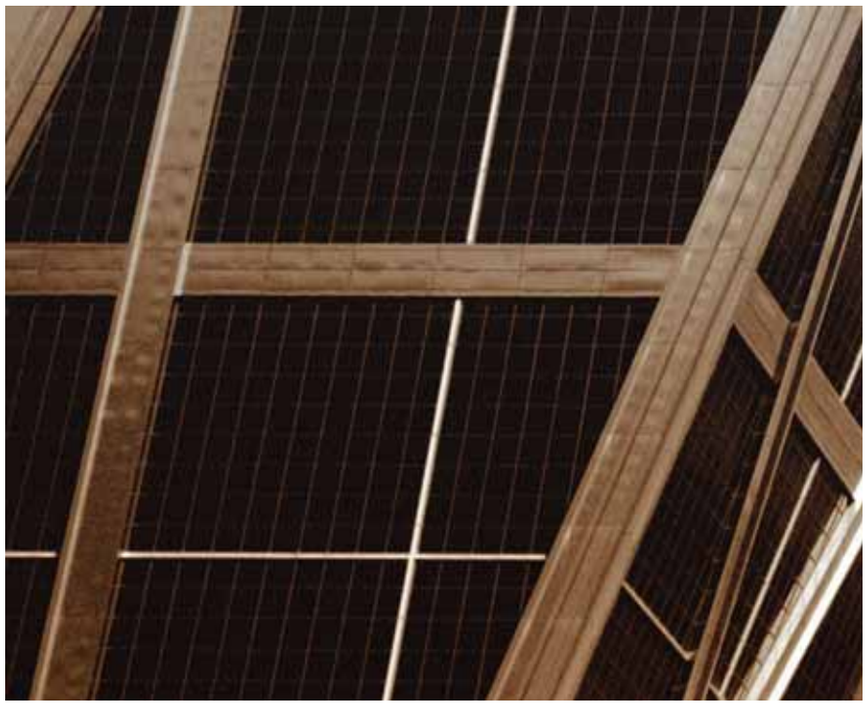

Things are at last starting to move, however. The government has passed legislation that allows the country's labour ministry to impose compulsory arbitration in some cases.

Recognising its potential to alleviate the courts, the government is also incentivising the transfer of pending litigation into arbitration.

Meanwhile the Portuguese Arbitration Association is weighing in with a proposal for a legislative update which would allow for interim measures and other provisions aimed at making arbitral awards more robust.

As for the caseload, much of the development has been hidden from public view - internal shareholder disputes going to arbitration, for example – but there is movement.

Other areas of ADR are decidedly stationary, however.

"It is easy to talk about mediation, because there isn't much to talk about," says Cavaleiro Brandão.

"Companies and their managers really aren't used to it and it's hard to sell it."

Given the relatively rapid adoption of arbitration and legal technology, the emergence of Portuguese mediation may only be a matter of time.

"I think it will happen. Even arbitration wasn't regarded as a first option in this kind of dispute and now it is becoming more and more [prevalent]," Cavaleiro Brandão says.

"You have to pass on the message. What's important to the market agent is to have a fast and safe way to resolve issues. This is clearly the way to do it."

Change is abroad

As the neighbours inch towards a sort of integration, the real challenge may have less to do with what happens within the peninsula than what happens beyond it. Every leading firm in Spain and Portugal has one eye overseas.

For dispute resolution lawyers this means selling their arbitration expertise abroad, a tricky feat considering some parties at home are yet to be convinced.

But as we have learned from the days of empire, the Iberian ambition is quixotic by nature.

Latin America is an obvious destination: the hispanophone countries for the Spanish, Brazil for the Portuguese. Arbitrators like José María Alonso of Garrigues and Jesús Rémon of Cuatrecasas are among the region's most active disputes lawyers.

It doesn't stop there. Offices in London, New York and Brussels are de rigueur for large Spanish firms. Some have offices in Beijing, Shanghai, Warsaw or Bucharest.

Diaz-Bastien & Truan has the unusual goal of winning over India. It may seem a strange decision for a firm in a civil-law country with no obvious cultural ties, but the demand for Iberian expertise in real estate and green energy is strong.

For the Portuguese firms, meanwhile, there is a litter of ex-colonies brimming with opportunity: Angola, Mozambique, Cape Verde and Macau.

Some day soon the tide of insolvency will subside, the collapsing courts will find their feet again, and Iberian arbitration will come of age.

When that happens, we may again glimpse the rival empires of old. CDR