CUATRECASAS, GONÇALVES PEREIRA

NEWSLETTER | CORPORATE LAW

CORPORATE LAW NEWSLETTER I May, 2015

CORPORATE LAW NEWSLETTER

I THE PROHIBITION OF FINANCIAL ASSISTANCE FOR ACQUISITION OF OWN SHARES

i) The legal principle of prohibition of financial assistance

Article 322 of the Commercial Companies Code (CCC), into its Paragraph 1, states that "*a* (public limited liability) *company may not grant loans or in any way provide funds or furnish collateral for a third party to subscribe for or in any other way acquire shares representing its capital*".

This article thus establishes in Portuguese law the prohibition of financial assistance, aimed essentially at preventing the public limited liability company itself, whose shares are acquired, from supporting or guaranteeing their acquisition cost.

The prohibition of financial assistance in Portuguese law is the result of the transposition into national law of Article 23 of the Second Directive or Capital Directive[1].

Study of the principle underlying the prohibition of financial assistance in effect in Portuguese law has given rise to numerous disputes between Portuguese writers, with various reasons being identified to justify this prohibition, namely:

- reinforcement of the legal regime for treasury shares and protection of corporate assets, particularly protection of the principle of intangibility of the share capital;

- protection of the corporate structure, in order to prevent the company, using its own assets, from internally conditioning its organisational structure;

- equal treatment of shareholders, avoiding weakening the economic and political rights of shareholders that do not benefit from financial assistance.

Nevertheless, the prohibition of financial assistance is not absolute, and paragraph 2 of the article in question states that it does not apply "*to transactions concluded by banks and other financial institutions in the normal course of business, nor to transactions effected with a view to the acquisition of shares by or for the company's employees or the employees of an associate company*". However, "*these transactions may not have the effect of reducing the company's net assets lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes*".

In turn, Article 322.3 CCC prescribes the invalidity of all contracts and unilateral acts of the assisting company that are in breach of paragraph 1 and last part of paragraph 2 of that

[1] Directive 77/91/EEC, published in OJ L 026, on 30.01.77 and subsequently amended by Directive 2006/68/EC. This directive has since been repealed and replaced by Directive 2012/30/EU of the European Parliament and of the Council, of 25.10.2012, published in OJ L 315/74, on 14.11.2012.

Article, the third party assisted being responsible for returning to the assisting company any funds that it may have been granted.

The question that raises greatest difficulties is whether the invalidity of the financial assistance transaction will also affect the share acquisition transaction. According to the majority view, in some cases the invalidity of the financial assistance transaction extends to the acquisition of the shares, but there are other cases in which the effect of the invalidity is restricted to the assistance transaction, depending on the importance of various factors such as interests at stake, the degree of dependence of the transactions in question and the primary need to protect third parties who have acted in good faith.

It is also to be noted that in the event of breach of the prohibition of financial assistance, the directors of the assisting company shall incur civil liability for damage caused to the company, its creditors, partners and third parties[2], as well as criminal liability[3].

ii) Characteristics of the legal regime of prohibition of financial assistance

Under the terms of the aforementioned Article 322 CCC, the assumptions for application of the prohibition of financial assistance are the following: the existence of a financing transaction, the subscription for or acquisition of shares in the assisting company (objectives requirements) and the causal link between both transactions or collusion (subjective requirement).

With regard to the "financing transaction", it is unanimously agreed in legal theory that the legislature used the expression "*grant loans*" to refer to simple loans as regulated in Articles 1142 to 1151 of the Civil Code, and to commercial loans, as set out in Articles 394 to 396 of the Commercial Code. Thus, transactions by which the company lends cash or other fungibles to a third party will be prohibited, the latter being required to return the same amount in the same kind and quality.
The use of the general clause "*or by other means supply funds*" is apparently related to the aim of establishing a general prohibitive principle, instead of exemplifying possible conducts specifically covered. The intention was thus to ban all acts that represent the granting of credit by the company to third parties and which, although not covered by the legal concept of the loan agreement, lead to the same economic result. This way, the courts are assigned the significant role of, by means of analysis of case law and specific cases, deciding whether the transactions carried out lead to the same economic result as the loan and, for this reason, must be prohibited or, on the contrary, whether they must be admitted, as they do not damage the interests protected by the provision.

Finally, with regard to the provision of guarantees, this prohibition is based on the extent to which the company, despite not directly granting a loan, may indirectly and potentially sacrifice its assets. Now, with due regard to the intention of the legislature in repressing

2 See Articles 72, 78 and 79 of the Commercial Companies Code, respectively.

3 Pursuant to Article 510 of the Commercial Companies Code.

financial assistance, the term "*guarantees*" must be interpreted in a broad sense, covering not only typical security or personal guarantee agreements, such as sureties, personal guarantees, pledges and mortgages, but also all those by which the company guarantees compliance with the third party's obligation to others, in other words, those in which the economic result is identical to that referred to above.

An essential assumption for financial assistance to be prohibited under the rule in question is for it to have been granted for a third party to subscribe for or acquire shares representing the share capital of the assisting company, in other words, it requires a intention common to the company and to the third party assisted in order to facilitate the latter's access to shareholder status (or the reinforcement of that position), and this should be the primary purpose of the conclusion of the financing agreement.

iii) The application by analogy of the legal regime of prohibition of financial assistance to private limited liability companies

In both European legislation and Portuguese law there is no parallel for the prohibition of financial assistance in the legal regime of private limited liability companies and it only refers to public limited liability companies. There has therefore been discussion of the possibility of the prohibition being applied by analogy to private limited liability companies.

Contrary to the application by analogy of this provision, the Appeal Court of Coimbra, in a Judgment dated 03.03.2009, ruled that if "*in private limited liability companies* the *acquisition by the Company of shares is not permitted except in the cases specifically provided for by law – Art. 220 of the CCC – in this type of company the legislature felt no need to prevent a possible acquisition by subjective simulation, not having prohibited financial support of the company for the acquisition of shares in itself, as a result of not having included Art. 322 of the CCC in the referral set out in Art. 220.4 CCC* [which refers only to the regime of treasury shares (Article 324 of the Commercial Companies Code)]*".*
Further adding that "*The establishment of a much less restrictive regime for the acquisition of own shares for private limited liability companies and the greater difficulty in making a simulated acquisition in this type of highly personalised company, justify the fact that there is no prohibition identical to that stipulated for public limited liability companies in Art. 322 of the CCC".*
Having concluded that "*For this reason, the application of the provisions in this concept to private limited liability companies, by analogy, cannot be defended*".

Other arguments have also been made in legal theory contrary to this application by analogy, involving, in particular, consideration of the principle of private autonomy, in that if law has not limited the freedom of private limited liability companies, an interpreter cannot do so and consideration of Article 322 as an exceptional provision, since it restricts the general rule of private autonomy and therefore cannot be applied by analogy, pursuant to Article 11 of the Portuguese Civil Code.

In turn, the legal theory that defends the application by analogy of the concept of prohibition of financial assistance to private limited liability companies, considers that legal theory and case law, as summarised above, forget the essential matter: the underlying principle of the prohibition. Indeed, these writers argue that the risks of distortion of the corporate reality that financial assistance seeks to safeguard against also occur in private limited liability companies, particularly with regard to corporate control, the failure to observe the principle of equal treatment of partners and the weakening of collateral, for which reason any solution other than the application by analogy of the prohibition to the private limited liability companies would be contrary to the a principle of justice.

II NATIONAL LEGISLATION

Decree-Law no. 69/2015 - Diário da República no. 87/2015, Series I of 2015-05-06

Ministries of Finance and Economic Affairs

Approves the process of reprivatisation of CP Carga - Logística e Transportes Ferroviários de Mercadorias, S.A.

Decree-Law no. 70/2015 - Diário da República no. 87/2015, Series I of 2015-05-06

Ministries of Finance and Economic Affairs

Approves the process of reprivatisation of EMEF - Empresa de Manutenção de Equipamento Ferroviário, S.A.

Decree-Law no. 73/2015 - Diário da República no. 90/2015, Series I of 2015-05-11

Ministry of Economic Affairs

Makes the first amendment to the Responsible Industry System, approved in the annex to Decree-Law no. 169/2012, of 1 August.

Decree-Law no. 74/2015 - Diário da República no. 90/2015, Series I of 2015-05-11

Ministry of Economic Affairs

Makes the second amendment to Decree-Law no. 187/2002, of 21 August (which created the regulatory framework for the venture capital syndication funds - FSCR) and the first amendment to Decree-Law no. 175/2008 (which established FINOVA – Support Fund for Financing Innovation), of 26 August, in order to harmonise the regimes for annual approval of FSCR and FINOVA accounts with the calendar for approval of the accounts of the entities in which they hold interests.

III CASE LAW

Judgment no. 227/2015 of the Constitutional Court of 28 April 2015
Unconstitutionality – Joint interpretation of Articles 334 of the Labour Code and 481.2, of the Commercial Companies Code

The Court ruled unconstitutional the combined interpretation of the rules set out in Article 334 of the Labour Code and Article 481.2, introduction, of the Commercial Companies Code, in the part in which they prevent joint liability of a company headquartered outside the country, in a relationship of reciprocal holdings, control or group with a Portuguese company, for claims arising from an employment relationship established with the Portuguese company, or its rupture, due to breach of the principle of equality, set down in Article 13 of the Portuguese Constitution.

Judgment of the Supreme Court of 5 May 2015
Exclusion of partner – Fault – Conviction in criminal proceedings – Extra-procedural value of evidence – Non-contractual liability – Default interest

Summary: I - In a suit brought to seek compensation for losses caused by an unlawful action, the responsibility for any unlawful and damaging acts is only established and determined with the decision rendered by the Court, which leads the legislature to have assumed for these situations, pursuant to Article 805.3 of the Portuguese Civil Code, that the default by the person responsible for production of the unlawful acts giving rise to responsibility starts on the date of service of judicial process.
II - The right to exclude a partner is a potestative right of the company.
III - The exclusion is justified when the corporate interest is undermined by a partner who, through breach of their obligations, leads to results or effects that are detrimental to the corporate purpose. Hence the company can only terminate the contract in relation to a certain partner by means of exclusion, when that partner threatens the corporate interest, not as a result of breaches, but as a result of their effects.
IV - Unlawful and culpable acts, proven in a criminal conviction that has already been made final, that are the grounds for a claim for compensation in a civil action, brought against the perpetrator of the criminal act, can be used as proof of unlawfulness and the fault, even if the injured party is still obliged to prove the actual damage and link of causality.
V – In an action to exclude partners, the period for bringing the action intended to achieve the exclusion of the partner only begins when the manager becomes aware of, or if the partner to be excluded is also a director of the company, when the partners have access to elements that form the grounds for exclusion.
VI - The company must repay the private share of the excluded partner, within 30 days from the decision ordering the exclusion becoming final.
VII – The default resulting from the obligation to compensate for unlawful acts only begins with the serving of a writ on the debtor/party in breach – see second part of Article 805.3 of the Civil Code.

Judgment of the Supreme Court of 12 March 2015
Objection to Enforcement – Commercial Company – Guarantee – Standing of Companies – Managers – Abuse of law

Summary: I - Contractual clauses that establish a particular purpose for the company or prohibit it from engaging in certain acts, do not limit the company's capacity, but bind the company's boards to not exceeding that purpose or not engaging in those acts.
II – A narrow interpretation of Art. 260.1 of the CCC must be adopted, according to which the company's partners and directors (or members of other corporate boards), that enter into contracts with the company, are not third parties in relation the company, and for this reason they do not warrant the protection afforded by Art. 260.1 of the CCC.
III - It is no abuse of rights for the Company to rely on the enforceability, in relation to the judgment creditors, of the statutory clause concerning prohibition of the subscription of securities or personal guarantees, since legal persons have an autonomous "life" within the legal order that transcends that of the natural persons that represent them and the judgment debtors acted in a personal capacity in the transactions that they entered into with the judgment creditors.
The Tribunal believed that as the judgment creditors were former partners and former-directors of the company they are not considered third parties covered by the protection of Art. 26.1 of the CCC, and the statutory limit that prohibited directors from engaging in acts or entering into contracts outside the corporate business, as would have been the subscription of the guarantee, is enforceable against them. The Court concluded that third parties can only be non-partners, and not partners or former partners.

CONTACT

CUATRECASAS, GONÇALVES PEREIRA & ASSOCIADOS, RL
Sociedade de Advogados de Responsabilidade Limitada

LISBOA
Praça Marquês de Pombal, 2 (e 1-8º) I 1250-160 Lisboa I Portugal
Tel. (351) 21 355 3800 I Fax (351) 21 353 2362
cuatrecasasportugal@cuatrecasas.com I www.cuatrecasas.com

PORTO
Avenida da Boavista, 3265 – 5.1 I 4100-137 Porto I Portugal
Tel. (351) 22 616 6920 I Fax (351) 22 616 6949
cuatrecasasporto@cuatrecasas.com I www.cuatrecasas.com