

CONFLICTS OF INTEREST IN SPAIN

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FINANCIAL INSTITUTIONS

1. GENERAL INTRODUCTION

Conflicts of interest in the financial services industry are commonly attributed to factors such as: (i) universal banking, where various financial activities (research, underwriting, lending, etc) are combined in one single organisation; and (ii) the different relationships that the various parties operating in financial markets enter into (in some cases, such relationships are contractual, like the potential conflicts of interests that may derive from an underwriting agreement or a corporate finance mandate between an investment bank and its corporate clients; and in other cases, such relationships consist of the holding of shares or other financial interests by financial institutions in other companies). Some of these factors have been noted by the Spanish courts, which have sanctioned investment firms for biased investment advice to clients.

The Spanish regulation of conflicts of interest affecting financial institutions is essentially contained within Law 24/1988, of July 28, on the securities market (the Securities Market Law) and Royal Decree 629/1993, of May 3, regarding rules of conduct in the securities markets and registration requirements (the Securities Markets Rules of Conduct). These rules address two main types of conflicts of interest: (i) those arising between the financial institution and the client (in which case, the general rule will be that priority will be granted to the client's interests and the financial organisation will be required to disclose any facts that could create conflicts of interest); and (ii) those emerging between various clients of the same financial organisation (where the general rule will be that all affected clients should be treated equally).

The supervision and enforcement of the obligations imposed on Spanish financial institutions in relation to conflicts of interest is carried out by the Spanish National Securities Market Commission (*Comisión Nacional del Mercado de Valores* - the CNMV), a public organisation with powers to impose sanctions. The CNMV's decisions can be appealed to the Spanish courts.

2. BACKGROUND/ENVIRONMENT

The regulation of conflicts of interest as provided by the Securities Market Law was amended by Law 44/2002, of November 22, which was drafted to improve

corporate governance and transparency in the securities markets in response to high-profile corporate scandals in the United States and Europe.

As explained below, the rules of conduct relating to conflicts of interest, as contained in the Securities Market Law, combine: (i) requirements for organisational separation (eg information barriers) with (ii) mandatory disclosure of information (in some cases, the disclosure is made to the CNMV, which will decide whether or not the information should be made publicly available - see, for example, section 40 of the Securities Market Law - and in others, the disclosure is made directly to the public - see, for example, section 79.1.h) of the same law), in order to prevent conflicts of interest in the financial sector.

3. APPLICABLE LAW, REGULATION, CODES AND CASE LAW

The rules regarding conflicts of interest in the Securities Market Law and the Securities Markets Rules of Conduct are both sets of “ethical” rules for all involved in financial markets. Another characteristic of the rules is the diversity of parties they address, ie, the various parties and organisations acting within securities markets.

Aside from those legal provisions, certain private associations of business brokers and financial analysts in Spain have published codes of conduct for their members. These codes set out rules of conduct in situations of conflicts of interest, but they are not legal in nature and are not, therefore, enforceable by the courts.

With respect to case law, it should be noted that several judgments from Spanish courts have obliged financial intermediaries to compensate clients for inducing them to purchase certain financial assets with biased advice. However, these judgements do not analyse in detail the potential conflicts of interest of the financial intermediaries involved in the cases.

4. THE REQUIREMENTS

Securities market law

The requirements established by the Securities Market Law can be divided into two groups: (a) structural or “organisational” requirements; and (b) disclosure requirements.

(a) “Organisational requirements”:

- (i) Section 79.1.b) establishes a general rule as regards conflicts of interest for investment services organisations, credit organisations and those persons or organisations that receive or carry out instructions, or provide advice on investments in the securities markets. According to this provision, those persons or organisations must be organised in such a way that the risks of conflicts of interest are minimised. In the case of any conflict of interest, clients’ interests must be granted

priority, without any client being treated more favourably than another.

- (ii) Section 83.1 requires that organisations or groups of organisations providing investment services, and any other organisations acting or rendering advisory services in relation to investments, establish the measures necessary for preventing the exchange of insider information between the different areas of its work. Such measures must guarantee that each of these areas of work takes its decisions independently, and that conflicts of interest are avoided.
- (iii) Section 70.4 establishes that each of the organisations included in a consolidated investment services group must adopt the measures necessary for adequately resolving the conflicts of interest that may arise between clients of the different organisations within the group.

(b) Disclosure requirements:

- (i) Section 40 requires that each member of an official secondary market in Spain shall disclose to the CNMV its economic links or contractual relationships with third parties that may give rise to conflicts of interest with other clients. The CNMV in turn will determine, subject to the general criteria established by the applicable regulations, which of these links or relationships shall be publicly declared.
- (ii) Section 79.1.h) sets out a general requirement applicable to investment services organisations, credit organisations and those persons or organisations that act in the securities markets and receive or execute orders, or provide advice on investments. In accordance with this section, such persons and organisations shall disclose to their clients any potential conflicts of interest regarding the advice or the investment service being rendered.
- (iii) Section 83.2 requires that all organisations or groups of organisations that create, publish or distribute reports or recommendations regarding the issuers of listed securities must act faithfully and impartially. In addition, such organisations must disclose in their reports or recommendations any significant connection enjoyed, or intended to be enjoyed, by the organisation issuing the report or providing the recommendation with the company that is the subject of the corresponding report.

4.2. The Securities Markets Rules of Conduct

The Securities Markets Rules of Conduct apply, basically, to investment services organisations, credit organisations, and those persons or organisations that carry out activities relating to securities markets, including the rendering of advice and the issuing of information regarding matters relating to securities markets (the Subjects of the Rules of Conduct). The obligations regarding conflicts of interest

established by these rules generally fall into one of the following two groups:

- (a) Internal conduct regulations: According to the Securities Markets Rules of Conduct, any party subject to it shall prepare a set of internal conduct regulations, which must be observed by administrative bodies, employees and representatives of the relevant organisation. Any breach of the provisions of the internal conduct regulations, if such provisions implement the requirements of the Securities Market Law or the Securities Markets Rules of Conduct, can give rise to administrative sanctions upon the relevant employee or representative. Such internal control regulations must stipulate, among other things, that the relevant organisation shall request information (and update it) from its employees regarding conflicts of interest to which they may be a party as a result of their family relationships, own assets, or any other cause.
- (b) Code of Conduct for the Securities Markets: In addition to the obligation to prepare a set of regulations governing internal conduct, the Securities Markets Rules of Conduct set forth a Code of Conduct for the Securities Markets, which shall be observed by all the subjects of the Rules of Conduct. This Code of Conduct establishes a general principle (in section 1) under which the subjects of the Rules of Conduct shall act impartially, giving priority to their clients' interests over their own interests. In addition, the Code of Conduct sets out the following rules regarding conflicts of interest:
 - (i) "Organisational requirement": The Subjects of the Rules of Conduct shall ensure that information relating to any of the organisation's various areas of work is not, directly or indirectly, available to any parts of the organisation working in other areas. Thus, each area of work shall operate independently. In addition to such barriers, the relevant organisations must put in place the measures necessary for avoiding conflicts of interest while taking decisions, both within the same organisation and between different organisations of the same group.
 - (ii) Conflicts of interest between clients: Section 6 of the Code of Conduct requires that relevant organisations avoid conflicts of interest between clients, and when such conflicts cannot be avoided, that such organisations have appropriate internal procedures in place for resolving these conflicts without treating any one of their clients favourably in comparison with any of the others. In these cases, the relevant organisations shall observe the following rules: (a) not to reveal to any client the transactions carried out by other clients; (b) not to induce one client to carry out a transaction for the benefit of another client; and (c) to establish general rules providing for the pro rata distribution of instructions, in order to avoid potential conflicts in transactions affecting two or more clients simultaneously.

In addition, an Order dated 7 October, 1999, of the Ministry of Economy (the

Order), further develops the requirements of the Securities Markets Rules of Conduct, and sets out specific rules of conduct in relation to portfolio management activities. The Order establishes, as a general rule, that the portfolio manager shall avoid conflicts of interest: (i) between itself and companies of its group and the client; and (ii) between different clients, and that in the case of a conflict, the interests of the client shall be granted priority over the interests of the portfolio manager.

Moreover, the Order sets out specific disclosure requirements with which the portfolio manager must comply in relation to the ongoing information provided to clients, and when requesting the client's permission to exercise the voting rights derived from the shares included within the portfolio managed. The information periodically provided to the client shall provide information including details of: (i) investments in securities issued by the manager or organisations within its group, and investments in collective investment schemes managed by it; (ii) the subscription or acquisition of securities being placed or underwritten by the manager or by organisations within its group; and (iii) securities deriving from transactions executed by the manager on its own behalf or by any organisation within its group.

5. OUTLOOK

The main event on the horizon is the potential approval of a Royal Decree, a draft of which has recently been published for public discussion (the Draft RD on Market Abuse) developing the general requirements of the Securities Market Law with respect to market abuse, following the requirements of EU Directive 2003/6 on insider dealing and market manipulation (market abuse). According to the Draft RD on Market Abuse, financial institutions shall disclose, when issuing an investment recommendation, all circumstances that could reasonably jeopardise the objectivity of the recommendation (and, in particular, all significant financial interests held by the financial institution in the securities that are subject to the recommendation), or the conflicts of interest that the financial institution may have with the issuer referred to in the recommendation.

In addition to this general requirement, the Draft RD on Market Abuse establishes specific disclosure requirements applicable to investment services organisations and credit institutions that provide investment recommendations. These specific requirements include: (i) the obligation to disclose the provisions of the organisation's internal conduct regulations established to prevent and avoid conflicts of interest in relation to investment recommendations; and (ii) the obligation to disclose on a quarterly basis the proportions in which the organisation has made recommendations to "buy", "keep" or "sell" (or any other equivalent term), together with the corresponding proportions in which those issuers (to which the relevant investment services organisation or credit organisation have rendered investment banking services within the previous twelve months) have been affected by each of those recommendations.

6. USEFUL REFERENCES

The organisation in charge of the supervision and enforcement of the rules relating to conflicts of interest that are applicable to financial institutions is the CNMV, whose contact details are included below.

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AUDITORS

1. GENERAL INTRODUCTION

Given that auditors, unlike lawyers, do not represent the individual interests of clients who may enter into a conflict with interests of other clients, an analysis of the conflicts of interest in the profession of auditors should follow a different approach to that of those affecting lawyers. In this regard, the independent nature of the auditor, one of the essential requirements of the profession, becomes the basic element to analyse auditors' conflicts of interest. This section analyses the law and practice surrounding the independent nature of auditors.

The requirements of independence applicable to auditors in Spain are contained (excluding EU directives and recommendations) in Law 19/1988, of July 12, on the Auditing of Accounts (the Audit Law), Royal Decree 1636/1990, of December 20, on the Auditing of Accounts (the Audit Regulations) and in the Professional Auditing Rules published by resolution of the chairman of the Institute of Accounting and Auditing of Accounts (*Instituto de Contabilidad y Auditoría de Cuentas*) (ICAC), dated January 19, 1991 (the Professional Audit Rules). In addition, case law and the responses of the ICAC to particular questions on how to understand certain obligations of the independent nature of auditors clarify the rules.

The ICAC, a public administrative body of the Ministry of Economy, is in charge of the Public Registry of Auditors (*Registro Oficial de Auditores de Cuentas - ROAC-*), publishes the Professional Audit Rules, which detail how auditors must carry out their activities, supervises the activities of auditors and exercises the sanctioning powers in the event of a breach of auditors' obligations, among other duties. However, in addition to the ICAC, there are three official associations of auditors (*Instituto de Censores Jurados de Cuentas de España -ICJCE-*, *Registro de Economistas Auditores del Consejo General de Colegios de Economistas de España -REA-*, and *Registro de Auditores del Consejo Superior de Colegios Oficiales de Titulares Mercantiles de España -REGA-*), which review and control the quality of their members' work, and inform the ICAC at the end of each calendar year about the result of these controls. Notwithstanding the official associations' control duties, only the ICAC is vested with sanctioning powers, although its resolutions imposing penalties can be appealed before the courts.

2. BACKGROUND AND ENVIRONMENT

Although general independence requirements of auditors have been present in the Audit Law since its enactment, recent financial scandals in the United States and Europe have focused the attention of Spanish authorities, and the public in general, on the ethical duties of auditors and, in particular, on the obligations of auditors to remain independent from their clients' and their own interests. Spain saw a similar debate to the one held internationally between those who criticised

the weak system of safeguarding the auditor's independence and those who supported a system of protecting such independence based on the auditor's professionalism and internal control systems between auditors. As a consequence, the Audit Law was modified in 2002 (by Law 44/2002, of November 22, on certain measures for improving the financial system) reinforcing auditors' independence obligations and establishing certain measures (like the rotation of audit teams within the audit firm after having audited the same client for seven consecutive years) purported to encourage the auditor's independence. Moreover, Law 24/1988, of 28 July, on the securities market was also modified in 2002 by the same Law 44/2002, establishing the obligation of any company whose shares or bonds are listed in an official secondary market, to appoint an audit committee composed of a majority of non-executive directors designated by the board. The audit committee's duties include cultivating a relationship with the company's auditor in order to discover any matter that could jeopardise the auditor's independence.

Despite the amendments to the Audit Law, there remain critics who say Spanish law fails to provide sufficient guarantees of the auditor's independence. Scholars have identified the fact that seven-yearly rotation only affects the audit team and not the audit firm, the possibility of re-electing the auditor for successive one year periods after the first appointment term expires, or the possibility, in practical terms, of removing the auditor without cause as factors that jeopardise the auditor's independence. These factors make the auditor vulnerable to discretionary decisions of the client's directors, and at a higher risk from being influenced by those directors. In this regard, the obligation of establishing an audit committee (which will issue a proposal for the appointment of auditors) set forth by Law 44/2002 mentioned above, is a step in the right direction. Given that this committee will be composed of a majority of non-executive directors, it may help to reduce the risk of the auditor being exposed to the influence of the company's executive directors.

The debate regarding the loss of independence caused by the simultaneous rendering of legal and audit services by audit firms (so-called multi-disciplinary practices) is also present in Spain. In this regard, the Audit Law, as amended, establishes the possibility of rendering legal and audit services to the same client if these services are provided by different legal entities with different boards of directors. As this does not guarantee that both legal entities will not share a common interest, some scholars still see multi-disciplinary practices as a risk to the auditor's independence.

3. APPLICABLE LAW, REGULATION, CODES AND CASE LAW

As mentioned above, the two main sources of law establishing auditors' independence obligations in Spain are the Audit Law and the Audit Regulations on the one hand, and the Professional Audit Rules on the other.

Although both groups of rules are binding upon auditors, the nature and the enactment process of each group is different. In this regard, the Professional Audit Rules are prepared, adapted or reviewed, when necessary, by the official

associations in accordance with the general principles and practice commonly accepted within the European Union. Once the Professional Audit Rules have been drafted by the official associations, the relevant proposals are opened for public comments for six months. After this period, the rules become valid and effective once they are published by the ICAC. Only when the official associations, after a prior request from the ICAC, do not prepare, adapt or review a certain Professional Audit Rule in accordance with the procedure mentioned above, will the ICAC be entitled to prepare, adapt or review such a Professional Audit Rule, giving notice of this fact to the official associations.

With respect to the Audit Law and Audit Regulations, they have the legal nature of a law and royal decree, respectively, and, accordingly, are enacted and published in the State Official Gazette (*Boletín Oficial del Estado*) following the same procedures applicable to any other law and royal decree.

4. THE REQUIREMENTS

4.1. The Audit Law and the Audit Regulations

The requirements established by the Audit Law and the Audit Regulations regarding auditors' independence obligations are similar, although, due to the recent amendments to the Audit Law mentioned above, the requirements set forth by such Law are more detailed.

In accordance with section 8.1 of the Audit Law, auditors must be and appear to be independent from the companies they audit, in the performance of their functions. Therefore, they must refrain from acting when their objectivity in relation to the review of accounting documents could be jeopardised. In this regard, pursuant to section 36 of the Audit Regulations, independence will be understood as the absence of interests or influences that may undermine the auditor's objectivity. In order to assess a possible lack of independence, the Audit Regulations require that the performance of other services to the audited company that may limit the auditor's objectivity are taken into account (however, the Professional Audit Rules establish that, with the exception of services consisting of accounting activities, the rest of the services, such as consulting or tax advice, would not imply, in principle, the auditor's incompatibility).

Notwithstanding the above, section 8.2 of the Audit Law establishes a list of circumstances which determine when the auditor is not independent to exercise its duties with respect to a certain company or entity. Such circumstances include:

- (a) the holding of management positions or internal supervision positions in the audited company or any company directly or indirectly related to the audited company, or being employed by any of these companies (any company holding directly or indirectly more than 20 per cent of the voting rights in the audited company or any company where the audited company holds directly or indirectly more than 20 per cent of the voting rights will, in any case, be considered related to the audit company for these purposes);

- (b) holding a direct financial interest in the audited company, or an indirect financial interest if it is significant for any of the parties;
- (c) certain family relationships with the entrepreneurs, directors or persons responsible for the financial department of the audited company;
- (d) keeping or drafting the accounting documents or financial statements of the audited entity;
- (e) rendering (i) services relating to the design and commissioning of financial technological systems to provide the data to be included in the financial statements of the client, (ii) valuation services related to significant amounts in the financial statements of the client, or (iii) internal auditing services (however, all such services are permitted under certain conditions) for the audited company;
- (f) establishing business relationships with the audited client, unless this relationship corresponds to the normal business activity and it is not significant for either the auditor or the audited entity;
- (g) simultaneously rendering legal services to the audited client (or to those clients who were audited in the previous three years), unless such legal services are rendered by different legal entities, with different boards of directors;
- (h) participating in the hiring of top managers or key persons for the audited client if this client is subject to public supervision or has issued securities listed in an official secondary market;
- (i) rendering any service for the audited company other than the audit service by the partner who signs the audit report; and
- (j) collecting fees derived from the audit and non-audit services from one single client if such fees represent an unduly high percentage of the total annual income of the auditor (using for this calculation the average total annual income for the last five years).

The period to be taken into account for considering the circumstances mentioned above comprise the three fiscal years prior to the year referred to in the relevant audited financial statements and the fiscal year in which the audited services are performed. However, regarding the circumstance indicated in sub-paragraph (b) above (holding a financial interest in the audited company), it will cease to exist prior to the acceptance of the appointment as auditor.

Auditors will be appointed for a minimum initial period of three years and a maximum initial period of nine years, with the possibility of annual re-elections after the initial period for which they were appointed. This notwithstanding, section 8.4 of the Audit Law requires companies subject to public supervision, companies which have issued securities listed in an official secondary market and

companies with net revenues above Eu30 million, to change the auditor responsible for the work and all the audit team after the seventh year from the initial appointment. This auditor and team will only be allowed to audit the same company after three years from the rotation.

Finally, it should be noted that the provisions of the Audit Law summarised above which refer to the audit company also include those companies to which the audited company may be directly or indirectly related. Likewise, the provisions which refer to the auditor will include, when applicable, the wife or husband of the auditor, the auditors or audit companies to which the auditor may be directly or indirectly related, and the persons with the capacity to influence the final result of the audit, including those persons who compose the decision-making chain.

4.2. The Professional Audit Rules

The requirements of the Professional Audit Rules regarding auditors' duties of independence and objectivity are more general than the ones set forth in the Audit Law, foreseeing, in most cases, general ethical duties rather than specific obligations. In this connection, Professional Audit Rule number 1.3 establishes as a general principle that the auditor must observe the utmost independence, integrity and objectivity while carrying out its professional activity. Professional Audit Rule number 1.3.2 defines independence as a mental attitude which enables the auditor to express its professional judgment with freedom, for which purpose, the auditor will be free from any circumstance which may limit its impartiality in objectively considering the facts and expressing its conclusions.

However, the Professional Audit Rules, like the Audit Law, also define certain situations where the auditor will not be considered independent to exercise its duties. Such circumstances are the facts that the auditor carries out the accounting process of the audited entity or holds management functions in such entity. Additionally, the Professional Audit Rules require special attention to be paid to auditors' independence when the fees collected from a single audited client for any items represent an important percentage of the auditor's total gross income (for such purposes, all the companies belonging to the same group will be considered as the same client).

In addition to the mentioned general and specific requirements, the Professional Audit Rules require that the quality control system of the auditor must provide a reasonable certainty that all the professional auditing personnel of the auditing organisation, at any level of responsibility, observe their requirements of independence, integrity and objectivity (Professional Audit Rule number 1.4.10.a)). In addition, such quality control system must enable the auditor to decide about the acceptance and continuity of clients, taking into account, among other aspects, the auditor's independence.

Finally, the Professional Audit Rules establish that the auditor's obligation to rendering quality services to its clients and to respect its clients' interests will not prevail over the auditor's obligations *vis-à-vis* third parties, regarding the maintenance of the auditor's independence, integrity and objectivity. As this

matter is one of the key issues of auditors' conflicts of interest, the Professional Audit Rules recognise that both groups of obligations require a high degree of responsibility and ethical behaviour from the auditor in order to be fulfilled.

5. OUTLOOK

Given the recent amendment of the Audit Law, substantial changes to the legal framework governing auditors' obligations of independence and avoidance of conflicts of interest are unlikely in the near future. This notwithstanding, the Audit Regulations, which has not been amended after the last change of the Audit Law in 2002, need to be adapted to the amendments introduced in the Audit Law (as the Regulations are ranked below the Law, the amendment of the Audit Regulations cannot contravene the provisions of the Audit Law). Thus, certain amendments of the Audit Regulations are expected soon, although a draft of such amendments is not publicly available yet, and therefore, the scope of the potential modifications cannot be assessed at this stage. However, some of the official associations have warned about the potential negative consequences for the audit profession of aspects such as the compulsory rotation of the auditor and the incompatibility system, and request a special sensitivity from the ICAC and the government while amending such aspects, if so decided, in the Audit Regulations.

In addition, the recent regulation of corporate governance obligations in Spain (contained basically in Law 26/2003, of July 17 and Circular 1/2004, of March 17, of the Spanish National Securities Market Commission (CNMV) requires from certain companies (mainly listed companies) the preparation and filing with the CNMV of an annual report on corporate governance issues containing information about the company's auditor (information of other services rendered by the auditor to the company, number of years during which the auditor has been auditing the company, etc), among other things. In this regard, the obligation to comply with these corporate governance obligations and their disclosure by listed companies will most likely have an impact in the coming years on the process of appointment of auditors by listed companies and on the independence requirements that listed companies will request from auditors before their appointment or re-election. Although some authors are sceptical about the effectiveness of the corporate governance regulations, they may help to increase the standards of independence of Spanish auditors as their listed clients demand.

6. USEFUL REFERENCES

As mentioned above, the basic institutions on the surveillance and enforcement of auditors' independence obligations are the ICAC and the official associations, whose contact details are included below.

Instituto de Contabilidad y Auditoría de Cuentas (ICAC)
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LAWYERS

1. GENERAL INTRODUCTION

Mutual trust and loyalty to clients are at the core of lawyer-client relationships. Consequently, the prohibition against representing clients with conflicting interests is a paramount rule governing the activities of lawyers.

Spanish legislation prohibits the representation of clients in situations that constitute conflicts of interest according to the Criminal Code and to several other rules of conduct. In this regard, the fact that the Spanish Criminal Code penalises lawyers (or court agents -“*procuradores*”) who represent two clients with conflicting interests in the same litigious matter provides an indication of how seriously Spanish lawmakers regard such conflicts.

In addition to the Criminal Code, the prohibition against representing clients when there is a conflict of interest is regulated in the Spanish General Statute on the Legal Profession (*Estatuto General de la Abogacía Española*), approved by Royal Decree 658/2001, of June 22 (the General Regulations), the Code of Conduct for Lawyers in the European Union, adopted by the CCBE (Council of the Bars and Law Societies of the European Union) plenary session held on October 28, 1988, as amended (the EU Code of Conduct) and the Spanish Code of Conduct for Lawyers (*Código Deontológico de la Abogacía Española*) approved by the plenary session of the Spanish General Council of the Legal Profession (*Consejo General de la Abogacía Española*) held on September 27, 2002, as amended (the Spanish Code of Conduct).

On a general basis (a more in-depth analysis of the rules mentioned in the preceding paragraph is provided below), as with other codes of conduct for lawyers, such as the Law Society’s rules in the UK, despite being complete in certain aspects, the regulation of conflicts of interest in the Spanish Code of Conduct does not cater for all the current circumstances of multi-disciplinary law firms. The rules on conflicts of interest contained in the Code are not particularly helpful for Spanish law firms when it comes to resolving situations in which conflicts of interest appear in multiple forms and are far more diverse and complex than those set forth in the Spanish Code of Conduct or in the General Regulations.

With regard to the enforcement of conflicts of interest rules, the rules of the Criminal Code should be distinguished from the rules contained in the Code of Conduct and the General Regulations. The enforcement of the Criminal Code provisions on conflicts of interest corresponds exclusively to the criminal courts, whereas the enforcement of the provisions on the Code of Conduct and the General Regulations is firstly entrusted to the appropriate Bars, with the possibility for the parties to appeal the Bar’s decision before the administrative courts.

2. BACKGROUND/ENVIRONMENT

As stated above, although the representation of two or more clients with conflicting interests in the same case is regulated in the Criminal Code, the provisions of the Code of Conduct and the General Regulations do not provide the necessary means to resolve complex situations involving conflicts of interest. Unfortunately, the laws recently enacted in Spain to increase the transparency of financial markets and avoid conflicts of interest between clients of financial institutions have not included new rules specifically addressed to the activities of lawyers; nor has the Code of Conduct been modified in light of the new laws. Therefore, from a regulatory point of view, there has not been much change in Spain in the area of conflicts of interests in the legal profession since the spate of corporate scandals in the United States and Europe.

Although there is certainly a regulatory standstill, the approach of Spanish law firms and the resources used to detect and resolve conflict of interest issues have changed substantially compared with a decade ago. The growth of Spanish firms (three of which now have over 400 lawyers) and the greater complexity of the transactions that firms take part in have made conflict of interest avoidance a priority, and have prompted these firms to significantly improve their conflict-check systems.

3. APPLICABLE LAW, REGULATION, CODES AND CASE LAW

The sources of law on conflicts of interest affecting the legal profession are the Criminal Code, the General Regulations, the EU Code of Conduct and the Spanish Code of Conduct. Although the Criminal Code is a law and the General Regulations a royal decree, the Spanish Code of Conduct does not have the status of a law. It is merely a resolution issued by the Spanish Council of the Legal Profession. The Spanish Code of Conduct rules are binding to Spanish lawyers and their enforcement is carried out by Spanish Bars, although their resolutions are subject to appeal before the administrative courts. Additionally, the different Spanish Bars are entitled to adopt, in line with the basic rules of the Spanish Code of Conduct, local conduct codes for lawyers practising in their jurisdictions.

In addition to the statutory provisions and codes of conduct mentioned above, there are some decisions issued by the criminal courts and, to a lesser extent, the administrative courts on the breach of conflict of interest rules by lawyers. These decisions have helped define the crime set forth under section 467.1 of the Criminal Code, which is analysed below.

4. THE REQUIREMENTS

4.1. Spanish Criminal Code

According to section 467.1 of the Spanish Criminal Code, any lawyer or court agent (*procurador*) who, after having provided advice to a certain person, represents, without the consent of said person, another client with conflicting interests in the same matter, will be penalised with a fine and disqualified from

the legal profession for a period ranging from two to four years.

In practice, Spanish case law has limited the application of this crime to litigious matters where a lawyer represents, simultaneously and without the consent of the first client, two parties in the same matter with conflicting interests. However, the crime will also be committed if the lawyer previously represents the first client in a non-litigious matter and, thereafter, represents another party with conflicting interests in litigation concerning the same matter. In addition, case law has defined the concept of “the same matter” restrictively. According to various judgments issued by the courts of appeal, for the mentioned crime to be committed, both the parties and the object of the matter where the lawyer intervenes must be the same.

4.2. Spanish Code of Conduct for Lawyers

The Spanish Code of Conduct contains the following basic rules on conflicts of interest (the rules of the EU Code of Conduct and the local codes of conduct approved by some Spanish Bars, which are similar to those of the Code of Conduct mentioned below, are left outside the scope of this section):

- (i) Lawyers must not breach their client’s trust or defend any interests which are in conflict with their client’s interests or with the interests of the lawyers themselves.
- (ii) In the event of a conflict of interest between two clients with the same lawyer, the lawyer shall refrain from representing either client, except if both clients expressly authorise the lawyer to represent one of them. However, the lawyer will be allowed to advise in the interest of all the parties as mediator, or in the drafting of contracts, in which case, it shall act with the utmost objectivity.
- (iii) Lawyers must not accept professional matters which imply acting against a former client if there is a risk that the confidentiality of the information obtained from the previous client may be breached, or if the new client could benefit from such information.

In addition to the rules mentioned above, the Code of Conduct contains more specific rules regulating the duties of lawyers practising in the same firm with respect to conflicts of interest, and the obligations to follow if a conflict of interest arises within a group of clients collectively being represented by the same lawyer.

Although the Code of Conduct rules on conflicts of interest seem clear, their practical application is often less so. For instance, what should be understood by conflicting interest between two clients? Is a firm allowed to represent two clients in the same non-litigious matter if both clients consent and Chinese walls are put in place? These and many other practical questions arising in the day to day practice of law firms do not find clear responses in the rules of the Code of Conduct. Nor have the Spanish Bars or case law on the Code of Conduct rules established clear guidelines to interpret and apply the rules in such situations.

In view of the current legal framework, most Spanish law firms, following the same general rules on Codes of Conduct, have produced internal manuals describing how their lawyers must act when a conflict of interest is detected in accepting a new matter or client. Therefore, in practice, the internal rules produced by most law firms, together with the regulations of the Code of Conduct, are the elements taken into account by lawyers while facing conflict of interest situations.

4.3. Spanish General Regulations on the Legal Profession

By contrast with the Code of Conduct, the rules contained in the General Regulations refer more to incompatibilities of lawyers rather than conflicts between the interests of lawyers' clients.

In this connection, section 22 of the General Regulations requires lawyers (who perform another activity at the same time) to refrain from activities incompatible with the correct exercise of the legal profession due to conflicts of interest that hinder compliance with the principles contained in the General Regulations.

With respect to the practical application of the General Regulations, the same comments made for the Code of Conduct's rules apply. In this case, the lack of practical guidelines published by Spanish Bars and case law also implies that the content, limits and practical implications of the General Regulations are not totally clear.

5. OUTLOOK

Developments in this area will most likely be driven by factors such as (i) the increasing size of Spanish and foreign firms acting in Spain, (ii) the higher degree of complexity of transactions and, in general, matters entrusted to lawyers, which require taking into account further interests, and (iii) the increasing protection of the client's interests provided by the most recent securities market legislation.

As we have noted, Spanish firms have made the detection of conflicts of interest in their matter acceptance procedures one of their priorities and are investing substantial financial and human resources to that end, significantly improving their capabilities. This trend is likely to continue.

With regard to practical aspects, Chinese walls, client prior written consent procedures and other procedures have been applied by Spanish firms. Some techniques have become accepted market practice. In the absence of major changes to the current laws and conduct rules, such practices are likely to continue; although we could see more precise rules on conflicts of interest published by Spanish Bars in the next few years, as has been the case in the UK.

6. USEFUL REFERENCES

The basic Spanish institutions in connection with the surveillance and enforcement of conflicts of interest rules for lawyers are the Spanish General

Council of the Legal Profession (*Consejo General de la Abogacía Española*) (CGAE) and the different regional Bars. The contact details of the CGAE are included below. In addition, contact details for each of the regional Bars can be found in the CGAE website.

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