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Corporate Governance Failure at PT

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Abstract

The following case study depicts the bitter transfiguration of Portugal Telecom, SGPS (PT), a multinational telecommunications company that was once an honourable flag of innovation, corporate governance standards in Portugal and overseas. It scrutinises the controversial episodes that paved the way for the pitiful condition in which PT is nowadays: a company that carries the weight of a ruinous €897 million investment in a defaulted company and no more than a 25.6% stake in a heavily indebted Brazilian carrier. The free-fall is made, ironically, of a complete disregard for best corporate governance practices, allowing for PT's major shareholders to take over the helm of the company, using it selfishly as a *cash cow*.

Keywords: Corporate governance, major shareholders, *cash cow*.

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Corporate Governance Failure at PT

Throughout 2014, the market became increasingly worried about Espírito Santo Financial Group (ESFG), a leading financial institution in Portugal. The head company of the Espírito Santo Group (GES), Espírito Santo International (ESI), was found to be virtually bankrupt after being discovered that the company's accounts were window-dressed: the scheme hid a gap of €1.3Bn¹.

The 150 year-old group was subdivided in two main areas: financial and non-financial. At the top of the latter was Rioforte, who was rumoured to be struggling to refinance its short-term obligations. The financial side – ESFG – was under attack by media and speculators after Banco Espírito Santo (BES) completed a rights issue in May 2014. The bustle was such that Carlos Costa, Bank of Portugal's² (BdP) Governor had to intervene by publicly stressing that *“the solvability situation of BES is solid, having being significantly reinforced with the recent capital increase”*³, in an attempt to calm the markets. Additionally, President Cavaco Silva reiterated, in a visit to South Korea, that *“the Portuguese people can trust BES once the capital buffer is more than enough to cover the bank's exposure to the non-financial side, even in the most adverse situation”*⁴.

BES was the principal investor in Portugal Telecom, SGPS (PT) with a 10.06% stake and had – as everyone knew – a longstanding relation with the Portuguese leading telecommunications operator, once the largest national company by market capitalization. BES accompanied PT in all of its development stages: it conquered a robust market share in quad-play (TV, internet, fixed and mobile telephone services bundled) through the brand MEO (the former mobile brand TMN) and also achieved a strong presence in African countries and Brazil. As a result of the strong interconnection, rumours about the possible contamination of PT by GES problems were spreading in the news.

Forced by investors and media pressure, on the 30th June, 2014, Portugal Telecom, SGPS officially unveiled the hecatomb:

“PT subscribed (...) a total of Euro 897 million in commercial paper of Rioforte (...) All treasury applications will mature on 15 and 17 July 2014⁵ (...) Treasury applications are carried out in the context of analysis of various short-term investment options available in the market (...) and are monitored and approved by the Executive Committee. (...) note that the subscription (...) is based on the 14-year long adequate experience in treasury applications of Banco Espírito Santo (“BES”) and GES [Espírito Santo Group] entities”

¹ <http://www.dn.pt/economia/interior/auditoria-interna-arrasou-gestao-do-universo-espírito-santo-4338646.html>, accessed on November 2nd, 2015

² Portuguese Central Bank

³

http://www.jornaldenegocios.pt/empresas/detalhe/banco_de_portugal_a_situacao_de_solvabilidade_do_bes_e_solida.html, accessed November 15th, 2015

⁴ <http://www.tvi24.iol.pt/economia/pr/cavaco-diz-que-portugueses-podem-confiar-no-bes>, accessed November 15th, 2015

⁵ €847M and €50M, respectively.

By July 15th it was clear Rioforte defaulted on the €847M commercial paper. PT shares slumped almost 40% in a couple weeks. A fortnight later, on the 3rd August, the Bank of Portugal put BES under resolution. Portugal was bewildered: was the collapse of BES going to bring down to its knees the largest and most international company in the country? How could the telecom operator become so exposed to debt issued by a related party? Above all, how could this happen in a company whose award-collecting management and governance (**refer to Exhibit 1 for PT awards**) were so widely praised? How did the corporate governance failed?

Portugal Telecom SGPS, SA

PT was created in 1994 after the merger of TLP (the telephone monopoly of Lisbon and Porto, formerly operated under APT – Anglo-Portuguese Telephones) with the telephone branch of CTT (Post office and Telephones) and TDP (company responsible for the concession of broadcasting infrastructures). The operation created a nationwide Government-owned monopoly for telecommunications in Portugal.

In 1995, a 5-year privatization plan was put to work, leaving to the Government 500 class “A” shares with veto power on critical matters – the *golden shares* (**details on Exhibit 2**), which were maintained until July 2011. By December 2000, BES (9.9%) and the Government-owned bank CGD – Caixa Geral de Depósitos (4.8%) not only were two major shareholders but also had established a strategic partnership⁶ with PT, intensifying commercial transactions⁷ between the parties (**track of commercial transactions in Exhibit 3**).

On the same year, PT Multimedia (PTM) – PT’s branch mainly responsible for contents, cable-TV (TV Cabo brand) and internet services – became publicly listed on June 20th following an equity carve out. Still, PT maintained the control over PTM (58.43%) and therefore the monopoly over the two main wireline carriers – cable and copper -, an uncommon circumstance in the European telecom sector.

PT’s first and major expansion materialized in Brazil with the acquisition of Telesp Celular, the mobile segment of a Government-owned telecom company that in 2003 would – as a result of a joint-venture with the Spanish telecom leader Telefónica – give rise to Vivo, today one of the largest telecommunication providers in Brazil. PT critically empowered Vivo by continuously providing state of the art know-how through its R&D subsidiary PT Inovação.

Sonaecom’s Takeover Attempt

*“This is the biggest deal of my life”*⁸

– Belmiro de Azevedo, CEO of SONAE, February 6th, 2006

On February 6, 2006, SONAE, SGPS, SA (SONAE) communicated to CMVM – the Portuguese stock market supervisor – its intent to purchase, through Sonaecom, SGPS, SA

⁶ BES Group and CGD agreed to consider PT as their preferred supplier of telecommunication services while PT had to bias its financial preferences towards BES Group and CGD products.

⁷ In particular, BES provided more than financial services: security (ESEGUR), healthcare and cleansing were also provided by BES. Campos, Anabela; Ramos, João; Santos, Nicolau. 2009 “*PT é Euromilhões para Accionistas*”, Expresso: Economia pgs. 1-3

⁸

http://www.jornaldenegocios.pt/empresas/detalhe/belmiro_diz_que_opa_a_pt_e_a_maior_operacao_da_minha_vida.html, accessed 29 October 2015

(Sonaecom), 100% of PT shares and convertible bonds. It replicated, on the following day, the tender offer for PT Multimedia.

SONAE and Sonaecom

SONAE is a Portuguese conglomerate created by Belmiro de Azevedo – a chemical engineer and the 2nd richest person in Portugal⁹ – and nowadays run by his son, Paulo de Azevedo. Sonaecom is simultaneously SONAE's affiliated company and a holding itself, managing three core divisions: Telecommunications (mobile and fixed), Media&Software and Systems Integration (SSI) services. At the time, Sonaecom telecom's flag brand was Optimus, the mobile operator born in 1998 that competed in the market¹⁰ with the PT-owned-leader TMN and Vodafone (**evolution of market shares in Exhibit 4**). As for the fixed line segment and internet services, Novis and Clix¹¹ were consolidating as the second largest providers, again behind PT. By its turn, PT Multimedia dominated the cable-TV segment, leading comfortably with over two-thirds of the market.

The offer

Sonaecom offered to PT shareholders a price per share of €9.50 and €5,000 for each convertible bond, valuing PT's equity position around €10.7Bn. The offer represented a 16.1% premium¹² over PT shares at the announcement day (**share prices evolution in Exhibit 5**). The bid extended to PT's non-controlled stake of PT Multimedia at €9.03 per share. The bid was conditioned to the cumulative occurrence of certain conditions:

- Sonaecom acquiring a majority stake in PT (at least 50.01%);
- Removal of some binding clauses in PT statutes:
 - (1) Limitation on voting rights for shareholders owning more than 10% of PT shares;
 - (2) Limitation to 10% on the acquisition of PT shares by a competitor;
 - (3) Special rights of the Portuguese Government conceded by its *golden shares*, or;
- Non-opposition by the Portuguese Government to the takeover attempt.

Moreover, PT Multimedia's bid was conditioned to the success of the takeover over PT and the acquisition of more than 50% of PT Multimedia shares.

Notwithstanding Sonaecom's relatively smaller dimension when compared to PT – around 1/10 –, it had successfully gathered commitments for the whole financing¹³ (**see Exhibit 6 for financing structure**). On December 22, 2006, the Portuguese Competition Authority decided not to oppose to the merger under the completion of certain conditions to guarantee that consumers would not be penalized by the greater concentration. The measures were applauded by the European Commission and the Portuguese Government, which have been encouraging PT to separate copper and cable network segments.

⁹ Forbes, 2014

¹⁰ Reaching a 20% share at the end of 2005

¹¹ Directed for residential and corporate segments, respectively

¹² Disregarding a scheduled 2006 dividend distribution of €0.385 per share. Taking it into consideration would increase the premium to over 20%.

¹³ Spanish bank Santander guaranteed a debt facility totaling the full amount needed for the equity purchase.

A matter of perspective

Sonaecom considered that its offer delivered PT shareholders with “*premium value and cash certainty today*” vis-à-vis trading and transaction comparables and even to “*market analysts’ fair values*” (refer to **Exhibit 7 for premium analysis**). In contrast, PT’s Board hastened to express its lack of confidence in the terms and strategic fit (see **Sonaecom/PT project in Exhibit 8**) of the offer, recognizing that neither the “modest premium” nor the EBITDA multiple were in line with similar transactions involving change in control. It remembered its shareholders the determinant role PT has had in the Portuguese social development, standing out as to what innovation and shareholder returns were concerned.

Telecommunications at the time

According to the European Commission, the telecommunications market was facing a “*transition phase*” marked by “*the increase in competition, partly justified by regulatory intervention*” and the “*appearance of new technologies and services, some of those associated to the convergence process between services, networks and content*”¹⁴.

At the end of 2005, the Portuguese telecom market was valued at €5.3Bn, growing at a much greater pace than the Portuguese GDP¹⁵. Mobile services crucially accounted for 58.1% of the valuation while fixed telecommunications contributed 24.7%. Mobile communications’ still-growing dominance and pressure over fixed’ also stood out by the above-the-average market penetration (105.8%¹⁶).

Changes at PT – Shareholders

PT’s Board intended to collect a strong supportive shareholder base (**PT shareholder structure evolution in Exhibit 9**) to prevent further surprises at the decisive voting (Telefónica allegedly assured Sonaecom they would vote in favour of the takeover if the bid was raised by, at least, 12%)¹⁷. BES and Fundação José Berardo¹⁸ publicly stressed their opposition to the transaction. The board’s position was also supported by Ongoing Strategy Investments, a family office led by Nuno Vasconcellos and his partner, Rafael Mora (**profiles on Exhibit 10**) that, financed by Société des Banques Suisse (SBS), BES and Millennium BCP¹⁹, had recently acquired a 2% stake at PT. At a roadshow in Latin America, PT’s vice-CEO Zeinal Bava sought to persuade Carlos Slim, owner of Teléfonos de Mexico (Telmex), to purchase a relevant stake of PT shares, convinced that he could help blocking the transaction.

Changes at PT – Board of Directors

After the takeover announcement, a general shareholder meeting – GSM – that took place in April dictated significant changes at the top-management level: shareholders approved a list – elaborated by BES and CGD²⁰ – of personalities to face the challenges in the following

¹⁴ http://www.anacom.pt/render.jsp?categoryId=202882#.VnAH_kqLTIU, accessed on 14th October 2015

¹⁵ 5.8% increase, while GDP almost stagnated – 0.3%

¹⁶ Data for 3rd quarter 2005 – ANACOM; EU average was 93.9% for the same period.

¹⁷ <http://www.tvi24.iol.pt/portugal/espanha/telefonica-cede-posicao-na-pt-se-sonae-subir-preco-12>, accessed on 12th November 2015. Sonaecom was, at the time, keen on maintaining the bid unchanged at €9.50.

¹⁸ Increased its stake from 1.77% to 2.07% during 2006.

¹⁹ <http://www.publico.pt/destaque/jornal/seis-anos-depois-o-grupo-de-vasconcellos-e-mora-entrou-em-declinio-24061493>, accessed 14th December 2015

²⁰ The list got the appraisal of 75% of the voters which, despite being above the two-thirds needed for its approval, it is far below the 99% stake that all the other proposals received.

triennium, being the first to deal with the takeover attempt: the 62-year-old ex-ambassador of Portugal in OECD Henrique Granadeiro was appointed to replace simultaneously Miguel Horta e Costa²¹ as CEO and Ernâni Rodrigues Lopes as Chairman of the Group. Zeinal Bava and Rodrigo Costa were nominated vice-CEO, while Luís Pacheco de Melo replaced Bava as CFO. António Caria, Rui Pedro Soares and João Pedro Baptista were called to complete the enlarged²² executive body. To note the inclusion of the new comers Armando Vara (CGD), Franquelim Alves (Controlinveste), Nuno Vasconcellos (Ongoing) and Amílcar Morais Pires (BES) as non-executive members of the Board (**see BoD changes and key profiles on Exhibit 11**).

“The former [PT] management presented a program of anti-takeover measures. I believe that it is also the time for this team (...) to present its own program.”

– Ricardo Espírito Santo Salgado, CEO of BES, July 31st, 2006

March 2nd, 2007: the D-day for a process that lasted 13 months. After arguing that numerous factors²³ could have led to a downward revision of the offer, Sonaecom unexpectedly raised it to €10.5 per share two weeks before the GSM: it was the *“the price of peace”*²⁴. PT’s Board maintained its position upon the revision of the offer and proposed shareholders with an increased dividend payment, a new share buyback scheme and the spin-off of PT Multimédia (**details of remuneration packages ad spin-off proposal in Exhibit 12**).

*“What we see is the usage of hidden shares. They are better than the golden shares, they correspond to use the friends’ shares”*²⁵

– Belmiro de Azevedo, CEO of SONAE, September 2007

With 67% of PT shareholders represented in the extraordinary GSM, the voting for the 3rd point in the agenda – to remove PT binding clauses – was historically tight. Nevertheless, 46.6% of votes against the proposal were enough²⁶ to block and put an end to the hostile takeover. The Government abstained from using its *golden share* while CGD autonomously²⁷ voted against the transaction. Two months after the takeover, José Berardo sold more than 5 million PT shares, reducing its stake to 1.83% and thus leaving the list of “qualified shareholders”²⁸. Two months later, Partifel – also owned by José Berardo through Metalgest – agreed to sell three TV cable operators to PT Multimédia in an operation closed at 12 times EBITDA²⁹. After the spin-off, PT Multimedia revised the price downwards when it completed the purchase in 2008.

²¹ Miguel Horta e Costa then moved to BESI – Investment Banking unit of BES – to be its vice-CEO.

²² The enlargement caused some concern to PT Working Union. According to its spokesman, costs to maintain the 23 directors totaled, in 2005, €10.8 million (€9.1 million in 2004), *“which represents a third of what PT pays for its healthcare system, covering 53 thousand beneficiaries”*.

²³ PT’s poor performance and the higher-than-expected dividend paid in 2005, the fragility of pension funds and healthcare liabilities, the weakening performance of VIVO and the negative impact in the expected synergies caused by the remedies imposed by the Portuguese Competition Authority, AdC, among others.

²⁴ <http://www.tvi24.iol.pt/sonecom/16-02-2007/novo-valor-da-opa-sobre-a-pt-e-o-preco-da-paz>, accessed October 30th, 2015

²⁵ Alda Martins and Alexandra Machado. 2015. *A Implosão da PT*, Lua de Papel, pg. 36

²⁶ For the proposal to get through, at least two-thirds of the votes were needed. The quorum represented 67.4% of PT shareholders.

²⁷ http://www.jornaldenegocios.pt/empresas/detalhe/governo_cumpriu_a_neutralidade_com_rigor_act.html, accessed December 29th, 2015

²⁸ Holdings above 2%

²⁹ Bragatel, Pluricanal Leiria and Pluricanal Santarém; http://www.rtp.pt/noticias/economia/pt-multimedia-acordou-com-partifel-aquisicao-de-100-da-bragatel_n86460, accessed November 10th, 2015

Corporate Governance at PT

Until June 22nd, 2007 PT's governance structure was similar to a unitary board, but with several committees created within to take care of specific issues (governance, strategy, audit and others) separately. From then on, due to a revision of the Portuguese Companies Code and attending to PT's stock listing on the NYSE³⁰, PT chose to adopt an altered “Anglo-Saxon” model, composed by three main corporate bodies: the General Shareholder Meeting, the Board of Directors (BoD) and a Statutory Auditor. In parallel, the Compensation Committee – also elected in the GSM – defined the remuneration policy for the members of PT's corporate bodies (**refer to Exhibit 13 for Corporate Governance Structure**). According to the new governance model, Henrique Granadeiro could no longer accumulate the roles of Chairman of the BoD and CEO: he resigned as CEO and Zeinal Bava (on March 28th, 2008) was the chosen one to take over the seat.

Main Corporate Bodies

The board of directors of PT is elected for a three-year period (with no re-election restrictions) by the majority of the votes at the GSM. According to PT bylaws, the *golden shares* must approve of the election of one-third of the total number of directors – compulsory comprising the chairman of the BoD. The Executive Committee had several auxiliary committees to advise on strategic, disclosure and sustainability matters. The Audit Committee is a body composed exclusively of non-executive directors – majorly independent – that are elected in the GSM. It is responsible, together with the Chartered Professional Accountant (CPA) – the Statutory Auditor' representative –, to ensure that the company is acting within the applicable legal and regulatory – internal and external – framework (**details in Exhibit 14**).

PT Multimedia Spin-off

“PT never wanted to separate the networks because that would represent a loss of value³¹. Why doing it now?”

– Belmiro de Azevedo, August 4th, 2006

In the aftermath of the failed takeover attempt and in order to free PT from competition authorities' pressure – both national and European – the Group executed the already-approved³² spin-off³³ of PT Multimedia (**further information in Exhibit 12**). Still in the scope of the process, PT sold its cable network³⁴ to PTM.

Compared to cable network, PT traditional ADSL copper technology has operational disadvantages³⁵ and the market outlook was still showing reduction for wireline. Also, mobile

³⁰ An American Depositary Share – ADS – is a USD-denominated share available for trade on an American stock exchange. Part of an issuance of ADR – American Depositary Receipt, and therefore subject to compliance rules set by the SEC – Securities Exchange Commission

³¹ On June 6th, 2006, PT sent to AdC a document stating that the fragmentation of the company would bring the risk of “conducting to a substantial reduction in the capacity of the sector to realize strategic investments”. Earlier that year, PT defended that “the separation of property of the two networks would not improve market discipline”

³² In a GSM held in April 2007, with 99% of votes in favor.

³³ 50.1% until November 7th and the remaining one week later, having left a stake in Previsão, SGFP, S.A., PT health and pension fund's manager, inferior to 2% of voting rights in PTM.

³⁴ PT was the only European operator owning simultaneously copper network with ADSL and the coaxial cable infrastructure.

³⁵ Copper network structure – although already deployed – is heavier, needs repeaters to avoid loss of signal. By its turn, cable, though being costlier per unit of measure, allows for higher speed and covers a wider range, having also better properties for broadcasting purposes.

services were experiencing decreasing revenues per user and TV services were growing considerably (**evolution of revenues per segment in Exhibit 15**). Besides, multiple-play services were exploding at the time. PT dominated contents market and PT would have to make a great effort to compete in this front.

Did PT forgot to cut the umbilical cord?

Whilst it is true that PT neither had a qualified stake in PTM nor longer had directors in common with PTM (being the company inclusively rebranded as “ZON Multimédia”), it is also true that the shareholder structure maintained quite inert (**refer to Exhibit 16 for evolution of shareholder structure**): ANACOM (the Portuguese Telecom Regulator Authority) stated that although “*not having common elements in each company’s Boards (...) and the verification of appearance of competing offers between ZON and PT Group*”, “*the existence of a core shareholder base common to both companies (...) does not permit from excluding outright the hypothesis of those two companies to constitute an economic unit*”³⁶.

The Omen

“Investments with related parties should be object of internal regulation”

– Jorge Tomé, former Non-Executive Director at PT, April 23rd, 2010 (Parliamentary Committee³⁷)

Jorge Tomé, PT’s Board member in CGD’s representation and member of the Investment Committee (IC) of Previsão, SGFP, S.A. – PT’s pension and health funds’ manager – received the minutes of a meeting held by the on June, 30th relating the approval of a €55M investment in a private equity fund managed by Ongoing International, an RS Holding’s subsidiary³⁸. Perplexed, Jorge Tomé called the fund’s chairman, Fernando Soares Carneiro, asking to correct the minutes as the investment had, in fact, not been object of analysis by Previsão’s IC. Once the matter turned public, Soares Carneiro assured the media³⁹ that the investment had been indeed ratified by that body. On October 14th, 2009, Jorge Tomé announced that “*in the sequence [of the controversial statements] I resigned to the position. I considered myself no longer a member of the Investment Committee*”⁴⁰. Rafael Mora, an Ongoing director elected PT Non-Executive director in 2007, guaranteed that IC of Previsão “*did not raise any objection to the various investments applied in companies related with PT shareholders*”⁴¹. Suspicions increased as the turmoil preceded an attempt from Ongoing to acquire a stake in Media Capital Group (a major Portuguese media company owning, among others, the TV-channel TVI): was Ongoing using the proceeds to finance the investment? As

³⁶ ICP - ANACOM - *Report of its understanding over the spin-off of ZON Multimedia and its impact at market analysis-level and obligations arising from it*, April 2008

³⁷ Inquiry to clarify the alleged role of the Government and its Prime Minister, José Sócrates, in the failed takeover of Medial Capital Group (one of the main Portuguese media group owning, among other content platforms, TV channel TVI and several radio stations) by PT, ultimately blocked by the *golden share*.

³⁸ That controls 49.99% of Ongoing Strategy Investments

³⁹ To Diário Económico, a Portuguese newspaper 100% owned by Ongoing Group

⁴⁰ Parliamentary Committee (see note 34)

⁴¹ According to Público (<http://www.publico.pt/economia/noticia/bes-com-prejuizos-recorde-de-35-mil-milhoes-de-euros-1664898>, accessed 29th October 2015), “these statements were corrected later: ‘(...) the Board of Directors of PT did not raised any objection to the various investments applied in companies related to the shareholders’ of PT, Rafael Mora said”

of December 2008, Ongoing's debt – partly backed by PT shares – amounted to €837.5M (of which 97.3% corresponded to short-term debt) with BES and BCP as major claimers⁴².

Following the speculation hovering the case, Soares Carneiro and Rui Pedro Soares, PT's directors nominated by the Portuguese Government, abandoned their seats in the Board of PT, with a payment of €1.8M related to “*a compensation for a non-competition agreement paid to one of the board members*”⁴³. Later that year, Soares Carneiro started “*collaborating with the CEO of Ongoing Participations Brazil*” in the development of new projects.⁴⁴

The Sale of Vivo

In May 6th, 2010 Telefónica announced a €5.7Bn bid for the 50% stake that PT held on Brasilcel, N.V., the joint-venture established in 2003 which controlled⁴⁵ the Brazilian mobile operator Vivo. Telefónica wanted to merge Vivo with its fixed-line unit Telesp⁴⁶ to accompany the consolidation process in Latin America. Nevertheless, PT's long-standing relation with the Brazilian market was seen as strategic and Vivo has proven to be a valuable asset, setting-off the depressive trend of the Portuguese market⁴⁷: the offer fell too short and led to a unanimous rejection of the bid by PT's Board. The contempt shown to the proposal brought to equation other hypothesis⁴⁸ such as the possibility of a hostile takeover, which the market interpreted as a sign of conflict between the telecommunication partners⁴⁹. Consequently, Telefónica submitted, on June 1st, a €6.5Bn offer and, two days later, its Executive Chairman, César Alierta, flew to Lisbon to meet with BES top-management to ask for the banks' support in the voting process⁵⁰. The offer, although still not being seen as reflecting Vivo's true value, was that time submitted by the Board to a GSM that would take place on the 30th of June.

The day before the voting, Telefónica raised its bid to €7.15Bn: the surprise had the desired effect in most of shareholders as 74% voted in favour. Surprisingly⁵¹, the Portuguese Government used its *golden share* to block the sale, reaffirming the importance of PT's geostrategic presence in Brazil. Notwithstanding the legal issues related to the detention of the *golden shares*⁵² – the Government said that it would not change its position unless Telefónica submitted an amended offer. César Alierta would not consent further⁵³ mistakes in Brazilian

⁴² Approximately €200M and €400M, respectively: <http://www.publico.pt/economia/jornal/banco-espirito-santo-aplicou-perto-de-200-milhoes-de-euros-na-ongoing-18019646>, accessed 11th November 2015

⁴³ Consolidated Annual Report 2010.

⁴⁴ http://economico.sapo.pt/noticias/soares-carneiro-e-colaborador-da-ongoing-no-brasil_92843.html, accessed on 18th November 2015

⁴⁵ With a 60% ownership

⁴⁶ Telecomunicações de São Paulo, S.A.

⁴⁷ In the first quarter 2010, Vivo's revenues increased by 25.5% compared with the same quarter of 2009, while domestic operations generated revenues inferior in 3.6%.

⁴⁸ Telefonica “*threatened to wind up Brasilcel and block the distribution of dividends from Vivo*”

European Commission (Competition DG), Case AT.39839 – TELEFONICA/PORTUGAL TELECOM

⁴⁹ According to the Spanish newspaper El País: “*Telefónica threatens with all its weapons PT for it to sell Vivo*”

⁵⁰ <http://www.tvi24.iol.pt/economia/mercados/telefonica-veio-a-lisboa-falar-10-minutos-com-bes>, accessed 7th December, 2015

⁵¹ “*Can the Golden Share veto the transaction?/This is not a Golden Share matter*” – FAQs, PT shareholders' presentation, 17th June 2010

⁵² The European Commission took to the European Court of Justice an issue raised back in 2005 which claims that the influence embedded in the *golden shares* discouraged competition and investment in the sector, violating EU laws. Similarly, Spain, France, UK and Italy were forced to give up on their special rights.

⁵³ In 2004, Telefónica tried to acquire Embratel, the leading Brazilian phone operator and in 2009 he failed to get the control of GVT, a supplier of fixed line telephony and data transmission services.

market's foray and, advised by BESI and Caixa BI⁵⁴, reached an agreement, on the 28th July, for €7.5Bn⁵⁵ (**financial data and offer details in Exhibit 17**). The bulky amount paid – 10.6 times Vivo's EBITDA and remarkably higher than PT's market capitalization at the time⁵⁶ – was, according to some analysts, leveraged on the vast synergies to be exploited (**merger's synergies and analysts' opinion in Exhibit 18**).

A (convenience) marriage?

In parallel, PT sought to use part of the proceeds – besides partly capitalizing the pension fund and distributing generous dividends (**dividends history in Exhibit 19**) – to find a proper substitute in order to maintain its activity in Brazil. Under the monitoring of the Ministry of Public Works, Transports and Communications⁵⁷ and again advised by Caixa BI and BESI, PT agreed on a strategic partnership with Telemar Participações and its subsidiaries (Oi Group), one of the biggest telecom companies in Brazil (**Oi profile in Exhibit 20**). Materialized through a cross holding and a participation in a capital increase, the agreement would cost PT €3.75Bn (**further details in Exhibit 21**). Two-thirds of the cash-in would be used to reinforce Oi's balance-sheet and the remainder was distributed to Oi shareholders⁵⁸. Leveraged by Vivo and Oi's transactions, BESI figured on the top 5 of M&A transactions by deals value⁵⁹ and cashed-in €12.5 million (the same as Caixa BI) in advisory fees in 2010⁶⁰.

One Step Closer

On the 2nd October 2013, the Luso-brazilian integration went a step further: PT, Oi Group and its major shareholders⁶¹ signed a memorandum of understanding (MoU) setting the main terms for a merger of PT and Oi Group into a single Brazilian incorporated listed company – temporarily called “CorpCo”. Bava was naturally indicated to lead the transatlantic operator as he was, in earlier June, nominated the new CEO of Oi⁶² (**refer to Exhibit 22 for Board composition's proposal and merger details**).

The combination of PT with Oi would create a leading telecom operator covering a population of 260 million people and 100 million subscribers. In addition to the €1.8Bn cost-saving synergies estimated, CorpCo would benefit from a capital increase targeting €2.7Bn to strengthen the balance sheet of the merged entity (**Exhibit 22**). Additionally, PT was expected to contribute in kind, by transferring its operational assets – independently valued at €1.75Bn and concentrated in PT's subsidiary PT Portugal⁶³. In May 5th the capital increase was formally completed and resulted in a Portuguese stake of 39.7% in CorpCo. The deal appeared to please investors as both PT (6.5%) and Oi (12%) shares went up on the day of the announcement.

⁵⁴ Investment Banking branches of BES and CGD, respectively; http://economico.sapo.pt/noticias/besi-e-caixa-bi-lideram-negocios-de-fusoes-e-aquisicoes-em-portugal_143592.html and <http://www.publico.pt/economia/noticia/telefonica-sobe-oferta-pela-vivo-pt-rejeita-mas-vai-ouvir-opiniao-dos-accionistas-1440147>, accessed December 18th, 2015

⁵⁵ €4.5Bn at the closing, €1Bn until the end of December and the remainder until the 31st October 2011.

⁵⁶ Approximately €7.3Bn on the day prior to the announcement

⁵⁷ <http://www.publico.pt/economia/noticia/x-1713019>, accessed 8th December 2015

⁵⁸ <http://www.publico.pt/economia/noticia/x-1713019>, accessed 8th December 2015

⁵⁹ ANBIMA Report. 2011, “Volume de anúncios de fusões e aquisições alcança R\$ 184,8 bi em 2010”, *Ranking fechamento ano de 2010*

⁶⁰ http://www.jornaldenegocios.pt/empresas/detalhe/bes_e_caixa_com_comissotildees_de_25_milhotildees_da_pt_no_brasil.html, accessed 6th January 2016.

⁶¹ Andrade Gutiérrez, LF Tel, BES and Nivalis Holding, N.V. (an Ongoing's subsidiary)

⁶² His role at PT was left to be accumulated by Henrique Granadeiro

⁶³ Excluding stakes held direct and indirectly linked to Oi Group (Oi, Contax Participações, S.A. and Bratel B.V.)

Problems with PT’s Major Shareholder?

Following the 2008 financial crisis and Portugal’s bailout program, the major Portuguese lenders strengthened their balance sheets by using a €12Bn resolution fund created by the assistance program’s authorities. BES instead found means to capitalize without giving away control over the bank, mainly through different companies within GES complex holding structure (see **Exhibit 23 for GES structure**). Bank of Portugal asked for an external audit to ESI’s 2013 reports to assess the risk over the issued commercial paper BES was selling in its branches. The results of the audit came in May 2014 and concluded that the company presented “*a serious financial situation*”, potentially contaminating BES balance sheet⁶⁴ and reputation⁶⁵ – against BdP instructions, in late 2013, to ring fence the financial business and therefore protect its customers. ESFG’ Audit Committee “*also identified materially relevant irregularities in ESI accounts*”⁶⁶. In the wake of the latter report, Ricardo Salgado resigned from a seat he held for 20 years, being replaced, against the family’s proposal – Amílcar Morais Pires –, by Vitor Bento, until then CEO of SIBS, S.A. Morais Pires abandoned BES after declining an invitation to remain on the Board.

Troubling News

Less than two months after the capital increase and at a time PT and Oi teams were strictly focused on the full completion of the merger, the troublesome exposure to Rio Forte’s debt was finally turned public, first noticed by the Portuguese weekly newspaper Expresso and then officially through a corporate announcement. The news echoed across the Atlantic Ocean and Oi’s Board urged to communicate that they were “*not informed, nor did (...) participate in the decisions that led to the implementation of this financial investment (...)*”⁶⁷. However, Carlos Tavares – CMVM’s Chairman – said that “*the circulation of information enabled Oi to know [about the investments]*”⁶⁸. It remained unclear whether Zeinal Bava, once the steersman of the Portuguese carrier, knew about the investments. In less than a month, PT lost close to half of its market capitalization (**Exhibit 24 for share price evolution**).

The Inconvenient Truth

PT’s Board requested an independent audit to trace all financial relations between PT and GES since the strategic partnership established in 2000. According to the report built by PwC and despite several omissions⁶⁹, PT’s long-lasting exposure was carried out under a sequence of “job orders” (**Exhibit 25 for report highlights**) that gave members of the Executive Committee powers to autonomously invest treasury surpluses for periods no greater

⁶⁴ On July 10th, BES revealed its exposure linked to GES amounted to €1.18Bn in loans, securities and other financial instruments as of June 30th. <http://www.bloomberg.com/news/articles/2014-07-10/espírito-santo-discloses-1-2-billion-euro-exposure-to-e-s-group>, accessed 29th November 2015

⁶⁵ There were many BES directors with positions in several GES subsidiaries: <http://www.publico.pt/economia/noticia/irregularidades-na-esi-podem-beliscar-reputacao-e-cotacao-do-bes-1636836>, accessed 25th November 2015.

⁶⁶ http://economico.sapo.pt/noticias/auditoria-releva-irregularidades-materialmente-relevantes-na-esi_193782.html, accessed 27th November 2015

⁶⁷ Material Fact disclosed by Oi, 2nd July 2014

⁶⁸ <http://www.ionline.pt/266801>, accessed 11th November 2014

⁶⁹ “*The definition of the terms is defined by the customer [PT] (...) and we removed from the report what, according to the customer, should not be there. And it no longer included value judgements of legal order*” – José Alves, Territory Senior Partner of PwC Portugal and <http://www.publico.pt/economia/noticia/pwc-declara-que-relatorio-nao-esta-de-acordo-com-as-normas-internacionais-de-auditoria-1681701>, accessed on 29th October 2015

than 180 days and with no restrictions of amount. In fact, the investments “*have never been subject of approval or previous appraisal by the Board of Directors, the Executive Committee and/or the Audit Committee.*”. The auditors also relate meetings between key executives of PT and BES, one of those “*about the continuation of the existing investments in commercial paper issued by Rioforte*”, allegedly mandated by the respective CEOs. Nonetheless, the defaulted company’s ominous annual report was only received by PT three days before the latter decided to announce the bomb clock. Granadeiro ended up resigning from his seat in early August: “*I can live well with my acts, but not with the charges and liabilities of others*”, he wrote in his resignation letter.

The Lusophone Dream Stands Still

The day after Rioforte’s first default, Oi and PT issued corporate announcements reassuring investors about their plans to proceed with the merger, albeit with some changes: the claims on the debt, transferred to Oi in the capital increase, would be shifted back to PT in exchange for 6-year maturity call options⁷⁰ on Oi shares. The transaction left PT shareholders with a 25.6% equity participation on CorpCo. PT, SGPS would remain publicly listed with nothing but the aforementioned assets. After a steep decrease⁷¹ in prices, PT (3%) and Oi (10%) seen their shares in a rare positive session at the announcement day (**see Exhibit 24**): “*(...) this deal is significantly positive for PT investors and modestly positive for Oi investors, with it very much in the interest of both parties to progress with the merger*”, a Credit Insights’ Senior Analyst said⁷².

On July 22nd, the Luxembourg-based holding Rioforte ended up filing for creditors’ protection, shortly after missing the second payment on the commercial paper to PT, following its parent’s footsteps, ESI. However, the Luxembourg court denied the request for controlled management procedures, meaning the companies would go into a liquidation process.

BES Resolution Plan

The Ponzi scheme held and hidden through window dressing and internal cross-financing was too fragile and collapsed abruptly⁷³. On the 30th of July, it was now time for the Portuguese biggest lender to disclose its problems: BES posted a €3.6Bn first-half net loss, the largest in the corporate Portuguese history: people could not believe in such a mismatch between Carlos Costa and the President’s statements and the real dimension of the problem. Two days after, BES stocks’ trading was suspended after plunging 40% (**see Exhibit 24 for share price evolution**) and on the following Monday, Carlos Costa announced the resolution plan, where BES healthy assets – the 10.06% equity held over PT included – would be allocated to a new institution called *Novo Banco* (the *good bank*) while the remaining stood at the *bad bank* and would be liquidated afterwards. *Novo Banco* would be capitalized through a massive €4.9Bn bailout package⁷⁴ and expected to be offered for sale subsequently. PT’s investment in

⁷⁰ Option rights will be reduced by 10% at the end of the first year and 18% subsequently.

⁷¹ PT and Oi seen their shares decrease 32% and 21% since June, 30th until July, 15th.

⁷² <http://www.reuters.com/article/portugal-bes-pt-idUSL6N0PR1H220140716>, accessed 19th November 2015

⁷³ ESI, ESFG, ES Financière, Banque Privée ES filed for bankruptcy in less than a month.

⁷⁴ Funds came from the Resolution Fund set up in 2012 under Portugal bailout program.

BES (*bad bank*) shares was turned to dust. Fortunately, it had withdrawn the deposits (€128M) held in the bank within the last month before the bailout⁷⁵.

“It’s a lesser of two evils, but PT really shot itself in the foot with that loan.”

– Allan Nichols, Senior Analyst at Morningstar Equity, September 8th, 2014 (*in Reuters*)

Oi and PT signed a second MoU with the proposed amendments, being approved by 98.25% of the shareholders in a GSM held on September 18th. However, not everyone was conformed: Octávio Viana, minority shareholders’ representative, transmitted huge dissatisfaction with the deal and the promiscuity revealed in the PwC audit and filled a class-action suit against all PT management teams since 2001. At that GSM⁷⁶, João Mello Franco, Chairman of the Audit Committee and Non-Executive Director of PT for more than 20 years, was nominated as the Chairman of the Board.

Other Priorities

In the middle of the turmoil, in early October (a year after the announcement of the merger), rumours appeared linking the billionaire Patrick Drahi and its multinational cable carrier Altice to the Portuguese assets of PT Portugal⁷⁷, showing plans to further expand⁷⁸ in the Portuguese telecom market. By its turn, Oi repeatedly stressed the will to reinforce its financial capacity – namely through the sale of non-strategic assets – in order to enable strategic moves in Brazil. On the 7th October, Zeinal Bava stepped down from CEO, *“potentially paving the way for a breakup of the indebted Brazilian phone (...) with Portugal Telecom SGPS SA.”*⁷⁹. Conversations run and, despite having a private-equity consortium⁸⁰ as a competitor, Altice managed to negotiate with exclusivity the final terms of the deal. The enterprise value for the targeted⁸¹ assets was set at €7.4 billion⁸².

Portugal Telecom to have the Final Say

Oi’s Board approved the sale of PT Portugal assets to Altice, being the success of the transaction subject to the approval of market regulators and the Portuguese shareholders in a GSM to be held in January. On one hand, the sale of Portuguese operations will preclude the dream of a transatlantic carrier with intents of covering the Lusophone world; however, the Brazilian partners showed relentlessly biased toward a fast and significant cash-in and do not seemed worried with expanding but rather consolidating home operations. The historical telecom operator, once a well-recognized multinational company, might see its position reduced to a 25.6% stake in a Brazilian company and a debt over a defaulted company... But will an opposition to the transaction be worthwhile?

⁷⁵ http://economico.sapo.pt/noticias/pt-retirou-todos-os-depositos-do-bes-num-mes_199104.html, accessed 2nd December 2015

⁷⁶ Held on September 18th. Additionally, with no operations left to manage, PT’s executive body was dissolved.

⁷⁷ Meanwhile transferred to Oi in the CorpCo constitution process

⁷⁸ Altice had recently acquired the telecom operators Cabovisão (2012) and Oni (2013)

⁷⁹ <http://www.bloomberg.com/news/articles/2014-10-08/oi-ceo-bava-resigns-amid-deal-speculation-in-brazil>, accessed 1st December 2015

⁸⁰ Apax Partners and Bain Capital Partners

⁸¹ Assets in Portugal and Hungary

⁸² After applying adjustments for cash, debt and a €500M earn-out paid upon the completion of certain revenue targets

Teaching Notes

The case relates the events that decisively contributed for the deterioration of the Portuguese telecommunications company Portugal Telecom, SGPS (PT) since its establishment as a public monopoly until being reduced to a mere holding with no operations, a defaulted €897M debt and a 25.6% stake on a heavily indebted Brazilian carrier. The strategic partnership set in 2000 with the century-old Banco Espírito Santo (BES) and the Government-owned bank Caixa Geral de Depósitos (CGD) – together with the privileged-shares retained by the Government after the privatization – gave room for a set of decisions whose economic and ethical sense is nowadays fiercely contested by the public in general. The major shareholder have seen its position reinforced and propagated into the Board to collude against an undesired takeover in 2006, being compensated with a generous dividend and the spin-off of PT’s multimedia subsidiary. In 2010 came the sale to its long-lasting partner Telefónica of the co-founded Brazilian mobile operator Vivo, being initially blocked by the Government which interfered by “ordering” PT to stick to its presence in Brazil. Oi, the leading and leveraged Brazilian operator, enabled PT to make a bulky cash-in with the sale of Vivo, enough to pay the new strategic arrangement and to reward again PT shareholders. While PT and Oi were processing the merger, PT’s reckless investment in Rioforte – the non-financial head of Espírito Santo Group (GES) and parent of BES – was turned public, disrupting the merger. GES domino-fall did not take long to contaminate PT and the Lusophone operator’s dream.

The discussion of the case should be centred on the corporate governance issues within the telecom operator and on the way it relates with its stakeholders, in particular about the mechanisms that rule the interaction with those who constitute a related party. The case pretends to clarify the role and accountability that diverse corporate bodies should have in an organization. Additionally, students should assess to witch extent a partnership with financial institutions is consistent with the best practices of market/risk analysis and the advantages of diversification in investment decisions. Ultimately, students should be able to identify and explain how entities with stakes not considered relevant can exert unmeasured interference in the control of a company and how can control diverge from ownership.

The case is directed to be analysed in courses that cover corporate governance themes, corporate decision making, ethics and corporate standards as well as the principal-agent problem. It is recommended for courses such as corporate finance, applied corporate finance and corporate governance. To better understand the case and its learning purposes, the student should be able to have basic understanding of the dynamics of (1) M&A transactions such as spin-offs, mergers and takeovers, (2) capital markets behaviour and signalling and (3) the principal-agent problem.

Proposed Case Analysis

- 1. Which were the real motivations underlying the blockage of SONAE’s takeover attempt? In which way this episode revealed crucial in the history of PT? Analyse and evaluate the defence process.**

The lack of consensus before the takeover attempt was clear among shareholders and was ultimately proven with a historically tight voting for the removal of binding clauses (of the total shareholders, only 31.4% voted against the removal of the clauses). The management, afraid of losing their seats in the takeover, sought to (1) deliberately manipulate the shareholder base with the inclusion/reinforcement of anti-takeover investors (creating a sort of iron curtain) and

(2) lure most of shareholders with a massive remuneration plan (**Exhibit 12**), eventually deviating capital from PT future growth's funding. In fact, the members of the Board were themselves proposed by the major shareholders and their choices seemed to rely on their capability to deal with (or, regardless of the terms, shield PT from) the hostile takeover. BES and CGD, through the strategic partnership established in 2000, could lose (at least, part of) a revenue stream that was virtually taken for granted, as well as the generous remuneration policy PT maintained for years and reinforced to counter the takeover (**Exhibits 3 and 19**). Additionally, the private lender helped on the defence by partly funding Ongoing's investment in PT, a strong advocate of the latter's independence (acting as a *White Knight*). By its turn, one can establish a conflict of interest in José Berardo's intervention; he might have increased its stake to increase the odds of blocking the transaction in exchange of selling some of its assets at an attractive – and, it seems by the 2008 revision, generous – price.

This episode marked the history of PT as for (1) the changes in the management, with personalities (aligned with the major shareholders' and Government's interests – **Exhibit 11**) that would reveal critical in the path PT followed thereafter, (2) changes in the shareholding structure (**Exhibit 9**), accounting for the inclusion and reinforcement of a perennial and pretty much inter-aligned major shareholder base (which, as seen further in the case, took decisions regardless of PT workers' and minority shareholders' will). Finally, it marks the beginning of an increase in the dividends distributed per share (and the remuneration policy in general, with shares buyback programs included), amounting to €9.5Bn since the takeover announcement until 2014, an amount exceeding PT's market capitalization throughout most of those years (**Exhibit 19**).

2. How would you describe the remuneration policy PT adopted since 2000? Was it protecting shareholders' interests?

(**Exhibit 19**) In principle, a company – that may be considered as capital intensive – that grants so much money along the years (being a significant part related to (1) the remuneration plan to counter Sonaecom's hostile takeover (**Exhibit 12**) and (2) the sale of Vivo) seems not to be caring for the long-term interest of the company. However, PT appeared to be a modern company, offering state of the art know-how to its Brazilian subsidiary, highlighting the role of PT Inovação as an innovation's catalyser. Although the right answer, given the information available, is not clear, the promiscuity revealed in the relations with some major shareholders signals a bias towards short-term profit rather than assuring the sustainability of the company.

3. Was the strategic partnership with BES and CGD appropriate to an ethical – and financial – standing? How is it related with the unpleasant fate PT followed?

If investments in financial instruments are to be made attending market conditions and risk analysis, the existence of an agreement with two financial institutions can undermine those principles, as it is related in the extract of the PwC report. PT was not only incited to invest in BES instruments but it seems that the partnership not only included more than financial services (security, healthcare and cleansing services – **see note 5**), but it [the partnership] also spilled all over GES structure – even in companies whose financial viability was unknown (Rioforte) – which may be ultimately considered as the main reason why the Lusophone dream – the merger with Oi – fell apart. Analysing **Exhibit 3**, one can see CGD and BES together represented 46% (€997 million) of the total transactions made with major shareholders (as

revenues and gains account for interests received, the associated deposits represent a benefit for CGD and should be taken into consideration) in the given timeframe (approximately 7 years). Obviously, the issues raised do not merely constitute a pure consequence of the establishment of a partnership (rather call it a *corrosive* partnership); lots of checks and balances failed/were manipulated to permit such reckless levels of exposure (for more details see answers to questions 8 and 9). Nevertheless, the key message is that the line separating financial transactions in market conditions from those disregarding competitive offers can easily be disrupted by such an agreement.

4. Is it fair to say that any shareholder(s) controlled PT Group? To which extent? How does it achieved such control?

Owning is not the same as controlling. Typical examples are those where the cash-flow rights are inferior to control rights, either through stock pyramids (the effect of indirect participations), cross-ownership (separate companies own shares of each other) or dual class shares (stocks with differential voting rights) or also management participation⁸³. The distortion between owning and controlling hovered PT throughout the years: (1) the Government had great power on critical matters through their *golden shares* and extended its control in the Board (through personalities closely related to the socialist Government) and with CGD as a major shareholder; (2) BES, together with the cross-holding in the light of the strategic partnership, might have stretched its influence over Ongoing Investment Strategy as the bank revealed to be an important financier (in other words, BES summoned the *White Knight* at the time of the Sonaecom's takeover attempt). After the 2006 elections, PT's Board included the presence of 4 people direct or indirectly related to BES (Joaquim Goes Luís Pacheco de Melo and Amílcar Morais Pires). The fourth is Nuno Vasconcellos, Ongoing's CEO, who has family ties with Espírito Santo Family. Its [Ongoing and, therefore, BES] influence extended when, a year later, his wingman Rafael Mora was elected as Non-Executive member. In short, and analysing the set of decisions made in the time span covered, it is fair to say that the Government – until mid-2011 – and BES had relevant control on PT, despite their relatively reduced ownership. The lenders' control may be also identified by the meeting arranged by César Alierta with BES, detecting its influence on PT and therefore seeking to ease the purchase of Vivo's stake.

5. The Government – through its *golden share* and CGD – intervened in critical corporate decisions throughout the history of PT. Do you think the existence of special right shares made sense in the context provided?

The *golden shares* provided the Government with decision power on critical matters such as dividends and shareholding policy, Board composition and general strategy, namely M&A and capital structure (**Exhibit 2**). The *golden shares* were originally created to oversee the so-called *public utilities*, being those products “*of fundamental importance for a country's existence since not only its economy but above all its institutions, its essential public services and even the survival of its inhabitants depend upon them*”⁸⁴.

The answers to this question are multiple and each country, political and corporate culture has different ways of dealing with the Government's intervention on private companies. The rights

⁸³ Bebchuk, Lucian Aye; Kraakman, Reinier; Trantis, George. 1999 “*Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control From Cash-Flow Rights*”, pgs. 2-8

⁸⁴ Grundmann and Möslin, “*Golden Shares – State Control in Privatized Companies: Comparative Law, European Law and Policy Aspects*”, pg. 662

embedded aimed at guaranteeing that the company did not follow a path that may move away from/goes against its strategic importance to Portugal, namely as a prevention from foreign takeovers.

However, the existence of *golden shares* was tending to disappear in Europe. Moreover, the legality of those instruments has been challenged by the European Commission, which claimed that it discouraged competition and investment in the sector, thus violating EU laws. In fact, it can be said that the *golden share* distorts the one share-one vote policy and makes the investment in one share less attractive from a control point-of-view, translating a restriction to the free movement of capital. Despite the strategic value PT comprised, it may not be considered a public good: this view is reinforced in the context of telecommunication's liberalization in Europe and Portugal in particular.

6. Once PT Multimedia's spin-off got completed, not even the Portuguese regulator could clearly assess whether the transaction created a full-fledged competitor. If you were ANACOM, what would have you decided?

With the lack of market data that could translate the behaviour of PT and PTM (hereinafter called ZON), one can only rely on indicators that could incentivise the existence or absence of competition. On one hand, it is known that human capital had been completely split, with no Director accumulating functions in both companies. Also, PT no longer had a relevant equity participation in ZON (the residual stake was maintained on a financial approach and was too small to be considered from a control perspective) and that, according to ANACOM's report, PT and ZON were launching "*competing offers*". On another hand, the permanence of common relevant shareholders must be taken into account and enhanced if one takes the whole picture while thinking of the activist role those shareholders have had along PT's walkthrough. Furthermore, one can see (what appears to be) a sudden change in the shareholding structure with the appearance of 5 new "qualified shareholders", corresponding to the leave of the major shareholder, CGD, and two other common shareholders, CInveste and Telefónica, with no relevant connotation at a first sight, tough.

One can see that PT's main segments have not had a positive year prior to the spinoff and that, technically, ZON was better resourced to provide triple and quad-play (bundled) services than PT. Once again, there is no exact answer but, considering the influence major shareholders – mainly CGD, BES and Ongoing – had on PT, the inertia can be explained as to soften/moderate the competitive foray in the first years as to give time to PT to prepare to compete against ZON.

7. What is a related party? Has PT dealt correctly with the issue? If not, would you propose a suitable oversight of such matters?

Definition of related party according to IAS (International Accounting Standards) 24.9 to be found in <http://www.iasplus.com/en/standards/ias/ias24> - "*Who are related parties?*" A party is related to an entity if it has any *relevant* degree of influence – association, control (joint or individual) or relationship of other nature (e.g. familiar) – that might lead to a distortion (conflicts of interests) on the way those parties relate to the *reporting entity* – in this case, PT. Examples of related parties are owners' family members, directors/shareholders and companies owned/controlled by them, companies belonging to the same group and post-employment benefit manager.

(Exhibit 25 – PwC Report’s Highlights’ analysis is permanently necessary hereinafter) PT experienced troublesome episodes that illustrate its lack of clarity when dealing with related parties. The controversial case involving the alleged (in)existence of appraisal by the Investment Committee of the employees benefits’ fund manager is the first: according to Jorge Tomé, the investments in an Ongoing fund were never discussed in the Investment Committee’s meetings. The issue was raised by him and were immediately denied to the press⁸⁵ by two elements whose independence before the transaction is doubtful: the first – Fernando Soares Carneiro – moved to Ongoing after resigning at PT; the second, Rafael Mora, was Vice-CEO of the BoD of Ongoing and inclusively was found to correct his public statement later in an attempt to drag the scope of the responsibilities from the Investment Committee to PT Directors. Jorge Tomé’s statement (“*Investments with related parties should be object of internal regulation*”) can be seen both as a warning and an omen for the disastrous related parties’ management at PT. It is related by PwC that PT did not consider BES shareholders as related parties. The same obviously did not apply to BES itself. BES, as history showed, significantly influenced PT, to say the least. PT was labelled by many as sort of *cash cow* for BES (see question 3), its parents and close shareholders (**Exhibits 3 and 19**).

It seemed that most of the proper control and evaluation mechanisms were put to work with internal control and risk management systems inherent to the “*altered Anglo-Saxon model*”, mainly through the Corporate Governance and Audit Committees functions (the tighter control seemed to work from February 2008 until September 2010, when PT’s exposure to GES’ debt was null). However, it got clear that not only PT invested a great stake of its treasury surpluses in a related party but also demobilized deposits and even issued additional debt (!) to invest the amount supposedly – and according to PwC report – requested by Ricardo Salgado in the – so far – unknown Rioforte.

All of this was possible due to the creation – and, within the Executive Committee⁸⁶, the approval – of job orders that gave, to single individuals, the power to take investment decisions “with no value restrictions” regarding those treasury surpluses. Not even a job order (409) replacement permitted the exposure to be controlled: two months were enough to implement another job order to exempt related parties’ transactions from the Audit Committee’s approval, if made in market conditions. Even the bodies responsible for verifying the accuracy of the financial statements – CPA, Audit Committee and the External Auditor – failed to notice a mistake when omitting the short-term investment’ benefiter – ESI. PwC report also relates the absence of risk and market analysis prior to the lethal investments made and contradictory statements received, showing the lack of transparency in the information flow.

In short, one can say that mainly (1) the Corporate Governance Committee and (2) the CPA, Audit Committee and External Auditors – were too passive and reckless in their duties: the first failed to identify and react upon the creation and abusive overwriting of the famous job orders, that translated into an excessive concentration of powers and the absence of appraisal by the Audit Committee, procedures that go against the best corporate governance practices. The latter bodies not only lacked capacity to detect the absence⁸⁷ of risk and market analysis and

⁸⁵ Diário Económico, owned by Ongoing

⁸⁶ Should not the approval of these job orders be conditioned, at least, to the analysis of the Corporate Governance Committee?

⁸⁷ The auditors’ report relates that they were not provided with the documents. Assuming that providing them would only benefit PT’s Board, it is fair to assume that the absence of its delivery indicates that they did not exist at all.

diversification criterion that should rule the investments – under the job orders but also out of it –, but also failed to spot the inaccurate reporting in the notes to the 2014 financial statements. Provided that, in the existing control system, the Executive Committee had no need to consult the Audit Committee on those matters – but had, through its CEO, the duty to provide information “to the Chairman of the Board of Directors and of the Audit Committee all notices and minutes of the meetings of the Executive Committee (...)”⁸⁸ –, the latter should at least have asked for the *Tableaux de Bord* or another reporting tool that could depict the financial situation of the company to properly assess the risks embedded.

No matter how robust and fool proof the control mechanisms may seem, it appears they will never be the pinnacle of a company’s (and its decision-makers’) behaviour. However, it is also clear that such job orders are deemed not to exist – or should at least be submitted to previous and independent analysis and appraisal – in a company that praises (and is awarded) for good corporate governance practices. Furthermore, all decisions that aim at streamlining processes should be approved either in the BoD or subject to further appraisal by the Audit and/or the Corporate Governance Committee.

8. CMVM’s Chairman was sure that, even if Oi did not know about PT’s exposure to Rioforte’s debt, it had the means to do so. Based on the information available, do you share his view? Why?

At the time of the strategic partnership, it is presumed that each company conducted due diligence over each other to know better the current conditions, weaknesses and opportunities that could affect the partnership, being the diligence reinforced before the two parties decided to merge. The first operation [strategic partnership] happened at a time when PT’s exposure to GES was inexistent but, even if the exposure existed, it was not likely that it would be correctly stressed anywhere, as the PwC report relates.

Still, one can look at the role Zeinal Bava allegedly (see **Exhibit 25**) had on the scandal: he still run PT at the time of the €750 million investment in ESI and most likely had the same – or more – means to know that the increase in the exposure to GES instruments was made with recourse to debt issuance. It is noteworthy to call the attention to the information – again, provided in PwC’s report – made available by BES’ CFO – and PT’s Board member – that said Bava participated in the informal agreement prior to the meeting arranged to extend PT’s investment in Rioforte’s debt. It is – assuming the statement is true (recall the contradictions in the interviews revealed in the same report), though, unknown whether he transmitted this information to the rest of the Board once he moved to Oi as CEO.

9. Analyse the Corporate Governance structure of PT. Were all necessary checks and balances put in place to prevent conflicts of interest in the decision-making process? Briefly identify the main conflicts of interests arising throughout the case.

The Corporate Governance model existing prior to June 2007 lacked the clear separation of powers between execution and supervision bodies, allowing for the Chairman to accumulate CEO functions and vice-versa. Once PT adopted the “altered Anglo-Saxon model”, the theoretical framework brought more of the best practices missing previously. The Compensation Committee and the Statutory Auditor were separated from the Board, (in

⁸⁸ Exhibit 14 – Key Corporate Bodies’ Responsibilities (Executive Committee’s Section)

principle) empowering the impartiality of its supervision and evaluation. By its turn, the absence of restriction in the re-election carries both pros and cons: while the longer tenure incentivises managers to think long-term and may allow for an improvement in the decision-making, some (major) shareholders (blocks) – and the managers themselves – may force excessive inertia and a “corporate dictatorship”, regardless of corporate achievements, as long as the blockers are satisfied. The theoretical independence conceded to the Audit Committee is also noteworthy, although the clear separation from the Board was still not put in place.

In theory, most of the checks and balances necessary to block the conflicts of interest were put in place, but in some cases they were overwritten by job orders whose appraisal was needed, at least, by the Corporate Governance Committee, failing thus to comply with its responsibilities. The responsibilities conveyed in each body (**Exhibit 14**) obliged the information regarding the investments made in GES companies to flow, at least, to the Audit Committee.

In particular, the Board failed to ensure that “the company has effective internal control, risk management and internal auditing systems implemented”; the Executive Committee failed with its fiduciary duty before all the shareholders; the Audit Committee neither checked properly “the accuracy of financial statements” nor supervised “the quality and integrity (...) and control the preparation and disclosure of financial information”. Finally, the Corporate Governance Committee failed in the “review and permanent evaluation of the corporate governance model, of internal rules and procedures”. To note the presence of the *golden shares* present in the statutes and imposed at the time of the privatization, whose interests majorly conflicted with the management’s and shareholders’ at the sale of Vivo.

The conflicts of interest occurred (1) the major shareholders and the management to the minority shareholders and PT workers at the time of the hostile takeover (see question 1); (2) the opposition from the Government to the sale of Vivo conflicted with the management and the shareholders’ interests, “obliging” PT to maintain operations in Brazil; (3) the role of BES in Vivo’s sale, cashing-in twice with the deal: through dividends and BES’s (the Investment Banking segment of BES) advisory fees (as well as Caixa BI, closely linked to CGD) and enhanced reputation in the Brazilian market (being the advisory role extended to the settlement of the partnership with Oi); (4) the controversial investments made on an Ongoing fund and in BES related entities, overlapping the latter’s interests to those of the remaining shareholders, and (5) (in theory, but with no relevant outcomes – at least, made public – in that sense) the nomination of João Franco Mello, the Chairman of the Audit Committee, to temporarily be the Chairman of the Group, disrupting the good principles of corporate governance (decentralisation of powers). Finally, one can also recall the informal deal Telefónica made with Sonaecom to sell its stake upon a revision that pleased – regardless of the other shareholders’ opinion or the strategic fit of the offer – the Spanish telecommunications operator.

Board Plan

In order to prepare conveniently the students to efficiently absorb the key learning objectives proposed, students should be given a brief intro about the following themes:

- Corporate Governance models, general trends and powers separation;
- Exposition of the principal agency problem and its possible scopes (shareholders-management; audit body(ies)-management; minority shareholders-controlling shareholder; within elements of the Board of Directors and shareholders-related parties) and the possible

origins (personal ties, roles held elsewhere, % ownership/control in the company, financial (or other) benefits);

- The role of independent directors; the concept of independence;
- The extent of Government's intervention in private companies, recent trends (e.g. the German case of Volkswagen);
- The concept of related party and the problems that may arise (e.g. the Enron scandal).

Epilogue

PT's GSM to decide on the sale of PT Portugal to Altice was scheduled on the 12th January 2015. However, following PwC audit' release – January 8th – CMVM required PT's Board to provide all necessary information for its shareholders to make a sound judgment, which postponed the final decision by ten days. During that gap, the rebellions led by PT workers against the sale to Altice and the merger with Oi decreased, with a bitter sensation of impotency toward PT's imminent fate. With less than 45% of shareholders represented and 34% of voters – a record low attendance –, the sale was approved with 97.8% of the voting cast. This represented the end of *“the creation of a Portuguese-language operator, (...) which was a great shame”*, said PT's new Chairman João Mello Franco. *“There was an emotional debate (...) It was the best solution.”*, he added. Happy to be now able to repay some of its huge debt burden was Bayard Gontijo, Oi's CEO: *“This is the best for the two companies, for PT Portugal and Oi”*. On April 2015 it was time for the European Commission to approve the sale under the condition that Altice disinvested in Oni and Cabovisão, removing competitive pressure (concentration) from the Portuguese fixed telecom sector. Oi cashed-in €5.8Bn and gave Altice the official control of PT Portugal on June, 2nd.

PT Portugal, through MEO, still leads the market but is recording the *“lowest value since the beginning of liberalization, [being its market share] for the first time below 50%”*⁸⁹. As for PT, SGPS, it changed name to PHarol, SGPS, changed its headquarters and initiated lawsuits against some ex-Directors of PT, namely Henrique Granadeiro, Amílcar Morais Pires and Luís Pacheco de Melo, with the possibility of enlarging the targeted list. Granadeiro countered with another lawsuit to nullify the accusations against him. The process is ongoing and is not predicted to be solved in the meantime.

With respect to the spin-off of PT Multimedia, the apparent shareholders' inertia lasted until the businesswoman Isabel dos Santos⁹⁰ achieved a relevant control (28.8%) upon the company (in 2009 through Kento Holdings, Ltd.⁹¹ and in 2011 via Unitel International Holdings, BV⁹², where she were a majority shareholder). The businesswoman gave power⁹³ to the rumors and indeed conducted, together with SONAE's team, the fusion between Optimus and ZON that would in 2014 give rise to NOS, nowadays a robust competitor of PT Portugal.

⁸⁹ http://economico.sapo.pt/noticias/quota-de-mercado-da-pt-fica-abaxio-dos-50-pela-primeira-vez-desde-a-liberalizacao_214279.html, accessed 26th December 2015

⁹⁰ Daughter of Angola's longtime president, José Eduardo dos Santos, and richest woman in Africa. Invests in Angola and Portugal in various markets, and recently expanding to telecommunications, retail and real estate.

⁹¹ 10%, apparently financed by CGD:

http://www.jornaldenegocios.pt/empresas/detalhe/entrada_de_isabel_dos_santos_na_zon_financiada_pela_cgd.html, accessed 18th November 2015

⁹² 18.8%, 10.93% of which bought to CGD

⁹³ *“If it was not for Isabel dos Santos' takeover in ZON, where she controls 28.8%, the fusion between the TV-by-subscription market leader' operator and Optimus may have never happened”* – Dinheiro Vivo, March 7, 2013

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