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## ANALYSIS OF PROVISIONS FOR LITIGATION IN COMPANIES OF THE IBEX 35

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## Introduction

In recent years, we have witnessed a considerable increase in the litigiousness of public and private life in Spain. **Society and companies are taking legal action more and more frequently and for a great variety of issues**, which has led to severe overburdening of the courts. Especially during the years of the economic crisis, that increased caseload has been particularly evident in relation to **banking issues**. In July this year, the consumers' association FACUA **reported** that the Courts of First Instance specializing in floor clauses are overwhelmed because they do not have sufficient means to cope with the claims filed in this regard. As reported in the newspaper **El País**, according to data from the General Council of the Judiciary, in the month of June 2017 alone almost 16,000 claims were presented to those courts, and it is expected that, over the course of the year, they will receive more than 190,000 claims related to mortgage clauses.

The **need for companies to make financial provisions** in order to pay the costs associated with these matters has increased very considerably.

In this study, we have examined the **public data which the companies of the IBEX 35<sup>1</sup> provide with regard to the amounts and concepts of provisions for legal risks.**<sup>2</sup> Those data can generally be obtained from the **consolidated annual accounts**, though they are also included in the corporate reports and audit reports.

Though they are listed companies, the regulations are relatively ambiguous with regard to the obligation, or otherwise, of providing information on the legal risks identified (or the lawsuits they are facing), as well as the need to publicize the provisioned amounts associated with those risks. **The regulations makes it obligatory to inform about them if the risk is high**, and it is the company itself and its consultants which are responsible for evaluating that risk, without any other reference criteria which would help to standardize the degree of information and details they must provide. In the end, the decision on whether to inform or not is reduced to a relatively subjective evaluation which depends on the opinion and experience of the experts and the judgment of the company's management.

Likewise, **IAS 37** indicates that, if the lawsuits covered by the provisions are related to third parties and the company believes that the amount reported would cause damage to the company, **it will only inform of the facts and not the amounts.**

Thus, we must understand that, if companies do not inform and do not give details of the amount, **that is not necessarily because they have not identified legal risks or do not have any lawsuits in progress**, but that the company and its consultants do not consider the risk to be sufficiently high.

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<sup>1</sup>The IBEX 35 is composed of the 35 companies with the greatest liquidity listed in the Electronic Stock Market Interconnection System (SIBE) in the four Spanish stock exchanges (Madrid, Barcelona, Bilbao and Valencia).

<sup>2</sup>The amounts of funds allocated to provisions for litigation are those which the company considers could be necessary to meet the costs of ongoing litigation, or for any risks it has identified, even if there are no lawsuits in that regard.



Before going further in the analysis of the figures, it is necessary to explain that provisions are an essential item in the preparation of annual accounts, as well as an aspect to be carefully analyzed by external agents, because, due to the subjectivity inherent in their nature, they can be a focus of irregularities or ways in which the accountancy can be questioned.

In this study, we have taken into account the data attributable to provisions of funds to cover probable lawsuits and other liabilities. Thus, we detail the amounts allocated by the **companies of the IBEX 35** to these provisions in **2016** if they were included in the annual accounts, and we outline the most relevant conclusions by **sectors of activity and types of risks or lawsuits** they must respond to in all the markets in which they are present, though they are listed in Spain. Likewise, in some of the most significant cases, we will consider their evolution compared to the previous year (2015) and will give some information on the provisions of 2017 which have already been published during the year to date.

It is necessary to clarify that, as **there is no specific nomenclature** used by all companies to refer to the provision set aside for lawsuits, the concept taken into account for this study differs in many cases (some examples are “provision for liabilities”, “provisions for taxes and other legal contingencies and other provisions”, “judicial matters and lawsuits for taxes pending” or “provisions for lawsuits, compensation and other legal or contractual obligations”). Therefore, it should also be noted that

it is possible that not all the companies include the same items in the selected provision. Thus, while some include, for example, the provisions deriving from the regulatory framework, others only mention the costs equal to the amounts claimed in the lawsuits.





# Analysis of provision of funds for litigation and risks in companies of the IBEX 35

This study reviews the public information provided in the consolidated annual accounts of the companies of the IBEX 35 in financial year 2016. Thus, we observe that those companies treat the information about provisions for litigation and legal risks in four different ways, depending on whether or not they provide information about the amount and about specific cases:

1. The **vast majority** of the companies (a total of 21 of the 35 analyzed) **indicate both the amount of their provisions and information and details of the cases and the types of risks identified**. Those 21 companies are: Grupo ACS, Repsol, Endesa, Gas Natural, Iberdrola, ArcelorMittal, Acerinox, Acciona, Grupo Ferrovial, Viscofan, Supermercados Dia, IAG (Iberia), Mediaset, AENA, Meliá Hotels, BBVA, Banco Santander, Bankia, Indra, Amadeus and Cellnex.

*The need for companies to make financial provisions in order to pay the costs associated with these matters has increased very considerably*

2. On the other hand, there are eight companies which, **though they report the amount of provisions for litigation, do not give a detailed breakdown of cases or identified risks**. Those companies are Enagás, Inditex, Bankinter, Caixabank, Banco Sabadell, Merlin Properties, Red Eléctrica de España and Gamesa.
3. In addition, there are only three which **do not provide a figure which can be attributed specifically to the provision for litigation, but they do provide information on the cases or the risks identified**. Those three companies are Telefónica, Grifols and Inmobiliaria Colonial.

4. Finally, there are also three companies which we were unable to take into account in this analysis **because they do not indicate the amount or give any other information about their provisions for risks or litigation**, either because they don't exist or because they do not consider them to be of sufficiently high risk to be included in their annual reports. Those companies are Técnicas Reunidas, Abertis, and Mapfre.

## THOSE WHICH ALLOCATE THE LARGEST AMOUNTS:

The companies of the IBEX 35 which indicate that they have set aside funds for lawsuits and risk in this regard **allocated over 11,659 million euros in 2016**. To give us some idea of the magnitude of that figure, it is over five times the amount allocated to the [Ministry of Education, Culture and Sport](#) in the General State Budgets (which was 2,483 million euros in 2016).

The **company which allocated the largest amount in financial year 2016** was **Banco Santander, with almost 3 billion euros, mainly for litigation abroad**, notably tax issues in Brazil, the United States and Spain, consumer claims in the UK, and commercial lawsuits with other companies for different matters, as detailed below in the section on the types of legal threats faced by the analyzed companies. Banco Santander was also in first place in 2015. **The amount allocated by**

**Figure 1. No. of companies according to the degree of information they provide**

		They indicate the amount set aside for provisions for litigation	
		YES	NO
They give information on the cases and/or risks identified	YES	21	3
	NO	8	3

Source: in house



that banking entity is virtually double that of the company with the second largest provision: Repsol, with over 1.5 billion euros set aside for litigation and legal risks (mainly for tax-related issues). The top ten is completed by the following companies, in this order: Caixabank, BBVA, Grupo ACS, Endesa, Iberdrola, Bankia, Ferrovial and ArcelorMittal.

The three companies with the largest provisions in 2016 (Banco Santander, Repsol and Caixabank) accounted for over 50 percent of the total amount of provisions by all companies, due, above all, to the fact that Banco Santander alone represented almost 25 percent of the total.

On the other hand, it is notable that Bankia was in second place among the companies with the largest provisions in 2015, but then fell to eighth place in 2016. In 2015, its provisions were over 1.9 billion euros, whereas in 2016 that amount fell to just over 420 million. That fall is due mainly to the payment of 1.78 billion which the company had set aside in 2015 to meet the claims for the return of the amount invested by minority shareholders in the initial public offering during the flotation of the banking entity in 2011. That payment was finally made at the start of 2016 and it was therefore removed from the provisions of that year, thus reducing the amount allocated.

Figure 2. Ranking of sectors by amount of provisions

Company	Sector	Amount of provisions for litigation and other legal risks
Banco Santander	Financial and Real Estate Services	€2,994,000,000
Repsol	Oil and Energy	€1,501,000,000
Caixabank	Financial and Real Estate Services	€1,458,462,000
BBVA	Financial and Real Estate Services	€995,000,000
ACS	Basic Materials, Industry and Construction	€831,807,000
Endesa	Oil and Energy	€732,000,000
Iberdrola	Oil and Energy	€600,733,000
Bankia	Financial and Real Estate Services	€421,071,000
Grupo Ferrovial	Basic Materials, Industry and Construction	€415,000,000
ArcelorMittal	Basic Materials, Industry and Construction	€351,000,000
Gas Natural	Oil and Energy	€345,000,000
IAG (Iberia)	Consumer Services	€189,000,000
Indra	Technology and Telecommunications	€170,568,000
Acciona	Basic Materials, Industry and Construction	€170,000,000
Bankinter	Financial and Real Estate Services	€95,029,000
Sabadell	Financial and Real Estate Services	€79,404,000
Inditex	Consumer Goods	€57,440,000
Dia	Consumer Services	€41,430,000
Red Eléctrica de España (REC)	Oil and Energy	€39,053,000
AENA	Consumer Services	€36,553,000
Merlin Properties	Financial and Real Estate Services	€34,959,000
Amadeus	Technology and Telecommunications	€24,900,000
Cellnex	Technology and Telecommunications	€22,256,000
Siemens Gamesa Renewable Energy	Basic Materials, Industry and Construction	€16,649,000
Melia Hotels International	Consumer Services	€16,071,000
Enagás	Oil and Energy	€11,235,000
Mediaset	Consumer Services	€9,151,000
Viscofan	Consumer Goods	€398,000
Acerinox	Basic Materials, Industry and Construction	€387,000
<b>Total</b>		<b>€11,659,556,000</b>

Source: in house



In contrast, **the company of the IBEX 35 which registered the smallest provision for litigation**, of the 29 which provide this information, was **Acerinox**, which included an item of just **387,000 euros** for these matters, slightly less than Viscofan, which set aside 398,000 euros.

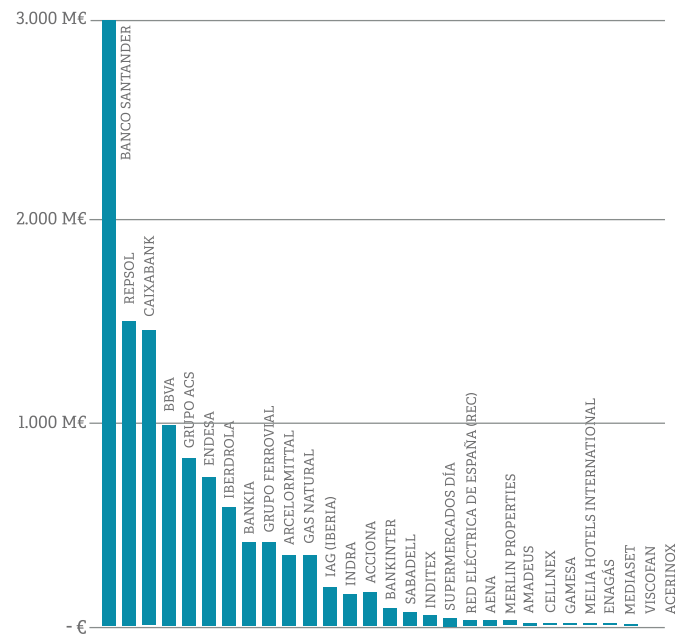
By sectors of activity,<sup>3</sup> it should be noted that the two **sectors with the largest provisions, in both 2015 and 2016, were Financial and Real Estate Services, followed by Oil and Energy**, as we might expect given the data outlined above. The Financial Services sector has the largest number of companies among the ten with the largest provisions (four in total), those being: Banco Santander, Bankia, BBVA and Caixabank.

For its part, the Oil and Energy sector has three companies in the top ten: Repsol, Endesa and Iberdrola. It is closely followed, in third place, by the Basic Materials, Industry and Construction sector, also with three companies in the top ten list: ACS, Grupo Ferrovial, and ArcelorMittal.

However, it is notable that **there is a difference of over 3 billion euros** in this amount between the sector with the largest provisions (Financial and Real Estate Services, with over 6 billion euros) and the second largest (Oil and Energy, with over 3.2 billion), which can be explained above all by the extremely large provisions allocated by Banco Santander. Something similar happens with the difference between the amount provisioned by the second and third largest sectors (Oil and Energy, and Basic Materials, Industry and Construction), with a difference between the two of over 1.4 billion euros. In fact those three sectors together account for over 95 percent of the total amount of funds set aside for these issues in 2016.

At the other end of the scale, the sector of the IBEX 35 with the **smallest amount of provisions in 2016 was Consumer Goods, comprising the companies Grifols, Inditex and Viscofan**. In total, this sector allocated

**Figure 3. Analysis of the amount of the provision of funds for litigation in companies of the ibex 35**



Source: in house

**Figure 4. Ranking of amount of provisions for litigation by sectors in 2016**

2016	
Financial and Real Estate Services	€6,077,925,000
Oil and Energy	€3,229,021,000
Industry and Construction	€1,784,843,000
Consumer Services	€292,205,000
Technology and Telecommunications	€217,724,000
Consumer Goods	€57,838,000
<b>Total</b>	<b>€11,659,556,000</b>

Source: in house

<sup>3</sup> Sectors of activity established in accordance with the Unified Sectoral and Sub-Sectoral Classification, implemented on the 1st of January 2005 and which encompasses six basic sectors of activity:

- Two related to energy and basic industry in the broadest sense: Oil and Energy; and Basic Materials, Industry and Construction.
- Two related to consumption: Consumer Goods and Consumer Services.
- One which groups together activities of a Financial nature: Financial and Real Estate Services.
- One which groups together activities related to technology and telecommunications: Technology and Telecommunications.



over 57 million euros. It is followed by Technology and Telecommunications, with 220 million, slightly less than the 292 million allocated by the Consumer Services Sector.

**THE LEGAL THREATS TO SPANISH COMPANIES:**

In the analysis of the information provided by the companies, we can see that 24 of the 35 which comprise the IBEX explain, in their public reports, the details of lawsuits and identified risks associated with the provision of funds. In this regard, we see that, within the **sector with the largest provisions (Financial and Real Estate Services)**, the companies which explain their lawsuits in greatest detail are **Banco Santander** and **Bankia**. That sector was also the one whose lawsuits aroused the greatest media interest in 2016. However, as we indicated at the start of the study, there are also companies, such as **Inditex**, for example, which, though they give the figure for provisions, **do not provide any information** about the types of lawsuits in which they are involved. We will now outline the most common types indicated in the details given by the different companies which are the object of this [analysis](#):

**Civil Claims:**

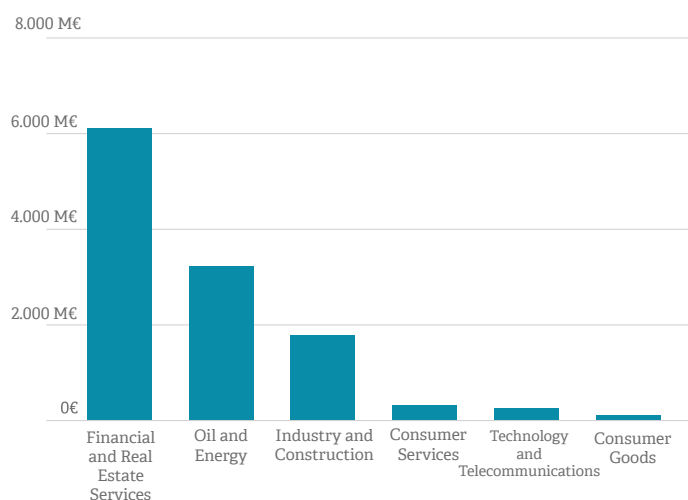
This is a fairly common type, especially in companies in the Financial and Real Estate Services sector. For example, among the lawsuits of **Banco Santander** for which it set aside funds, we find some in the civil sphere for claims for compensation to clients, among others those in the United Kingdom (customer remediation) for payment protection insurance. Also, in Bankia, most notable by far are **civil proceedings** brought by private investors (individual and collective) and extrajudicial claims. In its provisions in 2016, it had 76,546 civil claims, 69,041 of which were ongoing, and 27,448 extrajudicial claims. Likewise, Bankia registered provisions in that year for the 7,776 pending civil claims deriving from the flotation in 2011, subsequent purchases and extrajudicial claims. Of these companies, it is notable that Banco Santander is unlikely to reduce those funds, and indeed everything indicates that the provision will increase in 2017, as it already did in the first half of the year, due to the financial consequences that may derive from its tax, labor, legal, client and regulatory lawsuits following

the purchase of Banco Popular, as reported recently by the newspaper [Expansión](#). However, Bankia could decrease the amount of those provisions, because, as that same [newspaper](#) reported, the entity reduced its fund for claims by 50 percent in the first half of the year, after paying out 4,440 million euros.

It should also be noted that, in their annual accounts, both **Caixabank** and **BBVA** mention the pending lawsuits for floor clauses. Thus, Caixabank set aside 625 million euros to fund the repayment of the corresponding amounts, while BBVA set aside 577 million euros “to cover any future claims which may arise”. However, neither Banco Santander nor Sabadell contemplated provisions for floor clause litigation in their annual accounts, though the latter mentions that “the maximum estimated impact if all the clauses were declared null and void, and considering complete retroactivity, would be 490 million”. With regard to **Bankinter**, though it does make a provision for lawsuits, it does not give details or a breakdown

*The three companies with the largest provisions in 2016 (Banco Santander, Repsol and Caixabank) accounted for over 50% of the total amount of provisions by all companies*

**Figure 5. Ranking of sectors by total amount of provisions**



Source: in house





of them. However, [El Confidencial](#), in an article of the 4th of August 2017, reports that the **claims by clients** against Bankinter had increased by 480 percent comparing the first halves of 2016 and 2017 due to “excessive charging of mortgage costs”.

*there are also companies, such as Inditex, for example, which, though they give the figure for provisions, do not provide any information about the types of lawsuits in which they are involved*

But not only in the Financial and Real Estate Services sector do we find lawsuits of this kind. For example, in the Technology and Telecommunications sector, we see that **Telefónica** recorded proceedings in this sphere for the claim from FACUA due to the rise in prices of Movistar Fusión. Also in the Consumer Services sector, we observe civil claims due to price fixing against British Airways (IAG-Iberia).

#### **Tax-related litigation:**

This is one of the spheres in which the companies set aside the most funds in 2016 due to ongoing lawsuits with the tax authorities in different countries. In this regard, it is notable that **Banco Santander, Indra, Telefónica, Repsol** and **Viscofan** all allocated significant funds due to different lawsuits in **Brazil for tax issues**. But not only in that country were incidents of this kind registered - there are also similar proceedings in other countries, including Spain, which affect some of these companies (Santander, Repsol and Telefónica), and others such as **Amadeus, Endesa, ArcelorMittal, Acciona, Iberdrola, Cellnex, Dia** and **Ferrovial**. Thus, for example, Dia allocates over 23 million for risks deriving from inspection actions by the Tax Authority; Endesa also refers to the inspection actions of the Tax Agency in relation to corporation tax, VAT, and withholdings of personal income tax; Ferrovial provisions 247 million for “different interpretations” which may be made of tax regulations in the different countries in which the group operates; and so on, in a long list of similar issues in the companies cited above.

#### **Dominant position and commercial matters:**

Other legal affairs which account for a considerable portion of the provisions made in 2016 are related to lawsuits deriving from some kind of abuse of market position or other, similar cartel practices. This occurs in seven companies: **ArcelorMittal, Cellnex, Endesa, Ferrovial, IAG Iberia, Iberdrola** and **Indra**. For example, Cellnex (which is in the Technology and Telecommunications sector) has **contentious-administrative lawsuits for abuse of market dominance** in the Spanish TV signal transportation and broadcasting market and for its position in the wholesale services and broadcast centers markets. **Iberdrola** also gives a detailed breakdown of the lawsuits and risks it has identified, notably a number of commercial lawsuits against companies such as BP, Bankia, Euskaltel and Banco Mare Nostrum for matters of different kinds such as breaches of contract, claims for payment, etc.

#### **Corporate and labor actions:**

We also find different references to this type of lawsuits in some of the companies analyzed. Thus, there is a note by **Inmobiliaria Colonial**, which, though it does not include a specific figure for lawsuits, does specify that they have several **corporate actions** against certain former administrators for the purchase of assets and damage caused by acquisitions of shares. Viscofan also indicates lawsuits brought by certain employees against the company’s Brazilian subsidiary; and Dia, for its part, indicated, in its Consolidated Annual Accounts 2016, a provision of over 11 million euros for litigation with workers.

#### **Environmental litigation:**

The **Oil and Energy sector is the one with the most lawsuits related to protection of the environment**, as is logical due to its activity, and **Endesa** is the company which records the most incidents of this type, due, among other matters, to the consequences of **forest fires in Catalonia**. In fact, at the start of 2017, an article was published reporting that Endesa had reached an [agreement](#) to pay compensation of one million euros to the regional government of Catalonia plus a further three million to the municipalities and individuals affected by the fire in Cabanabona (Lleida). Companies such as Repsol, Endesa and Iberdrola also have lawsuits of an environmental nature. In this



regard, **Red Eléctrica de España** specifies that it does not have any lawsuits with regard to the protection and improvement of the environment, while **Enagás** does not provide information of any kind, beyond the amount of its provisions.

**Corruption:**

Some companies, such as **Grifols**, for example, set aside funds for risks of this kind. Thus, this company indicated that it had allocated a provision in 2016 due to an internal investigation in several countries against corrupt practices, without indicating the amount.

**Arbitration:**

Though less frequent, we also find provisions for matters which are in alternative conflict-resolution procedures such as arbitration. **Gas Natural**, for example, has several ongoing arbitrations: one with Qatar Liquefied Gas Company, with the aim of

setting the prices for the gas supplies received by that company; and another with Egyptian Natural Gas Holding, in which Unión Fenosa Gas (a company part-owned by Gas Natural) has initiated arbitration against the Egyptian Government and the supplier for the cessation of the supply to that company and the charge for use of the plant.

*The Oil and Energy sector is the one with the most lawsuits related to protection of the environment*

Likewise, in **Iberdrola** we find an arbitration procedure before the International Chamber of Commerce brought by the company which bought 30 wind farms belonging to Iberdrola, in which it alleges the non-fulfillment of the declarations and guarantees contemplated in the contract in relation to the maximum permitted noise levels.



## Quadruple impact on reputation

Without a doubt, all the **information contained in the accounts and reports of companies** of this size is **sensitive in that it refers to matters which represent a judicial process or risk**. The majority of those proceedings or risks could clearly have an impact on the reputation of those companies. That is understood by, for example, BBVA: in its Consolidated Annual Accounts 2016, it warned of the **reputational risk** to which the sector is exposed, indicating that it is seeing “a growing level of **scrutiny by regulators, governments and society itself**”. It also added that “negative news or improper behavior can mean **considerable damage to the reputation** and can affect an entity’s ability to develop a **sustainable business**”. Likewise, it indicated that the **Financial sector “is exposed to growing litigiousness**, which means that financial entities are facing a large number of lawsuits, whose financial consequences are difficult to determine”. In these cases, it is made even worse by the fact that the vast majority of them end up becoming particularly complex public processes, which are therefore difficult to explain to a reader who is not an expert in the matter, which could, as the banking entity indicated, undermine the sustainability of the activity or the business of those companies.

Companies are only obliged to inform about those affairs if the risk is high, so there is a **judgment component with a high degree of subjectivity**, and they may refrain from indicating the amount set aside if they believe that that could damage them. This allows a considerable margin, which means that **issues which are considered ‘minor’ or which affect third parties which may obtain a benefit can be left out of the details given in reports**.

*In general, providing this information in the reports or annual accounts, even taking into account the fact that they are sensitive cases which affects the reputation*

In general, **providing this information** in the reports or annual accounts, even taking into account the fact that they are sensitive cases which affect the reputation, **can be a good exercise of transparency** by the companies and even a tool which enables the companies to present their visions and positions in this regard, explaining the reasons behind the legal arguments of the lawsuits they are involved in.

However, we must take into account the fact that the information provided in those reports or annual accounts has a direct impact on the reputation for four fundamental reasons:

1. **The mere existence of those lawsuits** or legal risks **means that**, though there has been no firm ruling, **the managerial efficacy of the company or its management team is called into question**. In addition, the larger the amount which the company must set aside for this purpose, the greater the doubts which third parties may have with regard to its management capability and good governance.
2. **The fact that a company faces litigation of different types also has an impact on its reputation**, because it is associated with not just one but several undesirable practices. Thus, a company which is immersed in environmental, fiscal, commercial and civil lawsuits in the same financial year will have an even greater need to put forward a solid, believable narrative which explains its position and minimizes the impact which its involvement in those proceedings could have on its reputation.
3. **Transparency is another important question in the construction of reputation**. The failure to provide information on the amount or the details of lawsuits in companies of this size may be **interpreted in two ways** by those reading the reports or annual accounts: the most positive interpretation would be that the fact that no amount or breakdown is given means the **absence of litigation** or legal risks in the company in question; the most negative interpretation (more probable, given the subjectivity of the



regulations) is that the company is trying to **hide that information**. The lack of transparency is one of the indicators which has the greatest impact on the reputation of any company, so that aspect must be carefully considered when it comes to deciding whether or not to provide that information in the reports and annual accounts.

4. However, in addition to the information which appears in the accounts, the development of **the different judicial proceedings can also generate news and have a very considerable impact on the company's reputation**, due to leaks, actions by the counterparty, sentences and public trials, etc. Therefore, companies need to consider not only the information to be provided in the annual accounts and corporate reports, but also, perhaps even more intensely, the **management of communication during court proceedings**. To minimize the impact on the reputation, it will be vital to have a multidisciplinary team (legal, communication, company executives, etc.),

which works in a coordinated manner in order to communicate the company's position to the affected communities or those which may be interested, in due time and form. It is particularly important that they do this even before any lawsuit exists, i.e., as soon as the risk has been identified, the communication work must begin, thereby making it possible to prepare for and prevent future scenarios.

There can be no doubt that companies' actions, in all spheres, are coming under increasing scrutiny, and that any **lawsuit which a company may face is now more likely to have a direct impact on its reputation**. It is obvious that companies are more willing to inform about their lawsuits and risks in greater detail when they are already public knowledge, but, in today's **hyper-transparent society, a strategy of full disclosure might be valuable** and may enable the company to gain credibility in regard of its management while the legal risk or proceedings continue.

# Reputation Management, Communication and Public Affairs

## Leader in Spain, Portugal and Latin America

LLORENTE & CUENCA is the **leading reputation management, communication, and public affairs consulting firm in Spain, Portugal, and Latin America**. It has **20 partners** and almost **500 employees** who provide strategic consultancy services to companies in all industries, with operations aimed at the Spanish-speaking and Portuguese-speaking world.

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The industry's top two publications have rated the consulting firm as one of the most important communication agencies in the world. It is 54<sup>th</sup> in the **Global Ranking 2016** prepared by The Holmes Report and 53<sup>rd</sup> in terms of global revenue according to PRWeek's Global Agency Business Report 2016.

Most awarded communications firm in the markets where it operates, and has been recognized, in 2017, as the **Agency of the Year in Latin America** (Latin American Excellence Awards 2017).

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