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LEGAL PROTECTION OF MINORITY SHAREHOLDERS OF LISTED CORPORATIONS IN BRAZIL: BRIEF HISTORY, LEGAL STRUCTURE AND EMPIRICAL EVIDENCE

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I. INTRODUCTION

“Shareholders are stupid and impertinent: stupid, because they buy shares, and impertinent, because they demand a return.”¹ This is how Carl Fuerstenberg, a high profile German banker of the between-wars period once referred to minority shareholders. Today, the argument that minority shareholders are mere

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1. Theodor Baums & Kenneth Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31 (2005) (quoting Carl Fuerstenberg).

opportunists lacks foundation.² It is now well established that the existence of vibrant stock markets with ample participation by minority shareholders is an important vehicle for savings mobilization, financial development and economic growth.³ In recent years a number of studies have shown that enhanced minority shareholder protection is associated with higher valuation of corporate assets and with more developed and valuable capital markets.⁴ Because of this, in the past decade a consensus emerged in academic circles suggesting that minority shareholders deserve legal protection not only for equitable reasons, but for efficiency considerations as well.

This article examines key elements in the history, structure, and application of the legal framework offering protection to minority shareholders in Brazilian listed corporations. Such an examination is particularly timely. *The Economist* recently predicted that in the next 10-15 years, Brazil shall become the world's fifth-largest economy, surpassing both France and Britain.⁵ As an increasing number of Brazilian corporations become publicly traded, and stock ownership becomes dispersed, international companies seeking to acquire Brazilian assets will

2. In older texts, it is common to find minority shareholders portrayed on a negative light. See, e.g. Walter Rathenau, *Vom Aktienwesen*, 128 REVISTA DE DIREITO MERCANTIL 202 (2002) (translated into Portuguese).

3. See e.g., Asli Demirgüç-Kunt & Vojislav Maksimovic, *Law, Finance and Firm Growth*, 53 J. FIN. 2107 (1998) (showing that in countries with active stock markets firms were able to obtain larger funding); Ross Levine & Sara Zervos, *Stock Markets, Banks, and Economic Growth*, 88 AM. ECON. REV. 537 (1998) (relating financial development to economic growth); Maurice Obstfeld, *Risk-Taking, Global Diversification and Growth*, 84 AM. ECON. REV. 1310 (1994) (showing that growth is encouraged by the ability of investors to diversify investments through markets); Raghuram G. Rajan & Luigi Zingales, *Financial Dependence and Growth*, 88 AM. ECON. REV. 559 (1998) (showing that in countries with better protection of external investors the industries dependent on external finance are more developed); see also Hal S. Scott, *International Finance: Rule Choices for Global Financial Markets*, in RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW, (A. Guzman & A. Sykes eds. 2007).

4. Rafael La Porta et al., *Corporate Ownership around the World*, 54 J. OF FIN. 471 (1999); Rafael La Porta et al., *Investor Protection: Origins, Consequences and Reform*, NBER WORKING PAPER, n. W4728 (1999); Edward Glaeser et al., *Coase versus the Coasians*, 116:3 QUARTERLY J. OF ECON. 853-899 (2001); Andrei Shleifer & Daniel Wolfenzon, *Investor Protection and Equity Markets*, HARVARD INSTITUTE OF ECONOMIC RESEARCH PAPER NO. 1906 (2000); Robert D. Cooter, *Innovation, Information and the Poverty of Nations*, 33 FLA. ST. U. L. REV. 373 (2005).

5. *Brazil Takes-Off*, THE ECONOMIST MAGAZINE, Nov. 12, 2009, at 15.

have to deal with Brazilian regulations governing tender offers, minority shareholder rights, and fairness opinions and valuations.

This paper proceeds in Section II by examining the history of minority shareholders protection in Brazil. This will give some context to the main reformations to the Brazilian Corporations Law of 1976.⁶ It will also highlight recent developments in the Brazilian stock markets, particularly the fact that dispersed ownership can for the first time in Brazilian history be found in a few listed corporations. Section III presents the main features of the current legal framework for the protection of minority shareholders. It analyzes the most important provisions under the Brazilian Corporations Law, as well as the most relevant regulations issued by the São Paulo Stock Exchange (BM&FBovespa). Section IV presents the results of an empirical study of the degree of enforcement of laws and regulations protecting minority shareholders. The data shows that judicial and administrative application of such legal provisions is still relatively unpredictable and time consuming. Section V concludes.

II. THE PROTECTION OF MINORITY SHAREHOLDERS IN HISTORICAL PERSPECTIVE

The Corporations Law in Brazil governs joint stock companies and contains the most important legal provisions dealing with the protection of minority shareholders in Brazil. Its intellectual foundations can be traced to the Second Plan of National Development (“PND II”), a set of guidelines for national industrial policies that were put in place during the 1970s.⁷ At that time, the formation of large national economic groups was viewed as a central component of development strategies across the developing world. Inspired by a similar law in South Korea, the Corporations Law was conceived as a vehicle that would foster the creation of

6. Federal Law No. 6,404 of 1976.

7. See IV SECOND PLAN OF NATIONAL DEVELOPMENT CHAPTER (ECONOMIC STRATEGIES: BASIC OPTIONS. STRENGTHENING OF THE NATIONAL COMPANY AND FOREIGN CAPITAL); see also 1 ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, *A LEI DAS S.A.: PRESSUPOSTOS, ELABORAÇÃO E MODIFICAÇÕES* (3d ed., Rio de Janeiro, Renovar, 1997); EGBERTO LACERDA TEIXEIRA & JOSÉ ALEXANDRE TAVARES GUERREIRO, *DAS SOCIEDADES ANÔNIMAS NO DIREITO BRASILEIRO* 3-12 (São Paulo 1979); Orlando Gomes, *Fontes e Significado das Inovações da L. n. 6.404*, 275 *REVISTA FORENSE* (1981).

national “champions”—that is, large conglomerates controlled by Brazilian groups.⁸

The Corporations Law of 1976 reflected the political dynamics of the time. The then-incumbent military regime was striving to develop the economy while keeping political power concentrated.⁹ Similarly, the Corporations Law intended to spread capital ownership of listed corporations without democratizing the political power within them. According to most Brazilian legal scholars, the Corporation Law’s central objective was the preservation of the interests of large business groups.¹⁰ At the same time, and sometimes in tension with the goal of protecting controlling shareholders, the Corporations Law sought to extend enough protection to minority shareholders, so as to entice investors to voluntarily turn to the stock market.¹¹

In order to maintain the power structure within the Brazilian corporations that decided to go public, the Corporations Law of 1976 allowed corporations to issue preferred shares. Originally, up to 2/3 of the total capital stock could be comprised of preferred, nonvoting stock.¹² At the same time, the Corporations Law

8. See DAVID TRUBEK ET AL., *O MERCADO DE CAPITAIS E OS INCENTIVOS FISCAIS* (Rio de Janeiro, TN-APEC 1971); see also MÁRIO HENRIQUE SIMONSEN & ROBERTO DE OLIVEIRA CAMPOS, *A NOVA ECONOMIA BRASILEIRA* 206-207 (3d ed., Rio de Janeiro, José Olympio, 1979) (discussing how the enactment of the Corporations Law was part of a broad set of complementary measures designed to develop the Brazilian stock markets, including the granting of tax benefits for both companies that decided to go public and minority investors in the stock market.).

9. A military *coup* set the military forces in power in Brazil in 1964. The country remained under a military regime until 1985, when civil government was reinstated. A new Federal Constitution was enacted in 1988 and has been in full force ever since.

10. See e.g. MODESTO CARVALHOSA, *A NOVA LEI DAS SOCIEDADES ANÔNIMAS. SEU MODELO ECONÔMICO* (Rio de Janeiro, Paz e Terra, 1976).

11. This dual concern for strengthening of the Brazilian conglomerates and protecting minority shareholders can be found in the Motives (“*Exposição de Motivos*”) of the Corporations Law (EM No. 196/76) written by Mário Henrique Simonsen, then Minister of Finance:

4. The project basically aims at creating the legal structure necessary for strengthening of the country’s capital markets, which in the current stage of the development of the Brazilian economy is indispensable for the survival of private companies. The voluntary mobilization of savings toward the productive sector requires the establishment of a system that ensures minority shareholders the observance of clear and equitable rules that are appealing in terms of security and profitability without paralyzing the business community. MÁRIO HENRIQUE SIMONSEN, *EXPOSIÇÃO DE MOTIVOS*.

12. The permission to issue up to 2/3 of nonvoting stocks means that in the simplest ownership structure a company could be controlled with just one

required that such preferred nonvoting shares were granted some economic advantages over voting shares. It thus became common for listed corporations to establish a very narrow economic advantage for nonvoting stock only for the purposes of fulfilling this legal requirement. Listed corporations usually had bylaws establishing that nonvoting shares had a priority over voting shares upon liquidation. In practice, however, bankruptcy proceedings were such that shareholders (both voting and nonvoting) were left with hardly any value upon conclusion of the liquidation. The Corporations Law awarded minority shareholders a set of individual rights and established fiduciary duties and obligations for the corporation's administrators and controlling shareholders. Furthermore, the government created the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários* - CVM) which was, and still is, in charge of regulating and supervising securities markets.¹³

The Brazilian Corporations Law was basically in line with the state-led, import substitutions industrialization models of development prevailing in the mid-1970s.¹⁴ This largely explains why the law was not substantially amended until those models lost their supremacy in the policy debate. In Brazil, the shift between economic models gained momentum with the country's democratization and the economic reforms championed by President Fernando Collor (1990-1992), and consolidated by presidents Itamar Franco (1992-1994) and Fernando Henrique Cardoso (1995-2003). As a result, the Corporations Law was twice reformed, first in 1997¹⁵ and later in 2001.¹⁶

The 1997 reform of the Corporations Law aimed at facilitating the ongoing Brazilian privatizations program that was occurring at that time.¹⁷ The most relevant, and most polemic, change brought

sixth of its capital. Moreover, with additional layered structures control could in theory be exercised with an insignificant capital stake.

13. The CVM was created by Federal Law No. 6,385 of 1976. It is a federal agency linked to the Ministry of Finance.

14. Jeswald W. Salacuse, *From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World*, 33 INT'L LAW 875 (1999).

15. Federal Law No. 9.457, of 1997.

16. Law No. 10.303, of 2001. In addition, the sections of the Corporations Law establishing account rules were amended in 2007. See *infra* note 106.

17. The National Program of Privatizations (Programa Nacional de Desestatização-PND) was created in 1990 under Law No. 8.031. This law was later revoked by Law No. 9.491, of 1997, which revamped the program.

about was the elimination of tag along rights for minority voting shareholders.¹⁸ As originally enacted in 1976, the Corporations Law had provided for a mandatory tender offer for all of the outstanding voting stocks in case of a control transfer.¹⁹ The tender offer was required to be made for a price equal to that paid for the controlling block. Tag along rights compelled controlling shareholders to include the holdings of voting minorities in sale negotiations. In practice, controlling shareholders were then forced to share the control premium with all of the remaining voting shareholders. This framework placed an important check on the controlling groups' actions to capture private benefits of control.

Many of the state-controlled companies that were privatized by the end of the 1990s had minority voting shareholders. The removal of tag along rights meant that new owners could buy the controlling block without having to make tender offers for the shares of any minority groups. As a result, the government managed to capture the entire control premium paid by acquirers. The 1997 reform also abolished other minority protection mechanisms. Most noticeably, it eliminated shareholder withdrawal rights in mergers and spin-offs, and it lowered the price at which shareholders could withdraw in the cases where that right continued to be effective.²⁰

In Brazil, the immediate impact of the privatization program on the development of the local stock market was at best discrete, if

18. It has never been a mandatory requirement that the holders of non-voting shares receive tender offers directly.

19. Corporations Law, article 254:

The transfer of the control of a listed company shall be subject to the prior authorization of the Securities Commission. Paragraph 1-The Securities Commission shall ensure that the minority shareholders receive equitable treatment by means of a simultaneous public offer for acquisition of stocks. Paragraph 2.-If the number of stocks being offered, including those belonging to the controlling or majority shareholders, exceeds the limit set forth under the public offer, an apportionment as provided for in the instrument of offer shall be made.

(As of 1997, this provision is no longer in force.)

20. Before the 1997 reform, dissenting shareholders had the right to withdraw at a price equal to the book value of their stocks. The reform allowed the bylaws to establish that the redemption amount could be lower than book value if such redemption amount were calculated based on the economic value of the company, which would be based on forecast profits assessed through a discounted cash flow valuation or other criteria as set forth under the bylaws.

not negative.²¹ Accordingly, the 1997 reforms are now believed to have generally reduced minority investors' confidence.²² In fact, by the end of the 1990s the Brazilian stock market was facing a serious crisis. The number of corporations listed on BM&FBovespa had dropped from 550 in 1996 to 440 in 2001. The trade volume dropped from US\$ 191 billion in 1997 to US\$ 101 billion in 2000 and US\$ 65 billion in 2001.

This plunge in the Brazilian stock market was hastened by several additional factors. First, Brazil and a number of other countries (Mexico in 1995, South Korea and Thailand in 1997, Russia in 1998, Brazil in 1999, Turkey in 2000-2001 and Argentina in 2001-2002) faced a serious liquidity crisis.²³ In all of these countries, a combination of large short-term liabilities and relatively scarce internationally liquid assets resulted in extreme vulnerability and eventually in a confidence crisis and a reversal of capital flow. As international financial conditions worsened, Brazil experienced a recession and its currency devalued rapidly. In 1998-99, the average annual growth rate fell to 0.5%, the Brazilian currency lost approximately one-third of its purchasing power from April 1998 to April 1999, and fiscal deficits skyrocketed. Second, distortionary taxation contributed to further depress the local stock markets. In particular, fiscal deficits prompted the government to levy a tax on every financial transaction, including on every purchase and sale of stocks.²⁴ Finally, Brazilian corporations were

21. Érica Rocha Gorga, *Direito Societário Brasileiro e Desenvolvimento do Mercado de Capitais: Uma Perspectiva de "Direito e Economia"*, 93, Doctoral Thesis, Law School, University of São Paulo, 2005. ("the Brazilian privatization program, [contrary] to similar programs in other parts of the world, did not result in the consistent development of the national capital markets").

22. In early 1999, the CVM issued Ordinance No. 299 partially in an attempt to remedy the deleterious effects of the 1997 reform on the Brazilian stock market. In 2002, Ordinance No. 299 was partially revoked by Ordinance No. 358, which in turn was amended by Ordinances No. 369 in 2006, and 449 in 2007. The requirement to disclose the price of sales of 5% blocks of voting stock was maintained (in fact, enhanced) throughout all of this process.

23. Nelson H. Barbosa Filho, *International Liquidity and Growth in Brazil*, Center for Economic Policy Analysis Working Paper, 2001, <http://newschool.edu/cepa/publications/workingpapers/archive/cepa200104.pdf> (last visited April 21, 2011).

24. The tax on financial transactions (named CPMF) was levied on every debit (withdrawals and transfers of cash) made in bank account. It was originally charged at 0.2% but with time that rate went up to 0.38%. It was created in 1997 as a temporary tax and remained in force and effect until 2007. An exemption for investments in the stock markets was in place from 2004 to 2007.

given the option to negotiate their stock in the American market using American Depositary Receipts (ADRs), thus reducing even further the liquidity of the Brazilian stock market.²⁵

In reaction to this series of events, the Brazilian Congress started to debate a new round of reforms to the Brazilian Corporations Law. At first, Congress seemed to aim at eliminating nonvoting stock altogether and at reinstating full-fledged tag along rights. Political pressure from controlling groups however led the reformation to accomplish much less.²⁶ Instead of eliminating nonvoting stocks, as originally intended, the reform finally enacted in 2001 only reduced the limit for nonvoting stocks from 2/3 to 50% of the total capital stock.²⁷ Most importantly, existing listed corporations were exempted from the new limits. Furthermore, tag along rights were reinstated, but only for holders of voting shares and were limited to 80% of the price paid for the controlling stock.²⁸

To compensate for not eliminating the existence of preferred stocks, the 2001 reforms tried to give more palpable advantages for preferred shareholders. As detailed later on in this paper, this was done by giving the corporation the option to choose among establishing certain mandatory minimum dividends for preferred

25. In July of 2002, *The New York Times* wrote that the CPMF had made BM&FBovespa's transaction costs as much as 165% higher than those of The New York Stock Exchange. Between 1997 and 2002, about 40% of BM&FBovespa investors migrated to American Depositary Receipts of blue-chip Brazilian corporations. See Tony Smith, *Stoking a Stock Market 'Revolution'*, THE NEW YORK TIMES, July 30, 2002 available at <http://www.nytimes.com/2002/07/30/business/stoking-a-stock-market-revolution.html> (last visited April 21, 2011).

26. See Érica Rocha Gorga, *Culture and Corporate Law Reform: A Case Study of Brazil*, 27 U. PA. J. INT'L ECON. L. 803 (2006) (arguing that in the 2001 reformation "controllers' interest groups were able to 'capture' the legislation both directly and indirectly. Directly, and most effectively, the interest groups exerted pressure on legislators and the President to drop amendments aimed at increasing minority shareholders' rights. . . The interest groups were also able to indirectly influence the proposed reforms by adding several amendments to the text of the law. These amendments reduced the effectiveness of minority rights.").

27. Corporations Law, art. 15.

28. See *id.* at art. 254A ("The direct or indirect transfer of control of a listed corporation can only be effected under the condition that the purchaser agrees to conduct a public offer to acquire the voting stocks owned by the remaining shareholders. The offer price for such stocks shall be at least 80% of the amount paid for the voting stocks comprising the controlling block"); see also *id.* at art. 17, §7 (The 2001 reform also created the possibility that the government could have a golden share [giving special veto powers] in the corporations being privatized.).

stocks, establishing dividends for preferred stocks higher than those applying to voting stocks, or establishing limited tag along rights for preferred shareholders upon sale of the controlling interest.²⁹

It is fair to say that the 2001 reformation of the Corporations Law increased the overall level of protection of minority shareholders. Improvements included a requirement for making a tender offer to minority shareholders in case of delisting,³⁰ the enactment of provisions expressly prohibiting and criminalizing the practice of insider trading,³¹ and increased representation of minority shareholders in the board of directors of listed corporations.³² At the same time, the preservation of nonvoting stocks and the limitations in tag along rights meant that the improvements to the position of minority shareholders were less significant than what was boasted by numerous politicians of the time.

It was self-regulation—rather than state regulation—that created the conditions for truly enhanced corporate governance practices and higher protections for minority shareholders in Brazil. In December of 2000, just before the enactment of the 2001 reform of the Corporations Law by Congress, BM&FBovespa created three special corporate governance listing segments.³³ In

29. *Id.* at art. 17. *See infra* notes 72-74.

30. *Id.* at art. 4 (“The public listing of a corporation may only be canceled if the corporation that issued the stocks, the majority shareholder or the controlling corporation directly or indirectly makes a tender offer to acquire all of the outstanding stocks for a fair price, at least equal to the appraised equity value of the corporation, calculated based on one or more of the following criteria: accounting net worth, equity value calculated at market value, discounted cash flow, multiples comparison, market value, or another criterion adopted by the Brazilian Securities Commission.” . . . Shareholders holding at least 10% of outstanding stocks of a listed corporation may request the officers to call a special shareholders’ meeting with holders of outstanding stocks in order to determine a new appraisal, based on the same or different criteria from those originally adopted, for purposes of determining the valuation of the corporation as provided for [above]”).

31. *Id.* at art. 155; *see infra* notes 127-130.

32. *Id.* at art. 141.

33. The rules enacted by BM&FBovespa governing the new listing segments are currently being revised. The main topics being debated involve a requirement for the election of independent directors, the extension of arbitration to all shareholders, and the definition of “diffuse control.” The amended version of current rules is expected to be published still in 2010. Under the deliberation procedures presently in place, a proposed amendment must be previously presented in a closed hearing to the corporations listed in each segment. The proposition can be blocked by a formal rejection of at least 1/3 of

these new listing segments, corporations could voluntarily agree to adopt governance practices that went far beyond the minimum standards established under the Brazilian Corporations Law, arguably providing much greater transparency and strengthening the rights and protections of minority shareholders.³⁴

The three listing segments were named *Novo Mercado* (literally, “new market”), Level 2 and Level 1. Novo Mercado’s biggest advance was to do away with the nonvoting stock that had caused so much political controversy in the past.³⁵ Corporations listed in the Novo Mercado were also required to grant unrestricted tag along rights to all of their shareholders.³⁶ In addition, they were required to fulfill a number of additional obligations, for example:

the corporations listed in each such segment. Moreover, before coming into force, the amended regulations must be approved by the CVM. See Novo Mercado Listing Rules, item 14.2 available at www.bmfbovespa.com.br/en-us/markets/download/regulamento.pdf; Corporate Governance Level 1 Listing Rules, item 9.2 available at www.bmfbovespa.com.br/en-us/markets/download/regulamento_niveisI_ingles.pdf; Corporate Governance Level 2 Listing Rules, item 14.2 available at www.bmfbovespa.com.br/en-us/markets/download/regulamento_niveis_ingles.pdf (last visited April 21, 2011).

34. The creation of these special listing segments was partly inspired by the Germany’s *Neuer Markt*. See Jose Roberto Menconca de Barros et al., *Desafios e Oportunidades para o Mercado de Capitais Brasileiro*, MB Associados, June 2000 available at http://www.bmfbovespa.com.br/pt-br/a-bmfbovespa/download/mercado_capitaisdesafios.pdf. Notice that special European listing segments, such as Germany’s *Neuer Markt*, were generally designed to attract companies from fast-growing markets and high tech, especially in areas such as internet, telecommunications, media, and biotechnology. Conversely, BM&FBovespa’s special listing segments place no restriction on fields of activities, nor are they reserved for small companies. See Stijn Claessens et al., *Corporate Governance Reform Issues in Brazilian Equity Markets*, available at [www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/Brazil-CG%2BReform%2BIssues%2B\(2001\).pdf](http://www.ifc.org/ifcext/corporategovernance.nsf/AttachmentsByTitle/Brazil-CG%2BReform%2BIssues%2B(2001).pdf) (surveying the studies that led to the creation of the Novo Mercado); Maria Helena Santana et al., *Global Corporate Governance Forum, Novo Mercado and its followers: Case Studies in Corporate Governance Reform*, FOCUS 5 (2008), available at [http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+5/\\$FILE/Novo+Mercado+text+screen+4-21-08.pdf](http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+5/$FILE/Novo+Mercado+text+screen+4-21-08.pdf) (describing the history of the creation, implementation and assessing the concrete results within each listing segment); see also Ronald Gilson et al., *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU*, SOCIAL SCIENCE RESEARCH NETWORK, March 1, 2010 available at <http://ssrn.com/abstract=1541226> (using Brazil’s special listing segments as a case study for a theory of non-state, parallel securities regulation) (last visited April 21, 2011).

35. Novo Mercado Listing Rules, item 3.1, VI.

36. *Id.* at item 8.1 (providing that in the event of sale of control the buyer must make a tender offer to buy all outstanding stocks under equal terms, with no 80% ceiling).

(1) maintaining a minimum of 25% of capital stock in free float,³⁷ (2) establishing a unified maximum two-year term for the entire board of directors with at least five directors,³⁸ (3) submitting yearly financial statements pursuant to US GAAP or IRFS norms, improving the disclosure of information in the quarterly financial statements,³⁹ and (4) making tender offers based on economic value to holders of stock in free float both in case of delisting and of withdrawal from the Novo Mercado.⁴⁰ Moreover, any disputes between corporation and shareholders would be solved by binding arbitration.⁴¹

The key distinction between the Novo Mercado and Level 2 is that the latter allows the corporations to have nonvoting shares, while the former does not.⁴² Still, holders of preferred stock of corporations listed in Level 2 must be granted the right to vote in certain matters such as incorporation, merger, spin-off, the approval of contracts entered into between the corporation and firms of the same holding group, appraisal of assets contributed to pay up capital increases, the choice of the independent expert in charge of valuating the corporation, and the amendment to the corporation's bylaws, including with respect to its rules of corporate governance.⁴³ Moreover, in case controlling shareholders sell their stake, a tender offer must be presented to the preferred shareholders in the amount of at least 80% of the value/conditions paid to the controlling group (remember that under the Corporations Law, preferred shareholders have no tag along rights).⁴⁴ As to Level 1, which is the less stringent of the special listing segments, the adhering corporations have to fulfill less rigorous variations of obligations that apply to the Novo Mercado and to Level 2. Although Level 1 also requires corporations to maintain a minimum of 25% of capital stock in free float, most of

37. *Id.* at item 7.3 and item 2.1 (defining "Minimum Free Float").

38. *Id.* at items 4.3 and 4.4.

39. *Id.* at items 6.1 e 6.2.

40. *Id.* at item 10.2; and, *see also, id.* at item 11.7 (providing that the corporations' securities cannot be traded on the Novo Mercado for at least 2 years after the delisting is formalized).

41. *Id.* at item 13.1.

42. Corporate Governance Level 2 Listing Rules, item 3.1, (i).

43. *Id.* at item 4.1.

44. *Id.* at item 8.1.3. *See* RICARDO LEAL & ANDRÉ CARVALHAL DA SILVA, PRÊMIO IBGC DE GOVERNANÇA CORPORATIVA(2007) (noting that the percentage of corporations where nonvoting preferred stocks represents less than 20% sharply increased from 17.9% in 1998, to 39.6% in 2007).

its provisions deal with mechanisms that enhance transparency and disclosure requirements.⁴⁵ In any case, corporations listed in any of the special listing segments will always have to abide by the minimum standards set forth under the Corporations Law.

After a slow start, BM&FBovespa's new listing segments eventually took off. In November of 2007, the Financial Times wrote: "Not long ago the São Paulo Stock Exchange was a sleepy backwater, much like any other stock exchanges in Latin America . . . Since then, things have changed. By 2006, average daily trading had risen to R\$2.4bn (\$1.1bn). The [BM&FBovespa]'s extraordinary initial public offering on October 26 shot it into the top rank of world capital markets." BM&FBovespa closed 2007 with an accumulated rise of 72% (measured in U.S. dollars), the third biggest rise among the world's stock exchanges.⁴⁶ It should also be noted that the effects of the most recent international financial crisis on the Brazilian stock exchange have so far been mild. In truth, 2008 witnessed a reduction both in the number of corporations listed at the BM&FBovespa, as well as in total market capitalization.⁴⁷ However, this trend was soon reversed, as BM&FBovespa's market capitalization in 2009 ended 82.5% higher than that of 2008.⁴⁸

In the beginning of 2010, almost half of BM&FBovespa's 433 corporations were listed in a special segment: 106 corporations were listed in the Novo Mercado, 19 in Level 2, and 35 in Level 1.⁴⁹ The remaining 273 corporations are still listed at BM&FBovespa pursuant to traditional, legally required levels of corporate governance, but most of them had previously gone public. In fact, voluntarily adherence to one of the special listing segments has now become standard practice for the numerous

45. Corporate Governance Level 1 Listing Rules, Part IV, item 5.2.

46. *Bovespa fecha o ano como 3ª mais rentável do mundo, com alta de 72% em dólar*, O GLOBO ONLINE, (December 28, 2007) (The annual rise was overcome only by Shenzhen (180.84%) and Shanghai (110.15%) stock exchanges, both located in China. BOVESPA's main competitor in Latin America, Mexico's BMV accumulated a rise of 11.32% in 2007).

47. BM&FBovespa 2008 Annual Report, available at www.bmfbovespa.com.br/Relatorio2008/english/index_Anuar.pdf (last visited April 21, 2011).

48. BM&FBovespa, Boletim Empresas, Edition 12, Year 2, available at www.bmfbovespa.com.br/empresas/boletim_empresas.asp (last visited April 21, 2011).

49. *Id.*

IPOs that took place through BM&FBovespa during the last decade.

While the link between law and economic development remains a theoretical quagmire,⁵⁰ academics debate about whether improved corporate governance was a cause or a consequence of economic improvements in Brazil.⁵¹ There is no doubt that the protective framework for minority shareholders that emerged from the crisis of 2001 was the product of institutional fiat. However, it cannot be ignored that Brazil's robust economic cycle reinforced the effectiveness and stability of such a legal design. Be that as it may, the fact remains that the protection of minority shareholders is now substantially higher than when the Corporations Law was originally enacted.

III. THE LEGAL FRAMEWORK PROTECTING MINORITY SHAREHOLDERS

The legal framework pertaining to the protection of minority shareholders of listed corporations is fragmented and contained in essentially two, and in some cases three, statutory bodies. First, the Corporations Law itself;⁵² second, the myriad of instructions enacted by the supervising authority, the CVM; and third, in the special regulations enacted by the BM&FBovespa that apply to corporations listed in the special listing segments, as the case may be.

The starting point for an examination of the legal framework protecting minority shareholders of listed corporations should be the "essential" rights specified in the Corporations Law.⁵³ These

50. See e.g. Michael Trebilcock & Kevin Davis, *The Relationship Between Law and Development: Optimists Versus Skeptics* 56 AM. J. COMP. L. 895 (2008) (surveying the literature on the topic).

51. See Érica Gorga, *Changing The Paradigm of Stock Ownership from Concentrated Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries*, 29 NW. J. INT'L L. & BUS. 439, 444 (2009). See generally Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459, 469 (2001); John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L. J. 76 (2001).

52. In Brazil, securities and corporations are governed by federal legislation.

53. See WALDÍRIO BULGARELLI, *REGIME JURÍDICO DA PROTEÇÃO ÀS MINORIAS NAS S/A (DE ACORDO COM A REFORMA DA LEI N.º 6.404/76)* (Rio de Janeiro, Renovar, 1998) (with an overview of the protection of minorities

rights are established by Congress and they cannot be suppressed by the corporation's bylaws, or by a resolution of a shareholders meeting. There are five essential rights: (1) the right to receive dividends, (2) the right to participate in the sale of the corporation's assets upon liquidation, (3) the right to supervise the corporation's bodies, (4) the right of first refusal that arises upon the subscription of shares, founders' shares convertible into shares, debentures convertible into shares and subscription bonuses, and (5) the right to withdraw from the corporation in specific instances set forth under the Corporations Law.⁵⁴

These and other rights gain clearer focus through examination of various instances of Brazilian legislation. A more systematic description based on state and non-state law can be observed by categorizing minority shareholder rights based on their nature. Accordingly, they can be divided into political rights, economic rights, oversight and information rights and procedural rights, as follows.

A. Political Rights

Political rights allow shareholders to participate in the corporate bodies that make decisions on behalf of the corporation, particularly the shareholders' meeting ("*assembléia geral*") and the board of directors ("*conselho de administração*").

The most important political right set forth under the Corporations Law is the right to vote at shareholders' meetings. The law establishes certain formalities that have to be followed in order to safeguard the participation of voting minority shareholders in these meetings. These formalities include giving prior public notice of the meetings, having a minimum quorum for the holding of valid shareholders' meetings, and having the minimum percentage of votes for the approval of certain topics. Lack of observation of such formalities may cause the resolutions to be declared void by courts.⁵⁵

shareholders in Brazil); see also José Alexandre Tavares Guerreiro, *Direito das Minorias na Sociedade Anônima*, 63 REVISTA DE DIREITO MERCANTIL 106-111 (1986); and Tullio Ascarelli, *Usos e Abusos das Sociedades Anônimas*, 88 REVISTA FORENSE 5-33 (1941); TULLIO ASCARELLI, *PROBLEMAS DAS SOCIEDADES ANÔNIMAS E DIREITO COMPARADO* (2d ed. 1969).

54. Corporations Law, art. 109.

55. *Id.* at arts. 121-137. See LUIZ GASTÃO PAES DE BARROS LEÃES, *VÍCIOS EM ASSEMBLÉIA-GERAL ORDINÁRIA. ESTUDOS E PARECERES SOBRE*

Historically, the notice requirements for listed corporations before the valid holding of a shareholders' meeting was not a major concern of regulators, and for understandable reasons. Where there is a clear block of controlling shareholders, shareholder meetings are themselves oftentimes just a formality. Recently, however, the emergence of corporations with dispersed ownership led the CVM to start paying closer attention to formalities in shareholder meetings. Accordingly, the CVM established a detailed list of information to be provided to shareholders before a shareholder meeting can validly take place. In addition, the CVM finally allowed and regulated the exercise of proxy voting in shareholders' meetings.⁵⁶ It is notable that as of March of 2010, BM&FBovespa had five corporations in which the three largest shareholders jointly held less than 25% of total voting capital.⁵⁷ Furthermore, there were over a dozen corporations in which the three largest shareholders held between 25% and 49.9% of total voting capital.⁵⁸

Although there are now a few corporations with dispersed ownership in Brazil, a cautionary note still applies to the topic of political control in listed corporations. The general pattern of corporate control within Brazilian listed corporations is one of high political concentration.⁵⁹ The block of controlling shareholders systematically holds the majority vote in shareholder meetings, being able to solely adopt resolutions and to elect the

SOCIEDADES ANÔNIMAS 154-166 (1989) (discussing the legal requirements generally applicable to the adoption of valid resolutions in shareholders' meetings).

56. CVM Ordinance No. 481 of 2009.

57. BM&FBovespa; Gafisa, Lojas Renner, Ideiasnet, and Dimed. available at www.bmfbovespa.com.br/cias-listadas/empresas-listadas/BuscaEmpresaListada.aspx?idioma=en-us (last visited April 21, 2011).

58. Eternit, Tecnosolo, Bematech, Embraer, Tovs, Cia Hering, BR Brokers, Dasa, Odontoprev, ALL Amer Lat, Itaúsa, Mont Aranha, Agra Incorp, Tempo Part, Cremer, São Carlos, among others, available at: www.bmfbovespa.com.br/cias-listadas/empresas-listadas/BuscaEmpresaListada.aspx?idioma=en-us. (last visited April 21, 2011).

59. See Alexandre di Micelli da Silveira et al., *Evolution and Determinants of Firm-Level Corporate Governance Quality in Brazil*, June 2007, available at <http://ssrn.com/abstract=995764> (last visited April 21, 2011) (as of 2004, the three largest shareholders of Brazilian corporations held, on average, 79.3% of voting capital). See also Eduardo Secchi Munhoz, *Desafios do Direito Societário Brasileiro na Disciplina da Companhia Aberta: Avaliação dos Sistemas de Controle Diluído e Concentrado*, in 1 DIREITO SOCIETÁRIO: DESAFIOS ATUAIS 119-155 (Monteiro de Castro & Santos de Aragão eds. 2009) (discussing the optimal legal regime for corporations with concentrated control in Brazil).

administrators. Therefore, minority shareholders seldom take an active role in corporate matters. This is true notwithstanding the existence of voting rights that are strictly protected as a matter of law. In practice, minority shareholders tend to exercise their voting rights more often while supervising the actions of controlling shareholders. This commonly arises when certain matters must be made public and approved by the shareholder regardless of whether there is a controlling block at the meeting or not. These matters include the distribution of dividends, the approval of financial statements, and the election of administrators. Publicity of such information opens the possibility of questioning by minority shareholders in court or through the CVM.

The right to vote can be restricted by the corporations' bylaws, giving rise, as is common, to preferred shares with limited, or no voting rights. A longstanding debate surrounds the existence of nonvoting preferred stocks in Brazil. In line with the original justification for their creation in the 1970s, some authors hold that preferred stock is a practical and effective alternative for corporations to raise capital.⁶⁰ Accordingly, the market itself would determine the value of non-voting stock, while allowing business groups to reach the stock markets without having to share control. Other authors believe that lack of voting rights is intrinsically detrimental to minorities and to the development of the stock markets more broadly.⁶¹ As previously mentioned, the Corporations Law currently allows listed corporations to issue nonvoting preferred stock corresponding to up to 50% of the total

60. See 1 ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, *A LEI DAS S.A.: PRESSUPOSTOS, ELABORAÇÃO, APLICAÇÃO 182-197* (3d ed. 1997) (examining the historical debates surrounding the enactment of the Corporations Law in the 70s decade); see also Arnoldo Wald, *Em Defesa das Ações Preferenciais*, 78 *REVISTA DE DIREITO MERCANTIL* 19-23 (1990); Mauro Rodrigues Pentead, *Ações Preferenciais*, in JORGE LOBO, *REFORMA DA LEI DAS SOCIEDADES ANÔNIMAS: INOVAÇÕES E QUESTÕES CONTROVERTIDAS DA LEI n. 10.303, de 31.10.2001* (2002); NELSON EIZIRIK, *REFORMA DAS S.A. E DO MERCADO DE CAPITAIS* 29-52 (2d ed. 1998).

61. That was the official opinion held by the Rio de Janeiro Stock Exchange in the course of the debated surrounding the Corporations Law in the 70; See ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, *A LEI DAS S.A. 190-205* (1992); See also Érica Gorga, *Análise da Eficiência de Normas Societárias: Emissão de Preferenciais, Tag Along e Composição do Conselho Fiscal*, Berkley Program in Law & Economics, Latin American and Caribbean Law and Economics Association (ALACDE), Annual Paper 050307-01, available at <http://escholarship.org/uc/item/6xd441jc> (last visited April 21, 2011).

capital stock.⁶² It must be noted, moreover, that nonvoting preferred shares automatically acquire voting rights when the corporation fails to pay the fixed or minimum dividend to which a certain stock is entitled; and such rights to vote endure until payment has been made, if the dividend is not cumulative, or until all cumulative dividends in arrears have been paid.⁶³

Minority shareholders can also supervise the actions of controlling groups by appointing members to the board of directors.⁶⁴ Minority shareholders representing at least 10% of the voting capital have the right to request a multiple voting (“*voto múltiplo*”) for the election of the members of the board of directors.⁶⁵ Multiple voting is a mechanism whereby each voting stock is given the right to make as many votes as the number of vacant positions in the board of directors. For instance, if the shareholders are electing five board members, each voting stock will cast five votes. By concentrating all votes in one or two candidates, this procedure empowers minorities to elect at least a small number of board members.⁶⁶

It should also be noted that the 2001 reform to the Corporations Law established other means for the participation of minority shareholders in electing the Board of Directors. Minority shareholders representing 15% of the voting stocks can elect a member for the board of directors.⁶⁷ This same right was extended to shareholders having nonvoting preferred stocks that represent at least 10% of the corporation’s total stock capital.⁶⁸ In addition, corporations listed in the special listing segments follow more stringent rules: the board of directors of corporations listed in the

62. See *supra* note 28.

63. Corporations Law, art. 111; see also ERASMO VALLADÃO AZEVEDO E NOVAES FRANÇA, TEMAS DE DIREITO SOCIETÁRIO, FALIMENTAR E TEORIA DA EMPRESA 483-508 (2009).

64. See Nelson Eizirik, *Ações preferenciais, Não pagamento de dividendos. Aquisição do direito de voto*, 146 REVISTA DE DIREITO MERCANTIL 23-29 (2007) (arguing that the right to appoint members of the board of directors only applies to shareholders having right to fixed or minimum dividends).

65. Corporations Law, art. 141.

66. *Id.* at art. 141 (providing that even if the election of the Board of Directors is conducted through multiple voting, the shareholders bound by voting agreements representing more than 50% of voting stocks will have the right to appoint the same number of members appointed by the remaining shareholders plus one, regardless of the number of board members specified in the bylaws).

67. *Id.* at art. 141, §4, I.

68. *Id.* at art. 141, §4, II.

Novo Mercado and in Level 2 must be composed of at least five members, 20% of which must be independent directors.⁶⁹ However, controlling shareholders retain the right to appoint the majority of the members of the board of directors in any case.⁷⁰ Because of this, the right to be represented within the board of directors does not necessarily cause minority shareholders to have the power to actively influence decision-making within the board of directors. Nevertheless, representation within the board of directors creates at least an additional instance where minorities can obtain information about the corporations' business and sometimes oppose or question resolutions.

69. Novo Mercado Listing Rules, item 4.3 & Corporate Governance Level 2 Listing Rules, item 5.3. (An "Independent Member" is defined as "a member of the Board of Directors who: (i) has no ties to the Company except for owning an equity share of its capital stock; (ii) is not a Controlling Shareholder, the Controlling Shareholder's spouse or a relative to the second degree, is not or has not been linked in the last 3 (three) years to a company or entity with ties to the Controlling Shareholder (this restriction does not apply to people linked to governmental institutions of education and research); (iii) has not been a Senior Manager of the Company or employed by or worked for the Company, the Controlling Shareholder or any other company controlled by the Company; (iv) is not a direct or indirect supplier or purchaser of the Company's services or products or both, to a degree that results in loss of independency; (v) is not an employee or manager of a company or entity that supplies services or products or both to, or buys these from, the Company; (vi) is not a spouse or a relative to the second degree of any Senior Manager of the Company; (vii) does not receive any compensation from the Company except for that related to its activities as member of the Board of Directors (this restriction does not apply to cash from equity interests in the capital stock.)); see Rafael Liza Santos, Alexandre di Miceli da Silveira & Lucas Ayres B. de C. Barros, *Board Interlocking in Brazil: Directors' Participation in Multiple Companies and its Effect on Firm Value*, Jan. 2009, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1018796 (last visited April 21, 2011) (showing that having interlocking directorates is a common practice in Brazilian corporations, and also that larger boards, dispersed ownership, and larger corporation size are associated with higher levels of board interlocking and lower stock value).

70. The legal regime governing the participation of minority shareholders in the Board of Directors has been the subject of much legal controversy. The CVM has twice ruled on the subject. Firstly, it decided that, if the corporation has no preferred stocks, voting shareholders owning 10% of the total capital can appoint a member to the Board of Directors (even though the Corporations Law establishes a 15% requirement). See CVM/RJ Administrative Procedure 2005/5564 ("Processo Administrativo Sancionador 2005/5564"), available at www.cvm.gov.br/port/descol/respdecis.asp?File=4846-2.HTM. Secondly, upon a formal consultation, the CVM decided that if a shareholders exercises its right to appoint a member to the Board of Directors in a separate election at the general meeting, it cannot make use of multiple voting. See "Consulta de Ultrapar Participações S.A. sobre Eleição de Conselheiros, Reg. 3649/02," available at www.cvm.gov.br/port/descol/resp.asp?File=2002-016D16042002.htm (last visited April 21, 2011).

B. Economic Rights

Stock value is a function of the bundle of rights contained in each stock. Thus, most (if not all) of the individual rights contained in the Corporations Law are in some sense “economic” rights, because the stock valuation presumably reflects the present value of these rights—even if imperfectly so. Here, however, the expression “economic rights” is employed in the narrower sense typically used in doctrinal studies of Brazilian corporate law.⁷¹ From this perspective, the basic economic rights are the right to receive dividends, tag along rights, dissent and appraisal rights, and rights of first refusal.

To begin with, in principle, at least 25% of the corporation’s yearly net profits must be paid as dividends. The corporation’s bylaws can however establish a lower percentage.⁷² In addition, the percentage of the net profits that have to be paid out as dividends for the different types of stocks is flexible.⁷³ Nonvoting preferred stock can only be accepted for trading in the stock market if they are afforded at least one of three advantages: a priority in the receipt of dividends corresponding to at least 3% of the stock’s net worth, dividends at least 10% higher than the dividend assigned to the voting stocks, or the same tag along rights as those held by voting shareholders (that is, tag along rights with tender offer value based on 80% of the price paid to controlling shareholders).⁷⁴

Tag along rights have also been dealt with under the rubric of “economic rights.” The existence of tag along means that the purchaser of a controlling stake of a corporation must make a tender offer to holders of minority shares.⁷⁵ As previously

71. See LUIZ GASTÃO PAES DE BARROS LEÃES, DO DIREITO DO AÇIONISTA AO DIVIDENDO (1969); DIVIDENDO OBRIGATÓRIO E PARTICIPAÇÃO DOS ADMINISTRADORES NOS LUCROS DA COMPANHIA. ESTUDOS E PARECERES SOBRE SOCIEDADES ANÔNIMAS (Revista dos Tribunais 1989) (examining the right to receive dividends).

72. Corporations Law, art. 17. (announcing that the yearly net income should be calculated as set forth under article 202 of the Corporations Law and according to the following criteria: (i) a priority in the receipt of dividends corresponding to at least 3% of the stock’s equity value; and (ii) the right to have interest in the profit distributed in conditions equal to the common stocks, after a dividend equal to the minimum priority as set forth in item a is assured.).

73. *Id.* at art. 202, § 2d.

74. *Id.* at art. 17.

75. The Corporations Law defines a transfer of control as “transfer, whether direct or indirect, of stocks comprising the controlling block, of stocks bound by shareholders’ agreements and of securities convertible into voting

mentioned, the 2001 reforms of the Corporations Law reinstated tag along rights, albeit in a limited fashion. Mandatory tag along rights were made applicable only to bearers of voting shares, and tender offers can be limited to 80% of the price paid for the block of controlling shares.⁷⁶ In addition, the 2001 reformation also established an alternative mechanism for companies seeking to acquire control of listed corporations to remunerate minority shareholders. As currently set forth under the Corporations Law, purchasers can decide to offer minority shareholders the option to keep their holdings in the corporation in exchange for payment of a premium.⁷⁷ This premium should be equivalent to the difference between the market value of the stocks and the amount paid for shares comprising the controlling block.

The special listing segments establish more stringent rules. In the Novo Mercado, where nonvoting preferred stocks are forbidden, full tag along rights apply to all minority stocks.⁷⁸ The

stocks, assignment of stock subscription rights and other rights related to securities convertible into stocks which may result in the transfer of corporate control.” (art. 254, § 1st). In addition, CVM Ordinance No. 361 of 2002 defines transfer of control as the “operation, or a set of operations, of securities alienation with voting rights, or to which are convertible, or of onerous assignment of subscription rights to these securities, performed by the controlling shareholder or by people which are partners of the control group, by which a third party or a group of third parties representing same interests acquire the corporation control power, as defined in the art. 116 of the [Corporations Law].” The aforementioned art. 116 of the Corporations Law defines controlling shareholder as “an individual or a legal entity, or a group of individuals or legal entities by a voting agreement or under common control, which: (a) possesses rights which permanently assure it a majority of votes in resolutions of general meetings and the power to elect a majority of the corporation officers; and (b) in practice uses its power to direct the corporate activities and to guide the operations of the departments of the corporation.”

76. In practice, the debates over the exact events that trigger a transfer of control tend to end in controversy. A famous case involving this topic was the sale of Telecom Italia, which is the indirect controller of TIM, which provides cell phone services in Brazil. In a non-unanimous decision, the CVM ruled that a tender offer was mandatory. However, each member of CVM’s decisions body justified his vote on different grounds available at: www.cvm.gov.br/port/descol/resp.asp?File=2009-026ED15072009.htm (last visited April 21, 2011). See also GUILHERME DÖRING CUNHA PEREIRA, *ALIENAÇÃO DO PODER DE CONTROLE ACIONÁRIO* (1995); ROBERTA NIOAC PRADO, *OFERTA PÚBLICA DE AÇÕES OBRIGATÓRIA NAS S.A.: TAG ALONG* (2005); CALIXTO SALOMÃO FILHO, *Alienação de Controle: O Vaivém da Disciplina e seus Problemas*, in *O NOVO DIREITO SOCIETÁRIO* 117-140 (2d. ed. 2002).

77. Corporations Law, art. 254, § 4th.

78. Novo Mercado Listing Rules, item 8.1.

same rule applies to the voting common stocks traded at Level 2.⁷⁹ This listing segment allows corporations to issue nonvoting preferred stocks, but the latter must be granted tag along rights corresponding to least 80% of the value/conditions applicable to the controlling group.⁸⁰

The Corporations Law also establishes an appraisal right (“*direito de recesso*”) for shareholders dissenting from certain corporate resolutions. Appraisal rights can be triggered by the following events: a change in the proportion of classes of stock that causes a loss to the dissenting shareholder (unless this is expressly allowed for in the bylaws), a change in the redemption or amortization terms of one or more classes of preferred shares, or the creation of a new, more favored class that causes a loss to the dissenting shareholders.⁸¹ The dissent and appraisal right will also be triggered by a reduction of the compulsory dividend or a change in the corporate purpose.⁸² Dissenting shareholders of listed corporations that own illiquid stocks can also request the appraisal of their stocks in case of merger or incorporation by another company or participation in a “group of corporations.”⁸³ The same appraisal rights also apply in case of a spin-off of the corporation, but only if the spin-off results in a change in the corporate purposes (except when the spun-off assets are transferred to a company with a main line of business that coincides with that of the corporation originally spun-off), if there is a reduction in the mandatory dividend, or if the spin-off causes shareholders to join a group of corporations.⁸⁴

The bylaws can establish the criteria for appraisal of the stocks of dissenting shareholders, subject to a minimum value based on the book value of the corporation as recorded in the latest financial

79. Corporate Governance Level 2 Listing Rules, item 8.1.

80. *Id.* at item 8.1.3.

81. Corporations Law, art. 137, I, & art. 136, I and II (providing that in these cases, appraisal rights will apply only if the shareholder was harmed by the transaction).

82. *Id.* at art. 137, main provision, & art. 136, III and VI.

83. *Id.* at art. 137, II & art. 136, IV and V. The Corporations Law states that in these cases, the holders of stocks of a class or type that have market liquidity and dispersion shall not have the right to withdraw, provided that: liquidity is evidenced when the type or class of stock, or the certificate that represents it, is part of a general index representing a portfolio of securities in Brazil or abroad, defined by the CVM; and dispersion is evidenced when the majority shareholder, the controlling corporation or other corporations under their control hold less than half of issued stocks of the applicable type or class.

84. *Id.* at art. 137, III & art. 136, IX.

statements.⁸⁵ That said, appraising stock in concrete cases often gives rise to controversies and lawsuits.⁸⁶ In Brazil, this is particularly common in transactions involving the incorporation of a controlled company.⁸⁷ The Corporations Law establishes that in these cases the exchange ratio of stock shall be based on the net worth value of the shares of both controlling and controlled companies, the assets and liabilities (of both of them) valued pursuant to the same criteria and on the same date, at market prices, or according to another criteria indicated by the CVM.⁸⁸ However, if the conditions for the exchange of the stock of the non-controlling shareholders are considered less advantageous than those resulting from such criteria, dissenting shareholders have the right to choose between having the exchange ratio adjusted or having their stock appraised and refunded.⁸⁹ To mitigate the problems associated with conflicting of interests that inevitable arise in these kinds of transactions, in 2008 the CVM enacted a Guideline Opinion (“*Parecer Orientação* No. 35/2008”) containing a number of procedures to be followed during the negotiation of the merger protocol (including those involving downstream mergers). These procedures include the creation of an independent committee to opine on the fairness of the merger.

As of 2001, delisting is only possible if the corporation that issued the stock, the majority shareholders, or the controlling corporation makes a tender offer to acquire the outstanding shares.⁹⁰ The price of the tender offer will be calculated based on

85. *Id.* at art. 45, § 1st.

86. See Mary Siegel, *Back To The Future: Appraisal Rights In The Twenty-First Century*, 32 HARV. J. ON LEGIS. 79 (1995) (surveying the history of the remedy in the United States).

87. A leading case on this topic involves VASP, formerly a Brazilian airline corporation which went out of business after bankruptcy. The CVM examined the exchange ratio of stocks and ruled in favor of the minority shareholders. See CVM Administrative Procedure 23/99 (“*Processo Administrativo Sancionador 23/99*”). Another leading case was the incorporation of Banco Santander Noroeste S.A. by its controlling company, Banco Santander Brasil S.A. After the CVM ruled in favor of minority shareholders, Banco Santander appealed in court, but the CVM decision was ratified. See CVM Administrative Procedure 24/04 (“*Processo Administrativo Sancionador 24/04*”) and decisions by the São Paulo Appeal Court (“*Tribunal de Justiça de São Paulo*”) Nos. 510.984-4/8, 219.385-4/2, and 516.357-4/0.

88. Corporations Law, art. 264.

89. *Id.* at art. 264, § 3d.

90. In Brazil, there is no distinction between admission to listing and admission to trading. Once a corporation goes public, all of its securities may be negotiated on a stock exchange (or on the OTC market) as long as the more

one or more of the following criteria: net assets appraised at market value, discounted cash flow, comparison by multiples, share quotation in the securities market, or other criteria adopted by the CVM.⁹¹ If less than 5% of all stocks issued by the corporation are outstanding after the expiration of the tender offer, the corporation can unilaterally decide to redeem these outstanding shares (squeeze out).⁹² For corporations listed in the Novo Mercado or in Level 2, the valuation for the tender offer cannot be lower than the economic stock value.⁹³

Finally, shareholders have a right of first refusal for the subscription of a capital increase in proportion to the number of shares they currently own.⁹⁴ In order to avoid capital increases made only for the purpose of diluting minority holders, the Corporations Law requires that every proposal to increase the corporation's capital contain a detailed explanation of why the capital increase is necessary and the criteria used for the calculation of the price of the stocks being issued.⁹⁵

specific trading requirements are complied with. Currently, the only Brazilian stock exchange trading stocks is BM&FBovespa. To be admitted to listing and, consequently, to have its securities admitted to trading, a corporation must also be registered with the CVM.

91. Corporations Law, art. 4, § 4th.

92. *Id.* at art. 4, § 5th.

93. Novo Mercado Listing Rules, item 10.1 and Corporate Governance Level 1 Listing Rules, item 10.1. The 2001 reform to the Corporations Law also established that if the controlling shareholder acquires stocks of a listed corporation that is already under his control, and these stocks increase his interest in a certain class of stocks in a way that reduces the market liquidity of the remaining stocks, the controlling shareholder must make a tender offer for such remaining stocks (Corporations Law, art. 4, § 6th). CVM Ordinance No. 361 of 2002, art. 26, established that such tender offer should be performed whenever the controlling shareholder acquires directly or indirectly, other than through an IPO, stocks which represent more than a 1/3 of the total stocks of each type or class of stocks of the corporation.

94. Corporations Law, art. 171. The message from the house (“*exposição de motivos*”) grounding the Corporations Law contended that the “the elimination [of the right of first refusal] in listed companies is permitted only where the right of first refusal, besides rendering it difficult the organization and distribution of the issued stocks in the market, has no importance as an instrument for the protection of shareholders against the change of their capital stake, because anyone can acquire stocks in the market.” See Erasmo Valladão Azevedo & Novaes França, *A Proteção dos Credores e Acionistas nos Aumentos de Capital Social*, in TEMAS DE DIREITO SOCIETÁRIO, FALIMENTAR E TEORIA DA EMPRESA 230-252 (São Paulo, Malheiros 2009); 2 MODESTO CARVALHOSA, COMENTÁRIOS À LEI DAS SOCIEDADES ANÔNIMAS 290 (São Paulo, Saraiva 1997).

95. Corporations Law, art. 170. The criteria for calculation of issuance price can only be the expected profitability of the corporation, the equity value,

C. Oversight and Information Rights

Minority shareholders typically exercise their oversight and information rights through the statutory audit committee (“*conselho fiscal*”). The corporation’s bylaws can, but need not, require the audit committee to function indefinitely.⁹⁶ When the audit committee is not permanent, it can be brought to act upon the request of shareholders representing 10% of the corporation’s voting stocks or 5% of the corporation’s nonvoting stocks.⁹⁷ All of the preferred shareholders holding nonvoting or restricted voting shares can jointly appoint a member of the audit committee in a separate voting session, and that same right is granted to minority shareholders who own at least 10% of the voting capital.⁹⁸ However, the ability of minority shareholders to restrict the controlling group of shareholders by means of the audit committee is limited because the law guarantees the right of the controlling group to appoint the majority of the members of the audit committee.⁹⁹

or market value. See MAURO RODRIGUES PENTEADO, *AUMENTO DE CAPITAL DAS SOCIEDADES ANÔNIMAS* (1988).

96. Corporations Law, art. 161.

97. *Id.* CVM Instruction No. 324 reduces the percentages of votes necessary to bring audit committees into action proportionally to the corporation’s capital.

98. The CVM recently issued a formal warning against the chairman of a shareholders’ meeting for him having blocked the attempt of a minority shareholder to appoint a member to the audit committee based merely on formal considerations. See CVM/RJ Administrative Procedure 2008/12062 (“Processo Administrativo Sancionador 2008/12062”), available at www.cvm.gov.br/port/inqueritos/2009/rordinario/inqueritos/TA%20RJ2008-12062%20Telebr%C3%A1s (last visited April 21, 2011).

99. Corporations Law, art. 161, § 4th. See also CVM Guideline Opinion No. 19/1990 (“Parecer Orientação No. 19/1990”) establishing that the controlling shareholder cannot appoint members to the audit committee using its preferred, nonvoting stocks. Recently there have been cases where controlling shareholders acted contrarily to this CVM guideline, and the CVM ruled such appointments illegal. See CVM Administrative Procedure 02/07 (“Processo Administrativo Sancionador 02/07”), where the CVM found abusive the appointment to the audit committee of persons connected to the controlling shareholder, where such appointment was made in a separate voting available at www.cvm.gov.br/port/inqueritos/2009/rordinario/inqueritos/IA%202002-07%20T%C3%A1xil%20Renaux%20SA.asp. Other cases on this topic include CVM Administrative Procedure 20/04 (“Processo Administrativo Sancionador 20/04”), available at www.cvm.gov.br/port/inqueritos/2008/rordinario/inqueritos/IA%2020-04%20Springer.asp; CVM Administrative Procedure 07/05 (“Processo Administrativo Sancionador 07/05”), available at www.cvm.gov.br/port/inqueritos/2007/rordinario/inqueritos/04_24_07-05.asp; and CVM Administrative Procedure 2002/4985 (“Processo Administrativo

The audit committee does not have powers to make corporate resolutions. Nevertheless, its members can individually give an opinion about certain topics, particularly as regards the integrity of the management's actions and the fulfillment by the officers of their legal duties.¹⁰⁰ Upon the request of any of its members, the audit committee can also request information from the administrative bodies, as well as require the preparation of special financial or accounting statements.¹⁰¹ In addition, the audit committee opines on the management's annual report and on the management's proposals and plans to increase corporate capital, to make new investments, to distribute dividends and to undergo incorporations, mergers or spin-off transactions.¹⁰² Moreover, it is in charge of calling shareholders' meeting if the officers fail to timely do so, and of examining the corporation's books on a quarterly basis.¹⁰³

Minority shareholders can also act independently of the audit committee. At the request of shareholders representing at least 5% of the total stock capital, a complete inspection of the books of the corporation may be ordered by the court, whenever acts contrary to the law or to the bylaws occur, or there are grounds to suspect that serious irregularities may be present.¹⁰⁴

Brazilian listed corporations must publish annual financial statements that should include a balance sheet, a statement of retained earnings, a statement of income and a statement of changes in financial position.¹⁰⁵ In December of 2007, the section of the Corporations Law dealing with financial statements was amended with a view toward bringing Brazilian GAAP closer to international accounting standards.¹⁰⁶ These amendments created

Sancionador 2002/4985”), available at www.cvm.gov.br/port/inqueritos/2005/rordinario/inqueritos/11_08_RJ2002-4985.asp (last visited April 21, 2011).

100. Corporations Law, art. 163.

101. *Id.* at art. 163, § 2d.

102. *Id.* at art. 163, III.

103. *Id.* at art. 163 V & VI.

104. *Id.* at art. 105.

105. *Id.* at art. 176.

106. Federal Law No. 11,638 of 2007. Furthermore, CVM Ordinance No. 457 of 2007 has established that “listed companies shall, starting from reporting periods ending in 2010, present their consolidated financial statements according to International Financial Reporting Standards-IFRS, as issued by the International Accounting Standards Board-IASB . . . Until the reporting period ending in 2009, public corporations may, optionally, present their consolidated

the statement of cash flows and the value added statement, changed rules concerning accounting criteria and methods, classification of assets, restrictions for the use of deferred asset accounts, established criteria for valuation of cash equivalents, intangible assets and assets allocated to long-term operations and long-term liabilities. In addition, a few regulations have been issued more recently with to the goal of standardizing information available to regulators and investors. Under CVM Ordinance n. 480, of 2009, issuers are required to send periodical information to CVM according to a new format and to keep the data available for investors (including on their webpage) for three years.¹⁰⁷ Chiefly among such information to be disclosed is that involving transactions with related parties and the remuneration of officers and directors.¹⁰⁸

Corporations listed at BM&FBovespa's special segments face higher disclosure requirements. At the Novo Mercado and at Level 2, corporations must prepare annual balance sheets pursuant to international accounting standards (US GAAP or IFRS), thereby improving the quality (and quantity) of information that is publicly available.¹⁰⁹ These corporations must disclose the existence of their securities that are held by controlling shareholders.¹¹⁰ They also hold public meetings with analysts and investors at least once a year, present an annual calendar with the relevant events for the forthcoming year (such as the dates of shareholder meetings,

financial statements in accordance with IFRS as issued by IASB, in lieu of Brazilian accounting standards.”

107. CVM Ordinance No. 480 of 2009, art. 13, §§ 1st and 2d.

108. Under the argument that it violated a constitutional right to privacy, the Brazilian Institute of Finance Executives of Rio de Janeiro (IBEF-Instituto Brasileiro dos Executivos de Finanças do Rio de Janeiro) questioned in court the constitutionality of the requirement on the remuneration of administrators. The CVM wants listed corporations to disclose the maximum, average, and minimum remuneration of the members of the board of officers and board of directors. The IBEF accepts the disclosure of global amounts, but contends that the illegality lies in that the proposed scheme allows the public to identify the CEO's compensation. The IBEF obtained a provisional remedy (“*medida cautelar*”) allowing its members not to disclose information on remuneration. See SLS 1.210-RJ, Justice Cesar Asfor Rocha, April 13, 2010 *available at* www.stj.gov.br (last visited April 21, 2011).

109. Novo Mercado Listing Rules, item 6.2 and Corporate Governance Level 2 Listing Rules, item 6.2.

110. Novo Mercado Listing Rules, item 9.1; Corporate Governance Level 2 Listing Rules, item 9.1; and Corporate Governance Level 1 Listing Rules, item 6.1.

release of financial results, etc.),¹¹¹ present detailed information about related party transactions,¹¹² and disclose on a monthly basis a summary of the transactions with derivatives and securities of the corporation that were carried out by the controlling shareholders.¹¹³

Officers of listed corporations have to inform the stock exchange, as well as publish in the press, any resolution of a general meeting or of the corporation's managing bodies. Further, they must disclose any material events which occur in the course of business that may substantially influence the market price of the securities issued by the corporation, or the decision of investors to sell, buy, or exercise any right pertaining to the corporation's securities.¹¹⁴ Under current CVM regulations, material events include the signing of contracts for the transfer of control of the corporation (even if under conditional provisions), changes in the control of the corporation (including through the execution, or amendments to a shareholder agreement), the authorization for listing securities issued by the corporation (in any domestic or foreign markets), changes in accounting criteria, and approval of stock options plans, among others.¹¹⁵ Furthermore, CVM regulations require the disclosure of information about sales of 5% blocks of voting stock or more. Disclosure is also necessary when the ownership of a type or class of stocks reaches 5% (or is reduced by 5%) of the total of such type or class.¹¹⁶

111. Novo Mercado Listing Rules, items 6.6 and 6.7; Corporate Governance Level 2 Listing Rules, items 6.6 and 6.7; and Corporate Governance Level 1 Listing Rules, items 4.4 and 4.5.

112. Novo Mercado Listing Rules, item 6.8; Corporate Governance Level 2 Listing Rules, item 6.8; and Corporate Governance Level 1 Listing Rules, item 4.6.

113. Novo Mercado Listing Rules, items 9.1.1 and 9.1.2; Corporate Governance Level 2 Listing Rules, items 9.1.1 and 9.1.2; and Corporate Governance Level 1 Listing Rules, items 6.1.1 and 6.1.2.

114. Corporations Law, art. 157 (Officers may however refuse to disclose such information when they feel that such disclosure would subject a legitimate interest of the corporation to risk (CVM Ordinance No. 258 of 2002)).

115. CVM Ordinance No. 358 of 2002.

116. CVM Ordinance No. 299 of 1999, art. 6; and CVM Ordinance No. 358 of 2002, art. 11 (administrators) and art. 12 (shareholders). (providing that corporations listed in BM&FBovespa's special listing segments must also disclose any direct or indirect ownership interest exceeding 5% of the corporation's capital stock, up to the level of individual shareholders (Novo Mercado Listing Rules, item 7.2, XV; Corporate Governance Level 2 Listing Rules, item 7.2, (XV); Corporate Governance Level 1 Listing Rules, item 5.2, (XV)).

D. Procedural Rights

Procedural rights are the inherent abilities to litigate and to demand legal remedies in court. Lawsuits against officers can be brought to court by the corporation upon the request of the minority shareholders, similarly to American-style derivative lawsuits.¹¹⁷ However, the effectiveness of these lawsuits is impaired by the fact that the shareholders' meeting (and not the board of directors, as typically occurs in the United States) has to approve them; and controlling shareholders have historically disfavored such lawsuits.¹¹⁸ These efforts are further hampered by the fact that in Brazil it is still common for officers to have close personal ties (often family ties) with the controlling group.

If the shareholders' meeting fails to approve the filing of derivative lawsuits, minority shareholders representing at least 5% of the corporation's aggregate stock capital may still file the claim.¹¹⁹ But the incentives for minority shareholders to file such claims are low, because they will bear the initial costs of the lawsuit and the verdict—which is somewhat uncertain and typically takes a long time—will go to the corporation. Hence, derivative lawsuits against officers are rare. Arguably, the procedural mechanism that could really protect minority shareholders is class action lawsuits. However, Brazilian procedural laws do not make room for them. The result is that minority shareholders remain more likely than controlling shareholders to be hurt by actions of the officers. After all, if officers hurt the controlling group they can be easily dismissed; yet if they hurt only the minorities, they remain unlikely to be sued.

117. A shareholder derivative suit is a lawsuit instigated by a shareholder of a corporation, not on the shareholder's own behalf, but on behalf of the corporation. The shareholder brings an action in the name of the corporation against the parties allegedly causing harm to the corporation. Often derivative suits are brought against officers or directors of a corporation for violations of fiduciary duties owed to the shareholders *vis-à-vis* the corporation. Any proceeds of a successful action are rewarded to the corporation.

118. Any shareholder may bring the action if proceedings are not instituted within three months from the date of the resolution of the shareholders' meeting approving the lawsuit. Corporations Law, art. 159.

119. *Id.* at art. 159.

E. Indirect Protection

Minority shareholders may also be indirectly protected through a number of legal remedies that aim at safeguarding the corporation from value-destructing actions of its controlling shareholders and officers. These are means of “indirect” protection because the immediate focus is on the protection of the corporation, and the minority shareholders only benefit from such actions to the extent that the improvement of the corporation’s state of affairs enhances their stock value and dividends payments.

The Corporations Law rules the exercise of voting in shareholder meetings and the exercise of controlling power in the course of the corporation’s businesses. Accordingly, each shareholder has a legal duty to vote in the corporation’s interest.¹²⁰ In practice, a vote will be deemed “abusive” if it is exercised with the intent to cause damage to the corporation or to other shareholders, or of obtaining an advantage for the shareholder or for a third party to which neither is entitled, and which results or may result in damage to the corporation or to other shareholders.¹²¹ In addition, each shareholder is barred from voting on any corporate resolutions dealing with the evaluation report on the property which he contributed to form the corporation’s capital, or on the approval of his own accounts as officer, or on any other resolution which may benefit him personally or in which he and the corporation may have conflicting interests.¹²²

120. *Id.* at art. 115.

121. *Id.*

122. *See id.*; Carvalhosa *supra* note 95, at 264 (both contending that the verification of the conflict of interests require a formal, abstract and *a priori* examination of the position of each shareholder in face of the corporation and the law). *But see* FÁBIO KONDER COMPARATO, CONTROLE CONJUNTO, ABUSO NO EXERCÍCIO DO VOTO ACIONÁRIO E ALIENAÇÃO INDIRETA DE CONTROLE EMPRESARIAL, DIREITO EMPRESARIAL, ESTUDOS E PARECERES 89 (1995) (arguing that the prohibition for voting under certain circumstances should be interpreted in such way that no shareholder shall obtain an advantage at the expense of other shareholders). *See also* LUIZ GASTÃO PAES DE BARROS LEÃES, CONFLITO DE INTERESSES, ESTUDOS E PARECERES SOBRE SOCIEDADES ANÔNIMAS 9-27 (1989); ERASMO VALLADÃO AZEVEDO E NOVAES FRANÇA, CONFLITO DE INTERESSES NAS ASSEMBLÉIAS DE S.A. 91 (1993); José Alexandre Tavares Guerreiro, *Conflito entre Sociedade Controladora e Controlada e ente Coligadas, No Exercício do Voto em Assembléias Gerais e Reuniões Sociais*, in 51 REVISTA DE DIREITO MERCANTIL 30 (1983) (all arguing that issues of conflicts of interest should be approached *a posteriori* and on a case-by-case basis). The CVM decisions do not follow a clear pattern. *See* Administrative Probe (“*Inquérito Administrativo*”) RJ 2001/4977 (deciding that a controlling

Controlling shareholders are required to use their controlling powers in order to make the corporation accomplish its purpose and perform its “social function,”¹²³ and have duties and responsibilities to the other shareholders of the corporation, to those who work for the corporation and to the community in which it operates, the rights and interests of which the controlling shareholder must loyally respect and heed.¹²⁴ The Corporations Law also contains a detailed description of the duties and responsibilities of the corporation’s officers.¹²⁵ Officers generally have fiduciary duties of diligence¹²⁶ and loyalty, as is common in

shareholder is *a priori* prevented from approving the payment of royalties under a contract to be entered into with the indirect controlling company). For a comment on this decision, see Erasmo Valadão Azevedo e Novaes França in 125 REVISTA DE DIREITO MERCANTIL 140-170 (2002). *But see* Administrative Probe (“*Inquérito Administrativo*”) CVM 2002/1153 (deciding that conflicts of interest should be analyzed *a posteriori* and on a case-by-case basis in order to verify whether there is an actual loss for the corporation).

123. See Fábio Konder Comparato, *A Reforma da Empresa*, in DIREITO EMPRESARIAL. ESTUDOS E PARECERES (1995) (examining the so-called “social function” of corporations).

124. Corporations Law, article 117, § 1st contains a non-exhaustive list of “abusive” actions which includes those circumstances where controlling shareholders (i) guide the corporation towards an objective other than in accordance with its corporate purposes clause or harmful to national interest, (ii) provide for the liquidation of a viable corporation or for the transformation, merger or spin-off of a corporation in order to obtain, for itself or for a third party, any undue advantage to the detriment of the other shareholders, of those working for the corporation or of investors in securities issued by the corporation, (iii) to provide for a statutory amendment, an issue of securities or an adoption of policies or decisions which are not in the best interests of the corporation but are intended to cause damage to the minority shareholders, to those working for the corporation or to investors in securities issued by the corporation, (iv) elect a corporation officer or audit committee member known to be unfit for the position or unqualified, (v) induce, or attempt to induce, any officer or audit committee member to take any unlawful action, or, contrary to their duties under this Law and under the bylaws, and contrary to the interest of the corporation, to ratify any such action in a general meeting, (vi) sign contracts with the corporation directly, through a third party or through a business in which the controlling shareholder has an interest, incorporating unduly favorable or inequitable terms, (vii) approve, or cause to be approved, irregular accounts rendered by corporation officers as a personal favor, or to fail to verify a complaint which he knows, or should know, to be well founded, or which gives grounds for a reasonable suspicion of irregularity, and (viii) subscribe stocks with the contribution of property unrelated to the purpose of the corporation. See *also* FÁBIO KONDER COMPARATO & CALIXTO SALOMÃO FILHO, O PODER DE CONTROLE NA SOCIEDADE ANÔNIMA (4th ed. 2005).

125. Corporations Law, arts. 153-160.

126. Brazilian case law on the duty of diligence is murky and offers no clear articulation of a “Business Judgment Rule” or similar doctrine. The Corporations Law states that the “officer shall not be personally liable for the commitments he undertakes on behalf of the corporation and by virtue of action

modern corporate legislation around the world.¹²⁷ There are also responsibilities that apply to the corporation itself. For instance, the corporation is liable for any loss caused to interested parties by errors or irregularities found in its corporate books.¹²⁸

The restrictions against trading stocks based on privileged information held by officers and controlling shareholders is another form of indirect protection of minority shareholders. The prohibition against insider trading had been inserted in the Corporations Law since its inception in 1976, but until recently enforcement was rare. It was only with the 2001 reform to the Corporations Law that the practice of insider trading was classified as a criminal offense.¹²⁹ However, it was not until 2009 that the

taken in the ordinary course of business; he shall, however, be liable for any loss caused when he acts: (i) within the scope of his authority, with fault or fraud; (ii) contrary to the provisions of the law or of the bylaws.” Corporations Law, art. 158. The 2008 financial crisis led to large losses to some listed corporations exposed to foreign exchange fluctuation in derivatives markets. Noteworthy cases include those of Sadia and Aracruz. In these cases, the corporations sued some of their officers, particularly their chief financial officers (source: Sadia’s minutes of shareholders meeting (“*assembléia geral extraordinária*”) dated as of April 6, 2009, and Aracruz’ minutes of shareholders meeting dated as of November 24, 2008, both available at www.cvm.gov.br (last visited April 21, 2011)). Completion of these lawsuits is expected to still take many years.

127. Under Brazilian Law, each officer is prohibited from performing any acts of generosity to the detriment of the corporation; borrowing money or property from the corporation or using its property, services or taking advantage of its standing for his own benefit or for the benefit of a corporation in which he has an interest or of a third party, without the prior approval of a general meeting or the administrative council; by virtue of his position, receiving any type of direct, or indirect, personal advantage from third parties, without authorization in the bylaws or from a general meeting; usurping a commercial opportunity which may come to his knowledge, by virtue of his position, for his own benefit or that of a third party (even if this is not harmful to the corporation); failing to exercise or protect corporation rights or, in seeking to obtain advantages for himself or for a third party, failing to make use of a commercial opportunity which he knows to be of interest to the corporation (although the law allows officers to contract with the corporation on arm-length basis); acquiring for resale at a profit property or rights which he knows the corporation needs or which the corporation intends to acquire. Corporations Law, arts. 154 and 155. The 2001 reform to the Corporations Law also included an express prohibition against insider trading. Art. 155 of the Corporations Law now states that “any officer who may receive any confidential information not yet revealed to the public shall not make use of such information to obtain any advantages for himself or for third parties by purchasing or selling securities.”

128. Corporations Law, art. 104.

129. *Id.* at art. 155, § 4t and art. 117. CVM Ordinance No. 31 of 1984 reinforced the prohibition to administrators and controlling shareholders to use privileged information for the obtainment of personal advantages while trading with securities. In fact, CVM Ordinance No. 31 of 1984 extended such prohibition to any person that could gain access to privileged information due to

public prosecution and the CVM filed the first lawsuit based on charges of insider trading. Charges were brought against persons involved in the merger of Perdigão and Sadia that occurred in 2006.¹³⁰

In spite of the myriad of regulations on the topic, the effective protection of minorities in Brazilian stock markets still hinges on at least two factors. First, on the improvement of the formal regulation itself. Sensitive issues include the quality, quantity and standardization of the information that is publicly disclosed, the use of poison pills by corporations with concentrated ownership, and the use of Brazilian Depositary Receipts by corporations with large operations in Brazil, among others.¹³¹

Second, in developing countries it is not uncommon to find fairly modern legislation that does not work well in practice. To a large extent, this depressing note applies to Brazil. In particular, Brazilian courts are largely deemed by corporate lawyers and other market players to lack the necessary expertise to delve into the intricacies of securities laws and the economic dynamics of securities transactions. This trait can be partly attributed to the absence of courts and judges specialized in corporate and securities transactions. In fact, Brazilian courts are remarkably slow and their decisions on corporate matters are somewhat unpredictable.¹³² As so, the interpretation and doctrinal analysis of corporate law is

her function or position. In 2002, CVM Ordinance No. 358 of 2002 objectively prohibited broader forms of insider trading. Accordingly, controlling shareholders, administrators, members of the audit committee, members of the board of directors, and members of any other statutory or advisory bodies to trade securities before the formal release by the corporation of notices required under the law in specific cases (“*fatos relevantes*”), or before the release of financial statements or of information on mergers and acquisitions involving the issuing corporation (art. 13). At the same time, the Capital Markets Law (Law No. 6,385 of 1976) was amended in order to criminalize the practice of insider trading (art. 27-D).

130. See LUIZ GASTÃO PAES DE BARROS LEÃES, *MERCADO DE CAPITAIS E INSIDER TRADING* (1982); JOSÉ MARCELO MARTINS PROENÇA, *INSIDER TRADING: REGIME JURÍDICO DO USO DE INFORMAÇÕES PRIVILEGIADAS NO MERCADO DE CAPITAIS* (2005).

131. See generally, Alexandre di Micelli da Silveira & Sete Erros, *Os Equívocos Cometidos pelas Companhias que Aproveitaram o Boom de IPOs* CAPITAL ABERTO, Jul. 2009, at 62-63 (Part I) and Aug. 2009, at 58-59 (Part II).

132. See Luciana Gross Cunha et al, 2010, Relatório ICJBrasil, fourth quarter 2009, available at www.direitogv.com.br/subportais/RelICJBrasil4TRI2009.pdf (last visited April 21, 2011) (with a broad empirical research showing that the Brazilian Judiciary Power is perceived by the Brazilian population as relatively slow, partial, dishonest, and difficult to reach).

insufficient to reflect the reality of the standards of protection of minority shareholders. The most sophisticated debates within securities litigation take place in the course of administrative disputes at the CVM. To understand the big picture, however, one should also examine the actual enforcement of laws and regulations, both in court and at the administrative level by the CVM. This exercise is touched upon in the next section.

IV. THE ENFORCEMENT OF PROTECTIVE MECHANISMS

Analyzing trends and identifying patterns in Brazilian case law is not an easy task.¹³³ First, the country does not adhere to principles of *stare decisis*, and inconsistency in case law over corporate matters is legendary. Second, the country adopts a diffuse system of judicial review (meaning that any judge can declare a law unconstitutional), making it harder to identify the predominant judicial opinions.¹³⁴ Finally, the degree to which judicial decisions are available for consultation over the internet varies depending on the topic and the state.

This situation reinforces the usefulness of conducting statistical analysis to understand Brazilian case law. In a recent study, Viviane Muller Prado and Vinícius Buranelli analyzed a sample of

133. Luciana Luk-Tai Yeung & Paulo Furquim Azevedo, Beyond Conventional Wisdom and Anecdotal Evidence: Measuring Efficiency of Brazilian Courts, *available at* www.anpec.org.br/encontro2009/inscricao.on/arquivos/000-84cae2373a83e83852e80f24733f709e.pdf (arguing that “little effort has been made to objectively measure the efficiency in Brazilian courts. Studies that combine quantitative and qualitative analysis are even harder to find”). *See also* José Marcelo Maia Nogueira & Regina Silvia Pacheco, A Gestão do Poder Judiciário nos Estudos de Administração Pública, *available at* www.consad.org.br/sites/1500/1504/00000091.pdf (last visited April 21, 2011).

134. The Brazilian judicial review system is based on the coexistence of centralized and decentralized judicial review. It is partly inspired by the American model, in the sense that private parties bring constitutional issues before ordinary courts in regular judicial proceedings. At the same time, it is also possible to bring actions in relation to constitutional matters directly to the Federal Supreme Court (Supremo Tribunal Federal, STF). The Federal Supreme Court also has jurisdiction to examine the constitutionality of statutes *in abstracto*. *See*, Miyuki Sato, *Judicial Review in Brazil. Nominal and Real*, 3:1 GLOBAL JURIST ADVANCES, art. 4 (2003) *available at* www.bepress.com/gj/advances/vol3/iss1/art4 (last visited April 21, 2011); *see also* Joaquim Barbosa, *Reflections on Brazilian Constitutionalism*, 12 UCLA J. INT'L L. & FOR. AFF. 181 (2007).

50 cases and 92 appeals¹³⁵ ruling on the protection of minority shareholders. This sample was comprised only of decisions given between 1998 and 2005 by the Superior Court of the State of São Paulo.¹³⁶ This is the state where the BM&FBovespa is located, and also the state where most listed corporations have their headquarters.

As illustrated in Table 1, most of the cases (66%) were brought to court by individuals, and institutional investors were the plaintiffs in only 18% of the cases. This finding contradicted the expectations of the researchers because the absence of class action mechanisms and problems of “rational ignorance”¹³⁷ would suggest that the institutional investors—who have higher stakes and are more sophisticated than the individuals—would be the plaintiffs in most cases. The explanation could be that institutional investors have enough powers to engender political arrangements with the controlling groups that avoid the need of going to court, or perhaps it has to do with the nature of the issues being litigated.

The corporations that issued the stocks were the defendants in most cases (88%). Controlling shareholders were the defendants in only 10% of the cases and the corporate officers in only 2%. In an environment where private benefits of control have historically been deemed to be high, the small amount of lawsuits against controlling shareholders may suggest that the regulations are lax on restricting controlling shareholders, and/or that proving a case against controlling shareholders is very difficult.

135. Different aspects of a case can be appealed many times, explaining why there are more appeals than cases in the sample. For methodological details on this research see Viviane Muller Prado & Vinícius Correa Buranelli, *Relatório da Pesquisa de Jurisprudência sobre Direito Societário e Mercado de Capitais no Tribunal de Justiça de São Paulo*, Cadernos Direito GV. Relatório de Pesquisa, no. 9, São Paulo, January 2006, available at www.direitogv.com.br/interna.aspx?PagId=HTKCNKWI&IDCategory=4&IDSubCategory=68 (last visited April 21, 2011).

136. Tribunal de Justiça do Estado de São Paulo (TJSP).

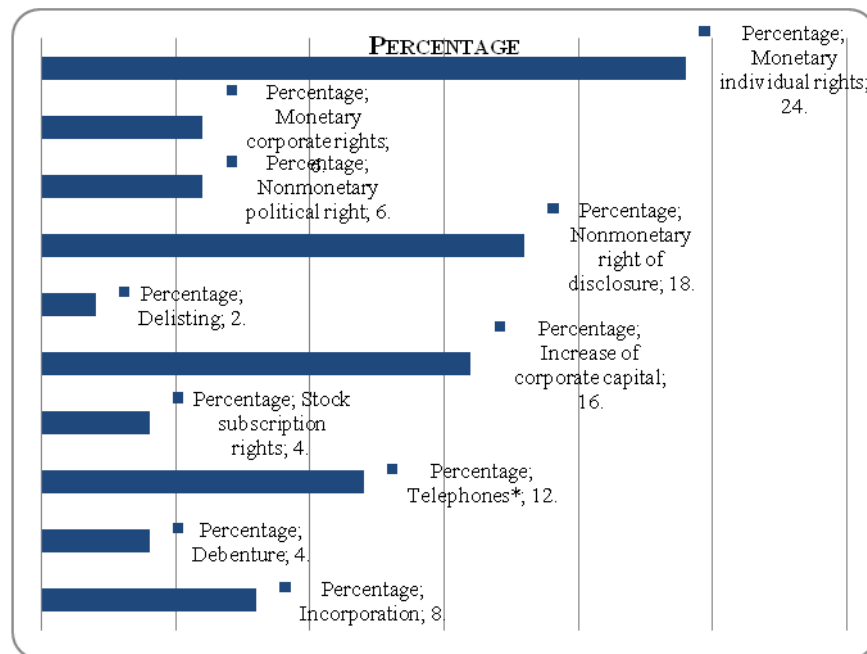
137. Ignorance about an issue is said to be “rational” when the cost of educating oneself about the issue sufficiently to make an informed decision can outweigh any potential benefit one could reasonably expect to gain from that decision, and so it would be irrational to waste time doing so.

PLAINTIFFS	PERCENTAGE
Institutional investors	18
Legal entities	14
Individuals	66
Public Prosecutor's Office	2
<i>Total</i>	<i>100</i>

DEFENDANT	PERCENTAGE
Corporation	88
Controlling shareholder	10
Officer	2
<i>Total</i>	<i>100</i>

The research also tried to identify the specific questions that were being litigated. As expected, the sample showed a larger proportion of lawsuits where shareholders tried to enforce their own direct interests and a lower proportion of lawsuits trying to hold officers or controlling shareholders liable.¹³⁸ Common topics included the request for recognition of dissent and appraisal, request for higher dividends payments, and the request for the exhibition of corporation's documents, etc.

138. See *supra* notes 117-118.



* Legal disputes with shareholders who received stocks of telecom public utilities upon the purchase of new telephone lines in past decades.

The CVM is in charge of supervising, investigating and punishing irregular acts that occur in the Brazilian capital market. In a recent study, Maria Cecília Rossi, Viviane Muller Prado and Alexandre Di Miceli have analyzed one hundred and one CVM decisions dealing with corporate law issues in the period between 2000 and 2006.¹³⁹ Approximately one in every four investors in the Brazilian market is an individual,¹⁴⁰ which highlights the importance of the CVM because individual shareholders tend to be less sophisticated and less powerful than corporate shareholders.

The CVM is in most cases responsible for initiating the investigations that eventually lead to an administrative proceedings seeking to punish some player in the capital market. In 61 of the cases (around 60% of the sample), the CVM became aware of some alleged wrongdoing by means of its own initiatives. Only in 29 cases (29%) did the CVM initiate the investigation after it was

139. Maria Cecília Rossi et al., *Decisões da CVM em Matéria Societária no Período de 2000 a 2006*, 37 REVISTA DE DIREITO BANCÁRIO E DE MERCADO DE CAPITAIS 88-106 (2007).

140. NATIONAL INSTITUTE OF INVESTORS HOME PAGE, http://www.ini.org.br/ini/site/informativo/Informativo_janeiro_2006_.pdf (last visited April 21, 2011).

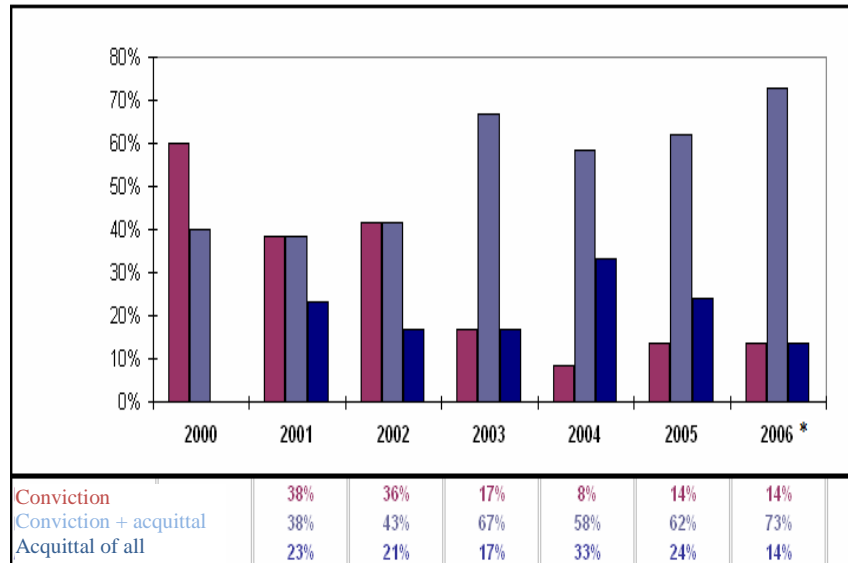
notified by minority shareholders, by investors in securities other than stocks, or by associations representing minority shareholders. Moreover, in four cases the CVM acted upon a notification by the Central Bank of Brazil, in three cases upon a notification of a member of an audit committee, and in one case the CVM acted upon a joint notification given by a member of the board of directors together with the corporation. In the remaining seven cases, the CVM acted because of other unrelated reasons.

Officers, directors, controlling shareholders were the main targets of the CVM's administrative processes. Here there is a sharp distinction with the judicial proceedings, in which the corporation itself was most often the defendant. The CVM filed 80 proceedings against officers, 66 against directors, 40 against the controlling shareholders, 11 against auditors, and 27 proceedings were filed against members that are not in any of these categories.

The length of time between the date of the infraction and the conclusion of the administrative proceeding lasted on average six years. In spite of some investments that had been made by the government to strengthen the CVM, the study could not identify any trend demonstrating a decrease in the duration of the proceedings.

Alleged infractions to disclosure requirements, abuse of controlling powers and wrongdoings by officers were the themes that appeared most frequently in the administrative proceedings. The high number of disclosure issues being litigated can be partially explained by the fact that these kinds of infraction are the easiest detected by the CVM, yet that does not mean that disclosure problems are the most relevant ones. Moreover, the degree of acquittal of the individuals being prosecuted for disclosure mistakes is rather high.

Table 2 below shows that the proportion of convictions over time had increased for certain groups and decreased for others. This is due to a change in the pattern of issuances of subpoenas by the CVM, because in recent times the CVM has been adopting a strategy of issuing subpoenas to a large number of individuals who may be potentially involved in wrongdoing, even if there is not clear evidence against any one of them individually sufficient to initiate a proceeding.



*Updated as of June 2006.

The main reasons for acquittal of the defendants were the inapplicability of the specific legal provision to the conduct that gave rise to the investigation, the absence of responsibility of the defendant for the specific conduct being prosecuted, and the absence of sufficient evidence. The cases of insider trading presented higher levels of acquittals, and this is probably due to the fact that they are harder to prove. In the cases where there was a conviction, the penalties most commonly applied were fines.

The relatively low levels of enforcement of the law and the legal uncertainties prevailing in Brazil with respect to corporate matters have contributed to the expansion of alternative dispute resolution methods, particularly through arbitration proceedings. Historically, Brazilian courts have been refractory to arbitration. Because of this, the 2001 amendment to the Corporations Law has expressly permitted the corporation's bylaws to specify arbitration as a means to resolve disputes involving shareholders. Moreover, BM&FBovespa has made the use of arbitration mandatory for corporations listed in the Novo Mercado and Level 2.

While the study found no statistical evidence on effectiveness and frequency of arbitration proceedings, anecdotal evidence shows that the use of arbitration in corporate matters involving

minority shareholders remains problematic.¹⁴¹ The election to use arbitration does not preclude the parties from requesting precautionary injunctions in court. Such precautionary injunctions can be appealed, often leading to time consuming court battles that can paralyze arbitration proceedings for a long time. Further and more importantly, court enforcement of arbitration awards can itself lead to lengthy court proceedings. This is particularly problematic because it is not uncommon to find cases where judges reopen the merits of the arbiter's decision. All of that suggest that the improvement of Brazilian courts should remain an important concern for investors, lawyers and policymakers in the years to come.

V. CONCLUSION

The protection of minority shareholders in Brazilian listed corporations is subject to a dual legal framework. The relative laxity of the Corporations Law lies in direct contrast with the much greater stringency of the rules established by BM&FBovespa for stocks traded in its Novo Mercado. In any case, the effectiveness of either framework is hampered by procedural problems both at the judicial and administrative levels. However, the existence of these problems should not obscure the fact that corporate governance practices have dramatically improved in Brazil over the past decade. BM&FBovespa would probably not have advanced so dramatically had it not been for a major change in the attitude toward corporate governance. A static approach leaves some questions as to the quality of the legal protection currently available to minority shareholders. Yet, examining a more dynamic, or historical approach, suggests a promising trend.

141. See Adriana Braghetta et al, *Arbitragem e Poder Judiciário: Uma Radiografia dos Casos de Arbitragem que Chegam ao Judiciário Brasileiro*, 6:6 CADERNOS DIREITO GV (Nov. 2009) (generally surveying arbitration proceedings in Brazil).

