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A new policy agenda for Latin American company law

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Publication date:
2011

Document Version
Publisher's PDF, also known as Version of record

[Link to publication in Tilburg University Research Portal](#)

Citation for published version (APA):

Reyes Villamizar, F. H. (2011). *A new policy agenda for Latin American company law: Reshaping the closely-held entity landscape*. [n.n.].

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**A New Policy Agenda for Latin American Company Law:
Reshaping the Closely-Held Entity Landscape**

Francisco Reyes



2011

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Table of Contents

Preface

Introduction

1. The Law of Business Associations in Latin America
 - 1.1 Corporate Law Structure in Latin America
 - 1.2 Overview of Basic Business Entities
 - 1.3 Partnership (*Sociedad Colectiva*)
 - 1.4 Stock Corporation (*Sociedad Anónima*)
 - 1.5 *Closely-held Company* or Limited Liability Company (*Sociedad de Responsabilidad Limitada*)
 - 1.6 Limited Partnership (*Sociedad en Comandita*)

2. Basic Problems in Current Legislative Approaches
 - 2.1 Codification of Company Law
 - 2.2 Public Order Nature of Most Company Law Provisions
 - 2.3 The Dichotomy of Corporation Law in Latin America
 - 2.4 The Contractual Nature of Company Law in Latin America
 - 2.5 Reluctance to Provide Full Enforceability to Shareholders' Agreements
 - 2.6 Exceptions to Limited Liability
 - 2.7 Excessive Legal Formalities for Incorporation
 - 2.8 The Limited Role of the Mercantile Registry
 - 2.9 Overreaching Causes for Nullification
 - 2.10 Regulatory Nature of Most Company Law Rules
 - 2.11 The Negative Impact of the *Ultra Vires* Theory
 - 2.12 Rigid Regulations Regarding Capital Contributions
 - 2.13 Lack of an Effective Judicial Control on Business Associations
 - 2.14 Enforcement of Corporate Governance Rules
 - 2.14.1 The General Inspection of Justice
 - 2.14.2 The Superintendence of Corporations

3. Corporate Governance Reforms in Latin America
 - 3.1 Policy Agenda for Corporate Governance Reform
 - 3.2 Principles of Corporate Governance
 - 3.2.1 The Context of Corporate Governance: Block-Holding versus Market Systems
 - 3.3 Strategies to Mitigate the Agency Problems Arising from Conflicts between Majority and Minority Shareholders
 - 3.3.1 The Appointment Rights Strategy
 - 3.3.2 The Decision Rights Strategy
 - 3.3.3 The Trusteeship Strategy
 - 3.3.4 The Reward, Constraints, and Affiliation Rights Strategies
 - 3.4 OECD White Paper on Corporate Governance in Latin America
 - 3.5 The Modest Impact of Reforms on Corporate Governance for Listed Firms

4. Legal Framework for Company Law Reform in Latin America
 - 4.1 Shifting the Policy Agenda to the Closely-held Company
 - 4.2 The appropriateness of Legal Transplants
 - 4.3 Structural Transplants and the Good Corporate Judge
 - 4.4 Path Dependence and Company Law Reform
 - 4.5 The Impact of Company Law for Economic Development
 - 4.6 Proposals for Latin American Company Law Reform
 - 4.6.1 Publicly-held Corporations
 - 4.6.2 Closely-held Corporations
 - 4.7 The Model Act on Simplified Stock Corporations for Latin America
 - 4.7.1 General Aspect
 - 4.7.2 Specific Aspects
 - 4.7.2.1 Rules on the Nature of SAS and Legal Personality
 - 4.7.2.2 Incorporation and Proof of Existence of the Company
 - 4.7.2.3 Special Rules Regarding Capital Contributions and Shares
 - 4.7.2.4 Change of Control in a Corporate Shareholder
 - 4.7.2.5 Company Organization
 - 4.7.2.6 Shareholders' Assembly
 - 4.7.2.7 Operation of the Shareholders' Assembly
 - 4.7.2.8 Action Without a Meeting (Simultaneous or Successive Communications)
 - 4.7.2.9 Calling of Meetings
 - 4.7.2.10 Express Waiver of Notice to Meetings of Shareholders
 - 4.7.2.11 Implicit Waiver of Notice
 - 4.7.2.12 Quorum and Majorities in Assembly Meetings
 - 4.7.2.13 Shareholders' Agreements
 - 4.7.2.14 Board of Directors
 - 4.7.2.15 Legal Representation
 - 4.7.2.16 Liability of SAS Managers
 - 4.7.2.17 Corporate Audit Organs
 - 4.7.2.18 Bylaw Amendments and Corporate Restructurings
 - 4.7.2.19 Dissolution and Winding Up
 - 4.7.2.20 Piercing the Corporate Veil
5. The Model Act on Procedural Rules for the Resolution of Conflicts in Simplified Stock Corporations
 - 5.1 Purpose and Principles
 - 5.2 Specialized Jurisdiction
 - 5.3 Expeditious Filing of a Complaint
 - 5.4 Simplified Procedures
 - 5.5 Restrictions on Admission of Evidence
 - 5.6 Simultaneous Service of Process
 - 5.7 Exceptional Nature of Appeals
 - 5.8 Anticipated Judgment and Summary Decision

5.9 Abuse of Rights, Alternative Procedural Provisions and other Rules

6. The Simplified Stock Corporation: An Empirical Demonstration

6.1 Consolidated Empirical Data for the Entire Country

6.2 Comparative Analysis Concerning SAS Incorporated in Colombia's Largest Cities

6.2.1 Incorporation *Ex Novo* and Conversion into SAS

6.2.2 Private Documents and Public Deeds of Incorporation

6.2.3 Term of Duration

6.2.4 Board of Directors

6.2.5 Fiscal Auditors

6.2.6 Common Shares of Stock vs. Other Types of Equity Securities

6.2.7 Dimension of SAS

6.2.8 Purpose Clause

6.2.9 Parent-Subsidiary Relationships

6.3 Criticism to Legal Reform in Latin America

7. Conclusion

Annex A. Model Act on the Simplified Stock Corporation

Annex B. Model Act on Procedural Rules for the Resolution of Conflicts in the Simplified Stock Corporation

Annex C. Corporate Governance Legal Provisions in Major South American Jurisdictions

Annex D. The SAS Compared to Traditional Business Associations in Latin America

Index of Tables and Graphs

Bibliography

Preface

Is there a subject matter that could be accurately referred to as Latin American Company Law? The answer will largely depend on each scholar's specific academic approach. For some authors there are specificities that differentiate every jurisdiction in this region to such an extent that it becomes impossible to formulate an all-encompassing analytical framework for the entire geographical zone. Irrespective of the academic approach it is, however, undisputable that all these countries present a level of normative convergence. This is due to their shared cultural heritage and the joint appropriation of a common legal tradition. Such factors still today determine the configuration of the region's institutional and legal frameworks. This assertion is undeniable both in the general field of Private Law as it is in the more specific of Business Associations. Within the latter, and despite obvious differences in the configuration of each type of commercial entity, it is clear that the basic features of their regulation are by and large homogenous, at least in those countries that have embraced the ideology of market economies. Regrettably, this homogeneity is particularly noticeable in these systems' protuberant deficiencies. In fact, not only the substantive provisions are generally antiquated and obsolete, but they are also characterized by their very limited enforceability as a consequence of inefficient judiciaries. Paraphrasing Rosco Pound's famous sentence, it can be said that in Latin America there is a significant gap between the "law in the books and the law in action".

The colonial heritage, especially from Spanish and Portuguese origins, has crafted an important part of the legal culture in this region, usually characterized by the veneration of formalities and the overwhelming presence of regulatory provisions for all kinds of matters that should generally be subject to private ordering. Lengthy lists of commercial transactions subject to authentication and public deeds speak loudly of a legal framework that creates costly and inefficient conditions for businesses. This situation is symptomatic of the prevailing tendency of Latin American legal systems to give more weight to form than substance.

It goes without saying that the reduction of sterile formalities, flexibility and freedom of contract should be the guiding principles for any legal reform aimed at the modernization of these countries' juridical context. Likewise, the effective and expeditious enforceability of agreements should be the rule and not the exception, as it is today in all jurisdictions in this region. The lessons learned from the practical and efficiency-minded approaches undertaken in various Common Law systems may, and in fact have been, a useful point of departure for the modernization of legal rules and proceedings in other parts of the world.

Fortunately, this sort of trend is starting to permeate the formerly dogmatic approaches prevailing in the realm of business association law in Latin America. The inception of the new Simplified Stock Corporation in Colombia in 2008 has already changed the closely held entity landscape in this country by displacing backward looking notions imbedded in traditional Company Laws in Latin America. More than

50.000 SAS (as the new type of entity is referred to by its acronym in Spanish) were created during the first to years after the enactment of the law that introduced the innovative business form. Today 85% of the total formalization of start-ups is made through the incorporation of simplified stock corporations. The SAS revolution has been so profound that during 2010 (the second year after the entity was legally adopted) there was an increase of more than 100% in the number of incorporations of this type of companies in comparison with the previous year. At the same time the overall number of business entities created in that same period was augmented in more than 25%. These data clearly suggest that a simple, but comprehensive change in the legal framework can significantly contribute to the formalization of thousands of enterprises that otherwise would remain in absolute informality. Empirical observation can also demonstrate that such an overhaul in the Company Law infrastructure can significantly impact economic development. In fact, the new regularized business entities are subject to mercantile publicity, pay taxes and abide by general Labor Law regulations. Above all, these new simplified stock corporations have access to credit and are given the opportunity to grow beyond the usually unsurpassable micro-enterprise size.

While the Colombian SAS reform has revolutionized the manner in which closely held corporations are formed and operated, the corporate governance reforms designed to deal with listed corporations has not appear to have significantly impacted the stock markets in the region. Despite certain achievements, particularly after the inception of the Brazilian Novo Mercado, the empirical data presented in this book demonstrates that there has been a consistent decrease in the amount of listed corporations in the entire region.

Analyzing and recognizing these competing realities is the main purposes of this book. By confronting the avant-garde recently modernized Colombian law with the old-fashioned systems of most other Latin American jurisdictions a significant disparity in law-making techniques becomes evident. In fact, corporations according to the former legislation are created online through digitally signed articles of incorporation, whereas in the latter regimes a protracted process plagued with formalism and distrust is required for their formation. This gap between modern Corporate Law and nineteenth century types of regulation is the most eloquent demonstration that legal reform is urgently required in most of these jurisdictions.

This research is aimed at proposing a new policy agenda for Latin American Company Law. This shift of focus should take into account the enormous importance of the closely held business entities in this region. In spite of the empirically proven fact that these entities contribute significantly to the creation of employment and wealth, they are still subject to an obsolete and antiquated legal framework that needs to be surpassed.

It is my expectation that this research shall provide new access to a reliable source of information concerning crucial aspects of Company Law in Latin America. I also hope that the proposals contained in this book will also propel a renewed interest in the urgent reform of the legal infrastructure for business in this increasingly important region.

Finally, I would like to express my gratitude to professor Erik Vermeulen, Director of the International Business Law Program at the University of Tilburg, who encouraged me to undertake this research.

Francisco Reyes

INTRODUCTION

The wave of corporate governance reforms that has permeated most of the major systems in Latin America in recent years has not had a significant impact on the legislation applicable to closely held companies. This appears to be a misdirected approach since the region's economic reality is characterized by family control and concentrated ownership. Even listed corporations are generally subject to a block-holding structure. Policy-makers have not given enough weight to these factors when determining legislative changes. Not surprisingly, most legal reforms in this field have targeted agency problems more commonly arising in the context of dispersed equity ownership models. This approach disregards the nature of agency problems arising in the context of ownership concentration, which differs to a large extent from that of those present in highly developed markets characterized by dispersed ownership. Policy-makers in the region appear to have neglected this reality when defining the Company Law reform agenda for Latin America.

Corporate governance reforms have imported the notions of mandatory independent directors, auditing committees and certification of financial statements which have become commonplace in the securities regulations across the region. Albeit important in improving the legal framework of listed companies, these legal reforms disregard the basic underlying agency problem between controlling shareholders and their minority counterparts. Generally, reforms in this field have not been successful in the objective of deepening the stock markets. A sense of confidence in substantive law investor protection has not been achieved, particularly due to the lack of a sufficiently strong institutional infrastructure for its enforcement.

On the other hand, rules for closely held entities are mostly of a regulatory nature, imposing severe restrictions on private ordering and preventing parties from opting out cumbersome imperative norms. These suboptimal approaches are usually defended on the grounds of public policy, protection of the legal system or tradition and are maintained at any cost by local legal operators. In several cases, path dependence in Company Law represents an almost unsurpassable obstacle for the adoption of modern rules. In fact, Company Law in most Latin American jurisdictions continues to follow the taxonomy of business associations inherited from the nineteenth century French codification movement. Such business forms generally lack the necessary flexibility to cope with new economic realities given their obsolescence and rigidity.

It is suggested here that hybrid business forms could be an appealing solution to deal with closely held firms in the region. The inception of these new company types could be welfare enhancing, due to the generation of business opportunities and growth that arise from these vehicles' adaptability to economic change. Undertaking legal reforms in this field should follow a structural transplant approach, instead of the recurrent translation of foreign models. Therefore, the adoption of substantive law provisions will not suffice. An overhaul of the institutional framework shall also be needed in order to ensure their enforceability.

In studying the different forms of business associations existing in Latin America, it becomes evident that stock corporations are heavily regulated irrespective of their publicly held or closely held nature. This one-size-fits-all approach is detrimental to the business environment, to the extent that it restricts private ordering particularly in non-listed firms. To be sure, mandatory provisions imposed upon closely held companies curtail entrepreneurial activity, limiting innovation and precluding the emergence of new businesses. As a result of stringent regulation, entrepreneurs are forced to contract around mandatory provisions in order to create a suitable framework for their business activities. Sidestepping mandatory statutes requires cumbersome and costly negotiations between the parties.

The modern propensity to foster innovation through flexible rules has also led to the inception of new business vehicles that combine elements pertaining to the different existing forms. Examples include the Limited Liability Company (LLC) in the United States, the Limited Liability Partnership (LLP) in the United Kingdom, and the *Société par Actions Simplifiée* (SAS) in France. The growing popularity of LLC's, LLP's, and SAS shows how joint ventures, family companies, corporate conglomerates, venture capital firms and even small start-ups can better adapt to a changing business environment. Despite certain shortcomings, such as some degree of legal uncertainty, mainly due to the lack of applicable case law, it is now widely recognized that these hybrid entities are the next step in the evolution of Company Law.

The case for developing new business forms is strong in Latin American countries. Concentrated ownership, family-owned businesses and a small number of listed corporations characterize the prevailing economic model in the region. This landscape creates significant demand for flexible business entities in which parties can be extensively engaged in private ordering. Certainly, in order to function properly, family-owned businesses require a high degree of contractual arrangements aimed at governing intra-firm relations. However, most Latin American legislators (much like their European counterparts) have been reluctant to develop new hybrid vehicles. Increasing entrepreneurial demand for reform has only recently spurred several initiatives within the region.

This research is intended to provide an analytical framework for the adoption of a hybrid business form as a model law for closely held firms in Latin America. It is suggested that the advantages of flexibility and freedom of contract make such business form especially suitable for family-owned firms, start-ups, professional undertakings, and all sorts of small, medium and large firms within this region. The proposed Model Act will seek to combine the traditional features of the corporate form with rules that have hitherto been absent in Latin American statutes. In order to do so, the Act will include provisions removing public deed requirements for incorporation and will allow single member companies to exist. The Simplified Stock Corporation (following the Colombian model) will also be characterized by limited liability balanced by veil-piercing remedies in case of fraud, suppression of the *ultra vires* doctrine; unlimited duration; removal of mandatory auditing committees and of the one-share,

one-vote rule, abuse of right remedies, possibility of eliminating prohibitions for managers, and freedom to set forth restrictions on share transferability and simplified merger proceedings. All in all, the rules that will be included in the Model Act escape traditional Latin American Company Law statutes in more than one way. The research is aimed at showing that the model act on simplified stock corporations for Latin America will allow the incorporation of modern trends into legal systems characterized by a formalistic and backward structure in which regulatory provisions prevail to an overwhelming extent.

The extremely successful, empirically measured result of Colombian Law 1258 of 2008 clearly suggests that businesspeople prefer flexibility to old-fashioned misguided paternalism. A widespread adoption of the model act would not only allow for a certain degree of convergence in countries that require a higher level of legal integration, but also could foster innovation and foreign investment. This research will also attempt to demonstrate that statutes such as the Model Act are welfare enhancing, to the extent that they foster innovation and entrepreneurship.

This book is divided in seven chapters. Chapter 1 provides an overview of the current landscape of Company Law in Latin America, including a description of the basic types of business associations that exist in the major jurisdictions in the area. It is evident from the analysis in this first chapter that the existing regulations, characterized by a rigid and inflexible legal taxonomy, have not been sufficiently updated to cope with present economic needs. It is held that the *numerus clausus* approach prevailing in statutes and Commercial Codes in this region lacks the adaptability and contractual flexibility to design appropriate business structures.

Chapter 2 analyzes some of the basic problems ensuing from the current regulation for closely held firms as it appears in codes and statutes across the region. Within these issues, the following difficulties are highlighted: the rigidities arising from the codification of Company Law in the region, which make it difficult for policy makers to rapidly undertake law reforms; the public order nature of most company law provisions, by which private parties are unable to define optimal contractual structures; the Dichotomy of Corporation Law in Latin America that creates confusion as to the applicable legislation applicable to a business entity and constitutes a reminiscence of nineteenth century approaches that should be abolished, and the dogmatism concerning the contractual nature of Company Law, which is yet another expression of a backward conception that hinders legislative improvement. As it is held in this chapter, this conception has been used as the main argument to attack the legal possibility of single member corporations in the broad majority of Latin American countries. The reader will be able to realize how, as a corollary of the same approach, there is a general reluctance to allow for the enforceability of shareholders' agreements. The idea whereby the only binding provisions are those contained in the corporation's by-laws (*the corporate contract*) creates an additional obstacle for the enforceability of any additional agreements executed by the shareholders. Additional topics in Chapter 2 relate to the several exceptions to the principle of limited liability that Constitutional Courts and other tribunals have defined. The overwhelming formalities for incorporation

that exist in these countries are also analyzed here as well as additional aspects that create transaction costs such as the overreaching causes for nullification, the regulatory nature of most Company Law rules and the rigid regulations concerning capital contributions. The problem of enforceability is singled out at the end of this chapter as one of the most significant obstacles for the development of a modern Business Associations Law in the region.

Chapter 3 touches upon the corporate governance reforms that have taken place in all major jurisdictions in the region during the last decade. The analysis is especially referred to the OECD White Paper for Corporate Governance in Latin America. The chapter proposes a critical approach to the recommendations made by the organization and concludes that some of the proposals are at best illusory and at worse detrimental to the corporate law systems in the region due, among other reasons, to the increase in costs of compliance for listed firms. At the same time a critique is posed also concerning the fact that the OECD does not seem to give sufficient weight to the weakness of the judicial infrastructure in all Latin American jurisdictions.

Chapter 4 assesses various proposals for law reform in Latin American Company Law. The focus here is on the importance of shifting the policy agenda to the closely held entity. For that purpose the importation and adaptation of rules from advanced jurisdictions is recommended. The underlying theory is that a legal transplant in the field of closely held firms is significantly facilitated by the homogeneity of agency problems that are present in non-listed firms everywhere. Therefore, the dichotomy between diffused and concentrated ownership as well as the corresponding differences in the assessment of agency problems are not all that relevant in non-listed firms. The optimal incentives to neutralize agency problems in the context of closely held companies could be applied in different jurisdictions, without regard to the economic circumstances prevailing in each country. The same chapter also includes a comprehensive explanation on the Model Act on Simplified Stock Corporations for Latin America.

Chapter 5 proposes a complementary Model Act on Procedural Rules for the Resolution of Conflicts in Simplified Stock Corporations. This additional proposal is related to an ancillary proceeding specifically designed to facilitate litigation concerning disputes in the context of such business entities. The recommended Procedural Model Act is characterized by a simple structure intended to allow for rapid enforcement of the SAS' substantive provisions. It is suggested that the resolution of conflicts in Simplified Stock Corporations could become a tailor-made process highly suitable to deal with the specific circumstances surrounding litigation in the context of closely held entities. It is also concluded that flexibility, simplicity and expeditiousness surrounding such proceeding could greatly facilitate the enforcement of substantive provisions contained in the SAS Model Act.

Chapter 6 encompasses an empirical analysis concerning the Colombian Simplified Stock Corporation and its positive impact on the business environment of that country. It also intends to demonstrate how an overhaul in the regulatory framework for the closely held entity can definitely improve the manner in which businesses are

handled in the region. The statistical data presented in this chapter show how the enactment of Colombian Law 1258 of 2008 (by means of which the Simplified Stock Corporation was introduced in that country) has been by far the most successful Colombian company law reform in the last several decades. The SAS has acquired the highest level of importance within local business associations. The data not only show the impressive acceptance of the SAS during the first two years after the enactment of Law 1258, but also the progress made by this company type *vis-à-vis* the previously existing business forms. Pursuant to the same information during the same period Colombia has made significant progress in reducing the steps required for the incorporation of new business entities and implemented online incorporation of simplified stock corporations.

Finally, Chapter 7 provides conclusions arising from the theoretical and empirical analysis contained in this book. It is suggested that the sort of agency problems that prevail in Latin American Company Law should be the starting point to redefine the policy agenda. Taking into account the high degree of concentrated ownership that prevails across Latin American countries, it is concluded that most legal solutions should counteract the potentiality for oppression of minority shareholders at the hands of block-holders, particularly in the field of closely held entities. The recommended adoption of the Model Act on Simplified Stock Corporations in other Latin American jurisdictions is a natural corollary of this research. An additional conclusion relates to the importance of enforcement and the recommendation of a specific statute concerning procedural rules for the resolution of conflicts in Simplified Stock Corporations.

1. THE LAW OF BUSINESS ASSOCIATIONS IN LATIN AMERICA

In December of 2008, the Congress of the Republic of Colombia enacted a law creating a new form of hybrid-business entity referred to as the Simplified Stock Corporation (*SAS, for its initials in Spanish*)¹. Following an Anglo-American approach to corporate law, this act reduced all formalities for incorporation to a simple registration before a public registry². It also ameliorated expenses associated with the formation and operation of boards of directors, fiscal auditors, multiple managers, and other formalistic requirements. The Act made it plain that shareholders would be shielded from any liability concerning any obligations arising from the business activities of the corporation. Furthermore, it reduced old-fashioned prohibitions regarding the activity of shareholders and managers and, above all, introduced a straightforward and effective principle of freedom of contract.

Applying the method of *structural transplants*, the new law introduced an innovative enforcement environment in which arbitration and administrative adjudication superseded the inefficient judiciary of that country. Only two years after the enactment of this law, more than 52,000 simplified stock corporations had been created. All kinds of business enterprises, irrespective of their size or activities, took quick advantage of the multiple innovations offered by the SAS. Corporate groups rushed to convert their previous subsidiaries into the new, flexible business form. More significantly, all the types of business associations that existed before the enactment of this law rapidly fell behind, and in only four months the SAS was the entrepreneurs' favorite business entity, as measured by the amount of new incorporations. The revered and highly valued closely held companies (*sociedades de responsabilidad limitada*) and stock corporations (*sociedades anónimas*) were rapidly defeated in this race for new incorporations. This rather unusual experiment may evidence that the anachronistic *status quo* of company law in Latin America can be successfully challenged³.

¹ Law 1258 of 2008.

² See Section 5, *infra*.

³ Some of the most salient features of the SAS can be summarized as follows: (i) Formation by one or more shareholders; (ii) Incorporation by simple private or electronic document (as opposed to granting a public deed for incorporation); (iii) Simple process of formation through registration before Mercantile Registry; (iv) Full-fledged limited liability, with the only exception of piercing the veil for fraud or abuse of the corporate form; (v) Abolition of the *ultra vires* doctrine; (vi) Unlimited corporate duration; (vii) Full contractual freedom for corporate organization; (viii) Suppression of superfluous internal controls such as statutory auditors; (ix) Admission of several different classes of stock, including shares with multiple voting rights; (x) Simple majority to make corporate decisions; (xi) Waiver of notice for shareholders' meetings; (xii) Specific regulation for abuse of rights; (xiii) Flexibility to define subscribed capital (without minimum capitalization requirements); (xiv) Long term for the effective contribution of paid-in capital; (xv) Broad contractual freedom to execute shareholders' agreements; (xvi) Remedy of specific performance to enforce shareholders' agreements in the event of default; (xvii) Dividend distribution and regulation detached from regulatory thresholds or mandatory minimum proportional allocation of profits; (xviii) Freedom to provide for arbitration for all kinds of conflicts (including disputes among shareholders or with

1.1 Corporate Law Structure in Latin America

Following the Continental European tradition and particularly the French heritage of the *Code Napoleon*⁴, the long-standing civil-commercial dichotomy of private law still prevails in most Latin American countries⁵. This legal duality is troublesome in the specific field of contracts and corporations, due to the existence of two-tier regulations for many private agreements⁶. The assessment of the applicable substantive regime is usually difficult and often characterized by subjective definitions⁷. Scholars and case law have extensively addressed the problem associated with the dichotomy of private law⁸. The lack of solid, objective criteria to determine the civil or commercial nature of a business corporation creates difficulties for the assessment of applicable substantive law. Although in the original French regime the dichotomy is particularly relevant to differentiate jurisdictions and procedures, in Latin America it is not necessarily reflected in procedural rules. Thus, in various countries of the region there are no differences between civil and commercial courts as there are in their French judicial counterpart.

management); (xix) Restrictions on the free transferability of shares (beyond the right of first refusal); (xx) Possibility to squeeze-out shareholders in the event of changes of control or merger (provided that an appropriate compensation at market value is granted); (xxi) Definition of the sale of all or substantially all assets, and (xxii) Introduction of triangular mergers and full dissenters' remedies.

⁴ Professor Matthew Mirow vigorously contests as simplistic a characterization of the Latin American legal systems as essentially systems that are based on the Napoleonic Code. "Successful codifications of private law were often exercises in comparative legislation. At the core of those exercises were the *Code Napoleon* and the European commentary sources that quickly grew around the main text. This however does not mean that Latin American countries merely translated and borrowed the *Code* article by article". See Mathew Mirow, "Latin American Legal History: Some Essential Spanish Terms", in *La Raza Law Journal*, Vol. 12, No.1, 2000-2001*Id.* at 183. Also, Jorge Esquirol holds rather ironically that "Latin American societies are not European, only their jurists pretend to be", "The Fictions of Latin American Law" (Part I) in *Utah Law Review*, 425, 1997, at 470.

⁵ "The distinction between Civil and Commercial law is deeply rooted in continental countries..." Adriaan Dorresteyn, *European Corporate Law*, Deventer, Kluwer Law and Taxation Publishers, 1994, at 8. Such dichotomy usually creates interpretation problems. "As a result, therefore, while contracts of a commercial nature [...] are governed by the applicable provisions of the Commercial Code, the basic principles of contractual obligation are determined according to the rules stated in the Civil Code applicable to the transaction". Stephen Zamora et al., *Mexican Law*, New York, Oxford University Press, 2004, at 551.

⁶ Since the enactment of the 1942 Civil Code of Italy, there is a tendency towards the unification of Private Law. A previous move towards the same unitary direction was made through the Swiss Code of Obligations adopted in 1907. There is a branch of Private Law, which by simple inertia, is still labeled with an ancient name. Such name was meaningful in the past but lacks a specific purpose today. This branch is referred to as Commercial Law. See Francesco Galgano, *Derecho Comercial*, Bogotá, Ed. Temis 1999, at 1.

⁷ According to Stephen Zamora, "unlike the Uniform Commercial Code adopted in the United States, which in general applies to merchants and non-merchants, the Commercial Code (of Mexico) only applies to 'acts of commerce'...". Zamora *et al.*, *supra* note 5, at page 541.

⁸ Even in those cases in which the authors of civil and commercial codes adopted what they believed were clear boundaries between these codes, the reality of business transactions showed them their failure. See Boris Kozolchyk, *El derecho comercial ante el libre comercio y el desarrollo económico*, México, McGraw-Hill, 1996, at 193.

This difference makes the dichotomy generally pointless here, for both civil and commercial processes tend to be equally inefficient due to an absence of expeditious rules of procedure in either side of Private Law⁹.

Although an effort to reunite the above-mentioned disciplines has resulted in the preparation of several draft legislations in some Latin American countries¹⁰, local legislators have not been inclined to adopt unified statutes for Private Law in which obligations and contracts could be homogeneously regulated¹¹. As a result of this dichotomy, company law is usually divided into two different sets of legislation included in separate codes or statutes.

Similar to their European counterparts, Latin American codes and statutes on corporations tend to be characterized by a framework of mandatory rules on accounting principles, capital maintenance, disclosure standards, domestic mergers, and securities regulation¹². Corporate law in Latin America can be accurately described as a shareholder-friendly regulation in which controlling equity owners are granted full powers to determine corporate policy both in closely held companies and public corporations¹³.

⁹ More than fifty years ago, Phanor Eder observed appropriately that “in countries where there are no special courts for merchants I can find no justification today for the basic distinction made in Latin America between civil and commercial law”. Phanor Eder, *A Comparative Survey of Anglo-American and Latin-American Law*, New York, New York University Press, 1950, at 32.

¹⁰ See generally Arturo Valencia Zea, *Proyecto de Código de Derecho Privado*, Bogotá, Superintendencia de Notariado y Registro, 1980. See also Adolfo Ruiz de Velasco y Del Valle, explaining some of the failed efforts to unify civil and commercial law in Latin America and Spain (*Manual de Derecho Mercantil*, Comillas, Universidad Pontificia de Comillas, 2007 at 19).

¹¹ Incredibly enough, several Latin American authors still promote the dichotomy of private law under theoretical and historical arguments. According to Roberto Mantilla Molina, “merging civil and commercial law is not viable. Nevertheless, it would be convenient to eliminate several differences that exist between them”. *Derecho mercantil*, 29th Edition, Mexico, Editorial Porrúa, at 36. In a similar fashion, the Mexican author Joaquín Rodríguez emphasizes on the independence of commercial law vis-à-vis civil law. “The underlying unity of civil and commercial law is undeniable; but its separation is not capricious or arbitrary for it obeys to profound reasons, basically related to the need to attend to the demands of commerce, for which civil law had proven to be insufficient and useless due to its formalistic and ritual nature...” *Curso de Derecho mercantil*, 26th Edition, México, Editorial Porrúa, 2003, at 17. A very relevant exception to this anachronism can be found in the enactment of the Brazilian Civil Code (effective as of 12 January 2002). Such important codification unifies civil and commercial law regulations on obligations and contracts. See Werter R. Faria, “O Aval, O Código Civil E Os Bancos” in *Revista de Direito Mercantil: Industrial, Econômico e Financeiro*, Vol. 134, São Paulo, 2004, at 49.

¹² See Joseph McCahery *et al.*, *European Company Law: The Governance of Close Corporations and Partnerships US and European Perspectives*, Oxford University Press, 2004, at 195.

¹³ See generally, Jose W. Fernández *et al.*, “Caveat Emptor: Minority Shareholder Rights in Mexico, Chile, Brazil, Venezuela and Argentina”, 32, *University of Miami, Law Reviews* 157, Spring-Summer, 2001, explaining that majority shareholders in Latin America often have a statutory right to dominate minority shareholders.

Nevertheless, an overwhelming concern with the enactment of directory regulations associated with the protection of investors, creditors, and minority shareholders has been a constant preoccupation in Latin America. As early as 1952, Phanor Eder pointed to the concern of Latin American Corporate Law legislators regarding “the integrity of the capital, in order to protect creditors and investors, and to adopt measures which will protect minority shareholders”¹⁴. Indeed, several different provisions included in most Commercial Codes and corporate statutes in Latin America consecrate countless protections for minority shareholders. Criticism based upon the lack of enforceability of many of these restrictive regulations can be found in texts written by the same author in the nineteen fifties¹⁵.

In a recent survey of the laws of corporations of several Latin American countries, another author’s conclusion is similar to Eder’s, in the sense that in the region, shareholders generally are subject to a less significant degree of legal protection, as compared to the U.S.¹⁶. Another frequent criticism relates to the inadequate drafting of many of these provisions and the ease with which investors can find loopholes and other manners to circumvent imperative provisions and expropriate minority shareholders¹⁷.

1.2 Overview of Basic Business Entities

Despite several differences in technical details, the rather homogeneous layout of Company Law in the Latin American region allows for a business associations’ taxonomy to be made. Such classification reflects the manner in which they are

¹⁴ See Phanor Eder *supra* note 9.

¹⁵ “All the laws [of Latin America], like our own, contain prohibitions against the declaration of dividends, or other devices of distribution, except out of surplus net profits; but our prohibitions are more effective in practice”. See Phanor Eder, *Company Law in Latin America*, 27 Notre Dame Law 5, at 223.

¹⁶ See Fernández, *et al.*, *supra* note 13, at 6.

¹⁷ Fernando Londoño commented on the corporate provisions contained in the Colombian Commercial Code of 1971: “Code provisions banning directors to vote in shareholders’ assemblies’, others requiring minimum distributions of dividends and mandatory information preceding shareholders’ meetings or the requirement of a plural number of persons in order for a quorum to be present, turned out to be a joking matter for experts in playing games with the law”. “El Código de Comercio 15 años después: ¿En qué ha cambiado la vida colombiana?” in *Revista de Derecho Privado*, No. 2, Vol. I, Bogotá, 1987, at 159. La Porta thinks that this phenomenon is germane only to countries that pertain to the civil law tradition. “The expansion of legal precedents to additional violations of fiduciary duty, and the fear of such expansion, limit the expropriation by the insiders in common law countries. In contrast, laws in civil law systems are made by legislatures, and judges are not supposed to go beyond the statutes and apply ‘smell tests’ and fairness opinions. As a consequence, a corporate insider who finds a way not explicitly forbidden by the statutes to expropriate outside investors can proceed without fear of an adverse judicial ruling [...]. The vague fiduciary duty principles of the common law are more protective of investors than the bright line rules of the civil law, which can often be circumvented by sufficiently imaginative insiders”. La Porta, Rafael, Lopez de Silanes, Florencio, Shleifer, Andrei and Vishny, Robert W., *Investor Protection and Corporate Governance* (June 1999). Available at SSRN: <http://ssrn.com/abstract=183908> or doi:10.2139/ssrn.183908, at 9-10.

generally configured in codes and statutes across these countries' major jurisdictions. The following description of existing business entities in the region will provide a clear evidence of the urgent need to update the legal framework for company law in Latin America.

The legal systems of Latin America share a rather homogenous taxonomy for business associations. The point of departure for these systems can be found in the 19th century codifications in which the basic types of companies were included. With the exception of the closely held company (*sociedad de responsabilidad limitada*), the basic business forms already existed in those codes¹⁸. Accordingly, most countries in the region have regulated four basic types of business associations: (1) Stock corporations (*sociedades anónimas*); (2) Partnerships (*sociedades colectivas*); (3) Limited partnerships (*sociedades en comandita*); and (4) Closely held companies (*sociedades de responsabilidad limitada*)¹⁹.

The traditional classification is tightly linked with a major distinction between business entities, which is mostly based on two criteria: (1) the identity of the associates (*intuitus personae*), and (2) the importance of capital contributions that are given by the parties (*intuitus pecuniae*). All the business association forms related to both legal approaches fall under the ancient notion of *societas* that encompasses all the different types of companies. This taxonomy is somewhat advantageous, as it allows for the existence of general legal principles applicable to all the different forms of business associations. Within these general principles (*general part*) there are common rules for several different aspects, such as company formation, causes for nullification, legal capacity of shareholders and partners, capital contributions, profit allocation, amendments to the company's by-laws, structural changes, mergers, split-ups, dissolution, liquidation, etc.²⁰. The typology defining each business entity requires that there exists a *special part* within these Company Law statutes, dealing with the specificities concerning each one of the business forms provided therein. The two extremes of the continuum are the partnership (*sociedad colectiva*), on one side, which is characterized by the highest relevance given to the *intuitus personae* element, and, on the other, the stock corporation (*sociedad anónima*), which is usually depicted as the quintessential capitalist business entity. There is a middle ground between those two extremes in which the rules for composite business entities are laid out. In this type of companies elements of a personal nature are mingled with capitalist ingredients to create a syncretism usually devised for small or medium-sized entities. These mixed

¹⁸ The 'SRL' was introduced in Brazil after the Portuguese 'sociedade por quotas' of 1905. The same type of business entity was brought to other Latin American countries after the enactment of the Spanish statute of 1927.

¹⁹ For a detailed analysis of the main traits of Latin American business forms, see José W. Fernández, et al., 'Corporate Caveat Emptor: minority shareholder rights in Mexico, Chile, Brazil, Venezuela and Argentina', 32 *University of Miami Inter-American Law Review* (2001) 157.

²⁰ See, for instance, Law 19.550 for Argentina, the Colombian Commercial Code, the company law of Ecuador, the general law of Commercial Companies of Mexico, etc.

entities include the closely held company (*sociedad de responsabilidad limitada*) and the limited partnership (*sociedad en comandita*). Within this last form there are, in turn, two separate species: the limited partnerships by quotas and the limited partnership by stocks. The obvious difference between these two forms lies with their differing capital structure. As a consequence, the former is assimilated partially to the *limitada*, whereas the latter partly resembles the *anónima*.

1.3 Partnerships (*Sociedad Colectiva*)

A *sociedad colectiva* is very similar to a partnership and can even be defined, in a similar way, as a contract between two or more persons that make contributions in cash, in labor, or in kind with the purpose of carrying on a business for profit. The partners are jointly and severally liable for all debts and obligations in which the partnership may incur²¹. As opposed to Common Law systems, partnerships in Latin America are generally subject to the same formalities that are required in order for any other company to operate regularly²². Therefore, it is usual for the law to require that a public deed be granted as well as a registration for public record before a mercantile registry. In the absence of such formalities the partnership will not form a legal entity separate and distinct from its partners, namely it will lack legal personality²³.

There is an emphasis of a personal trait (*intuitu personae*) that permeates the partnership's structure, inner workings, operation, and even its dissolution. The partners enjoy a high degree of contractual flexibility. Consequently, it is generally possible to provide for very restrictive constraints to the partners, including, for instance, the inability to compete with the business activities of the partnership as laid out in the

²¹ See for Brazil, section 1.039 of the Civil Code; Argentina, section 125 of Law 19.550; Colombia, section 294, Commercial Code; Mexico, section 25 of LGSM (*Ley General de Sociedades Mercantiles* or General Law for Business Associations). For instance the LGSM states that "A general partnership is an association which trades under a business name and in which all the partners are liable in a subsidiary, unlimited, and joint manner for business obligations".

²² See for Brazil, sections 45 of the Civil Code; Mexico, section 5 of LGSM; Argentina, sections 4 and 5 of Law 19.550, and Colombia, sections 110 and 111 of the Commercial Code. Pursuant to article 45 of the Brazilian Civil Code, in order for a private law entity to legally exist, the constitutional document must be registered. For this registration to take place, an authorization or approval granted by the executive branch of the Government may be required as well. On the other hand, according to section 4 of the Argentine Law 19.550, "The contract by which a company is constituted or modified will be granted by public or private instrument." Furthermore, section 5 of the same Act provides that, "A contract which has been amended or constituted will be registered in the Public Commercial Register of the company's domicile, under the terms and conditions of articles 36 and 39 of the Commercial Code. The registration shall be made after being ratified by the incorporators before a court that will dispose it, except when it is extended by public instrument, or if the signatures are authenticated by a notary public or any other competent official".

²³ See for Brazil, section 985 of the Civil Code; Mexico, section 2 of LGSM; Colombia, section 499 of the Commercial Code, and Argentina, section 7 of Law 19.550. In Colombia section 499 provides that "a business enterprise should be *de facto* if not formed by public deed. Its existence may be demonstrated by any of the evidence means provided by Law".

purpose clause, or the possibility to expel partners if certain obligations set up in the constitutional documents are not met²⁴. Control over the businesses and assets of the partnership is exercised directly by the partners, who are entitled to represent the business entity *vis-à-vis* third parties unless such representation is delegated in a centralized administrative body or manager²⁵.

Even if this contractual flexibility appears to be highly convenient, since it allows the partners to provide sophisticated internal governance mechanisms, such advantage is offset by the unlimited liability regime to which the partners are exposed. Consequently, the number of *colectivas* that are formally created tends to be generally low. As an alternative to the regular partnership (i.e., formally created), the parties who purport to carry out a certain business can generally opt to create the so-called *sociedad de hecho* (literally, a *de facto* partnership) in which no formalities whatsoever are required. Hence, the mere consent (even tacitly granted) of the partners suffices for its legal existence. The only difference in terms of liability between a *de facto* partnership and a regular partnership is normally related to the secondary nature of the liability of the latter's partners, as compared to the direct and personal exposure of the former's associates²⁶.

1.4 Stock Corporation (*Sociedad Anónima*)

On the other end of the continuum, the *sociedad anónima* (Stock Corporation) epitomizes the prevalence of the *intuitus pecuniae*, namely the higher weight that is given to capital contributions over the identity of the individuals forming the business entity. This feature normally identifies the *sociedad anónima* with large-dimension undertakings. *Anónimas* are the appropriate vehicle for an enterprise to go public. In fact, securities regulation and stock exchange rules generally restrict IPOs to companies formed as *anónimas*. Nevertheless, the *anónima* is also very popular among small and medium enterprises.

The bureaucratic structure that is usually required in order to set up an *anónima* is much more complicated than the one necessary to run any other business association. In fact, pursuant to corporate statutes in the region, it is normally needed, in

²⁴ See for Mexico, section 35 of LGSM; Colombia, sections 296 and 297 of the Commercial Code, and Argentina, section 133 of Law 19.550, which states the following: "A partner may not execute on his own account or another, transactions that cause competition with the company, except by an express and unanimous consent of the copartners."

²⁵ See for Brazil, section 1.042 of the Civil Code; Mexico, sections 36 and 40 of Law LGSM; Argentina, section 128 of Law 19.550, and Colombia, section 310 of the Commercial Code.

²⁶ See for Brazil, section 990 of the Civil Code; Mexico, section 25 of Law LGSM; Argentina, sections 23 and 56 of Law 19.550; and Colombia, section 499 of the Commercial Code, which reads as follows, "A *de facto* corporation is not a juridical person. Therefore any rights acquired and any commitments made by the partnership shall be understood to have been acquired or undertaken on behalf or for the account of all *de facto* partners."

addition to the shareholders' assembly, to appoint a board of directors, managers (legal representatives), mandatory auditors, etc., regardless of whether the company is listed or not²⁷. Even if this cumbersome structure is clearly excessive for small enterprises, many businesspeople are forced to use it in small and medium undertakings only to achieve the benefits of full-fledged limited liability²⁸. As a result of this choice, entrepreneurs could be subject to high transaction costs when using this form.

In most jurisdictions in the region the *anónimas*' capital is divided into shares of stock that are freely negotiable unless a right of first refusal is set forth in the corporation's by-laws²⁹. Normally, the business of the corporation is carried out under a board of directors, which in turn appoints officers and managers who undertake its day-to-day operations. Such centralized management is usually characterized by an election system with proportional representation, such as cumulative voting, so as to allow minority shareholders to directly participate in management³⁰. Liability is restricted to each shareholder's capital contribution and, thus, there is affirmative and defensive asset partitioning. In some Latin American jurisdictions piercing the corporate veil doctrines have been incorporated in statutory provisions³¹. Nonetheless its actual enforceability is very limited, showing a great disparity between law in the books and law in action.

²⁷ See for: Mexico, section 164 of LGSM; Argentina, sections 233, 255, and 280 of Law 19.550; Colombia, sections 203, 419, 434, and 440 of the Commercial Code, and Brazil, section 121,138,143, and 161 of Law 6404 of 1976, as it states that "A company shall have a Fiscal Council and the bylaws shall provide for its operation, which may be either permanent or in a fiscal year in which the same shall be installed at the request of shareholders."

²⁸ See for Brazil, section 1 of Law 6404 of 1976; Mexico, section 87 of LGSM; Argentina, section 163 of Law 19.550, and Colombia, section 373 of the Commercial Code. Pursuant to the Brazilian Law 6404, section 1, "The capital of a company or corporation shall be divided into shares. The liability of a partner, member or shareholder thereof shall be limited to the issue price of shares subscribed to or acquired."

²⁹ See for Brazil, section 36 of Law 6404 of 1976; Mexico, sections 130 and 132 of LGSM; Argentina, section 214 of Law 19.550, and Colombia, sections 403 and 407 of the Commercial Code. For instance the Brazilian law sets forth the rule whereby the "Bylaws of a closed company may impose limitations on the transfer of nominative shares, provided they define in detail said limitations and do not impede their negotiability nor subject a shareholder to arbitrary decision of the administrative bodies of the company or of the majority of shareholders."

³⁰ See for Brazil, section 141 of Law 6404 of 1976; Mexico, section 144 of LGSM; Argentina, section 263 of Law 19.550. The Colombian Commercial Code provides that "Principal and alternative members of the board shall be elected by the general shareholders' assembly, for given terms and by electoral quotient method, and may be entitled to re-election or be freely removed by the assembly." (Section 436).

³¹ See for Brazil, section 117 of Law 6.040; Colombia, section 61 of Law 1116 of 2006, and Argentina, section 54 of Law 19.550. The last paragraph of the Argentine provision reads as follows: "An act of the company that conceals the attainment of ends that are outside the corporate purpose or constitutes a mere recourse for breaching the law, public order, good faith, or that is intended to thwart the rights of third parties, shall be attributed directly to the partners or the controlling shareholders responsible for those acts, who will be jointly and severally liable for the damages caused".

1.5 Limited Liability Company (*Sociedad de Responsabilidad Limitada*)

A highly popular form of business association is the *sociedad de responsabilidad limitada* (Closely held Company or Limited Liability Company), which exists in all Latin American jurisdictions and closely resembles the original model of the German *GmbH* of 1892 and the *société a responsabilité limité* introduced in France in 1927. The original 19th century European LLC model is an attempt to reconcile the basic feature of limited liability provided for stock corporations and the broader level of flexibility allotted to partnerships³². In that sense, it was originally a *hybrid* business form that was transplanted into Latin American legislations under a similar conception.

A caveat must be made concerning the significant difference that exists between the United States LLC and the Latin American *limitada*. To be sure, even if the first LLC statute enacted in the state of Wyoming is said to have been crafted along the lines of the Panamanian *limitada*³³, present American LLC's are very distant from their originating model³⁴.

While a process of modernization has taken place in the United States over the past three decades, the Latin American *limitadas* are still linked to their early twentieth century European model. For this reason, this type of entity is characterized by all kinds of formalistic proceedings that make it a highly rigid business form. As an example, it is interesting to highlight, *inter alia*, the cumbersome proceedings for its formation, conveyance of quota shares, by-law amendments, capital contributions, and rights of first refusal³⁵.

³² See Peter Ulmer, *Principios fundamentales del Derecho alemán de sociedades de responsabilidad limitada*, Madrid, Editorial Civitas, 1998 at. 22-23.

³³ See Joseph A. McCahery, Erik Vermeulen, et al., *The New Company Law: What Happens in an Innovative Economy*, SSRN Id. No. 942993.

³⁴ The tax-driven legislative process carried out in the US for the inception of the LLC was aimed at obtaining a pass-through treatment to overcome double taxation for a vehicle endowed with limited liability. Therefore, the new business entity had to surpass the four-item test set up by the Internal Revenue Service in order not to be treated as a corporation. Consequently, while the original model granted limited liability, it lacked continuity of existence, centralized management and free transferability of shares. Opting these three elements out of the IRS' four-item test for corporations, required to use a rather anachronistic approach in which shareholders had the direct administration of the LLC's day-to-day affairs, a term of fixed duration was mandatory in the organizational documents and a right of refusal was also included as an imperative stipulation. The newer US statutes on LLCs are of a facilitating nature and therefore the Wyoming model has been upgraded through enabling provisions in a manner in which regulatory rules are exceptional. Robert R. Keatinge, 'The Limited Liability Company, A Study of the Emerging Entity', in *The Business Lawyer*, Vol. 47, Feb. 1992, p. 378.

³⁵ See for Brazil, sections 1.057 and 1.061 of the Civil Code; Mexico, sections 64, 83 and 86 of LGSM; Argentina, sections 149 and 153 of Law 19.550, and Colombia, sections 360 and 364 of the Commercial Code. Section 364 provides that "Should the interested partners disagree as to the price or terms of the quotas, experts should be appointed to appraise both questions. The appraisal and the terms so determined shall be compulsory on the parties. These may however agree on that the conditions of the

1.6 Limited Partnership (*Sociedad en Comandita*)

The *sociedad en comandita* (limited partnership) is one of the oldest forms of business associations dating back to medieval times, when the famous *commenda* was created as a contract between a person who made a contribution in labor (*tractator*) and another who would make contributions in money or in kind (*commendator*). The latter is usually referred to as a dormant partner, for she was not entitled to participate in the proposed business. The *commendator* was shielded from liability *vis-à-vis* third parties concerning any unsatisfied debts that could arise from the venture. The *tractator* carried on the business and representative activities and, as a result, was personally liable for all debts and obligations incurred in the course of the undertaking. This structure was disseminated through all European countries and served as the basis for the modern *sociedad en comandita* as it exists in European and Latin American jurisdictions³⁶.

The *sociedad en comandita* is characterized by the presence of a general partner (*socio gestor*) who conducts the affairs of the company and is subject to unlimited liability for all obligations arising in connection with the undertaking³⁷. General partners are governed under the laws applicable to *sociedades colectivas* (general partnerships)³⁸. Limited partners provide capital contributions and are precluded from engaging themselves in managing the company³⁹. As a result of such management system, limited partners, as a general rule, do not incur liability for the company's debts beyond the amounts that they have infused into the venture. Profits are allocated between the general and limited partners in the proportions laid out in the organizational documents or by-laws. It is usually possible for a closely held company or a stock corporation to be a general partner within a limited partnership. In this manner, the effect of unlimited liability is offset due to the usual undercapitalization of the vehicle appointed as a general partner.

offer be final, should they be more favorable for the prospective transferees than those set by the experts. The by-laws may lay down other procedures to determine the terms of the assignment”.

³⁶ According to Benedikt Koehler, “the antecedents of the limited partnership “are commonly seen to emerge amongst medieval Italian merchant bankers in so-called *commendas*, commercial arrangements combining investors and entrepreneurs ...” (Islamic finance as a progenitor of venture capital, in *Economic Affairs* 29, Issue 4, December 2009 at 89-91). Folsom and Levasseur explain that the US regulation concerning Limited Partnerships can be traced back to the Civil Law *sociedad en comandita*. ‘This business form was first introduced in the United States via an 1822 statute enacted in the state of New York’ (Ralph H. Folsom and Alain A. Levasseur, *Pratique du droit des affaires aux États-Unis* (Paris, Ed. Dalloz 1995) p. 250.

³⁷ See for Mexico, sections 51, 207 of LGSM; Argentina, sections 59, 134 and 136 of Law 19.550; and Colombia, sections 323 and 326 of the Commercial Code.

³⁸ See for Mexico, section 211 of LGSM.

³⁹ See for Brazil, section 1.047 of the Civil Code; Mexico, section 54 of LGSM; Argentina, sections 137 and 315 of Law 19.550, and Colombia, section 327 of the Commercial Code.

This business association is divided into two separate sub-species that depend on the manner in which the company's capital is divided. In accordance with this classification, there is a first type in which the capital is divided into quotas. This entity is referred to as simple limited partnership (*sociedad en comandita simple*)⁴⁰. In the second type, the capital is divided into shares of stock; the resulting company is called limited partnership by stock (*sociedad en comandita por acciones*)⁴¹. This entity is more suitable for larger enterprises, since it allows for a more expeditious capitalization. Both sub-types of limited partnerships are particularly suitable for family businesses due to the ability to separate the roles of founding partners (who have the direct administration of the company's business) from those pertaining to limited partners (who are excluded from management).

It follows from the previous analysis of existing business associations in Latin America that the legislative approach is rather restrictive. This is partly due to the fact that the legal framework was conceived along the lines of company law theories developed in 19th century European codifications and their progeny. Reluctance by traditional legal scholars and legislators in the region to switch to a more advanced conception of company law has prevented the inception of more flexible rules and regulations for company law.

Notwithstanding characteristic skepticism, backward approaches by legal elites, and prevailing path dependence, efficiency-minded legislators could easily enact statutes such as the one concerning the Colombian simplified stock corporation on other major Latin American jurisdictions. As will be analyzed in further detail in this book, countries in the area could certainly benefit from a more progressive and investor-friendly corporate form.

⁴⁰ See for Brazil, section 1.045 of the Civil Code; Mexico, section 51 of LGSM; Argentina, section 134 of Law 19.550, and Colombia, sections 337 and 338 of the Commercial Code.

⁴¹ See for Brazil, section 1.090 of the Civil Code; Mexico, section 207 of LGSM; Argentina, section 315 of Law 19.550; and Colombia, section 343 of the Commercial Code.

2. BASIC PROBLEMS IN CURRENT LEGISLATIVE APPROACHES

2.1 Codification of Company Law

All Latin American countries belong to the Civil Law tradition. Its most salient features are evident: prevalence of legislative law-making processes over judge-made law, deductive methods of reasoning on the judicial adjudication process, and codification. Civil and Commercial Codes define the backbone of private law across the region. Given the influence of European scholarship since colonial times, there is a continued reliance on the evolution of French and Spanish legislations⁴². Such dependence is still significant today in the field of company law⁴³.

Although there are advantages to codification, such as the systematic organization of legal provisions, it is obvious that codes also create a rigid framework that is difficult to update due to the implications regarding multiple rules directly or indirectly related to those to be amended. In practice, the fear of desynchronizing the code structure usually results in delays concerning any legislative reform. The idea that any code reform affects legal certainty is always a good one to prevent the modernization of private law in Latin America. The so-called *numerus clausus* approach

⁴² According to James G. Apple and Robert P. Deyling “the content of civil, commercial, and procedural codes, legal education, the structure of the legal profession, the influence of legal scholars, and the role of the judge in the judicial process in almost all Latin American countries conform very much to the civil-law tradition that evolved in central and western Europe” (A Primer on the Civil-Law System. Federal Judicial Center of the United States [Online] [http://www.fjc.gov/public/pdf.nsf/lookup/CivilLaw.pdf/\\$file/CivilLaw.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/CivilLaw.pdf/$file/CivilLaw.pdf), at 19). For an explanation regarding the codification movement in 19th century Latin America see Boris Kozolchyk, *supra* note 8 at 130-133. This author describes the so-called Latin American codification family, which encompasses three master codes drafted by great jurists: Dalmacio Vélez-Sársfield (1800-1875) for Argentina, Andrés Bello (1781-1865) for Chile, and Augusto Teixeira de Freitas (1816-1883) for Brazil (id.). See also John Henry Merryman and Rogelio Pérez Perdomo, *The Civil Law Tradition. An introduction to the Legal Systems of Europe and Latin America*. Third Edition, Stanford, Stanford University Press, 2007, at 27-86.

⁴³ Regarding codification in Latin America, see, generally, John Henry Merryman *et al.*, *Comparative Law: Western European and Latin American Legal Systems, Cases and Materials* (Charlottesville, The Michie Company 1978), at 208-220. Schlesinger points out to the so-called exogenous influence, which is particularly noticeable in instances in which legislators have resorted to the *wholesale importation* of foreign law. “Most of the codes presently in force in Latin America are the result of extensive comparative study and eclectic choice among European models”. Rudolf Schlesinger, *et al.*, *Comparative Law, Cases-Texts-Materials*, 6th Ed., New York, The Foundation Press, 1998, at 11. Schlesinger also adds that this process involves the danger – evident in Latin America – that foreign institutions may be copied without sufficient adaptation to local conditions (id.). However, it is also important to consider that during the last century the codification process, understood as an all-inclusive model of legislation, was partially replaced in most Latin American countries. According to Sánchez Cordero, “the replacement of the XIXth Century *Codes Civils* in Hispanic America during the XXth century was carried out by means of special and singular laws responding to social and economic change [...]. The old conception of the *Code Civil* as a comprehensive model was fractured” See Jorge Sánchez Cordero, *The Reception of Legal Systems in the Americas: Diversities and Convergences*, 24 Tul. Eur. & Civ. L.F., 231, 2009, at 33.

inherited from Roman Civil Law also contributes to the stiffness of legal institutions. To be sure, such rigid classifications are based upon elements deemed to be essential to each contract. Legislative innovation and change are hindered by this Aristotelic approach in which all too often a *substance* represents an unsurpassable theoretical obstacle to the modernization of business law rules.

Breaking Company Law dependence on Civil and Commercial Codes should be of paramount importance in order to set up a flexible environment for legal reform in the region. One avenue for change consists of creating separate statutes dealing with each business law subject matter individually. A higher level of flexibility to amend statutory provisions without affecting provisions regarding other legal matters evidences the usefulness of such an approach. There are basically two ways of severing the company law from the Civil and Commercial Codes. The first approach recommends the creation of a statute containing *general company law* in which both general principles and specific provisions for each type of entity coexist. The second approach consists of a separate and independent statute for each form of business, which allows greater specialization, but also may lead to some normative dispersion. This latter approach is not altogether undesirable, given the greater level of flexibility that isolated statutes provide. In fact, it is more difficult to update Civil and Commercial Codes than to reform individual pieces of legislation.

2.2 Public Order Nature of Most Company Law Provisions

A considerable deterrent to business activities is related to the regulatory nature of a substantial part of company law provisions. The 'public policy' and 'public order' character of such regulations is usually argued to be one of the main reasons to maintain the legislative *status quo* in Latin American codes and statutes. The highly restrictive nature of these provisions is related to the underlying purpose of protecting investors mostly in the field of publicly held corporations⁴⁴. However, since most of the business entities in the region operate outside the stream of the securities market, the applicable company law rules become unnecessarily restrictive and cumbersome.

Paradoxically, Civil and Commercial Codes across the region embrace the principles of 19th century liberalism, including freedom of contract. Lip service is paid to the latter principle to the extent that almost every company law treatise includes explicit reference regarding its supposed broad application.

Some company law statutes contain specific provisions regarding the freedom of contractual stipulation, although limited by the typology of business association forms⁴⁵.

⁴⁴ See for Brazil, section 8 of Law 6404; Mexico, section 105 of the LGSM; Argentina, section 168 of Law 19.550, and Colombia, section 203 of the Commercial Code, which requires the permanent presence of an internal fiscal auditor in every stock corporation (*sociedad anónima*).

⁴⁵ See for Brazil, section 983 of the Civil Code; Mexico, section 1 of LGSM; Argentina, section 1 of Law

For instance, Article 110-14 of the Colombian Commercial Code determines the basic contents of the public deed of association, including “all other arrangements which might be set forth by the associates to regulate the relations arising from the contract, *provided that they are compatible with each type of association*” (Emphasis supplied).

Notwithstanding the apparent flexibility of the quoted provision, it is obvious that the ‘compatibility’ issue results in a significant deterrent to private ordering. The existence of public policy provisions is always a good argument to prevent parties from opting out a statutory rule. This legal rigidity also impacts the way in which by-laws and other association documents are drafted⁴⁶. In fact, standardization (characterized by the propagation of boiler-plate corporate forms) hinders innovation and deters transaction cost-effective legal engineering.

In contrast, corporate law systems such as the ones prevailing in other jurisdictions, including the United States, provide a set of enabling non-regulatory corporate statutes. Parties, therefore, are entitled to bargain for the most appropriate contractual framework to deal with the problems arising from a specific business arrangement. Accordingly, these statutes provide off-the-rack housekeeping rules that can be opted out by the parties. In the absence of negotiation, the legal provisions contained in the corporate statute are applicable by default⁴⁷. Certainly, such flexible

19.550; and Colombia, section 110, subsection 2, of the Commercial Code. For instance, in Mexico there are certain association forms which are formally recognized, therefore as according to section 1 of the LGSM, “This Law recognizes the following kinds of mercantile companies: 1. General Partnerships. 2. Special Partnerships (*Partnerships en commandite*). 3. Limited Liability Companies. 4. Joint Stock Companies (corporations). 5. Special partnerships with shares. (Partnerships en commandite with shares.) 6. Cooperative associations.

⁴⁶ See for Brazil, section 997 of the Civil Code, for Mexico Section 6 of the LGSM; for Argentina Section 11 of Law 19.550; and for Colombia, Section 110 of the Commercial Code. Pursuant to Section 11 of Argentinean Law 19.550, “the instrument of constitution should contain the following, without prejudice to that which may be established for certain types of companies: 1) the name, age, civil status, nationality, occupation and identification card number of the associates; 2) the firm name or the trade name, and domicile of the company. If the contract only contains the domicile, the address of the headquarters must be registered by petition signed separately by the organ of administration. All notices effected at the headquarters will be valid and retained; 3) the designation of its purpose, which must be determined precisely; 4) capital stock, which must be expressed in Argentine currency, and the contribution of each associate should be mentioned; 5) term of duration, which must be determined; 6) organization of the administration, control, and of the meetings of associates; 7) rules for distributing the profits and supporting the losses. In default of the latter, they will be distributed in proportion to the contributions. If only the manner of distribution of profits is provided, it will apply also to supporting the losses, and vice versa; 8) in order to establish the rights and obligations between partners and with respect to third parties, the necessary clauses will be established precisely; 9) clauses relevant to the functioning, dissolution and liquidation of the company.”

⁴⁷ Statutory provisions are said to reflect a *hypothetical bargaining* in which all the constituencies’ interests are considered by the legislator. Therefore, the legislator’s role is to provide an optimal set of rules, which should reflect a balance between the parties’ expectations. According to Bainbridge, “the legislator should ask the prospective shareholders, employees, contract creditors, tort victims and the like to bargain over what rules they would want to govern their relationships. Adopt that bargain as the

system requires the parties to ideally negotiate a comprehensive contractual framework by addressing *ex ante* all relevant matters from which a conflict may arise⁴⁸.

2.3 The Dichotomy of Company Law in Latin America

The already mentioned anachronistic dichotomy of Private Law is an all-pervasive phenomenon in Latin America. In fact, most codes and corporation statutes in the region have maintained a differentiation between civil and commercial companies⁴⁹. Following the French 19th century model, separate substantive rules apply according to the nature of the business company. In order to determine such nature, it is usually necessary to undertake an analysis of the purpose clause as laid out in the company's by-laws. Through the application of this *objective* approach the concerned entity can be labeled commercial or civil. Accordingly, a commercial company will be such entity that has been set up for the purpose of undertaking *commercial acts*⁵⁰, pursuant to the list contained in the relevant statutory provision⁵¹. Conversely, a civil company will be the one created to carry out acts that are not legally defined as commercial acts⁵². The legal consequences ensuing from the private law dichotomy are not irrelevant. They range from mere substantive law provisions, to a few procedural aspects. Even formation proceedings may differ to the extent that commercial firms are generally subject to higher standards as compared to civil companies⁵³. Such differences are not exclusively related to formation requirements, but also include aspects such as tax rates, disclosure of information, etc.

corporate law default rule. Doing so reduces transaction costs and therefore makes it more efficient to run a business. See Stephen Bainbridge, *Corporation Law and Economics*, New York, Foundation Press (2002) at 30.

⁴⁸ These careful and sometimes costly negotiations may not always be feasible for the incumbent parties. It is true that this kind of statutes require the parties to carefully negotiate the terms and conditions of their specific arrangements. The flexibility provided to contracting parties may cause an increase of negotiation expenses to opt out default rules. Pursuant to Bainbridge, lack of appropriate negotiation may result in future conflicts between shareholders. See Stephen Bainbridge, *supra note 47*, at 9.

⁴⁹ See for Brazil, section 982 of the Civil Code; Mexico, section 1 of the Commercial Code; Argentina, section 33, subsection 2, of the Civil Code; and Colombia, section 100 of the Commercial Code. In regard of the Mexican Commercial Code, it provides that "Commercial acts shall only be regulated by that which is provided in this Code and the other applicable mercantile laws."

⁵⁰ See for Brazil, section 982 of the Civil Code; Mexico, section 75 of the Commercial Code; and Colombia, section 20 of the Commercial Code.

⁵¹ Commercial Codes list all acts and enterprises that are considered as mercantile. Within those acts, there are basic intermediation transactions, leasing activities, engineering, banking, insurance, etc. The same Codes regulate non-commercial (i.e., civil) acts, including the exercise of professional activities, agricultural business carried out by an individual, etc.

⁵² See for Mexico, section 76 of the Commercial Code, and Colombia, section 23 of the Commercial Code. The Mexican law provides a delimitation of non commercial acts as follows: "Purchase of articles or merchandise which merchants effect for their own use or consumption, or for that of their family, do not constitute acts of commerce, nor resale by workmen, when a natural consequence of their work".

⁵³ See for Colombia, section 1, Decree 3100 of 1997.

This two-fold regulatory scheme creates significant transaction costs and legal uncertainty. In several cases it is not easy to determine the nature of a business entity. Complex or multiple activity purpose clauses are difficult to read in light of the dichotomy. The analysis is not prone to error and is frequently submitted to difficult analytical assessment and subjective interpretation.

Even in continental European countries where the dichotomy subsists, a solution has been crafted for business associations. It basically consists in creating a *typical* criterion to define the firm's nature. Such criterion is more readily defined in terms of the *type* of business association at stake. Instead of defining the civil or commercial nature of a business association depending on the scope of their purpose clause or activity, the assessment is made on the grounds of the form adopted by the business entity. Normally stock companies, closely held corporations, and limited partnerships are deemed to be commercial entities irrespective of the activities set forth in their purpose clauses. Therefore, the civil company arises as an isolated business entity of a limited usefulness. This is the approach adopted, for instance, by the French⁵⁴ and Spanish⁵⁵ legislations. One of the few exceptions in the Latin American region can be found in the Argentine Law 19.550, which sets forth a simple unifying commercial criterion based upon the type of business entity that is created. Accordingly, all the entities governed under such statute (which contains all the basic types of business associations) are deemed to be commercial by its form, irrespective of the nature of the business activities set up in their respective purpose clause.

Another approach – which appears to be highly recommendable – would consist of the eventual suppression of the civil company in favor of a fully unified system of company law, characterized by a unique substantive and procedural regulation such as the one that exists in the corporate statutes of the United States.

2.4 The Contractual Nature of Company Law in Latin America

The Roman law concept of *societas*, which was later developed into different forms of business entities, was strongly grounded upon a contractual scheme⁵⁶. The

⁵⁴ See for France, section 1 of Law 66-537 of 1966: "The commercial nature of a company is determined either by its form or its objects. The following companies will be commercial irrespective of their objects: the general partnerships (*sociétés en nom collectif*), the limited partnership (*sociétés en commandite simple*), the closely-held companies (*société à responsabilité limitée*), and the stock corporations (*sociétés par actions*)".

⁵⁵ See for Spain, section 3 of Law 1564 of 1989.

⁵⁶ See Sections 1832 of the French Civil Code and 2247 of the Italian Civil Code, which defines the Company agreement as follows: "By means of the Company contract two or more persons provide contributions in goods or services for the joint undertaking of an economic activity, for profit". For Latin America, see; Brazil, Section 981 of the Civil Code; Mexico, Section 51 of LGSM; Argentina, Section 1 of Law 19.550; and Colombia, Section 98 of the Commercial Code. "The incorporation of a Company shall depend on the fulfillment of the following preliminary requirements: (1) subscription by at least two persons of all the shares into which the corporate capital established in the bylaws is divided".

French Commercial Codes maintained the idea whereby all forms of business associations arise out of an agreement between two or more persons⁵⁷. The adoption of Commercial Codes and company law statutes in Latin America, allowed for the inception of a full-fledged contractual theory all over the region⁵⁸. Such an all-pervasive concept is relevant to define requirements for the creation and maintenance of new companies in the area. The idea of a multi-owner entity as the basis for legal personality and limited liability represents a deterrent to admit single member corporations and wholly owned subsidiaries.

Therefore, most countries in this region have rejected legislation suppressing multi-ownership requirements. In some cases the statutes are so stringent that two shareholders do not suffice for the purpose of incorporation⁵⁹. Obviously this restrictive approach creates severe transaction costs, for it forces entrepreneurs either to undergo joint ventures or to create simulated and, often, illegal contracts in which straw men act as shareholders for the sole purpose of fulfilling a formalistic requirement.

A sound solution adopted in continental Europe after the issuance of the twelfth community directive (regarding single member entities) was to allow companies to be formed through contracts or 'unilateral acts'. The implementation of this directive in the European Union allowed for the presence of one-person stock corporations. As a result of this twelfth directive, even countries that were traditionally reluctant to admit the existence of one-member firms eventually gave up on their backward approaches to allow for the formation of companies in which a single shareholder was sufficient for the incorporation process to take place. For instance, it was only until 1993 that the single member limited liability company was introduced in Italy. By means of this subtype of business association a single individual through a unilateral act can create a *società a responsabilità limitata unipersonali* (D.Lgs.3/3/1993, n. 88). In 2003, through Legislative Decree 6/2003, the *società per azioni unipersonali* was eventually established in that country. In France, Law 85-697 of July 11, 1985 introduced the *enterprise unipersonnelle à responsabilité limitée*, through which Section 1832 of the Civil Code was modified to include a paragraph allowing for the formation of companies by means of unilateral acts, in those cases specifically permitted by law.

2.5 Reluctance to Provide Full Enforceability to Shareholders' Agreements

⁵⁷ An advantage of the contractual approach is that all regulations regarding obligations and contracts contained in Civil and Commercial Codes will be automatically applicable. Case law and doctrine regarding these rules and principles will also be used to fill existing gaps.

⁵⁸ Art. 98 of the Colombian Commercial Code: "By means of the Company Contract two or more persons undertake to make a contribution in cash, work or in other goods representing currency, for the purpose of sharing in the profits derived from their enterprise. On legal formation of a company, it will turn into a juridical person distinct from each individual shareholder."

⁵⁹ See for Colombia, section 374 of the Commercial Code, regarding stock Corporations whereby "...may not be formed or start operation with less than five stockholders."

There has been a traditional reluctance in Latin American company laws to recognize and enforce shareholders' agreements⁶⁰. This lack of recognition disregards the importance of private ordering, which is central to foster innovation and creativity. The Brazilian corporate law is certainly an important exception to this rule. Undoubtedly, after the enactment of Law 10.303 of 2001, various legal devices were created to allow for the enforceability of this kind of agreements. The general disregard of such important contractual devices hinders the development of more flexible and useful schemes for firms characterized by a multi-ownership structure.

2.6 Exceptions to Limited Liability

The influence of new political constitutions and constitutional courts in Latin American countries has created several piercing the veil hypothesis grounded on causes outside the scope of corporate law. Furthermore, tax, labor, and environmental regulations set up numerous causes of action that allow a plaintiff to request that the legal entity be disregarded⁶¹. Aside from the cases of general and limited partnerships,

⁶⁰ See for Mexico, section LGSM; Argentina, section 12 of Law 19.550, and Colombia, section 118 of the Commercial Code. An exception of this reluctance to enforce shareholders' agreements can be found in section 118 of Brazilian Law 6.404, which reads as follows: "A shareholders' agreement on purchases and sales of shares, preference to acquire stock, or the exercise of the right to vote must be respected by the company, when registered at the head of a company. Subsection 1. A commitment or encumbrance resulting from such an agreement may only be enforced against a third party after it has been duly recorded in the registry books and on the share certificate, if issued. Subsection 2. Such agreements may not be invoked to exempt a shareholder from liability when exercising his right to vote (article 115) or power of control (articles 116 and 117)". As it will be explained later, Law 10.303 of 2001 increased the enforceability of shareholders' agreements in Brazil. This enhanced enforceability is grounded upon the so-called *private autonomy principle*, which implies that such agreements must be complied with not only by the shareholders, but also by the corporation itself (See Rachel Stajn, "Acordo de acionistas", in Jairo Saddy et.al, *Fusões e aquisições, Aspectos jurídicos e econômicos*, São Paulo, IOB Thompson and IBEMEC Law, 2002, at 275). Celso Barbifilho explains, from a historical perspective, how the enforceability of shareholders agreements in Brazil was possible because of the several number of cases that were judicially decided in that country. In 1990, for example, complaints concerning shareholders agreements were increased by 23% and 29% for 1991..." (*Acordo de Acionistas*, Belo Horizonte, Del Rey, 1993, at 115, and José Laexandre Tavares Guerreiro, "Execução Específica do Acordo de Acionistas", in *Revista de Direito Mercantil, Industrial, Econômico e Financeiro*, Rio de Janeiro, No. 41, Year 20, 1981, at 40-68).

⁶¹ See for Argentina, section 54 of Law 19.550; for Brazil, article 117 of Law 6.404 of 1976; and for Colombia, section 36 of the Labor Code. In Mexico, a draft "Law for the disregarding of the corporate legal entity" was presented in November 2002; for the full text of the initiative (in Spanish), see <http://www.senado.gob.mx/sqsp/gaceta/59/1/2004-06-09-1/assets/documentos/iniciativas-3/12.ppt>. In the Latin-American scenario, it is also interesting to analyze the Brazilian laws concerning piercing the corporate veil. In fact, the large number of hypothesis that allow courts to ignore the corporate legal personality create uncertainty concerning the actual boundaries of limited liability. However, local scholars seem to see these broad possibilities to disregard the legal entity in a positive light. For instance, according to Modesto Carvalhosa "the Brazilian regulation in this topic is one of the most advanced regulations within Latin-American countries, not only due to the large number of judicial decisions that have been rendered in this matter, but also because of the possibility of piercing the veil as a consequence of multiple innovative hypothesis". *Comentários à Lei de Sociedades Anônimas*, Vol. 1, São

in which there has been a traditional liability extension in the event of bankruptcy, there is no justification for such a broad extension of liability⁶². Such written rules and judicial precedents discourage local and foreign investment leading to simulation or otherwise wrongful configuration of the corporate contract. Parent companies are exposed to excessive risks⁶³ in which piercing the veil becomes tantamount to strict liability⁶⁴. Defending weak creditors through expeditious writs – in which constitutional courts fail to assess the true merits of each case – affects certainty and reliance on the legal systems.

Piercing the veil has been justifiably criticized in common law systems due to legal uncertainty concerns. However, such judicial solution has enjoyed support in the United States, for it is decided on a case-by-case basis under an inductive method of reasoning in which facts are carefully scrutinized by each court.

2.7 Excessive Legal Formalities for Incorporation

Legal formalities for incorporation constitute one of the most significant entry barriers for entrepreneurs in Latin America. Forming a regular business entity may cost hundreds of dollars and require the fulfillment of time-consuming and cumbersome steps. Some of these proceedings are reminiscent of ancient institutions, many of which are kept mainly due to pressure groups that have the ability and power to hinder legal reform. The necessary participation of a notary public in the process of incorporation is a good example of such widespread formalism⁶⁵. Notaries are well-paid bureaucratic

Paulo, Editora Saraiva, 2010, at 448. See also Fabio Ulhoa Coelho, *Curso de Direito Comercial*. 7ª Edição, São Paulo, Editora Saraiva, 2004, at 35. In contrast, certain scholars in the US would prefer that piercing the corporate veil be abolished. See for instance, Stephen Bainbridge, Abolishing Veil Piercing, in *The Journal of Corporation Law*, Vol.26, N.3, Spring, 2001.

⁶² Even in these forms of business associations it is viable to provide for a limitation on the liability of general partners. New forms of entities have arisen, such as the Limited Liability Partnership (LLP) and Limited Liability Limited Partnership (LLLLP). These business associations combine the advantages of partnerships and limited partnerships with the benefits of business corporations, i.e., they add to a person-based business entity, the useful feature of limited liability.

⁶³ See for Brazil, section 246 of Law 6.404 of 1967; ; Argentina, section 161 of Law 24.522; and Colombia, sections 61 and 82 of Law 1116 of 2006. Pursuant to section 61 of the aforesaid Colombian Law, the parent company shall be liable only when the subsidiary's insolvency or liquidation was caused by acts attributable to the parent corporation. In this event, the latter must take on all of the former's liabilities.

⁶⁴ See for instance Decision SU-1023 of 2001 rendered by the Colombian Constitutional Court holding a parent company liable on the grounds of the simple fact of being the parent. For an analysis of this decision, see Angel Oquendo, *Latin American Law*, New York, Foundation Press, 2006, p. 793.

⁶⁵ See for Brazil, section 997 of the Civil Code; Mexico, section 5 of the LGSM; Argentina, section 165 of Law 19.550; and Colombia, section 110 of the Commercial Code. Pursuant to section 5 of the LGSM, "Companies shall be incorporated before a Notary, and modifications to their articles of association shall be made in like manner. The notary shall not authorize the articles when the statutes or their amendments contravene the provisions of this Law". In Colombia, Law 222 of 1995 created the so-called *empresa unipersonal*, whereby one individual or legal entity is enabled to form a separate legal entity

officers whose income is mainly associated with the so-called 'public faith' that is given to contracts and other instruments once their authorized stamp and signature have been apposed onto a document. Aside from notaries, other professionals such as attorneys and certified accountants may also have a part in the process of incorporation, not to mention the requirement to obtain certain governmental authorizations as well as the usual mandate to publish excerpts of the articles of incorporation in official gazettes.

Paradoxically, this formalistic approach represents a significant obstacle for the formalization of business enterprises. There is empirical evidence that the most flexible legal systems are more suitable to attract investment and, correspondingly, to obtain higher income arising from registration of new companies. It has been held that the citizens of Delaware pay comparatively less income taxes due to the significant amounts that are contributed by foreign corporations in the form of registration fees. In fact, the so-called franchise tax represents almost a fifth of the overall revenue gathered by the State of Delaware. Naturally, there are several factors that characterize the institutional framework that is needed to administer such a successful corporate law jurisdiction. It is not only the substantive regulation that makes Delaware so attractive for corporations, the judiciary and even the specialization of the state's bar also play a significant role⁶⁶.

Conversely, those systems that make it difficult for business people to create corporations tend to fall behind. In the recent incipient competition for corporate chartering taking place in Europe, burdensome legal provisions, such as minimum capitalization requirements, two-tiered corporate governance structures, and the participation of notaries, as well as other bureaucratic authorizations, could have the impact of creating a new market in which some entrepreneurs will prefer to incorporate in the United Kingdom, where the processes seem to be simpler. After the *Centros v.*

through a private written document (i.e., without the participation of a notary public). Section 22 of Law 1014 of 2006 extended this benefit to all new companies with capital that did not exceed 500 monthly minimum wages, and which employed no more than 10 workers. It was only with the creation of the SAS in 2008 that this formality was completely abolished for a company type, irrespective of its size and capital. Paradoxically, formalism increases informality. According to Norman Loayza "informality arises when the costs of belonging to the country's legal and regulatory framework exceed its benefits. Formality entails costs of entry --in the form of lengthy, expensive, and complicated registration procedures-- and costs of permanence --including payment of taxes, compliance with mandated labor benefits and remunerations, and observance of environmental, health, and other regulations" (Loayza, Norman, Servén, Luis and Sugawara, Naotaka, *Informality in Latin America and the Caribbean* (March 1, 2009). World Bank Policy Research Working Paper Series, Vol. , pp. -, 2009. Available at SSRN: <http://ssrn.com/abstract=1372965>).

⁶⁶ For an explanation concerning franchise taxes in Delaware and the percentages that they represent with respect to the total amount of taxes collected by that state, see Roberta Romano, *The Genius of American Corporate Law*, Washington D.C., AEI Studies in Regulations and Federalism, 1993, at 6-12. See also, Alan Palmiter and Francisco Reyes, *Arbitraje Comercial y Otros Mecanismos de Resolución de Conflictos Societarios en Estados Unidos*, (Bogotá, Cámara de Comercio, 2001) at 77-87.

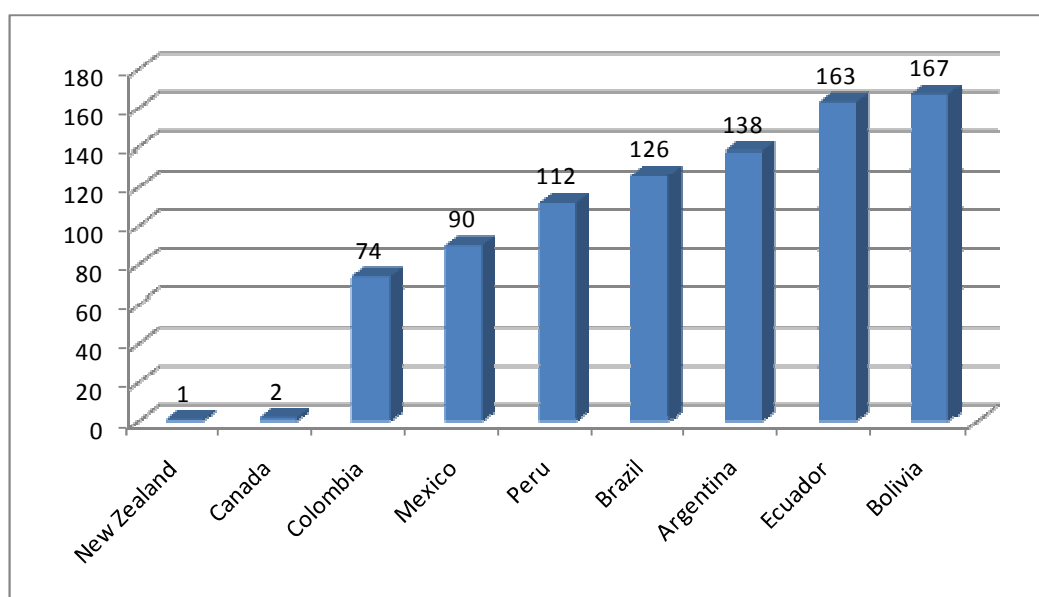
*Erthvers-og*⁶⁷ decision back in 1997, several businesses have fled from the continent to London, taking advantage of the great flexibility offered by British Company Law. Migration of business and capital, propelled by this developing new market, has created a unique economic incentive for law reform in Europe. In fact, some of the company laws of France have been overhauled, apparently reflecting new trends in the regulation of business associations. That would be the case, for instance, of the successive reforms of the laws concerning the *société par actions simplifiée*. These legislative amendments are an attempt to make this hybrid business form ever more flexible and friendly to investors.

International standards set up by multilateral institutions are useful to assess the quality of company laws and to measure the business climate in different jurisdictions. The Doing Business project of the World Bank “provides objective measures of business regulations and their enforcement across 183 economies and selected cities at the sub national and regional level”. One of the areas examined in this project relates to the so-called business start-up, where four aspects are taken into consideration: 1) the amount of procedures needed to register a company; 2) the number of days it takes to incorporate; 3) the official cost, shown as percentage of the income per capita; and 4) the minimum paid-in capital required, also expressed as a percentage of income per capita. The business corporations observed in these studies are small- to medium-sized domestic businesses “with up to 50 employees and start-up capital of 10 times the economy’s per-capita gross national income” (See the Doing Business official website at <http://www.doingbusiness.org/>).

According to the data provided in the Doing Business 2010 Report entitled “Reforming through Difficult Times” (a co-publication of The World Bank, the IFC and Palgrave MacMillan), Latin American countries perform poorly on the ranking of economies where it is easier to start a business. Even though reforms have been constant in this region within the last decade, there is significant room for improvement when compared to good practice economies (See Graph 1). For instance, in New Zealand and Canada only one procedure is required to get a business started; it takes approximately one to five days, costs 0.4% of income per capita, and no minimum capital is mandatory. At the same time, in Brazil the most rapidly growing economy in the area, it takes 120 days to start-up a company, costs 6.9% of per capita income, and 16 procedures are needed for that purpose (See Table 1).

Graph 1
Ease of Starting a Business Global Rank – Latin America Compared to Good Practice Economies

⁶⁷ Decision C-212, March 9th, 1997.



Source: *Doing Business 2010: Reforming through Difficult Times*, available at <http://www.doingbusiness.org/documents/fullreport/2010/DB10-full-report.pdf>.

Table 1
Starting a Business: Procedures, Time, Cost, and Minimum Capital - Latin America
Compared to Good Practice Economies

Region or Economy	Global Rank	Procedures (number)	Time (days)	Cost (% of income per capita)	Min. capital (% of income per capita)
Good Practice Economies					
New Zealand	1	1	1	0,4	0
Canada	2	1	5	0,4	0
Australia	3	2	2	0,8	0
United States	8	6	6	0,7	0
Latin America – Selected Economies					
Colombia	74	9	20	12,8	0

Mexico	90	8	13	11,7	8,9
Brazil	126	16	120	6,9	0
Argentina	138	15	27	11	2,9

Source: Doing Business 2010, at <http://www.doingbusiness.org/ExploreTopics/StartingBusiness/>.

The aforementioned figures reflect the cumbersome steps needed to set up a business in the region and show how transaction cost oriented regulations hinder the processes for incorporation in Latin American Economies. The all-pervasive presence of countless formalities can be contrasted with modern online incorporation proceedings. In New Zealand, for example, the entire procedure can be completed by applying for registration on the Companies Office's website (www.companies.govt.nz). The first step is to log on, through the setting up of a user account, at the designated website. Afterwards, the applicant must reserve the corporate name, complete the relevant forms, and pay the registration fee. Responses and notifications from the Companies Office, as well as the certificate of incorporation, are sent by e-mail. While incorporating a company, an applicant can, at the same time, register online for the Goods and Services Tax and apply for a company Inland Revenue Department number (See the registration requirements for New Zealand, at <http://www.doingbusiness.org/ExploreTopics/StartingBusiness/Details.aspx?economyid=140#1>).

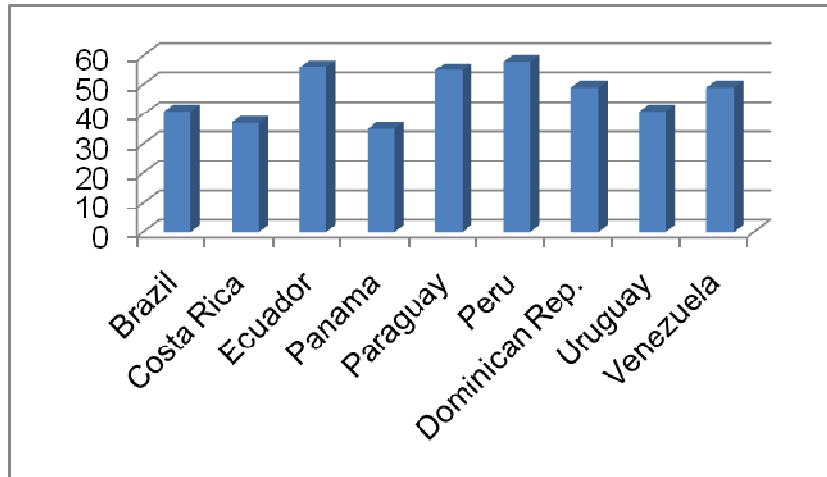
In most Latin American countries, each of these procedures requires that the applicant personally appear before the respective governmental entity (tax, social security, pension and severance funds, notary public, mercantile registry, foreign direct investment registration, etc.), fill out endless forms, and, consequently, spend considerable amounts of time and money. Supporters of these outdated regulations defend them on the basis of legal certainty. According to this common academic trend, the manner in which these procedures are laid out in local regulations guarantees the identity of applicants, prevents fraud, and ensures transparency.

However, current technological developments have surpassed these concerns, as they are more efficient, reduce administrative costs, and also provide a significant level of legal certainty and security. In fact, digital signatures and Secure Sockets Layer (SSL) certificates are widely used to prevent fraud and guarantee expeditious and safe transactions.

When considering the costly and burdensome procedures explained above, it is important to mention the negative impact that they have on formal employment. Informality is abundant in Latin American economies, where 30 to 70% of the total occupied urban population works in informal sectors (See Graph 2). The World Bank has identified the following as the main obstacles for formalization: 1) the excessive costs in registering a company; 2) the rigid regulations and extreme bureaucracy; and 3)

the inefficiency of institutions involved in the incorporation processes (World Bank, *Doing Business 2010*).

Graph 2
Informal Sector as a Percentage of Total Occupied Urban Population



This chart includes data for the year 2008

Source: Economic Commission for Latin America (ECLA), statistics available at <http://www.eclac.org/estadisticas/default.asp?idioma=IN>.

The benefits of formalization are numerous, and they range from advantages to the general economy (such as an increase in investment, formal employment, tax revenues and market information), to benefits for businesses (which include access to services provided by financial institutions and insurance companies) and individuals (such as greater family income and social security affiliation). Even when considering these benefits, the costs imposed by Latin American regulations are so high that many business participants refuse to formalize their economic activities.

This scenario, as the World Bank has sufficiently demonstrated in the tables shown above, not only represents a barrier to the creation of new business entities, but also hinders the economic activity. The irrationality of this formalistic *modus operandi* is more than evident. To be sure, public deeds granted before notaries, filing before a mercantile registry, authorization granted by a governmental office, and publication in an official gazette, could all be reduced to a single act of registration before a company's office or a similar agency. Furthermore, this entire process can easily be made available online.

2.8 The Limited Role of the Mercantile Registry

The so-called *commercial publicity* is an important factor in the configuration of company law in civil law jurisdictions. Pursuant to a general rule, any act or contract that

is duly registered before a mercantile registry will be deemed to have legal effects vis-à-vis third parties⁶⁸. This concept is relevant in company law, for it provides legal certainty for creditors and other stakeholders, who can rely upon the information certified by the mercantile registrar⁶⁹. Due to purely theoretical reasons, it has been held that the only function performed by the registry is to provide publicity. Thus, the possibility of allowing registration to become a determinant factor for the legal formation of companies has been generally denied by most systems in Latin America. A more practical approach is offered by the corporate laws of the different American states in which the existence of the corporation is conclusively presumed upon the filing of the articles of incorporation before the relevant governmental office (i.e., the Secretariat of State) (See, Revised Model Business Corporation Act, Section 2.03).

On the other hand, the mercantile registrar is usually deprived of the ability to scrutinize the legal foundations of any act or contract that is subject to registration. As a result, a company that has been duly registered is still subject to challenges that may arise from several different factors. Virtually any person who proves a legitimate interest has standing to sue and request that the corporation contract be set aside on the grounds of non-compliance with substantive provisions.

Therefore, it would be useful to introduce in the different jurisdictions of Latin America, the so-called *foundational* mercantile registry (*registro constitutivo*). Under this system, registration provides legal certainty regarding the existence of the corporation as well as full validity to business transactions that have been carried out by its officers and directors after such registration has taken place⁷⁰. This principle can be stressed out in simple terms such as a straightforward provision whereby the company's legal personality arises after the formation documents have been filed before the relevant office. Furthermore, such system of registration ameliorates the problems associated with so-called *de facto* corporations. Certainly, where the law only requires a single act for the creation of a company, the difficulties arising out of pre-incorporation

⁶⁸ See for Brazil, section 993 of the Civil Code; Mexico, section 5 of the LGSM; Argentina, section 12 of Law 19.550; and Colombia, section 112 of the Commercial Code. Pursuant to Law 19.550: "Amendments not regularly recorded shall obligate the founding partners. They are not opposable against third parties; notwithstanding, the latter may allege them against the company and the associates, except in stock corporations and in limited liability companies."

⁶⁹ See for Brazil, section 1.154 of the Civil Code; Mexico, section 27 of the Commercial Code, and Colombia, section 112 of the Commercial Code, providing that: "As long as a deed is not registered with the Chamber of Commerce of the main domicile of the association, contracts with third parties may not be opposed even if contributions of the partners have actually been made."

⁷⁰ See for Brazil, section 984 of the Civil Code; Mexico, section 2 of the LGSM; Argentina, section 5 of Law 19.550; and Colombia, section 117 of the Commercial Code, providing the following statement: "The existence of the firm and the clauses of the contract may be supported with affidavits of the Chamber of Commerce of the main domicile, attesting to the number, date and notary office of the deed of institution and amendments thereto, if any; the affidavit shall further state the date and number of the decree whereby it was authorized to operate and, at any rate, attestation to the effect that the association has not been dissolved."

transactions tend to be significantly reduced. The unpredictability and uncertainty concerning the validity of acts undertaken by a company in formation disappear under such *foundational* registration system. At the same time, the liabilities of directors, officers, and shareholders are clearly defined as of the moment in which the formation documents are filed before the mercantile registry. Obviously, this recommendation is closely linked with the suppression of any notarial intervention in the formation process. A simple private document—even an electronic one—, duly executed by the relevant parties, should suffice for the purposes of registration.

2.9 Overreaching Causes for Nullification

Several causes for the nullification of the corporate contract can be found within commercial codes and corporate statutes⁷¹. These regulations allow any party to challenge the existence of the corporation. Through the so-called absolute and relative nullification regime, company law provisions contribute to create legal uncertainty and instability of existing business entities. These regulations are inconsistent with modern trends in which the causes for nullification are reduced to a minimum. The first European Community directive regarding disclosure, *ultra vires*, and nullity adopts a restrictive approach in this respect. Pursuant to this directive, nullity can only be decided through a judicial proceeding. Therefore, a court can declare that a company is void, provided that the restrictive grounds specified in Section 2 are fully proven. Such grounds include, *inter alia*, that no instrument of formation was executed, that certain required legal formalities were not fulfilled, or that specific requirements provided for under the national legislation were not complied with. The European directive is intended to grant legal certainty and protection to third parties dealing with the company. By restricting the grounds upon which a person can challenge the act of incorporation, the validity of the legal entity is enhanced and the chances for opportunistic legal complaints are severely reduced.

2.10 Regulatory Nature of Most Company Law Rules

Company law statutes and codes are mostly of a regulatory nature. Provisions concerning all aspects of corporate governance, minority shareholders' rights, structural changes, mergers, dissolution, and liquidation are overwhelming⁷². Regulations

⁷¹ See for Mexico; section 3 of the LGSM; Argentina, sections 17 and 18 of Law 19.550, and Colombia, sections 104, 106 108 of the Commercial Code. In accordance with section 17 of Law 19.550, it is understood that "The constitution of a company of a type not authorized by the law shall be null. The omission of any essential requirement shall make the contract annulable, but it may subsist until its judicial refutation".

⁷² See for Brazil, sections 224 of Law 6404, and section 1.036 of the Civil Code; Mexico, sections 223 and 240 of the LGSM; Argentina, sections 83, 110 of Law 19.550; and Colombia, sections 158 and 173 of the Commercial Code, which provides the following: "Partners' board meetings or assembly shall approve with the quorum provided by the by-laws for mergers, or otherwise an early dissolution, the respective undertaking which should cover: 1. The reason for the proposed merger and the manner in which it will

concerning the basic contents of the articles of association or by-laws tend to be comprehensive and imperative. To be sure, company law statutes contain lists of clauses that have to be included within the by-laws of any company that is created⁷³. Failure to provide any of those required clauses could result in the nullification of the entire contract⁷⁴. In contrast with modern corporate law in which most provisions are not regulatory, the approach in this region is increasingly complex. In contrast, the approach existing in all U.S. jurisdictions characterized by enabling statutes has not been followed in Latin America. Notwithstanding the well-known and highly publicized principle of freedom of contract imbedded in 19th century codifications, the flexibility afforded to shareholders at the moment of drafting or amending the company's constitutional documents is, in most of the cases, insignificant.

Such a cumbersome regulation hinders the economic activity, creates transaction costs, and prevents the parties from reaching adequate agreements concerning the basic elements of the business association. As it has been said before, these restrictions are particularly detrimental as they regard the closely held corporation. Most of these imperative legal provisions appear to be designed to deal with the problems arising in the context of publicly held entities. They are needed to protect a myriad of anonymous and dispersed shareholders and to resolve problems associated with collective action. These situations obviously demand a comprehensive legal framework. The extant regulation of shareholders' meetings as well as rules on quorum, election of board members, structural changes, appraisal remedies, forceful dissolution, etc.,

take place; 2. Data and figures, taken from the accounting books of the parties involved, which would have served as the basis to determine the conditions of the merger; 3. Breakdown and evaluation of the assets and liabilities of the companies to be absorbed and those of the absorbing concern; 4. An annex explaining the methods for the appraisal and exchange of interests, quotas or shares the transaction will involve; 5. Certified copies of the general financial statements of the contracting parties”.

⁷³ See for Brazil, section 997 of the Civil Code; Mexico, section 6 of the LGSM; Argentina, section 11 of Law 19.550; and Colombia, section 110 of the Commercial Code. According to Law 19.550, “The instrument of constitution should contain the following, without prejudice to that which may be established for certain types of companies: 1) the name, age, civil status, nationality, occupation and identification card number of the associates; 2) the firm name or the trade name, and domicile of the company. If the contract only contains the domicile, the address of the headquarters must be registered by petition signed separately by the organ of administration. All notices effected at the headquarters will be valid and retained; 3) the designation of its purpose, which must be determined precisely; 4) capital stock, which must be expressed in Argentine currency, and the contribution of each associate should be mentioned; 5) term of duration, which must be determined; 6) organization of the administration, control, and of the meetings of associates; 7) rules for distributing the profits and supporting the losses. In default of the latter, they will be distributed in proportion to the contributions. If only the manner of distribution of profits is provided, it will apply also to supporting the losses, and vice versa; 8) in order to establish the rights and obligations between partners and with respect to third parties, the necessary clauses will be established precisely 9) clauses relevant to the functioning, dissolution and liquidation of the company.”

⁷⁴ See for Brazil, section 166 of the Civil Code; Mexico, section 8 of the LGSM; Argentina, sections 16 and 17 of Law 19.550; and Colombia, sections 104 and 108 of the Commercial Code.

seems to be more appropriate for the protection of investors trading securities in stock exchanges⁷⁵.

The closely held corporation gives rise to an altogether different scenario. The specific problems that are germane to this form of private association require flexibility in order for the concerned parties to be able to lay down appropriate rules to govern their business relationships. Private ordering is an essential element without which the company law system cannot respond effectively to the challenges arising from the different interests that shareholders may have. Therefore, reduction of unnecessary mandatory provisions constitutes a natural step in the modernization of Latin American company law. Specifically, the decrease in the number of imperative clauses that have to be included within the constitutional document could enable the parties to freely define the framework within which the company will operate. At the same time, such flexibility will foster the drafting of shareholders' agreements, which – at least for the time being – are usually unenforceable *vis-à-vis* the corporation.

2.11 The Negative Impact of the *Ultra Vires* Theory

The so-called *specialty theory*, whereby the company's legal capacity depends upon the business activities provided for under the purpose clause in the corporation's by-laws⁷⁶, is an anachronistic reminiscence of the concepts that were in vogue in the beginning of the 20th century. The purported advantages that arise from this theory in terms of protection to the shareholders are overshadowed by its detrimental impact on third parties. The latter are clearly affected due to the uncertainty concerning the validity of business transactions carried out by the corporation. Under the general approach existing in Latin America, it is obvious that the corporation can easily find a way out from inconvenient contracts through the simple expedient of showing that the relevant act is *ultra vires*.

This theory has been abolished in most advanced legal systems. The movement began in the United States, where old state legislation used to embrace such theory. The difficulties arising from its application caused the state legislators to repeal it

⁷⁵ See for Brazil, sections 125, 206 and 221 of Law 6.404; Mexico, sections 145, 178 and 189 of the LGSM; Argentina, sections 78, 233, 243 and 255 of Law 19.550; and Colombia, sections 420, 427 and 436 of the Commercial Code. Pursuant to section 78 of Argentine Law 19.550, "should unanimous consent not be required, the partners or shareholders who have voted against the decision and those who were absent, shall have the right of separation without prejudice for their liability vis-à-vis third parties for obligations incurred up to the filing date of the transformation document before the Public Mercantile Registry [...]"

⁷⁶ See Colombia, section 99 of the Commercial Code, whereby: "The capacity of the association shall be confined to the development of the venture or activity contemplated in its objectives." See also, Section 58 of Argentine Law 19.550, which reads as follows: "The officer or agent who, pursuant to the contract or by legal provision, represents the company, binds the latter for all acts which are not radically different from the corporate purpose..."

altogether from all corporate statutes. Also, the requirement to stress out a fully defined purpose clause in the articles of incorporation by describing the business activities to be carried out by the business entity was also repealed. Such important legislative step weakened the *ultra vires* theory by enhancing the legal capacity of the corporation and its ability to carry out any lawful legal transaction.

From the enactment of the First Community Directive, a similar approach was undertaken for European company law. Even if such directive starts off by recognizing that the corporation's legal capacity is defined by the purpose clause as it has been laid out in the articles of Association, it is also said that third parties shall be protected concerning the validity of any *ultra vires* business transaction to which they were a party, provided that they did not know that the corporation lacked sufficient capacity to undertake such transaction. Pursuant to the same directive, bad faith will not be presumed on the grounds that the concerned party had access to a certificate rendered by the relevant company's registrar, in which the purpose clause may appear.

2.12 Rigid Regulations Regarding Capital Contributions

An excessive reverence is given to the concept of legal capital and par value. There is almost an obsession with the so-called integrity and maintenance of legal capital. Some regulations even provide that a corporation shall be dissolved whenever a certain amount of losses affects its capital⁷⁷ (i.e., whenever, as a result of losses, the corporation's equity falls below the amount of subscribed paid in capital). Under a related provision, contributions cannot be made for any amount below the par value set up at the inception of the corporation contract⁷⁸. This rule clearly contradicts the economic reality in the frequent case in which the corporation's equity value has been reduced as a result of losses. The only exception to this drastic rule requires an amendment of the articles of association to reduce the shares' par value.

Likewise, various legal provisions concerning the terms and conditions for the payment of capital contributions⁷⁹ tend to reduce the corporation's ability to attract capital, particularly when it is undergoing financial stress. In-kind contributions are in many cases subject to several different formalities, including requirements such as independent appraisal, governmental authorization, and even imposing unlimited liability

⁷⁷ See for Mexico, section 229, subsection 5, of the LGSM; Argentina, section 94 of Law 19.550; and Colombia, section 370 of the Commercial Code. According to the LGSM "Companies shall be dissolved: [...] 5. Due to loss of two-thirds of the corporate capital."

⁷⁸ See for Brazil, section 12 and 13 of Law 6.404; Mexico, section 115 of the LGSM; Argentina, section 202 of Law 19.550; and Colombia, section of the Commercial Code.

⁷⁹ See for Mexico, section 64 of the LGSM; Argentina, section 186 of Law 19.550; and Colombia, section 354 of the Commercial Code. As referring to Limited Liability Companies, Law 19.550 provides that: "The capital must be totally subscribed at the time of the execution of the formation deed. It must not be less than 100,000 Argentine pesos. This amount may be adjusted by the Executive Power each time it deems it necessary".

for those who make the contribution. These obstacles for capitalization are notoriously inconvenient for companies seeking to expand operations or to carry out financial reorganization. Furthermore, these cumbersome regulations can be a source of transaction costs and protracted litigation.

Some of these provisions contradict contemporary financial theories in which it is usually more important for a company to have substantial cash flows to pay all debts as they become due, rather than to show a fixed amount of subscribed paid in capital in the balance sheet.

2.13 Lack of an Effective Judicial Control on Business Associations

Some of the most relevant authors in the field of legal transplant in corporate law (i.e., Katarina Pistor, Luca Enriques, etc.) have stressed out the importance of the so-called structural transplants. This concept refers specifically to the adoption of substantive legal rules, which are suitable to be applied and enforced by the judicial and administrative authorities of the country to which the legal principle is being transplanted. Thus, it is generally acknowledged that it does not suffice to introduce appropriate substantive rules, but it is also necessary to emulate the institutional framework for the enforcement of such legal provisions that exists in the jurisdiction from which rules are being transplanted. Therefore, the determination of legal proceedings and judicial actions, as well as the strengthening of the institutions, are essential aspects without which legal reform becomes effective.

Latin American procedural law is characterized by a formalistic approach in which several different instances are granted to challenge every single decision rendered by the court. As a result, most processes tend to be lengthy and bureaucratic. Protracted litigation is, therefore, the rule. According to the data provided in the Doing Business 2011 Report, Latin American countries perform poorly on the global ranking for the enforceability of contracts (see Table 2). In fact, pursuant to the same report, only the southern part of Asia ranks lower than this region in the index.

Table 2
Enforcing contracts – Global rank

Country	Position in the global rank (from 183 examined States)
Brazil	118
Mexico	47
Argentina	109
Colombia	178

A peculiar system for adjudication that exists in some Latin American countries is based upon the granting of quasi-judicial powers to administrative agencies. Entities such as the General Inspection of Justice in Argentina or the Superintendence of Companies in Colombia have proven to be useful for the purpose of providing

expeditious and more technical solutions to conflicts arising in the field of Company Law.

Several procedural and even substantive regulations create obstacles that make it difficult for shareholders and other stakeholders to pursue legal actions before courts. Cumbersome regulations of this sort represent an entry barrier for litigation. Furthermore, the lack of predictability and the expectation of long-lasting and expensive processes are serious deterrents for the creation of an appropriate scenario, where shareholders' rights would find an adequate development.

According to Luca Enriques, the creation of an effective company law framework relies heavily upon the so-called good corporate law judge⁸⁰. Such concept features several different attributes, including a clear understanding of the core problems that underlie the corporate conflict as well as a non-formalistic approach and a serious concern for the precedential value of any decision rendered in this field.

The simplification of the legal process is not altogether unreachable in Latin America. In fact, it has been achieved in some countries in the region. Regrettably, those improvements have not taken place regarding purely civil or commercial cases, but instead have arisen in connection with constitutional issues. The consecration of the

⁸⁰ Luca Enriques. 'Off the Books but on the Record: Evidence from Italy on the Relevance of Judges to the Quality of Corporate Law', in *Global Markets. Domestic Institutions, Corporate Law and Governance in a New Era of Cross-Border Deals* (New York, Columbia University Press 2003) at 258 *et seq.* It is a fact that Latin American judiciaries are far from being specialized in Corporate Law. This phenomenon is also described by Robert Charles Means, who explains that "the tendency for Latin American countries to enact laws with little regard for social reality and less for effective implementation is well known. This tendency perhaps has roots in Latin American culture, in the preference for the word over the thing and for expressive over instrumental behavior. But it is also characteristic of follower countries of widely different cultures. The demonstration effect is not confined to consumer demand; international example may also lead a country to live beyond its legislative means, placing demands on the legal system that cannot be satisfied. This kind of isolation of legal rules from reality might be called enforcement unreality" (*Underdevelopment and the Development of Law: Corporations and Corporation Law in Nineteenth-century Colombia*, The University of North Carolina Press, 1980, at 151. Bruno Salama and Viviane Muller also describe this scenario, using Brazil as an example: "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. As so, the interpretation and doctrinal analysis of corporate law is 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". (Bruno Salama and Viviane Muller Prado, *Legal Protection of Minority Shareholders of Listed Corporations in Brazil: Brief History, Legal Structure and Empirical Evidence*, available at http://works.bepress.com/cgi/viewcontent.cgi?article=1017&context=bruno_meyerhof_salama, at 19). For another explanation about the importance of judges for the development of a good Corporate Law system, see John Coffee, *Law and Market: The Impact of Enforcement, Working paper 304*, The Center for Law and Economic Studies, Columbia University School of Law, April 4, 2007, at 6.

writ of constitutionality (*amparo*, *tutela* or *mandado de segurança*) has provided an interesting development of procedural rules. Generally, these legal actions can be easily filed, are not subject to complicated formalities and can be handled through an expeditious and proceeding that has to be resolved under a priority rule. A similar sort of writ, provided for the defense of constitutionally protected individual rights, could be adapted for shareholders' suits. The creation of a specific proceeding to deal with conflicts related to Company Law is a solution that has been recently adopted in Italy, through the so-called *rito societario* (Decree of January 17th of 2003).

2.14 Enforcement of Corporate Governance Rules

A determining factor for poor corporate governance in this region relates to the prevailing weakness of the legal infrastructure and, specifically, the comparative lack of enforceability⁸¹. The extent to which the legal system functions in Latin American countries is still a matter of debate⁸². Generally, it is acknowledged that there is a considerable disparity between the degrees to which the official legal systems penetrate in rural areas as compared to the same phenomenon in major urban centers⁸³. In the

⁸¹ Some authors have held that in the specific context of corporate governance, "[e]nforcement of laws is as crucial as their contents. In most countries, laws and regulations are enforced in part by market regulators, in part by courts, and in part by market participants themselves. All outside investors, be they large or small, shareholders or creditors, need to have their rights protected". Rafael La Porta *et al.*, "Investor Protection...", see *supra* note 17, at 5.

⁸² According to Thome, "[d]espite recent reform efforts, the administration of justice in Latin America to a large extent continues to be based on a bureaucratic model; as such, it is hierarchically organized and retains a written process that facilitates the internal control of the proceedings (and the judicial functionaries), but strictly limits participation in the process by affected parties". See, Joseph R. Thome, "Heading South but Looking North: Globalization and Law Reform in Latin America", in *Wisconsin Law Review*, Vol. 2000, No. 3, at 705). Likewise, Beibersheimer holds that statistical evidence about trends in justice in Latin America and the Caribbean show that the performance of the justice sector in much of Latin America and some of the Caribbean lags behind other regions of the world (See Christina Beibersheimer, "Justice Reform in Latin America and the Caribbean: The IDB Perspective," in Pilar Domingo and Rachel Sieder, (eds.), *Rule of Law in Latin America: The International Promotion of Judicial Reform*, Institute of Latin American Studies, London, 2001, at 99). Rosenn also shares this concern: "It is quite common to discover that the authorities charged with administering a particular body of law are unaware of significant changes in the statutory or case law. Inertia, ignorance, and inability to keep abreast of rapid-fire legislative change frequently combined to produce substantial differences between the formal norm and the law actually being applied". Keith Rossen, *The Jeito: Brazil's Institutional Bypass of the Formal Legal System and its Development Implications*, *The American Journal of Comparative Law*, vol. 19, 1971. This rather extreme vision of Latin America has been critiqued as unrealistic by Jorge L. Esquirol: "Exoticizing these societies indeed characterizing them as somehow beholden to different conceptions of the meaning of law, plays a large role". Jorge Esquirol, "Continuing Fictions of Latin American Law", *Florida Law Review*, Vol. 55, No. 1, 2003, at 87.

⁸³ Merryman points to the fact that to the urban oligarchy population, Western Law is the significant legal standard as opposed to customary law, which is the law for millions of marginal inhabitants in Latin America. John Henry Merryman, *et al.*, *Comparative Law, Western European and Latin American Legal Systems, Cases and Materials*, The Michie Company, 1978, at 365.

latter scenario, an increasing development of legal institutions has allowed for the modernization of several economic sectors⁸⁴.

Relevant substantive law factors that negatively impact corporate governance in Latin America have been fully identified in several studies concerning the region. There is some agreement as to the main structural substantive legal changes that could be made in order for business associations in the region to be more competitive in a global environment and to have a broader access to international capital markets. However, not enough emphasis has been placed in the need to develop effective mechanisms for the enforceability of corporate governance principles in the region⁸⁵. A failure to identify appropriate measures in order to effectuate a significant turnaround in traditional Latin American legal systems has caused corporate governance reforms to lack the usefulness they may have had in other parts of the world.

According to Bratton, empirical evidence demonstrates the obvious premise whereby there is a strong positive correlation between the rule of law and the ability to enhance and deepen local capital markets⁸⁶. In other words, the few thick and liquid

⁸⁴ “A more developed commercial and financial law, with related changes in property and procedural law, serves to build the framework for the expanding economic activity [in Brazil]. Legal forms for aggregation of capital and skills, or for the exertion of greater economic power, assume high significance”. Henry J. Steiner, *Legal Education and Socio-Economic Change: Brazilian Perspectives*, 19 *American Journal of Comp. Law* 39, 1971, at 51-55.

⁸⁵ According to Erik Berglöf and Stijn Claessens, “[e]nforcement more than regulations, laws-on-the-books or voluntary codes is key to effective corporate governance, at least in transition and developing countries”. Erik Berglöf et al, *Corporate Governance and Enforcement*, World Bank Policy Research Working Paper 3409, September 2004, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=625286, at 1. It must also be noted that “a corporate law regime will not be effective if it is not enforced. Shareholders’ rights are only meaningful to the extent they are protected. Simple bright-line rules and greater transparency facilitate enforcement, but more is needed. Rooting out corruption is essential to promoting the rule of law and is a precondition to any effective legal system. The law must be crafted and enforced by honest-dealing and competent judges, lawmakers, and regulators, and scores cannot be settled by bribes, violence, and politics”. See Troy A. Paredes, *A Systems Approach*, at 1154 - 1155. Using the Brazilian example by Salama and Muller, with regards to the enforcement of protective mechanisms for minority shareholders in Brazil, it can be noted that “the small amount of lawsuits against controlling shareholders may suggest that the regulations are lax on taming controlling shareholders, and/or that proving a case against controlling shareholders is very difficult”. According to the statistical analysis presented by these authors, 66% of studied cases were brought to court by individuals, 18% by institutional investors, 14% by legal entities, and 2% by the Public Prosecutor’s Office. 88% of defendants in those cases were corporations, while only 10% were controlling shareholders, and the remaining 2% were officers (see Bruno Salama, *Legal Protection...*, *supra* note 80, at 20).

⁸⁶ Keith Rosenn also holds that despite opinions to the contrary, it is undoubtedly true that strengthening the rule of law will bear on the developmental process and often in a positive way. See Keith Rosenn, *Lectures on Latin American Law*, Chapter 2, University of Miami, 1992, at 110 (on file with author). The opinion of Prillaman is also pertinent to this discussion: “Scholars also have stressed the judiciary’s role in laying the foundations for sustainable long-term economic growth, ensuring predictability in the market place, and facilitating the formation of a civil society economically independent from the regime in power. Critical preconditions for economic development are predictable laws governing the marketplace and a legal regime that protects capital formation and ensures property rights from one administration to the

capital markets that exist in the world are characterized by legal investor protection as opposed to thin markets lacking significant liquidity in which shareholders are subject to less effective legal safeguards⁸⁷. This author also stresses out the obvious rationale that underlies the previously mentioned assumption: “given a weak legal protection, only voting control will protect against expropriation by other equity investors”⁸⁸.

Interestingly, Roe states that there are limits associated with the ability of corporate law to change ownership patterns. Such boundaries are so clear that even in nations in which there is a significant protection awarded to investors (i.e., Germany and Scandinavian countries), there is no separation between ownership and control. This situation arises, according to Roe, from “deeper features of society, such as industrial organization and competition, politics, conditions of social regularity, or norms that support shareholder value...”⁸⁹.

For decades, efforts have been constantly made in order to improve the judicial system in the region. Although some significant achievements have been accomplished, imbedded vicious practices die hard in Latin American judiciaries. It can be anticipated that surpassing these obstacles will be a lengthy process to which significant corporate

next” (See William C. Prillaman, *The Judiciary and Democratic Decay in Latin America: Declining Confidence in the Rule of Law*, Westport, CT, Praeger Publishers, 2000, at 1).

⁸⁷ Authors such as Troy A. Paredes highlight the fact that “the law has a central role to play in the development of equity markets. In short, the law is essential to securing the property rights of shareholders. Strong legal protections shield shareholders, especially minority shareholders, from having their investments expropriated by insiders, including directors, officers, entrepreneurs, and controlling shareholders [...]. By protecting shareholders from insider abuses, the law can instill in shareholders the confidence needed to invest, thereby leading to thicker and more highly valued equity markets”. See Troy Paredes, *supra note 85*, at 1057. A good summary of the prevailing literature on this specific topic is provided by Mark J. Roe: “The critical precondition to developing modern securities markets, and the industrial, technological wealth that goes along with deep and vibrant financial markets, most recent analysis posit, is a foundation of highly developed corporate and securities laws that protect minority stockholders from the rampages of the dominant majority stockholders” (Mark J. Roe, *supra note 175* at 161). As a corollary, it can be said that “if minority stockholders are unprotected by corporate law, they do not buy or buy only at a discount” (*Id.* at 177).

⁸⁸ William W. Bratton, *et al.*, “Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross-Reference”, in *Columbia Journal of Transnational Law*, Vol. 38, No. 2, 1999, at 228-229. Mark Roe also addresses this concern pursuant to today’s dominant academic explanation regarding the lack of deep securities markets in Continental Europe, which is supposed to be linked to “the weak role of corporate and securities law in protecting minority stockholders, a weakness that is said to contrast with America’s strong protection of minority stockholders”. See Mark Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, Discussion Paper No. 339, April 2001, Harvard Law School, at 5.

⁸⁹ See Roe, *supra note 88*, at 5. Other authors like Jeffrey N. Gordon argue that corporate governance convergence does not depend exclusively on an economic logic (which assumes that legal systems will converge to best corporate practices), but on a country’s or group of countries’ commitment of transnational economic and political cooperation. Jeffrey N. Gordon, *An International Relations Perspective on the Convergence of Corporate Governance: German Shareholder Capitalism and the European Union, 1999-2000*, discussion paper No. 406, February 2003, Harvard Law School, 1. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=374620.

governance improvements cannot be subject to. Therefore, alternative avenues must be pursued. For instance, the application of arbitration for corporate matters has been regarded as a means to cope with the requirement for hasty resolution of these conflicts. Among these solutions, one of the most auspicious appears to be the strengthening of administrative agencies in charge of supervising Latin American corporations. As it will be seen below, the specific characteristics of these entities may enable them to solve corporate issues on a more technical and expeditious manner.

Probably, the lack of knowledge concerning the actual operation of these entities and in some cases the misuse of their powers have resulted in distrust towards their existence. In fact, governmental control on corporations in Latin America has not been exempt from constant criticism ever since these administrative agencies were created⁹⁰. “The requirement for prior government authorization has met with constant opposition in all countries on diverse grounds”⁹¹. It has also been asserted that these agencies lack sufficient transparency to deal with corporate affairs⁹². Moreover, it has been argued that conferring judicial functions upon administrative agencies is against the basic principles of democratic systems⁹³. The argument is grounded on the assumed lack of

⁹⁰ According to Guillermo Cabanellas de las Cuevas, governmental control on business corporations corresponds to historical reasons more than actual economic concerns. This control does not exist in the majority of industrialized countries (*Derecho Societario, Parte General, Intervención y fiscalización estatal de sociedades*, Vol. 8, Buenos Aires, Editorial Heliasta, 2003, at 33). “Using a widespread ill-conceived technique in Argentine law, corporate statutes grant supervisory agencies overwhelming powers and a great deal of discretionary authority to interfere in the creation and existence of corporate organizations. In doing so, such agencies have been converted into a kind of overpowering supervisory institutions, which may disregard subjective rights granted upon shareholders”. *Id.* at 12.

⁹¹ Phanor Eder, *Company Law...*, see *supra* note 15, at 38. The author lists the following challenges to government control of corporations: (i) it is an unconstitutional restriction on the right of freedom of association; (ii) the supposed protection to the public is illusory; (iii) the task is beyond the capacity of States with poorly organized civil services; (iv) it is a hindrance to progress; (v) it infringes on the constitutional separation of powers; (vi) it is an obstacle to commerce without corresponding benefits; (viii) tutelage by the law is better than tutelage by the government; (ix) judicial functions should not be entrusted to the administration; and (x) it is violative of principles of economic liberalism. *Id.*, at 38-39.

⁹² A rather cynical approach in regards to this same issue can be found in the following excerpt: “There is general agreement that in several Latin American nations, the government body charged with the supervision of companies has extended its powers of ensuring that the statutory mandates be fulfilled to a degree which tends to rigidify the S.A. (stock corporation) into an inflexible stereotype constantly subject to inspection from minor government officials not uncommonly hungry for a *mordida*”. P.B. Hannon, “Choice of Business Organization for Latin American Operations” in *Tulane Law Review*, Vol. 34, 1960, at 754.

⁹³ Pursuant to Adolfo Rouillon, the Colombian Constitution determines that the judges must remain independent from the executive branch of government. “Nevertheless, the officers of the Superintendence of Corporations (that acts as a judicial authority in bankruptcy proceedings) cannot guarantee an independence equal to the one granted to the judiciary”. Adolfo Rouillon, *Colombia: Derechos de crédito y procesos concursales*, Washington D.C., The World Bank, 2006, at 44, http://minhacienda.gov.co/pls/portal30/docs/PAGE/INTERNET/REGULATION/TAB69B8536/3_12.%2BCOLOMBIA%2BDERECHOS%2BDE%2BCREDITO%2BY%2BPROCESOS%2BCONCURSALES.PDF.

As a general rule, it is obvious that under normal circumstances the independence of branches of government is a fundamental tenet of democracy. As Baily stresses out, “the judicial system plays

independence of these agencies vis-à-vis the executive branch of government⁹⁴. It is said that the lack of autonomy of the agencies' directors is evidenced in the fact that they are usually appointed by Presidential Decree and, therefore, subject to undesirable political pressures⁹⁵.

However, it is acknowledged that these agencies have a higher technical qualification, and consequently a better understanding of complex corporate issues, as compared to the average Latin American judge⁹⁶. In fact, in some countries of the region there is a longstanding tradition of a kind of "administrative case law" rendered by these agencies⁹⁷. Furthermore, the degree of predictability, legal certainty and expeditiousness of this supervisory system is higher than the one that would exist in its absence⁹⁸. As it has been stressed out, the basic argument against the exercise of judicial powers by administrative agencies is their lack of independence vis-à-vis the

fundamental roles in democratic governability. It can provide for "horizontal accountability," i.e., guaranteeing the checks and balances needed to contain executive and legislative power. It constitutes the institutional framework and functioning agencies within which citizens can translate their abstract legal rights into practical action" (See John Baily, *Corruption and Democratic Governability in Latin America: Issues of Types, Arenas, Perceptions, and Linkages*, Prepared for delivery at the 2006 Meeting of the Latin American Studies Association, San Juan, Puerto Rico, March 15-18, 2006, at 16). It is the failure of Latin American judicial institutions to cope with an efficient adjudication system that is taken as a point of departure for the development of alternative mechanisms.

⁹⁴ It has also been held that the effectiveness of this kind of entities is usually linked to the person who is appointed to lead them. According to Guillermo Cabanellas, the Corporate Law of Argentina depends upon the premise whereby undesirable, incompetent individuals will not ever be in charge of institutions such as the Inspection of Justice. "This is a dangerous premise, the worst consequences of which we have been fortunate enough to avoid thus far". See *Derecho Societario, Parte General, Intervención...* *supra* note 90, at 12.

⁹⁵ In accordance with Adolfo Rouillon, the Colombian Superintendent of Corporations is appointed and removed by the President in a discretionary manner. As a consequence, "the person empowered to decide on final adjudication of debtors and creditors' rights within insolvency proceedings is politically appointed by the Colombian President". See *supra* note 93, at 44-45. The author further presents the following valid criticism: "There is no statute or regulation establishing neither objective criteria for the appointment and removal of the Superintendent of Corporations nor tenure for the officer to remain in charge of the agency during a determined period of time". *Id.*

⁹⁶ "Even countries with a career judiciary seldom attract the most able law students, who find the gap between judicial salaries and the remuneration of private practice too great. In many Latin American nations, these economic and legal-cultural explanations for a low level of judicial independence are overshadowed by political considerations". See Rosenn, *Lectures...*, *supra* note 86, at 135.

⁹⁷ "The rules enforced by the Superintendencia are for the most part cast in reasonably, precise terms (...). An administrative agency such as the Superintendencia may contribute to legal development in several ways. It may act as both an interested party and as a source of technical knowledge in the preparation of new statutes and codes. It may also promulgate regulations within the scope of its statutory authority. Finally, its own decisions in individual cases may constitute an administrative case law". See Eder, *Company Law*, *supra* note 15, at 284-285.

⁹⁸ See, e.g., Francisco Reyes, *Reforma al Régimen de Sociedades y Concursos*, 2nd Edition, Bogotá, Editorial Temis, 1999, at 339, (showing the rapid adjudication in bankruptcy proceedings filed before the Superintendencia of Corporations between the years 1969 and 1997).

executive branches of government⁹⁹. This assertion arises from a conception whereby there must be a complete separation of powers. Nevertheless, modern constitutional law embraces the notion of cooperation between the executive and judicial branches¹⁰⁰.

Furthermore, the criticism also arises from an idealized autonomy of the judiciary –intimately linked with pure Montesquieu theories– that in the Latin American area is still unrealistic. In the specific context of Latin America there are extensive studies as to the evils of which the local judicial systems are plagued. Mirow holds that for the region, the twentieth century “has been a period of relative judicial weakness. Too often courts are seen as riddled with delays, back logs, and bribes. The extreme extent to which the judiciary is dependent on the executive power has hindered the development of law, and throughout the twentieth century even the supreme courts of some Latin American countries have been summarily removed and replaced by the executive or the military”¹⁰¹. The same author has held that the Latin American judiciary in the twentieth century continued to be politically subordinate to the executive, to the extent that, in practice, “judges often function at the mercy of the executive”¹⁰². Rosenn further notes that no Latin American judiciary “enjoys the prestige, deference, and independence of the judiciary in Anglo-American countries”¹⁰³.

⁹⁹ For example, in Colombia, the Superintendent of Corporations is appointed by the President. As a result, this officer, in his capacity of adjudicator of rights, lacks institutional independence vis-à-vis the executive branch of government. Nevertheless, such independence, which constitutes a fundamental tenet of modern democracy, is granted by the Colombian Political Constitution to every judge as a member of the judiciary. Adolfo Rouillon, *see supra* note 93, at 45.

¹⁰⁰ *See, e.g.*, article 116 of the Colombian Constitution (allowing for the exercise of judicial powers by administrative agencies, provided that an express authorization is given by the legislator).

¹⁰¹ *See* Matthew Mirow, *Latin American Law... supra* note 4, at 174.

¹⁰² *Id.* at 193. Matthew Mirow explains in further detail the basic causes of such subordination, which are mainly of a financial and political nature. *Id.* Pursuant to the opinion of Stephen Zamora, “[t]he reasons for the endemic deficiency of Mexico’s judicial system lie in the country’s unique and complex historical, ideological, cultural and political traditions. Such traditions include the Spanish colonial practice of unifying executive, legislative, and judicial powers in a single organ, the *Audiencia*; a history of dominance of public life by the political executive; and the powerful forces of centralism that have shaped Mexico’s legal landscapes [...]. Mexico’s judicial inadequacies were seen as products of several key shortcomings including a lack of judicial independence”. *See, Zamora et al., supra* note 5, at 188. According to David S. Clark, the *audiencia* “was essentially a court of appeals with jurisdiction over roughly the same territory governed by the viceroy or captain general. It served, in addition, as a consultative counsel to the executive officials and had a limited degree of legislative power”. David S. Clark, *Judicial Protection of Constitution in Latin America*, 2 *Hastings Constitutional Law Quarterly* 405, 1975.

¹⁰³ According to Nagle, even Latin Americans tend to be distrustful of their own businesses, banks and financial institutions, and of the government. “Their wariness comes from long traditions of institutional corruption and unethical business practices”. *See* Luz E. Nagle, “E-Commerce in Latin America: Legal and Business Challenges for Developing Enterprise” in *American University Law Review*, Vol. 50, No.4, April, 2001. Concerning the impact of corrupted practices in Latin America, John Baily holds that “corruption is rightly seen as a prominent cause of low quality democracy throughout much of Latin America” (*See* John Baily, *supra* note 93 at 22).

To be sure, most comparative law authors who have written about Latin American legal systems point out to the notorious difference that exists between the law in the books and enforceability by a judiciary that is generally considered to be neither proficient nor independent¹⁰⁴. Precluding administrative agencies from adjudicating complex corporate matters may be tantamount to proposing a denial of justice. In fact, apart from independency, corporate litigation requires expeditious and technical processes that can only be achieved where highly qualified adjudicators are in place. Diminishing the degree of independence could be justified to allow for a more precise and timely enforceability of corporate law. Thus, if administrative agencies such as the Argentine General Inspection of Justice or the Colombian Superintendence of Companies were empowered with the enforcement of corporate governance provisions, due compliance with these statutes could probably be ensured. As it will be explained below, the usefulness of these institutions arises from their multi-functional nature as well as from their ability to enforce rules and regulations. These entities are not restrained to the cumbersome and lengthy proceedings to which judges are commonly subject. At the same time, their ability to issue regulations and to impose fines and other administrative penalties allows them to exercise broad disciplinary actions on shareholders, directors, officers, and other stakeholders of a given corporation. These agencies, therefore, could play a significant role in the enforceability of corporate governance rule in the near future¹⁰⁵.

Far-reaching powers granted on these administrative agencies are not necessarily prejudicial to the economic activity. Under Comparative Law analytical principles, it is recommended to study the specific economic, social, and political realities that underlie any given institution¹⁰⁶. Failing to do so may result in a misleading analysis of a specific legal reality. In the case of Latin American corporate law, such a reality is one of discrepancy between the law in the texts and its actual application¹⁰⁷. This evident downside needs to be dealt with by confronting two competing views. First: an unrestricted defense of the principle of judicial independence without regard to a particular country's specific circumstances. Second, the undisputed need for an expeditious adjudication in corporate litigation. It is true that a harmonization between

¹⁰⁴ "Judges, police chiefs, and other local officials in Latin America are notoriously underpaid and provided with inadequate working facilities; judges in smaller cities are usually isolated from each other for months or years at a time (there are no annual conferences or conventions); and finally, their tenure may well depend on maintaining their local political contacts and friendships. Not surprisingly, then, while adequate social and economic legislation (such as labor and water laws) is not difficult to find in Latin America, in many cases it is ignored, inefficiently enforced, or implemented in a manner that unduly favors a given element of society. J. R. Thome, quoted by Rudolph B. Schlesinger, *et al.*, *see supra* note 43, at 988.

¹⁰⁵ In fact, the Colombian Financial Superintendence has created a division entrusted with the enforceability of corporate governance as well as in corporations issuing securities in the stock exchange (Decree 4327 of 2005).

¹⁰⁶ Legal rules, institutions, or systems cannot be compared without knowing how they function, and in order to do that it is necessary to situate them "in their legal, economic and cultural context". Mary Ann Glendon, *et al.*, *Comparative Legal Traditions*, St. Paul, West Publishing Co., 2nd edition, 1999, at 9.

¹⁰⁷ See Rudolph B. Schlesinger, *et al.*, *supra* note 43, at 988.

those two views would be an ideal solution as it has been proven by more developed nations in which corporate matters can be rapidly resolved by an independent judiciary¹⁰⁸. Such an ideal solution is far beyond the realistic possibilities of Latin America, at least in the short run. An intermediate solution that corresponds to an accepted idea of cooperation between branches of government can and has proven useful towards this end.

The experience accumulated over years of administrative activity has determined the development of summary proceedings for the enforcement of rules. The rulings contained in resolutions and other decisions are usually reported in websites and published in books that are broadly accessible to the general public¹⁰⁹. The diffusion of these materials not only provides certainty as to the authoritative interpretation of corporate statutes, but also allows for predictability of the law. In a manner comparable to the so-called no-action letters rendered by the Securities and Exchange Commission, the *precedents* rendered by these administrative agencies may be deemed to give rise to “an alternative dispute resolution system”¹¹⁰. Criticism based on the assumed old-fashioned nature of these agencies, and the argument whereby they are inconsistent with modern corporate law, disregards the basic problem associated to the region’s legal systems. In fact, these entities have developed an expertise on specialized fields of business law that has in many cases contributed significantly to foster the rule of law.

2.14.1 The General Inspection of Justice

A significant institution that has allowed for the enforcement of corporate statutes in Argentina is the General Inspection of Justice. This administrative agency (presently regulated under Law 22.315 of 1980) has been vested with a series of powers that enable it to function as the leading enforcement institution in the province of Buenos Aires (section 2)¹¹¹. Such prerogatives include not only a permanent supervisory activity

¹⁰⁸ A major example of these characteristics is present in the jurisdiction of Delaware in which the prestigious Court of Chancery is considered to be an effective and independent system for the adjudication of corporate disputes. See Stephen M. Bainbridge, “Mergers and Acquisitions”, New York, *The Foundation Press*, 2003, at 135. See also Alan Palmiter *et al.*, *supra* note 66, at 79-90.

¹⁰⁹ The Superintendence of Companies has made available a large amount of information at www.supersociedades.gov.co. There is also a series of publications entitled *Doctrinas y conceptos jurídicos* of the Superintendence of Corporations that have been continuously published for more than four decades. The General Inspection of Justice’s resolutions are also available at www.infoleg.gov.ar. A number of publications carried out by private publishers also report on several resolutions and other decisions rendered by the Inspection. See, e.g., Silvana Martínez, *Nuevas resoluciones de la Inspección General de Justicia*, Buenos Aires, Ed. El Derecho, 2005 and “Nuevas normas de la Inspección General de Justicia, Resolución 7/2005 y Anexos”, Buenos Aires, *Diario El Accionista*, 2006.

¹¹⁰ See Alan Palmiter, *et al.*, *supra* note 66, at 99-125.

¹¹¹ Among the powers granted to such agency under article 12 of Law 22.315, “the General Inspection of Justice will impose fines to corporations, associations and non-profit organizations, their directors, receivers or officers, and all persons or entities that do not fulfill their obligation to provide information, supply false data or in any matter infringe the obligations imposed by law, the bylaws or regulations, or hinder the discharge of their functions. The General Inspection of Justice has no jurisdiction over the

on closely held corporations¹¹², but also a number of functions associated with the Argentine mercantile registry¹¹³. In addition, the Inspection of Justice is an important source of corporate doctrine in the area of its jurisdiction, due to its thorough catalogue of resolutions and other documents in which corporate law is analyzed. The latter feature has led some authors to consider this agency's rulings as one of Argentina's primary sources of regulation for corporate governance¹¹⁴.

The Inspection's wide-ranging powers to enforce corporate regulations have also allowed the agency to issue regulations forcing offshore companies to subject themselves to Argentine corporate statutes (Law 19.550 of 1972 and other relevant provisions)¹¹⁵. This drastic remedy arose as a reaction to the increasing number of companies that were incorporated outside the country, hiding behind the corporate cloak with the sole purpose of circumventing Argentine company laws¹¹⁶. Indeed, by means of Resolution No. IGJ-7 of 2003, the General Inspection of Justice determined that any corporation that meets certain criteria is compelled to undergo amendments to

imposition of sanctions in those cases that fall under the jurisdiction of the National Securities Commission".

¹¹² Those powers allow the Inspection to undertake, among others, the following measures: (i) Request information and documents from a given corporation; (ii) initiate investigations; (iii) receive and verify complaints against corporations; and (iv) void any actions undertaken by any company under its supervision, by means of administrative resolutions. Guillermo Cabanellas de las Cuevas, *Derecho Societario, Parte General, Los Órganos Societarios...*, Heliasta, 1993, at 136.

¹¹³ See article 4 of Law 22.315 of 1980 (describing the powers that the Inspection may exercise as keeper of the country's mercantile registry).

¹¹⁴ See, for example, Rodrigo Olivares Caminal, "Corporate Governance Rules under Argentine Law", 9-*SPG L. & Bus. Rev. Am.* 225, 2003, at 226.

¹¹⁵ The severe measures that the Inspection may undertake in regards to offshore corporations, have led some authors to challenge the agency's exercise or powers in excess of those legally granted to it. See Alicia Josefina Stratta, *La regulación de las sociedades extranjeras por la Inspección General de Justicia*, Buenos Aires, Universidad Católica Argentina, 2004, at 8, stressing that "personal opinions [of the Inspection's staff] may not replace the legislator's will without severely affecting legal certainty, the importance of which is undeniable for commercial affairs. Nonetheless, other authors have underlined the advantages of having the means to exercise control over the activity of companies incorporated outside of the Republic of Argentina. According to Daniel Roque Vítolo, generally speaking, it can be concluded that article 8 of Law 22.315 provides sufficient powers to the Inspection of Justice to undertake a regulation on foreign corporations. See, Daniel Roque Vítolo, *Sociedades constituidas en el extranjero o con sede o principal objeto en la República*, Buenos Aires, Universidad Católica Argentina, 2005, at 95. "The basis for Resolution 7/03 is both commendable and adjusted to the current demands of mercantile activity. Indeed, corporate practice showed that several foreign companies with little or no activity in their state of incorporation were registered to undertake business activities [in Argentina]". Carlos Molina Sandoval, "Sociedades extranjeras: Se acabó la fiesta!" in *Sociedades extranjeras*, Buenos Aires, Universidad Católica Argentina, 2004, at 104.

¹¹⁶ Regarding this topic, see Molina Sandoval, *supra* note 115, at 103 (suggesting that one of the main reasons that led to the adoption of such a drastic measure was the need to distinguish between companies that actually carry out business transactions in foreign countries from those incorporated abroad for the sole purpose of avoiding Argentine law).

its by-laws in order to adjust them to Law 19.550¹¹⁷. Reluctance to abide by these provisions may result in the corporation's delisting from the Argentine mercantile registry as well as the initiation of compulsory liquidation proceedings¹¹⁸.

The Inspection has also issued rules regarding the execution of single or unrepeatable acquisitions of real estate in Argentina by offshore corporations¹¹⁹. Since foreign companies undertaking these "isolated" transactions are generally not subject to Resolution No. IGJ-7 of 2003, such corporations were being used as straw men to hold property located in Argentina. By means of such a proceeding, the actual individual owners were able to disguise their identities, escaping legal actions that could be initiated against them. This fraudulent use of corporate entities compelled the Inspection of Justice to issue Resolution No. IGJ-8 of 2003. By means of this resolution the "Registry for the Isolated Activities of Foreign Corporations" was created¹²⁰. The Registry lists all offshore companies that have undertaken transactions concerning immovable property located in Argentina¹²¹. This measure is aimed at providing the General Inspection with sufficient information to determine whether a given corporation is being used as a mere holder of property so as to avoid Argentine legal provisions. Should this be the case, the Inspection would be entitled to force such corporation to abide by the strict regulations set forth under Resolution No. IGJ - 7 of 2003, which as it has been already explained, relates to corporations with permanent activities in Argentina¹²².

It is also important to note that the General Inspection of Justice has issued significant regulation on matters that concern corporate governance. For instance, it has addressed directors' and officers' liability for wrongful or negligent acts. Concerning these issues, Resolution No. IGJ-20 of 2004 (modified by Resolution No. IGJ-1 of 2005)

¹¹⁷ These criteria are contained in article 5 of Resolution No. IGJ-7. Some Argentine authors assert that whenever the General Inspection of Justice exercises the powers contained in Resolution No. IGJ 7 of 2003, the following consequences ensue: (i) The foreign company will have to meet local minimum shareholder plurality rules; (ii) fulfillment of Argentine prerequisites for incorporation must be complied with; (iii) the foreign entity will have to adopt one of the types of business associations regulated under Law 19.550; and (iv) the requirements for such type of business association will have to be met in their entirety. See Daniel Roque Vítolo, *Sociedades constituidas en el extranjero...*, *supra* note 115, at 80. It is relevant to stress out that in 2005 the General Inspection of Justice compiled in a single regulation the contents of Resolution IGJ 7/03 together with a number of dispersed rules regarding offshore corporations.

¹¹⁸ See article 6 of Resolution IGJ-7 of 2003.

¹¹⁹ The General Inspection of Justice has also enforced regulations aimed at preventing the misuse of the corporate form by foreign companies. For example, the Inspection has compelled offshore corporations to undertake the acts provided for under their purpose clause within the Argentine territory. Conversely, this has resulted in a ban to set up branches that due to their potential insolvency may not be able to satisfy their debts as they become due. See Resolution No. IGJ-1632 of 2003 and Ricardo A. Nissen, in *Nuevas resoluciones de la Inspección General de Justicia*, at 11.

¹²⁰ Martínez, *supra* note 109, at 10.

¹²¹ See article 1 of Resolution IGJ No. 8 of 2003.

¹²² See article 4 of Resolution IGJ No. 8 of 2003.

mandated directors and officers to provide sufficient collateral to make up for any damages that could be inflicted upon the corporation or its shareholders¹²³. In addition, the Inspection has dealt with issues regarding the relationship between shareholders including, *inter alia*, calling of meetings of the general assembly¹²⁴, rules regarding enforceability of shareholders' rights¹²⁵ including the inspection of books and records by shareholders¹²⁶, reduction of legal capital¹²⁷, as well as the winding up of corporations¹²⁸. In regards to stakeholders' protection, the General Inspection has set forth Resolutions concerning the prohibition to establish fictitious domiciles for a given corporation¹²⁹, time limits for the payment of subscribed shares¹³⁰, and minimum capital requirements¹³¹.

The Inspection's far-reaching activities have also allowed it to uphold minority shareholders' rights in the context of specific transactions. In a series of recent cases, the Inspection deterred several corporations from squeezing out non-voting shareholders by means of a proceeding known as the accordion maneuver (*coup d'accordéon*)¹³². Should this practice had been allowed, it would have resulted in the expropriation of non-voting shareholders by majorities¹³³. For this reason, the Inspection precluded several Argentine corporations from executing the accordion maneuver, in spite of their adverse financial situation¹³⁴.

The Resolutions and decisions rendered by the General Inspection of Justice demonstrate the importance of administrative agencies in furthering the effectiveness of

¹²³ This obligation had already been introduced in a general manner by article 256 of Law 19.550.

¹²⁴ See Resolutions No. IGJ-258, IGJ 259 and IGJ 1556 of 2004.

¹²⁵ See Resolution No. IGJ 1505 of 2003.

¹²⁶ See Resolutions No. IGJ 1257 of 2004.

¹²⁷ See Resolutions No. IGJ 1328 and IGJ 1619 of 2003.

¹²⁸ See Resolution No. IGJ 1619 of 2003.

¹²⁹ See Resolution No. IGJ 12 of 2004.

¹³⁰ See Resolution No. IGJ 24 of 2004.

¹³¹ See Resolution No. IGJ 9 of 2004. Even if this requirement has not been exempt from criticism, it has to be acknowledged that minimum capitalization requirements in Argentina arise directly from the law of stock corporations (19.550). The so-called principle of "congruence" requires the amount of paid-in capital to bear resemblance with the purported activities set forth in the purpose clause. Naturally, the judgment regarding which amount of capital is needed to undertake a given economic activity becomes highly subjective. Attributing an administrative agency the ability to define on the adequacy of this specific issue may very well establish grounds for arbitrary definitions rendered by the General Inspection of Justice.

¹³² The *coup d'accordéon* is a complex operation most commonly used by corporations in financial distress. See Maurice Cozian, *et al.*, *Droit des sociétés*, 18e édition, Paris, Ed. Lexis-Nexis, 2005, at 346. The proceeding commences with the shareholders' decision to reduce the corporation's subscribed paid-in capital to zero. Subsequently the board causes the corporation to issue new shares of stock. As a consequence, the company receives new resources from either stockholders or third parties. In the last case, incumbent shareholders may be diluted due to a significant reduction of their equity participation. They may also be altogether excluded from the corporation. *Id.*

¹³³ See Martínez, *supra* note 109, at 17, asserting that the accordion maneuver would have allowed the concerned corporations to squeeze out non-voting shareholders without proper consideration.

¹³⁴ See Resolutions No. IGJ 1471 and IGJ 851 of 2004, and IGJ 1452 of 2003.

Latin American corporate governance, particularly in cases in which corporations of a large dimension are supervised¹³⁵. The same may be said of the Colombian Superintendence of Companies.

2.14.2. The Superintendence of Companies

The Colombian Superintendence of Companies is a second example of the advantages of having an administrative agency dealing with corporate law matters. For more than 65 years, the Superintendence has assumed uninterruptedly important supervisory activities regarding the governance of business associations¹³⁶. The enactment of Law 58 of 1931, by which the Superintendence was initially created, was permeated by the idea of protection concerning the interests of shareholders and other stakeholders from potential abuses carried out in business corporations. The official comment written by the Congressmen who prepared the draft legislation reads as follows: “The disrespect of the corporate entity in our system is paradigmatic. We all have numerous examples taken from real life to prove that it is a threat against a person’s equity to contribute assets to a corporation. This word is tantamount to loss, failure, and fraud”¹³⁷.

In a process to update the legal infrastructure of the Superintendence – undertaken in 1995 (Law 222) and 1998 (Law 446) – the agency was vested with quasi-judicial powers to decide on litigation arising out of shareholders’ conflicts. Such allocation of judicial functions to administrative agencies corresponded to the authorization granted under article 116 of the Colombian Constitution. By means of this provision, the executive branch of government can assume certain non-criminal judicial powers. The statutes have applied this constitutional provision in those cases in which non-judicial governmental agencies have shown a particular expertise to offer rapid

¹³⁵ See Efraín H. Richard *et al.*, *Derecho Societario: Sociedades comerciales, civil y cooperativa*, Astrea, 2nd Ed., 1997. According to the author when the corporation reaches a certain size (given the importance of its capital resources), the social-economic influence that it can exercise supersedes the individual interests of equity owners, and it becomes pertinent for the government to exercise supervision in order to ensure compliance with applicable corporate statutes. Pursuant to Muguillo “this supervisory agency is not only empowered to verify the formal legality, but also to investigate the substantial lawfulness of the incorporation and all additional transactions provided for under the statute”. Roberto A. Muguillo, *Ley de Sociedades Comerciales, Ley 19.550 comentada y concordada. Normativa complementaria*, Buenos Aires, Lexis Nexis, 2005, at 390.

¹³⁶ “The Superintendencia possesses a broad mandate to supervise the creation and operation of Colombian non-financial corporations. Its creation was attended by sharp political controversy. The statute establishing it was enacted in 1931 over government opposition, but the implementing Decree was delayed until 1939 [...]”. Robert Charles Means, see *supra* note 80, at 283. For a complete description of the Superintendence’s history, see its web page: <http://www.supersociedades.gov.co/ss/drvisapi.dll?MIval=sec&dir=280>

¹³⁷ The Congressional Commission in charge of reviewing the draft legislation emphatically asserted that some “may find that there is an exaggerated intrusion of governmental powers in the supervision of corporations. We believe otherwise. Not only do we find it justified, but we hold that it is indispensable...” See Francisco Reyes, *Derecho Societario*, Second Edition, Bogotá, Ed. Temis, 2006, at 625.

solutions in the adjudication of subjective rights. Pursuant to the official comment of the draft legislation that resulted in the enactment of Law 446 of 1998, “upon demanding justice, conflicting parties in an economic dispute may well find an appropriate response from the government. The concept of ‘judicial relevance’ requires that the powers granted to the judiciary be kept for the adjudication of cases of a higher social and legal importance. At the same time, access to a better justice is also ensured”¹³⁸. The official comment also made it clear that at least at the time in which the draft legislation was prepared (1995), some of the remedies granted by the ordinary jurisdiction were illusory. This was due to the adverse equation arising from a comparison between the matter in demand, on one side, and the cost and time required for the process, in the other.

Among the specific processes that have been de-judicialized, the following are particularly relevant:

- a. Actions aimed at setting aside resolutions rendered by shareholders’ assemblies and boards of directors (See, generally, article 133 of Law 446 of 1998);
- b. Discrepancies arising from causes of dissolution (Id., Article 138);
- c. Complaints regarding the appraisal of shares of stock when there is a controversy between shareholders (Id., Articles 134-136);
- d. Actions regarding the validity of transactions involving the conveyance of shares of stock (Article 87 of Law 222 of 1995);
- e. Actions to challenge the effectiveness of an issuance of shares by a stock corporation (Id.);
- f. All bankruptcy proceedings involving corporations and other business entities (Article 90 of Law 222 of 1995).

As it has been held, one of the Superintendence’s major contributions to the interstitial development of Colombian corporate law relates to the “administrative case law” that it has provided. In fact, reported “precedents”, doctrinal opinions, and no-action letters form an impressive body of law that is permanently used as a point of reference to elucidate the meaning of corporate law provisions. Such reporting of decisions and other relevant materials supplies a large degree of predictability as to the outcome of proceedings that are litigated before the Superintendence. Robert Charles Means recognized this fact when he asserted that the Superintendence’s “primary contribution to the development of Colombian corporate law has been through its jurisprudence”¹³⁹. The Superintendence’s “administrative case law” encompasses topics of the most different vein. The entity has addressed issues such as voting procedures in the shareholders’ assembly¹⁴⁰, inspection of corporate books and records¹⁴¹, conversion of

¹³⁸ *Eficiencia y Acceso en la Justicia*, Bogotá, Ministerio de Justicia y del Derecho, April, 2005, at 112.

¹³⁹ See Robert Charles Means, *supra* note 136.

¹⁴⁰ See Opinion No. 220-18843 of April 19, 2002.

preferred and ordinary shares¹⁴², preemptive rights¹⁴³, as well as the impossibility to revoke dividends¹⁴⁴.

In addition to these functions, the recently approved Law 1258 of 2008 bestows new judicial powers to the Superintendence of Companies in cases related to the Simplified Stock Corporation. Sections 24, 40, 42, and 43 of the Law grant this entity specific functions to solve disputes regarding shareholders' agreements, piercing its corporate veil, abuse of rights, and, in general, to resolve any conflict concerning the SAS' internal affairs. Subsection 2 of Section 24 of such Law affords interested parties the right to solve disputes arising from shareholders' agreements through complaints filed before the Superintendence. By means of an expedite process, the governmental agency has the authority to order the specific enforcement of obligations included in such agreements, pursuant to the precise conditions set forth therein. In a similar manner, Section 42 of the cited law grants that entity the power to disregard the legal entity, through an extension of liability to any shareholder or even director or officer who has committed fraudulent on behalf of the corporation. The complaints concerning compensation of damages can be filed either in civil courts (as it has been traditionally done), or before the Superintendence of Companies.

Section 43 contains a comprehensive regulation of the abuse of right theory concerning decisions rendered by the shareholders assembly. According to this section, any aggrieved party can bring a suit in order to have the abusive decision set aside before the same Superintendence. Requests for the compensation of damages can only be brought before such administrative entity, and the matter will be resolved in an expeditious single-instance process. In fact, by virtue of Section 40, the Superintendence of Companies may resolve all disputes that arise between shareholders, officers or the corporation, whenever the parties have not agreed on another mechanism for the settlement of disputes.

The above-mentioned functions have been attributed in conformity with the National Constitution. Section 44 of Law 1258 of 2008 provides that all these judicial powers will be exercised by the Superintendence, in accordance with Article 116 of the Constitution. This provision authorizes the national Congress to assign judicial functions to certain administrative authorities regarding specific matters.

¹⁴¹ See Opinions No. 220-3036 of January 21, 2000 and No. 220-21510 of May 30, 2001.

¹⁴² See Opinion No. 74265 of December 30, 2000.

¹⁴³ See Opinion No. 220-2951 of February 1, 2002.

¹⁴⁴ See Opinion No. 220-72552 of November 30, 2000.

3. CORPORATE GOVERNANCE REFORMS IN LATIN AMERICA

3.1 Policy Agenda for Corporate Governance Reform

In Latin America, change has taken place at an unprecedented pace during the last decades. With a few exceptions, most countries in the region have witnessed an active process of trade liberalization and modernization of their economic institutions. Multinational free trade agreements with the United States¹⁴⁵, the European Union¹⁴⁶, and other nations are increasingly becoming commonplace, at least in the region's major jurisdictions. These factors may contribute to lay down the foundations for growth and economic development in the area. Insertion in a globalized framework may also allow local businesses to access the international securities market. In order for this process to be successful, a parallel adjustment of the legal infrastructure will have to be completed¹⁴⁷. The existence of an appropriate juridical framework has been identified as a crucial element, without which the benefits of free trade could be hindered¹⁴⁸. Regulatory efforts aimed at facilitating commerce, surpassing bureaucratic obstacles, and attenuating a paternalistic culture of legal formalities will be significant challenges in the near future for most Latin American nations¹⁴⁹. Furthermore, local codes, statutes, and business practices will have to be updated according to recent legal developments achieved in various parts of the world¹⁵⁰.

¹⁴⁵ At the end of 2005, Peru executed a Trade Promotion Agreement with the United States. Colombia also entered into a similar bilateral treaty in 2006. See Trade Promotion Agreement: U.S.- Col., Nov. 22, 2006, http://www.ustr.gov/Trade_Agreements/Bilateral/Colombia_FTA/Final_Text/Selection_Index.html. However, as of December 2010, the latter treaty had not entered into force, due to the US Congress's reluctance to ratify it.

¹⁴⁶ Chile and the European Union entered into an agreement that regulates cooperation between them in regards to political, commercial, economic, financial, scientific, technological, social, and cultural matters ("Agreement Establishing an Association between the European Community and the Republic of Chile", available at www.sice.oas.org).

¹⁴⁷ This ongoing process of modernization of the legal infrastructure began at least two decades ago. See, generally, Antonio Mendes, "Update on Laws Affecting Business" in *Proceedings of the Fifth Annual Seminar on Legal Aspects of Doing Business in Latin America: The Door Opens*, Volume 7, Number 1, 1992, at 1. (Describing the changes in Brazilian Law in the late 1980's and the subsequent effects on the economy).

¹⁴⁸ "Throughout Latin America, law reform is in the air. After decades of neglect, Latin American legal systems are experiencing substantial, if not drastic, processes of reform and transformation. (...) These reform processes respond to global and domestic actors and pressures". See Joseph R. Thome, *supra* note 82, at 691.

¹⁴⁹ For example, in Mexico, "there is a strong predilection in favor of adherence to formalities in commercial contracting". See Stephen Zamora, *supra* note 5, at 534.

¹⁵⁰ Some authors consider that this adaptation process may contribute to improve a country's economic perspectives. "If earnings are limited and financial resources considered insufficient to attain the desired growth rate, the challenge is to find domestic and international sources of capital. This often implies that governance practices have to be adapted to meet the demands of outside sources of finance, without sacrificing the benefits of the alignment of ownership and defined control". Heloisa B. Bedicks *et al.*, "Business Ethics and Corporate Governance in Latin America" in *Business & Society*, Vol. 44, No. 2, 2005, at 219), available at <http://bas.sagepub.com/cgi/content/abstract/44/2/218>.

3.2 Principles of Corporate Governance

The Organization for Economic Cooperation and Development (OECD)¹⁵¹ defines corporate governance as “the relationships between a company’s management, its board, its shareholders, and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”¹⁵².

Several different aspects and relationships are frequently included within this rather vague concept¹⁵³. Pursuant to a more precise definition, it can be held that corporate governance encompasses “the monitoring and control over how the firm resources are allocated and how relations within the firm are structured and managed”¹⁵⁴. In this sense, it does more than regulating ownership and control arrangements inside the corporation. “It also contains rules that protect other stakeholders like employees and creditors from moral hazard and adverse selection”¹⁵⁵. Multiple corporate relationships are included within the broad scope of this discipline. They include, *inter alia*, the ones that stem from control relations amongst management, the board of directors, shareholders, and other stakeholders such as the employees, suppliers, credit institutions, etc¹⁵⁶. Corporate governance not only arises out of Corporate Law regulations, but can also be found in agreements entered into by

¹⁵¹ “The Organization for Economic Cooperation and Development (‘OECD’) was established on December 14, 1960 and is now comprised of thirty four countries, including the United States and much of Europe. The OECD considers itself ‘a forum in which governments work together to address the economic, social and environmental challenges of interdependence and globalization’. Article 1 of the OECD Convention states that its mission is ‘to promote policies designed: ‘to contribute to growth in world trade on a multilateral, non discriminatory basis’”. See Kathryn Fugina, *Merger Control Review in the United States and the European Union: Working Toward Conflict Resolution*, 26 *New Journal of International Law and Business*, 471, (2006).

¹⁵² OECD, *White Paper on Corporate Governance in Latin America, Glossary*, 58 (2003) [Online] <http://www.oecd.org/dataoecd/25/2/18976210.pdf>

¹⁵³ “Changes in corporate governance cover a broad spectrum of issues: trying to ensure better discipline by the domestic financial system, requiring enhanced disclosure of financial transactions, adopting better rules for internal management of corporations, and implementing better capital market regulation and supervision.” Stijn Claessens, “Policy Approaches to Corporate Restructuring Around the World: What Worked, What Failed?” in *Corporate Restructuring: Lessons from experience*, 11 55, Michael Pomerleano & William Shaw Eds., 2005.

¹⁵⁴ Joseph A. McCahery and Eric P.M. Vermeulen, *Corporate Governance and Innovation: Venture Capital, Joint Venture and Family Businesses*, 1 (European Corporate Governance Institute, Working Paper No. 65, 2006), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=894785. According to Maria da Conceição da Costa Marques, “corporate governance’ main purpose is not to take part in corporation autonomy; its actual objective is to balance profitability and productivity with social responsibility and transparency...” (‘Aplicação dos princípios da governança corporativa ao sector público’, in *Revista de Administração Contemporânea*, Vol. 11, No. 2, 2007).

¹⁵⁵ *Id.* at 2.

¹⁵⁶ *Id.*

contracting parties and by optional guidelines that can be adopted by listed or non-listed corporations.

Corporate governance, understood as a system to protect external investors, is as ancient as the medieval *commenda*. In order to develop long-term relationships in medieval times, “disclosure and enforcement mechanisms were devised through a system of notaries, guilds and mercantile courts”¹⁵⁷. The development of the stock corporation characterized by centralized management, limited liability, free transferability of shares and continuity of existence, gave rise to additional governance problems that today are analyzed under the concept of agency costs. As early as 1776, Adam Smith pointed out to the opportunistic behavior of directors in stock corporations: “The directors of such [joint-stock] companies, however, being the managers rather of other people’s money than of their own, it cannot be well expected, that they should watch over it with the same anxious vigilance with which the partners in a private co-partnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master’s honor, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company”¹⁵⁸.

The modern Principles of Corporate Governance, as well as several other contemporary Corporate Law institutions, can be considered an American invention¹⁵⁹. In fact, the topic has been analyzed in the US for more than three decades. Already in 1978 the American Law Institute (ALI) had undertaken the project entitled “Principles of Corporate Governance and Structure: Restatement and Recommendations”. The first draft of the principles started out from the recognition of the goals of Corporate Law in regards to the objectives of the business corporation, namely, to conduct business activities with a view to corporate profit and shareholder gain. In furtherance of those goals, the principles proposed that the corporation, in the conduct of its business (a) should be obliged to act within the boundaries set by law; (b) may properly take into account ethical principles that are generally recognized as relevant to the conduct of business¹⁶⁰; and (c) may devote resources, within reasonable limits, to public welfare,

¹⁵⁷ *Id.* at 12. McCahery describes this ancient institution and explains how “the managerial agency problem and the corresponding governance concerns have existed as long as investors have allowed others to use their money and act on their behalf in risky business arrangements” *Id.*, at 8.

¹⁵⁸ Quoted by Michael C. Jensen “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure”, *Journal of Financial Economics*, October 1976, Vol. 3, No. 4, at 305.

¹⁵⁹ Even the terminology to identify this topic has been borrowed (in some cases even wrongly) by several Civil law jurisdictions. This phenomenon is widespread not only in Latin America, but also in European countries. See Pierre Mousseron, *Droit des sociétés*, Paris, Montchrestein 2nd Ed., 2005, at 22.

¹⁶⁰ In ascertaining the importance of business ethics in the field of corporate governance, Bedrick has addressed the usual lack of concern for discussing ethical standards in some Latin American institutions. “In most meetings with Latin American representatives of the corporate governance institutions, ethical principles have rarely come up as a significant topic. Discussions usually revolve around capital and

humanitarian, educational, and philanthropic causes¹⁶¹. The initial draft also addressed the duties of due care and loyalty as well as the business judgment rule. Attention was placed on the issues of derivative actions and delegation of management functions in publicly held corporations¹⁶².

The prominent evolution of this field is reflected in the influence that such a body of principles has had in reshaping corporate regulation throughout the world¹⁶³. The basic concern in regard to corporate governance relates to its ability to shape a regulatory structure that can foster risk taking, especially by institutional investors, and to promote start-up companies with innovative ideas¹⁶⁴. Nobody disagrees as to the usefulness of corporate governance as a means to foster investment. According to Embid Irujo, “a good corporate governance regime is crucial for an efficient management of capital markets and the investment system. At the same time, corporate governance insures that all participants in the market take into account the broad range of interests of a legal and economic nature in which those interests evolve...”¹⁶⁵.

Today, most countries acknowledge the need to incorporate provisions regarding transparency and timely disclosure on the part of directors and officers, at least in publicly held firms. The need to provide for auditing committees has also become a

ownership structure, the role and responsibilities of the board of directors, and market situations”, Heloisa B. Bedicks *et al.*, *supra* note 150, at 226.

¹⁶¹ A.L.I. Principles of Corporate Governance and Structure: Restatement and Recommendations. 2.01.

¹⁶² See Harry G. Henn and John R. Alexander, *Laws of Corporations*, West Publishing Co., 1983, at 35. (Discussing ALI principles of Corporate Governance). More recent versions of the “Principles” include a comprehensive treatment of the duties and responsibilities of directors and officers of business corporations to both the corporations and their shareholders, the objective and conduct of the business corporation, the structure of the corporation, the duty of care and the business judgment rule, the duty of fair dealing, the role of directors and shareholders in transactions in control and tender offers, and corporate remedies. See also ALI, *Principles of Corporate Governance: Analysis and Recommendations*, https://ali.org/index.cfm?fuseaction=publications.ppage&node_id=88.

¹⁶³ “Spurred by a global emphasis on corporate governance, many countries in recent years have been improving the rules on how corporations are monitored and governed”, Stijn Claessens, see *supra* note 153, at 55.

¹⁶⁴ See McCahery, *supra* note 154, at 1.

¹⁶⁵ Daniel Roque Vítolo, *et al.*, “Corporate Governance en “La nueva dinámica societaria”, in *Sociedades Comerciales, Los administradores y los socios, Gobierno corporativo*, Buenos Aires, Ed. Rubinzal-Culzoni, 2003, at 18. Many authors emphasize in the importance of corporate governance as a tool to improve national markets and economies; for instance, James Gordon explains that good corporate governance principles are useful in order to achieve multiple goals; in that way, “in a liberalized financial market, savers can choose between alternative investment opportunities. In such an environment, more open and transparent companies with good business prospects are likely to be better able to finance new investments” (James Gordon. The Macroeconomic benefits of good corporate governance. International Monetary Fund [Online] <http://www.imf.org/external/country/ind/rr/2002/pdf/011602.pdf>) See also, José Ferreira Chagas. ‘Governança corporativa. Aplicabilidade do Conceito, dos Princípios e Indicadores à Gestão de Pequenas e Médias Organizações’, 2003, in *Instituto Internacional de Custos (IIC)* [online] <http://www.intercostos.org/documentos/085.pdf>, where professor Chagas also emphasize in corporate governance importance for national markets and economies.

standard rule for those corporations willing to enter the competitive international capital markets¹⁶⁶. Some financial institutions have even developed methods to evaluate if a company complies with minimum corporate governance standards¹⁶⁷. Complex formulae to determine the probability of insider trading – an important variable of corporate governance – have also been proposed¹⁶⁸. It has also been said that there is a consistent positive correlation between the development of capital markets and the nature of legal rules, as long as they can be effectively enforced.¹⁶⁹ Some surveys have showed that investors are willing to pay a premium on securities issued by a well-governed company. In this sense, “corporate governance could be seen as a technology (similar to a manufacturing technique, an inventory management system, or an engineering economy of scale) and firms face powerful incentives to adopt the best corporate technologies possible”¹⁷⁰. The following table shows that, at least in theory, Latin American investors would be willing to pay an additional amount of money per share if the issuing entity is diligently managed¹⁷¹.

¹⁶⁶ It is accurate to state that companies pursuing international investments “must differentiate themselves by adopting stellar treatment of minority shareholders that go beyond any country-specific minimum requirements. In order to attract international investors, companies and their managements are not only required to be strong from a financial standpoint, but also to act with transparency and in the best interest of all of their shareholders; in other words, to exercise sound corporate governance practices”, Alex Brown, *Who has the Best Corporate Governance in Latin America*, Deutsche Bank, 2001, at 3

¹⁶⁷ For instance, the Deutsche Bank applies a method whereby companies are ranked according to the following categories:

1. Shareholders’ treatment (score range: -14 to +50 points);
2. Management’s independence (score range: -1 to +25 points);
3. Information disclosure (score range: -2 to +20 points);
4. Dividend Policy (score range: -4 to +10 points) (*Id.*, at 3).

¹⁶⁸ Variables such as the informed trading probability (ITP) index are important because “the expected probability that outside investors’ wealth will be confiscated through poor governance and informed trading is a crucial determinant of their portfolio allocation and the ensuing cost of capital for the corporations trying to raise it”, Juan J. Cruces *et al.*, *Insider Trading and Corporate Governance in Latin America*, Inter-American Development Bank Research Network Working Paper # R-513, September 2005, at 5.

¹⁶⁹ See, generally, Rafael La Porta *et al.*, *Legal Determinants of External Finance*, 52 J. Fin. 1131, 1997, at 1146.

¹⁷⁰ Lucian Arye Bebchuk *et al.*, “A Theory of Path-Dependence in Corporate Ownership and Governance”, 52 *Stanford Law Review*, No. 127, 1999, at 134.

¹⁷¹ Because these results are based on a survey, a question remains as to the practical behavior of investors in a given situation and the difficulty of defining the concept of a “well-governed” company. The latter subject is one in which reasonable minds could differ to a large extent.

Table 3
Average premium for “well governed” companies

Average premium for “well governed” companies	
Venezuela	24%
Colombia	21%
Brazil	24%
Mexico	19%
Argentina	24%
Chile	18%

Source: Global Investor Opinion Survey: Key findings, McKinsey and Company, July 2002 [Online]
www.mckinsey.com/.../globalinvestoropinionsurvey2002.pdf

The specific aims of corporate governance relate to the enhancement of transparency and disclosure, especially in listed corporations; to improve the monitoring role and performance of the board of directors; to ensure the independence of auditors; and to guarantee the autonomy of non-executive directors¹⁷².

3.2.1 The Context of Corporate Governance: Concentrated versus Dispersed Ownership

A good example of complicated and erroneous legal transplants can be observed in the specific context of business associations' law. Several aspects of corporate governance, which have been designed for publicly held corporations operating in systems such as those in the US and the UK, are frequently extrapolated for their importation into scenarios characterized by concentrated ownership structures like those prevailing in Continental Europe and Latin America¹⁷³. Very often the rules that are transplanted or recommended generally deal with problems that arise in the context of significant ownership dispersion. Therefore, the underlying concern in such regulations relates to the need to ameliorate the discrepancy of interests between those pursued by shareholders as opposed to managers. The main focus of corporate governance rules that arise in this context is aimed at the alignment of such interests. It is natural, therefore, that most devices sought to deal with this particular agency problem are oriented towards the granting of certain appointment rights, the ability to exercise voting rights concerning major corporate decisions, and the imposition of

¹⁷² See McCahery and Vermeulen, *supra* note 154, at 2.

¹⁷³ See, for example, Argentine Decree 677 of 2001, regarding transparency of public offering of securities; Brazilian Law 10.303 of 2001, regarding publicly-held corporations; and Colombian Law 964 of 2005 on securities regulation.

managers and directors' liabilities arising from the breach of the duties of care and loyalty¹⁷⁴. These rights and remedies are useful even in those systems in which there is no capital dispersion like the one existing in the US and the UK. However, they are insufficient to deal with corporate governance issues that exist in block-holding systems. Agency problems in the context of ownership concentration differ to a large extent from those present in highly developed and liquid capital markets.

Lefort has pointed out that the very high level of ownership concentration in the region implies that in Latin American firms, corporate majority shareholders tightly exercise control¹⁷⁵. The author further states that as a result of such pattern of equity ownership "the focus of corporate governance concern in the region is possible divergence of interests between majority and minority shareholders"¹⁷⁶.

Despite the simplicity of such an evident factual point of departure, the imported principles tend to deal with the tension arising between shareholders and directors¹⁷⁷, instead of addressing the agency problems between majority and minority shareholders.

¹⁷⁴ According to Roberta Romano, the more prominent examples of devices designed to mitigate agency problems ensuing from the dichotomy between ownership and control are the following: "(1) shareholder-elected boards of directors who monitor managers, (2) shareholder voting rights for fundamental corporate changes, and (3) fiduciary duties that impose liability on managers and directors who act negligently or with divided loyalty favoring their own financial interest over that of shareholders." (*The Genius of American Corporate Law*, Washington, D.C., The AIE Press, 1993, at 2). There are additional strategies to mitigate the referred agency problem. Paul G. Mahoney, for example, proposes the *mandatory disclosure* as an effective manner to counteract asymmetric information problems, which are the base for agency costs (See Paul Mahoney, "Mandatory Disclosure as a Solution to Agency Problems", in *The University of Chicago Law Review*, Vol. 62, No. 3 (Summer, 1995), at 1047-1112).

¹⁷⁵ Coffee states that ownership concentration is such a widespread condition that only a few systems allow for a clear separation between ownership and control. "Contemporary empirical evidence finds that, even at the level of the largest firms, dispersed share ownership is a localized phenomenon, largely limited to the United States and Great Britain" (John C. Coffee, *The Future as History: The Prospects for Global Corporate Governance and its Implications*, 93 Nw. U. L. Rev. 641, 1999, at 641). Likewise, Mark Roe stresses out that, "One persistent contrast in corporate ownership around the world is concentrated versus diffuse ownership. In many continental European nations, families or financial institutions have owned the largest business firms. In the United States for quite some time, and more recently in Great Britain, stock ownership is more diffuse" (Mark J. Roe, *Political Determinants of Corporate Governance, Political Context, Corporate Impact*, Oxford University Press, 2003, at 11). Pursuant to Eduardo Secchi Munhoz, "in countries where concentrated ownership prevails (such as Brazil), the challenge of Company Law is not that of searching, at all costs, for the transformation of their systems (from concentrated to diluted), but to ensure that concentrated ownership systems are welfare enhancing" ("Desafios do Direito Societário Brasileiro na Disciplina da Companhia Aberta: Avaliação dos Sistemas de Controle Diluído e Concentrado" in Rodrigo R. Monteiro et al., *Direito Societário Desafios Atuais*, São Paulo, Quartier Latin, 2009, at 131).

¹⁷⁶ See White Paper, *supra* note 152, at 48.

¹⁷⁷ Pursuant to Kraakman, these conflicts form part of the three agency problems that occur in any business firm. They involve, on the one hand, the conflict that exists between shareholders and directors and, on the other hand, the antagonism that is present amongst shareholders possessing a controlling interest and the minority owners. In the latest scenario "the non-controlling owners are the principals and the controlling owners are the agents, and the difficulty lies in assuring that the former are not

Vidal also captures this situation pursuant to the following description: “Latin American companies, in contrast [to US publicly held firms] are characterized by a high concentration of ownership in the hands of a few controlling shareholders. In Latin America, on average, the five largest shareholders of a company own 80% of the company’s shares”¹⁷⁸. This description corresponds to the so-called family control, namely, that in which members of a single family hold a large block of stock¹⁷⁹. Therefore, these family members will have the power to influence management policies and even replace officers and directors, if necessary, with people to their liking¹⁸⁰.

Ocampo concurs with Vidal and provides an accurate description regarding corporate governance in Latin America: “In this case, majority shareholders control the firm’s board of directors and management. The dispersion and varying interests of minority stakeholders, on the other hand, make it difficult for them to organize themselves effectively. Good corporate governance seeks to prevent the shareholders

expropriated by the latter”. Reiner Kraakman *et al.*, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford, Oxford University Press 2004, at 22. In a similar manner, Eduardo Secchi Munhoz identifies the pros and cons in each type of structure of control: “In dispersed ownership systems, the main problem is the supervising of managers, when searching for ways to ensure that their activity is exercised in the best interest of the shareholders (agency problems). In a concentrated ownership system this specific aspect is less significant, because if there is an organized and strong control, the problems of supervising managers are eliminated or drastically reduced. Nevertheless, in the latter system, another central problem arises, which is that of monitoring the acts of controlling shareholders, to prevent the extraction of excessive private benefits from their power” (Eduardo Secchi Munhoz, *supra* note 175, at 137).

¹⁷⁸ Dominique Vidal. “Corporate Governance in Latin America: Beyond Sarbanes-Oxley” in *Claves de Gobierno Corporativo*, Confecámaras, Bogotá, 2005, at 129. This situation has some correlation with the empirically demonstrated fact that “Latin America has the most unequal income distribution in the world”. See Jose Antonio Ocampo, *Globalization and Development, A Latin American and Caribbean Perspective*, Economic Commission for Latin America and the Caribbean, The World Bank, 2003.

¹⁷⁹ Bedicks has in fact asserted that “[f]amily control remains the norm for most of the region’s non-listed small- and medium- size enterprises”, Heloisa B. Bedicks. *et al.*, *supra* note 150, at 218. Family control is considered to be one of the major obstacles for proper corporate governance reform in Latin America. “Important objections to reform also come from the families that control large corporations. From the point of view of these families, an improvement in the rights of outside investors is first and foremost a reduction in the value of control due to the deterioration of expropriation opportunities [...]. What the reformers see as protection of investors, the founding families call ‘expropriation of entrepreneurs’. No wonder, then, that in all countries -from Latin America to Asia to Europe- the families have opposed legal reform”, Rafael La Porta *et al.*, “Investor Protection and Corporate Governance” in *Journal of Financial Economics*, No. 58, 2000.

¹⁸⁰ Rogene A. Bucholz, *Business Environment and Public Policy, Implications for Management and Strategy*, 4th Edition, Prentice Hall 1992, at 249. Mark J. Roe provides an interesting characterization of this corporate governance structure: “Well-to-do families in some nations are said to prefer family ownership of enterprise. Firms are passed from generation to generation; corporate governance sometimes becomes the governance of family relationships” See Roe, *supra* note 88, at 10. The author further states that the preference of such structure has a functional side, for shareholders in such family structures can keep more of the rents inside that family than can another structure. *Id.*

that have a controlling interest from obtaining a disproportionate share of profits or other benefits relative to the size of their holdings”¹⁸¹.

From a technical standpoint, the structure for corporate governance in the region could be accurately characterized as the so-called traditional model. It is based upon property rights, in which shareholders who supply the capital become the major factor in the governance process¹⁸². This economic model coincides with the corporate structure provided under most Latin American statutes regarding stock corporations (*sociedades anónimas*). Pursuant to these regulations, shareholders meet at least once a year to approve accounts of management and financial statements. In that meeting, the majority elects a board of directors, and controlling shareholders take care of any other general matters relating to the corporation’s business ventures. The board intermediates between the shareholders and the corporation’s officers. The latter, once appointed by the board, undertake the day-to-day management of the corporation. The board also monitors the activity of officers and other executives in order to protect the interests of shareholders¹⁸³.

Table 4
Ownership Concentration in Latin America¹⁸⁴

Country	Sample (2002)	% of the largest shareholder (2002)	% of 3 largest shareholders (2002)	% of 5 largest shareholders (2002)
Argentina	15	61%	82%	90%
Brazil	459	51%	65%	67%
Chile	260	55%	74%	80%
Colombia	74	44%	65%	73%
Mexico	27	52%	73%	81%
Peru	175	57%	78%	82%
Average	168.3	53%	73%	79%

The OECD recognizes the high degree of ownership concentration for listed companies in Latin America¹⁸⁵. It also acknowledges family control as the prevailing

¹⁸¹ Ocampo *et al*, *supra* note 178, at 137.

¹⁸² See Bucholz, *supra* note 180, at 243.

¹⁸³ This description matches the definition given by Bucholz, concerning traditional control. *Id.*, at 243.

¹⁸⁴ Source: ECONOMATICA and 20 F ADR Filings quoted by Lefort and Walker, *The Effect of Corporate Governance Practices on Company Market Valuation and Payout Policy in Chile*, Pontificia Universidad Católica de Chile, at 4, March 2005 <http://www.iadb.org/res/publications/pubfiles/pubR-515.pdf>. at 53.

¹⁸⁵ See OECD, *White Paper...*, *supra* note 152 at 9. Ownership concentration and non-listed companies appear to be the general rule throughout Latin America. In Brazil, for instance, only 377 corporations “are listed and regularly traded on the São Paulo Stock Exchange (Bovespa). Even some of the listed

structure for non-listed small and medium size concerns in this region¹⁸⁶. As it will be explained below, most of the recommendations rendered by the OECD seem to disregard the basic concentrated ownership framework. This assertion can be easily verified through an analysis of the White Paper for Corporate Governance in Latin America in which neither the difficulties nor the possible advantages of concentrated ownership appear to be carefully dealt with.

The OECD itself recognizes that, albeit troublesome in many aspects, equity blocks may also prove helpful in terms of efficient monitoring of management¹⁸⁷. “Clearly identified and actively-engaged majority shareholders can be a great strength for a company by ensuring active oversight of management and by providing a ready source of financial support to the company at critical junctures”¹⁸⁸. The International Finance Corporation (IFC) shares this approach and acknowledges the importance of majority or family ownership¹⁸⁹. “Much of the global corporate governance dialogue

companies, however, could be considered non-listed companies (NLCs) [...]. This is the case of large government-controlled companies in the energy and financial industries, large family-controlled groups and privatized companies under foreign control because of the small amount of shares that are freely traded. From a corporate governance point of view, these companies ‘look and feel’ like NLCs because boards of directors are appointed essentially by controlling shareholders” (Leonardo Viegas, “Brazil: Corporate Governance – Challenges and Opportunities” in *Corporate Governance of Non-listed Companies in Emerging Markets*, OECD Publishing, 2006, at 133). Even after the inception of the so-called *Novo Mercado*, concentrated ownership still remains the prevailing corporate structure in Brazil. As Eduardo Secchi Munhoz holds, “the reality of the structure of Brazilian corporations is, without a doubt, that of concentrated ownership. This means that the great majority of Brazilian corporations are controlled by family members or by a small group of investors. The significant development of the stock market in recent years, with dozens of public listings occurring in BOVESPA’s *Novo Mercado*, has not changed this reality. When analyzing the structure of control of companies listed in *Novo Mercado*, it is easy to reach the conclusion that, in almost all of them, there is a clear presence of a controlling shareholder who owns a significant portion of the company’s capital”. (Eduardo Secchi Munhoz, *supra* note 175, at 137). See also Bruno Salama and Vivianne Muller, *supra* note 80 at 20.

¹⁸⁶ White Paper, *supra* note 152, at 9. Bedicks and Arruda depict other regional structural characteristics that were identified by the OECD:

- Privatization
- Concentration of ownership, defined control, and the need for capital
- Importance of industrial groups
- Restructuring of banking systems
- Regionalization and relevance of multinational enterprises
- Limited domestic capital markets and growing importance of foreign listings
- Mandatory privately managed pension scheme
- Legal traditions and enforcement patterns. See *supra* note 15, at 222.

¹⁸⁷ See generally OECD, *White Paper...* *supra* note 152.

¹⁸⁸ *Id.* at 9.

¹⁸⁹ Family control is a straightforward fact in Latin America. Mexico, for instance, “with a smaller economy and a political economy that stifled competition for many decades, still shows a high concentration of economic power in several large extended family empires (the Garza Sada family in Monterrey, the Slim and Servitje families in Mexico city and others) that have had inordinate influence over particular sectors because of their majority ownership of financial and industrial enterprises”. See Zamora, Stephen *et al.*, *supra* note 5, at 536.

rightly focuses on managing conflicts between controlling shareholders and other stakeholders"¹⁹⁰. The IFC also concedes that, "it is also important to recognize the benefits, in terms of stability and focus that derive from having a committed set of controlling shareholders at the heart of a company"¹⁹¹. Even if the experiences in the US regarding the regulation of publicly held corporations might be useful as a reference for legal reform in Latin America, the significant structural differences between these two disparate corporate realities shall be a required point of departure¹⁹². Whereas U.S. Corporate Law and Securities Regulations' main concern is to address the problem of opportunistic behavior on the part of directors and officers vis-à-vis shareholders¹⁹³, the objective of Latin American regulations should be the protection of minority shareholders against the risk of expropriation by block-holders¹⁹⁴. The complete

¹⁹⁰ See generally International Finance Corporation, IFC and Corporate Governance, Latin America. See www.ifc.org.

¹⁹¹ *Id.*

¹⁹² According to Troy A. Paredes, "The right corporate governance regime for a country depends on its unique institutional makeup. In adopting a program of reform, therefore, policymakers ultimately must be pragmatic, looking past ideals and ideologies to what is possible and realistic. Even if the market-based corporate governance model of the United States, with its enabling corporate law, is the most effective system of governance for realizing the broadest and deepest securities markets, the U.S. approach is not achievable everywhere", Troy A. Paredes, *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer* 45 Wm. & Mary L. Rev. 1055, 2004, at 1155. The author has also stressed out the following: "[O]ne danger of transplanting U.S. Corporate Law to developing economies is that it might not fit with the 'importing' country's economic structure, political system, social order, or cultural values [...]. The bottom line for most developing countries is that importing a corporate law regime along the lines of the U.S. model, or otherwise depending on a market-based model of governance, is not a viable option" *Id.* at 1058-1059.

¹⁹³ See generally Berle, Adolf A. & Means, Gardiner C., *The Modern Corporation and Private Property*, The Macmillan Company, Ed. 1967. Such potential for abuse represents the basic *agency problem* in the U.S. publicly-held corporation. It is held that there is an information asymmetry, due to the superior knowledge that managers have in regards to investment policies and the firm's prospects. "Managers tend to be better informed, which allows them to pursue their own goals without significant risk. Consequently, shareholders find it difficult, due to their own limitations and priorities, to prompt managers to pursue the objectives of the firm's owners". McCahery and Vermeulen., *supra* note 154, at 6-7. Such agency problem gives rise to management's opportunistic behavior regarding the following aspects: (1) Exorbitant compensations; (2) usurpation of corporate opportunities; (3) Replacement resistance; (4) Resistance to profitable liquidation or merger; (5) Excessive risk taking; (6) Self dealing transfer pricing; and (7) Power struggles between managers. See *Id.*

¹⁹⁴ The need to protect minority shareholders from expropriation by block-holders is evident in Latin American markets. In fact, foreign investors in the region have shifted from acquiring minority ownership in local companies, to investing in controlling blocks. "Many of the first generation funds [that invested in Latin America] were content with minority positions; more recently funds are clamoring for at least a majority position. In cases where a majority position is not feasible, investors are focusing on voting mechanisms and other methods of de facto control." Alyssa A. Grikscheit, *Private Equity in Latin America: Strategies for Success*, <http://www.goodwinprocter.com/-/media/68D1941615F74EB8B4D02C2EEAC69EF4.ashx>. There is some consensus that an effective control on majorities' conduct may also be beneficial for the corporation itself and even for such controlling shareholders. "[L]egal constraints on the ability of controlling shareholders to expropriate minority shareholders should reduce the cost of outside equity capital for the corporation". Kraakman *et al.*, *supra* note 177, at 22.

absence of a separation between ownership and control in Latin American corporations imposes a necessary departure from applicable principles of corporate governance designed for systems where diffused ownership prevails¹⁹⁵. Accordingly, convergence in the field of best governance practices may prove troublesome due to fully identified systemic differences¹⁹⁶. Indeed, local regulators in the area and international cooperation institutions should focus on the agency problem derived from the conflict between majority and minority shareholders in order to adequately ameliorate self-dealing and potential reaping of private benefits by block-holders.¹⁹⁷ Nevertheless, it appears that the basic approach of convergence proposals generally deals with the tension between shareholders and directors¹⁹⁸.

From another perspective, it must be borne in mind that in Latin America most business associations are incorporated as closely held companies¹⁹⁹. The securities markets in the region tend to be small in comparison to those of developed market economies. Therefore, it must be recognized that the agency problem underlying corporate governance in Latin America relates to a large extent to conflicts between controlling shareholders and their counterparts in limited liability companies and closely

¹⁹⁵ Vermeulen has asserted that until recent times “few academics or policymakers even acknowledged the importance of creating effective measures for closely-held companies, let alone the need for improved institutions to stimulate social welfare and economic growth. The problems of publicly-held firms are not fully present in closely-held companies. The ‘closely-held *versus* public’ dichotomy is a useful classification system to explain the different kinds of incentive and governance structures in play and, more importantly, it helps policymakers to rethink corporate governance mechanisms and reforms.” Erik P.M. Vermeulen, “The Role of the Law in Developing Efficient Corporate Governance Frameworks”, in *Corporate Governance of Non-listed Companies in Emerging Markets*, OECD Publishing, 2006, at 93.

¹⁹⁶ This opinion coincides with Vidal’s view according to which, “the goal of corporate governance regulations in Latin American countries is the protection of minority public shareholders against any improper diversion of assets by controlling shareholders”. *Corporate Governance in Latin America*. See Vidal, Dominique, *Droit des sociétés*, 5e édition, Paris, L.G.D.J., 2006, at 130.

¹⁹⁷ An adequate focus on such matters may contribute to the appropriate development of liquid securities markets in emerging economies. In fact, “[i]nvestors will be reluctant to invest if they are not confident that insiders will not expropriate their investments by paying excessive compensation to executives, filling key positions with friends and family, engaging in self-dealing transactions, trading on inside information, shirking or stealing. In other words, investors will withhold funds if they are not adequately protected from agency problems”. Troy A. Paredes, *A Systems Approach...*, see *supra* note 85, at 1062.

¹⁹⁸ McCahery and Vermeulen conclude that corporate governance frameworks for closely-held corporations [such as the ones prevailing in Latin America] have failed to address the main issues that may arise in these companies. According to the authors, in closely-held firms “[t]he focus shifts from the relationship between management and shareholders to the relationship among several groups of shareholders. In this view, an effective legal governance framework must offer mechanisms that serve to protect shareholders from the misconduct by fellow shareholders”. See Joseph A. McCahery, and Vermeulen, *supra* note 154, at 5. http://www.rieti.go.jp/jp/events/06022701/pdf/2-1_3-1_mccahery_vermeulen_paper_1.pdf.

¹⁹⁹ There is also a large number of limited liability companies, which resemble the American statutory closely-held corporations and LLC’s. “Some of the forms of the limited liability firm are interesting examples of hybridism. It ranges from a true partnership to a form so closely resembling the corporation that it is practically indistinguishable from it...” Phanor J. Eder, “Limited Liability Firms Abroad”, in *University of Pittsburgh Law Review*, Vol. 13, No. 2, 1952, at 196.

held corporations²⁰⁰. The significant importance of non-listed firms in the region would also deserve a higher level of attention given their potential for employment opportunities and their contribution to economic growth.

An additional aspect that impairs corporate governance in Latin America is the widespread obstacles that exist for the enforceability of substantive law rules. As it will be analyzed in further detail below, this feature of Private Law in the region would require specific measures, particularly designed to counteract the inefficiency of these countries' judicial institutions.

The above-referred problems can also be associated with the already analyzed codified nature of private law institutions prevailing in Civil Law countries as opposed to the judicial decision making process of their common law counterparts. Even in the presence of multiple corporation law codes in the US, it has been appropriately held that the basic protections for investors and minority shareholders arise from judge-made law. According to Rudolf Schlesinger, after the evolution of state legislation on corporations, "it became apparent, therefore, that the state statutes, under which corporations are organized, could not afford sufficient protection for shareholders and creditors. Such protection had to be achieved outside of the corporation statutes, by courts of equity imposing fiduciary duties upon management, and by the *federal securities legislation* of the 1930's and 1940's. The result is that, in contrast to the method traditionally followed in the civil-law world, the most important legal devices used in this country for the protection of investors are not built into the corporation statutes themselves, but exist as a separate body of law"²⁰¹. Furthermore, certain authors point out to the rather evident finding whereby, "only US law aggressively protects minority shareholders by emphasizing independent directors, direct voting rights, and fiduciary duties"²⁰².

3.3 Strategies to Mitigate the Agency Problems Arising from Conflicts Between Majority and Minority Shareholders

²⁰⁰ "The agency problem underlying Code provisions for public corporations is also less severe in the close corporation because ownership and control are typically not severed. Concerns of close corporation shareholders involve instead conflicts between majority and minority shareholders and between shareholder-managers and non-managing shareholders, as well as valuation problems for shareholders that arise from the absence of a public market for shares". Romano, *supra* note 174, at 24.

²⁰¹ Rudolf Schlesinger *et al.*, *supra* note 107, at 803. Regarding the usually limited judicial function in Roman-Germanic systems, it has been said that, "In civil law systems, the role and influence of judicial precedent at least until more recent times, has been negligible..." See James G. Apple *et al.*, *supra* note 42 at 36. On the other hand, it has been held that certain Civil Law jurisdictions are shifting towards a more creative judicial function. "Although traditional civil law dogma denied that judges 'make' law and that judicial decisions can be a source of law, contemporary civil law systems are more and more openly acknowledging the inescapable dependence of legislation on the judges and administrators who interpret and apply it". Mary Ann Glendon *et al.*, *Comparative Legal Traditions*, Second Edition, Saint Paul, West Group 994, at 63.

²⁰² Kraakman *et al.*, *supra* note 177, at 60.

The prominent ownership concentration that prevails in the region justifies corporate governance strategies devised to protect minority shareholders. A reduction in controlling shareholders' powers for the benefit of minorities and other constituencies are usually considered to be a useful mechanism. Several strategies have been sought to achieve the goals of protection of weak investors from the risk of oppression by majorities. Following Kraakman and Hansmann's classification, it is useful to consider the following four strategies: (1) The appointment rights strategy; (2) The decision rights strategy; (3) The trusteeship strategy; and (4) The reward, constrains, and affiliation rights strategies²⁰³. All of these tactics have been dealt with to a high extent by Latin American corporate law statutes long before the emergence of corporate governance as a separate discipline. In fact, most of the legal devices required for the implementation of such four strategies are usually contained in regulatory provisions set forth in commercial codes and corporate law decrees and statutes across the area.

3.3.1 The Appointment Rights Strategy

Pursuant to Kraakman and Hansmann, the basic manner in which this tactic is legally pursued consists on the consecration of proportional voting for the election of directors. Systems such as cumulative voting, or the reservation of seats for minority shareholders, are some of the proceedings used for this purpose. Almost all Latin American jurisdictions include these sorts of legal devices. While most US jurisdictions have abandoned the concept of proportional representation in favor of a default rule of straight voting²⁰⁴, commercial codes and corporate statutes in several countries of Central and South America still abide by the more conservative representational rule.

An unusual possibility to curb the rights of majorities in the context of board elections relates to the existence of legally imposed vote caps. As a result of this sort of restrictions majority shareholders are not allowed to exercise more than a certain percentage of the votes attached to their shares, irrespective of the size of their holdings²⁰⁵. This system is still possible in Brazil and Chile and was legally feasible until

²⁰³ See Reinier Kraakman *et al.*, *supra* note 177, at 54-61.

²⁰⁴ Stephen Bainbridge explains the underlying rationale for such departure from cumulative voting in the US: "During the last decades, however, cumulative voting in public corporations has increasingly fallen out of favor. Opponents of cumulative voting argue it produces an adversarial board and results in critical decisions being made in private meetings held by the majority faction before the formal board meeting". See Bainbridge, *supra* note 47, at 445-446. Only 8 states in the US have mandatory cumulative voting. *Id*

²⁰⁵ These restrictions are referred to as strong vote caps. "Strong vote capping reduces the voting rights of large shareholders *below* their proportionate economic ownership, and thus implicitly inflates the voting power of smaller shareholders: for example, a stipulation that no shareholder, regardless of the size of her holdings, may exercise more than 5% of the votes at the annual shareholders' meeting". See Kraakman *et al.*, *supra* note 177, at 55. Nevertheless, the effectiveness of this sort of restrictions is at least debatable. As early as 1952, Phanor Eder had pointed out to the possible uselessness of such protective devices: "In the attempt to protect the minority shareholders against the majority, artificial

recently in Colombia²⁰⁶. Another possibility to assure minority representation stems out from the so-called weak vote caps²⁰⁷, namely, legal restrictions that prevent shareholders to exercise voting rights in excess of their economic stake in the corporation. Weak voting caps are related to the principle of one share, one vote, which reflects a pro-rata allocation of decision-making rights. They are usually present in most Latin American corporate codes and statutes²⁰⁸.

3.3.2 The Decision Rights Strategy

According to the same authors, the second strategy to protect minority shareholders' rights is related to the manner in which fundamental corporate transactions are adopted. The underlying concern here relates to the idea of allowing minority shareholders to block certain important decisions by the exercise of veto rights that co-relate with supermajority provisions. This is an extremely useful device in Latin America, for it allows holders of minority interests to actively participate in crafting policies regarding fundamental corporate transactions. As Hansmann and Kraakman properly suggest, "in most circumstances, supermajority voting, like voting caps or proportional voting, is likely to matter chiefly in closely held companies and public companies with concentrated ownership"²⁰⁹. Most jurisdictions in the area not only allow for supermajorities as a rule of choice, but also set forth regulatory provisions devising supermajority approval for various relevant shareholders' decisions.

3.3.3 The Trusteeship Strategy

This tactic relates to the usefulness of a board of directors that is not subject to pressures or dependency constraints arising from the relationship of its members with controlling shareholders. Therefore, the purpose of a trusteeship strategy is to allow for a considerable degree of independence of directors not only from the corporation's managers but also from the holders of majority interests. For this purpose, Hansmann and Kraakman suggest three basic methods: (1) To weaken the rights of shareholders as a whole to appoint directors; (2) to disrupt financial ties of board members to controlling shareholders; and (3) to require board approval for relevant corporate decisions²¹⁰.

restrictions, annoying and generally ineffective, have been imposed on voting rights". See Eder, *Company Law...*, *supra* note 15, at 230.

²⁰⁶ Article 242 of Law 222 of 1995, repealed the restriction provided under Article 428 of the Colombian Commercial Code whereby shareholders were not entitled to vote in excess of 25% irrespective of their shareholding percentage.

²⁰⁷ See Kraakman *et al.*, *supra* note 177, at 56.

²⁰⁸ A notorious exception is associated with multiple voting rights that exist in Argentina (article 216 of Law 19.550), Venezuela (article 292 of the Commercial Code) and Colombia (in which article 11 of Law 1258 of 2008 allowed those rights for the SAS).

²⁰⁹ See Kraakman *et al.*, *supra* note 177, at 57.

²¹⁰ *Id.* at 58-59.

This used to be one of the weakest fields of corporate governance substantive law in Latin America. However, most major jurisdictions in the area have now adopted regulations aimed at providing independence of board members and insulating them from undue influences coming from majority shareholders²¹¹.

3.3.4 The Reward, Constraints, and Affiliation Rights Strategies

A final strategy intended to protect minority shareholders encompasses legal devices aimed at providing all shareholders with an equal treatment, the enactment of provisions consecrating fiduciary duties, remedies for oppression, controls for the abuse of rights and other standards to scrutinize directors and majority shareholders' conduct. Within this same group of strategies, the above-quoted authors also include provisions regarding conflicted transactions, mandatory disclosure rules and dissenter rights such as the appraisal remedy²¹².

As it has already been said, most of these legal protections can be found in the substantive corporate laws of Latin America. In fact, the widespread concern as to the situation of minority shareholders has resulted in an ongoing process to amend statutes and codes governing business corporations. As a consequence of these legal reforms, the catalogue of minority shareholder rights in many of these countries may even exceed the number of prerogatives granted to minority investors within statutes enacted in other more developed areas of the world²¹³.

3.4 OECD White Paper on Corporate Governance in Latin America

The influence of the OECD, the World Bank and other international institutions²¹⁴, has fostered the adoption by various Latin American legislators of recommendations rendered by the different working groups of such organizations²¹⁵.

²¹¹ Many countries in Latin America have regulations dealing with corporate governance that were issued or enacted by local legislatures, governments, securities agencies, and stock exchanges throughout Latin America. Especially, *See, e.g.*, Venezuela: Resolution # 19-1-2005, issued by the Comisión Nacional de Valores; for Colombia, Resolution 275 of 2003, issued by the Superintendence of Securities, and Law 964 of 2005; for Brazil, see Law 10.303 of 2001; for Argentina, see Decree 677 of 2001.

²¹² Obviously, dissenter rights are more effective as an exit strategy than simple transference rights. "Standing alone a transfer right provides less protection than a withdrawal right, since an informed transferee steps into the shoes of the transferor, and will therefore offer a price that impounds the expected future loss of value from insider mismanagement or opportunism". *See Kraakman et al., supra* note 177, at 25.

²¹³ P.B. Hannon characterizes the regulation of the stock corporation in Latin America as irritating, even though it is justified by their apologists "as necessary for the protection of unsophisticated shareholders and creditors". Hannon, *supra* note 92, at 756.

²¹⁴ *See generally* The Latin American Corporative Governance and Companies Roundtable of the OECD, http://www.oecd.org/document/63/0,3343,en_2649_37439_2048255_1_1_1_37439,00.html (containing links to material on reform proposals related to Latin America). The predominance of international credit

In the specific field of corporate governance, the OECD has advanced a number of recommendations for reform in Latin America²¹⁶. For this purpose, the organization has taken into account the region's main legal and social features. The White Paper on Corporate Governance contains a list of priorities for reform and detailed suggestions in regard to detailed legal problems that arise in the context of the corporate organization²¹⁷.

The White Paper on Corporate Governance for Latin America focuses on legal reform priorities and specific recommendations on that subject. The former are aimed at identifying the fundamental weaknesses of the legal infrastructure that require urgent attention of policymakers across the region. The latter refer to specific topics that should be addressed in order to improve the corporate governance framework in the concerned countries²¹⁸.

agencies has also been a significant factor for the adoption of corporate governance recommendations. In accordance to their policies, "moving into an international equity market requires many Latin American companies to elevate their corporate governance to a new level". *IFC and Corporate Governance, Latin America*, www.ifc.org. According to Roe "international agencies such as the IMF and the World Bank have admirably promoted corporate law reform, especially that which would protect minority stockholders. The OECD and the World Bank have had major initiatives to improve corporate governance, both in the developing and the developed world". *Corporate Law's Limits*, Discussion paper No. 380, August 2002, Harvard Law School, at 5.

²¹⁵ See generally OECD, *White Paper*, *supra* note 152. Other international institutions are constantly promoting legal reform in Latin America. "The World Bank's active support for law reform projects in Latin America is premised on the idea that secure and predictable legal environments are necessary for investment and market oriented development". See Thome, *supra* note 82, at 706.

²¹⁶ Pursuant to Lefort and Walker, "a standard framework to analyze corporate governance practices is provided by the OECD principles. These principles acknowledge not only the importance of legal protection, but also of other mechanisms of corporate governance". (Lefort and Walker, *supra* note 184, at 4).

²¹⁷ Heloisa Bedicks considers that these recommendations relate to the following issues:

- Respecting the rights of shareholders (specifically minority shareholders) and taking voting rights seriously
- Emergence of active and informed owners (transparency practices)
- Equitable treatment of shareholders particularly in changes of control and in de-listings
- Emphasis on the role of stakeholders in corporate governance
- Quality and integrity of financial reporting
- Disclosure of ownership and control (transparency)
- Conflicts of interest and related-party transactions
- Reporting on internal corporate governance structures and practices
- Board integrity and director independence (i.e., acting in the best interest of the company)
- Improved compliance and effective enforcement
- Encouragement in reporting illegal or unethical behavior. Bedicks *et al.*, *supra* note 6, at 223.

²¹⁸ Such changes do not necessarily imply amendments of the corporate legislation. Interestingly enough, "recent Western scholarship has suggested that the key issues of corporate governance are largely outside corporate law, as conventionally defined. Corporate codes are largely devoted to regulating the interaction of shareholders, managers, and creditors. But the most important practical distinctions now seem to depend on how shares are allocated among different types of investors, which in turn depends

The OECD lists the following six reform priorities: (i) Taking voting rights seriously; (ii) treating shareholders fairly during changes in corporate control and de-listing; (iii) ensuring the integrity of financial reporting and improving the disclosure of related party transactions; (iv) developing effective boards of directors; (v) improving the quality, effectiveness and predictability of the legal and regulatory framework; and (vi) continuing regional cooperation.

The first preoccupation relates to the exercise of voting rights during shareholders' assemblies. The OECD considers that measures should be taken to allow for a more active participation of minority shareholders and institutional investors in such meetings²¹⁹. These steps include the reduction of procedural formalities for the disclosure of information, the incorporation of effective director nomination mechanisms that enable minority shareholders to elect board members, and the use of new technologies to "provide shareholders and markets with as timely access to required disclosures as possible"²²⁰.

The second OECD reform priority relates to the equitable treatment of shareholders in several different hypotheses. For instance, pursuant to the White Paper, Latin American legislators should set forth specific rules regarding minority rights during changes in corporate control²²¹. The Organization also focuses on the need to provide for fairness guidelines in order to protect minority shareholders in the event of de-listing of public corporations. Undeniably, minority shareholders must have exit rights to compensate the loss of liquidity that may ensue in the event of a shareholder decision to de-list. Failure to provide such appropriate mechanisms usually results in distrust and reluctance to invest in publicly held corporations. In fact, the risk of being held hostage in a closely held firm deters investors from participating in the securities market. Nevertheless, there is a delicate balance between dissenters' rights in de-listings and appropriate incentives for a corporation to go public. In fact, the requirements for de-listing should not be so burdensome as to discourage companies from listing their securities in the local stock exchanges²²².

on a variety of rules outside the corporate code". William H. Simon, "The Legal Structure of the Chinese 'Socialist Market' Enterprise" in 21 *J.Corp. L.* 267, 1996.

²¹⁹ OECD, *White Paper*, *supra* note 152, at 13.

²²⁰ *Id.*, at 15-16.

²²¹ "Improved predictability with respect to shareholder treatment during changes in corporate control will allow investors to make better informed investment decisions, increases the ability of markets to properly price traded shares, and should result in less overall volatility stemming from uncertainty and disappointment". *Id.* at 18.

²²² For instance, until 2006, article 1.1.4.2 of Resolution 400 of 1995 required for the de-listing of a Colombian corporation that shareholders holding at least 99% of the shares of stock approved the decision. If such supermajority was not reached, the controlling stockholders were forced to launch a tender offer to all dissenting persons. Even if the supermajority is reached, the remaining stockholders (no more than 1%) were allowed to exercise an exit right. *See Id.* Nevertheless, article 1.1.4.2 was reformed by section 1.1.2.23 of Resolution 3139 of 2006 and 5.2.6.1.2 of Decree 2555 of 2010, which eliminated the described supermajority. The present regulation allows for an absolute majority to approve

A third proposal to amend the legislation in the region is concerned with the need to insure transparency and appropriate disclosure not only with regards to the financial reporting by the corporation, but also concerning interested party transactions. Lack of disclosure of accurate information is a significant deterrent for the growth of capital markets in the area. Establishing homogenous disclosure rules necessarily enables the comparison of financial data and allows for informed decision-making. To be sure, unreliability of financial information gives rise to confusion as to the actual prices of securities. Using international accounting principles may also attract foreign investors who speak a uniform financial language. Irrespective of this necessary reform, such accounting and financial amendments must be accompanied by a serious policy of enforceability and monitoring by administrative agencies.

The regulation of interested party transactions has already been a matter of concern in some countries in the area. However, several corporate statutes lack a comprehensive treatment of these topics. The OECD suggests that ascertaining this issue by means of appropriate regulatory provisions could ameliorate the negative impact of conflicting transactions. It is true that prejudicial self-dealing is facilitated by the absence of prohibitions of this nature. It is also acknowledged that this problem can be dealt with in a more appropriate manner by full disclosure of such conflicting transactions accompanied by an authorization rendered by shareholders or disinterested directors rather than by altogether barring these transactions²²³.

A fourth priority is associated with the independence of boards of directors²²⁴. The OECD recommends that board members should act independently in the interest of the company and its shareholders in accordance with the duties of care and loyalty²²⁵.

the de-listing, provided that controlling shareholders launch a tender offer to all dissenting shareholders. Therefore, the new regulation eliminated the exit right that was conceived as an alternative to the tender offer, making the decision to de-list ever more burdensome today.

²²³ For example, Colombian Law 964 of 2005 and Decree 1925 of 2009, as well as Argentine Decree 677 of 2001. Moreover, while Mexican law “is not known for emphasizing conflicts of interest principles, Mexican corporations law takes conflicts seriously. Thus, board members who have a conflict of interests (*conflicto de intereses*) in any transaction of business of the corporation must apprise the other board members of the situation, and must refrain from participating in all deliberations concerning the matter in question (LGSM, Article 156). Where such conflict exists, a director is usually required to leave the board of directors meeting while a decision is made by the remaining directors.” Zamora *et al.*, *supra* note 5, at 588.

²²⁴ According to Lefort, “as a consequence of the high ownership concentration observed in most firms in the region, boards in Latin American countries tend to be much weaker than those in US or UK, and constitute a poor governance mechanism”. Lefort & Walker, *supra* note 184, at 18.

²²⁵ A relevant consequence of a truly independent board of directors is the possibility of an appropriate cross-scrutiny of fellow members and other parties. “A separately-constituted board can also provide a check on opportunistic behavior by controlling shareholders (either toward their fellow shareholders or toward other parties who deal with the firm, such as creditors or employees) by providing a convenient target of personal liability for decisions made by the firm”. Kraakman *et al.*, *supra* note 177, at 12. Obviously, in order for a board to be independent, such quality must be applicable to the majority of its

The need to foster objective decision-making processes, in accordance with the company's interests (and not only with the interests of a certain group of stockholders), may very well justify this recommendation. It is therefore appropriate to promote board structures and sound practices that reinforce the ability of directors to act independently of management and controlling shareholders. Various Latin American jurisdictions have enacted regulatory statutes to determine the need to include independent directors, especially, in publicly held corporations. In spite of the obvious importance of this recommendation, it must not be ignored that the absence of a separation between ownership and control allows direct monitoring on managers and directors by block-holders, which in turn subjects the former to a high degree of control. Accordingly, due care must be exercised to avoid the impairment of advantages arising from strict control by block-holders. A balance must be struck through legal reform between significant autonomy in the board's decision-making processes and the benefits for minority stockholders that stem from the so-called "free ride" regarding the monitoring activities of block-holders.

Even if it is listed as the fifth priority, the improvement of the regulatory infrastructure should be taken as the most significant problem in the area. The OECD points out the need to strengthen the capacity of rule-making and enforcement bodies and to ensure that the legal framework supports effective use of private actions. Probably one of the aspects in which the OECD demonstrates an acute assessment of Latin America's Company Law is that concerning causes of action granted to shareholders²²⁶. The White Paper considers that a reform priority should be the incorporation of *private actions* allowing shareholders to resort to class action suits and mechanisms for alternative dispute resolution²²⁷. The implementation of these mechanisms in different areas of Company Law and Corporate Governance will improve the quality of the regulatory framework²²⁸. It is also useful to contemplate and remove obstacles that hinder the effective use of potentially efficient mechanisms for the settlement of shareholders' disputes. As it will be explained in further detail below, some of the countries in the area have taken serious steps to improve the enforceability of Corporate Law by allocating quasi-judicial powers to administrative agencies. Such governmental institutions as the General Inspection of Justice of Argentina and the

members. A majority of outside directors is an important means of mitigating the agency problem between controlling and minority shareholders. *Id.* at 30.

²²⁶ In this sense, some authors have proposed the adoption of corporate governance codes: "Markets that have national corporate governance codes in place have a marginal advantage over those that do not in the competition for international equity capital. Codes contribute to reduce risk in a market by clarifying a benchmark of minimum standards of accountability, governance and control." *Revista Buen Gobierno*, Cámara de Comercio de Bogotá, 2003, at 112.

²²⁷ Until recently, class action suits were only allowed in certain common law countries.

²²⁸ According to Erik Berglöf "in most societies, it is largely private initiatives that help enforce existing laws and regulations. The government creates the rules governing private conduct but leaves the initiation of enforcement to private parties. When a party feels cheated, he or she could initiate a private suit and take it to the court or other agency". Erik Berglöf and Stijn Claessens, *supra* note 85, at 22.

Colombian Superintendence of Companies also provide predictability to the market participants by creating a significant body of administrative “case law”²²⁹.

The last priority concerns continuing legal cooperation. Probably the relevance of this recommendation relates more to the need to achieve a certain degree of harmonization among the different Company Law systems of the area, rather than to monitor the implementation of the OECD’s recommendations. The existence of a number of regional treaties such as Mercosur and the Andean Pact has not contributed to the actual approximation of the countries’ legislation in the field of business associations²³⁰. As a consequence of such lack of harmonization, a significant disparity is still the rule. The prevailing approach in the region, similar to the European real seat doctrine, determines that the law applicable to business associations is that of the country in which they have their actual operation²³¹. This circumstance hinders the development of a market for corporate chartering similar to the one existing in the U.S. Certainly, such situation is one of the factors for the underdevelopment of Corporate Law in the area due to the lack of competition between jurisdictions²³². This last circumstance is aggravated by a complete lack of concern for the harmonization of legal regimes. As a consequence, there is neither the market-driven pressure for the

²²⁹ “For the field of corporate law, the existence of the *Superintendencia* in particular probably also assures that there will be interstitial development of some kind: The value placed on consistency in the western legal tradition almost inevitably must give *Superintendencia* decisions at least a *de facto* precedential authority”. Robert Charles Means, *Underdevelopment and the Development of Law: Corporations and Corporation Law in Nineteenth-century Colombia*, The University of North Carolina Press, 1980, at 287.

²³⁰ “The most remarkable feature of South American integration is that it is a disorderly and multiple process that permits parallel and overlapping initiatives”. Raúl Aníbal Etcheverry, “The Mercosur: Business enterprise organization in joint ventures”, in *St. Louis University Law Journal*, Vol. 39, No. 979, 1995, at 983. Latin America has seen “the emergence of a number of economic unions patterned to some extent on the European Community. The largest of the South American Regional trade associations, MERCOSUR, for example, unites Brazil, Argentina, Uruguay and Paraguay. It is still too early to gauge the success of these new economic combinations”. Larry Catá Backer, *Comparative Corporate Law: United States, European Union, China and Japan*, North Carolina, Carolina Academic Press, 2002. For a complete analysis of this topic, see Diego Fernandez Arroyo, “Integración y derecho en América Latina: doscientos años de indiferencia mutua”, in *La Integración posible: Latinoamérica frente al espejo de su integración (1810-2010)*, Mexico City, 2010.

²³¹ The Treaty of Montevideo of 1889 sets forth a rule whereby all business associations will be governed under the laws existing in the country of their domicile. “In constructing TM 89, it was decided that the law of the country where the basic elements of a company were originated and perfected was the most appropriate to regulate the existence and capacity of a corporation. Article 4 provides that the relationships between the shareholders and the company and third persons, as well as the form of the contract, which gives birth to the company, are subject to the law of the corporation’s domicile”. Beatriz Pallarés, “International Regime of Commercial Companies in Argentina and Mercosur”, in *Stetson Law Review*, Vol. 32, 2003, at 801. Nevertheless, the comparative lack of corporate mobility within the region represents an obstacle for the creation of markets for corporate chartering. This lack of mobility is caused by the usual legal requirement to set up a local corporate structure in order to carry out businesses in each of the Latin American Jurisdictions.

²³² See Roberta Romano, *The Genius of American Corporate Law*, Washington D.C., The AEI Press, 1993 (explaining the race for the bottom or race to the top debate).

enactment of modern *avant-garde* corporate regulations, nor the legal obligation to adopt uniform standards imposed by supranational organisms such as the ones provided under the Andean Pact²³³. Harmonization in the field of Company Law could be a sensible step to be taken in the process of integration, even more so in light of the execution of Free Trade Agreements with the U.S. by some countries in this region.

Besides the above-mentioned reform priorities, the OECD has also developed recommendations related, *inter alia*, to shareholders' rights. In this sense, a suggestion that could be suitable for the matter of equity participation within a company is the one related to the one share/one vote rule. This rule should be enforced, "unless it can be demonstrated that sufficient checks and balances, effective legal protections, and enforcement mechanisms are in place to ensure that the contractual and statutory rights of limited voting and non-voting shares will be adequately protected"²³⁴. In this regard, Miarta Capaul holds that Brazil is well known for the widespread use of non-voting shares in order to separate control from cash flow rights²³⁵. In addition, in Mexico, dual-vote shareholding structures were designed to promote foreign investment without local entrepreneurs losing control of their companies²³⁶. As in other Latin American countries, Chile presents a very high ownership concentration and a corporate structure dominated by the presence of conglomerates, which in turn tend to separate their voting rights from cash flow rights through the use of the so-called pyramidal structures²³⁷.

²³³ A different dynamic arises from the activity of the European Council that has fostered several directives aimed at the harmonization of Corporate Law in the European Union. ADRIAN DORRESTEIJN *et al*, *European Corporate Law*, Deventer, Kluwer Law and Taxation Publishers, 1994, at 28.

²³⁴ OECD *White Paper*, *supra* note 152.

²³⁵ In this sense, Capaul holds that non-voting shares represented "the majority of traded shares and 46 percent of the total equity of listed companies". The author further notes that until 2001, "it was possible to structure the capital of a corporation with two-thirds of nonvoting shares, the rest being in the form of ordinary voting shares. Thus a corporation could be controlled by shareholders owning only 16.7 percent of its total share capital", Miarta Capaul, *Corporate Governance in Latin America* 5, [http://www.wbi018.worldbank.org/LAC/lacinfoclient.nsf/1daa46103229123885256831005ce0eb/7865c8ecf52ed8d585256ea9005b1b6a/\\$FILE/Corporate%20Governance%20in%20LAC.pdf](http://www.wbi018.worldbank.org/LAC/lacinfoclient.nsf/1daa46103229123885256831005ce0eb/7865c8ecf52ed8d585256ea9005b1b6a/$FILE/Corporate%20Governance%20in%20LAC.pdf). However, according to the different sources already quoted, the prevailing structure of control in Latin America shows a significant equity concentration and a tendency on the part of controlling stockholders to retain a large percentage of shares of stock.

²³⁶ "As a general rule, all shares must have equal value and confer equal rights on all shareholders, in keeping with the general requirement that shareholder agreements may not produce legal effects that exclude any shareholder from sharing in the profits (General Corporation Law of Mexico or L.G.S.M., article 17). There are important exceptions to this general rule, however, and L.G.S.M. Article 112 allows shareholders to agree that the capital stock may be divided into several different classes of shares, and that special rights may be granted to the respective holders of each type. Thus, the articles of incorporation may limit the rights of the holders of certain classes of shares to only one right: the right to vote at extraordinary shareholders' meetings where fundamental matters are decided" (Stephen Zamora, *see, supra* note 5, at 582).

²³⁷ According to Lefort, Chilean conglomerates have a relatively simple structure. "The most common way of separating voting from cash flow rights is through simple pyramid structures with only 1/3 of affiliated

The above-mentioned one share one vote rule is already set forth under most Latin American corporate codes and statutes. Exaggerating the importance of this principle may hinder the corporations' ability to reduce costs of capital through the placement of various types of securities. This assertion is particularly true where stock issuances are addressed to investors more interested in profitability and exit rights than in the actual participation in shareholders' meetings. In these cases, non-voting shares are an important mechanism that allows corporations to obtain financing²³⁸. Holders of this type of securities can benefit from a preferred dividend as well as a liquidation priority. Granting these groups of shareholders voting rights does not necessarily result in an active participation in the corresponding decision-making bodies. Empirical data show that, at least in large corporations, the principle of one share/one vote does not have a significant impact on the structures of ownership and control. In fact, according to La Porta, "the results suggest that multiple classes of shares are not a central mechanism of separating ownership and control"²³⁹.

According to the OECD's recommendation, non-voting shareholders' views should be taken into account in the company's decision-making process and "should be accorded the same rights and treatment regarding notice of and opportunity to be heard in the General Meetings"²⁴⁰. Bearing in mind that non-voting stockholders are not granted decision-making power, implementing this recommendation would be burdensome for the corporation. The emphasis should instead be placed in reinforcing their access to information, as well as to strengthen the possibility to challenge oppressive and unjust decisions on behalf of voting shareholders²⁴¹. If the recommendation is taken to an extreme, local regulation should not allow the issuance of non-voting securities by any corporation. This idea appears to be fully inconsistent with the need to develop local securities. Indeed, suppression of non-voting stock would be detrimental to local markets and may not provide a significant improvement in minority shareholders' treatment.

The organization also insists that shareholders be provided with adequate notice periods, specific voting procedures for general meetings, as well as the need to include

listed companies being second or higher tier in the pyramidal structure"., in White Paper, *supra* note 152, at 49.

²³⁸ There seems to be a contradiction between the idea of providing access to inexpensive financing for local corporations and the strict enforceability of the one share/one vote principle. Non-voting shares are a well-known, useful mechanism of obtaining capital resources at a lower cost. Furthermore, since minority shareholders are not entitled to veto rights, their participation at shareholders' meetings may become a mere formality.

²³⁹ La Porta *et al.*, *Investor Protection and Corporate Governance*, 54 J. Of FIN. ECON. 2, 499-500, 1999.

²⁴⁰ OECD, *White Paper...*, *supra* note 152.

²⁴¹ Some authors have pointed out that all shareholders should be treated in an equitable way, including the minority and foreign stockholders, which should be given causes of action to challenge the violation of their rights. *Cf.* Roque Vítolo *et al.*, *supra* note 165 at 24.

an agenda containing information about the matters to be treated in these meetings. In spite of the relevance of such recommendation, most Latin American corporate statutes have already adopted notice of meeting requirements²⁴². For example, Mexican and Colombian statutes generally demand a notice issued fifteen days in advance of a general meeting of shareholder²⁴³. Such provisions are usually specific and in some cases so restrictive that they prevent shareholders from modifying the agenda in the absence of majority vote. Some of these countries also require due notice in the press in order to fulfill the aforementioned duty to inform. These requirements may even be stricter than the U.S. standards.

The OECD also holds that non-controlling shareholders should be allowed “to collectively achieve a voice by influencing the composition of the board of directors”²⁴⁴. According to the organization, non-controlling shareholders should have a realistic opportunity, not only to appoint board members, but to also have access to information relevant to the company.

The OECD strongly recommends the so-called “shareholder activism”. It holds that an appropriate legal environment could have the effect of encouraging institutional investors to make informed decisions that allow them to maximize returns²⁴⁵. For such purpose, the White Paper emphasizes on adopting corporate statutes that encourage pension funds and other institutional investors to exercise their ownership rights in an informed way. Specifically, the OECD suggests the implementation of provisions that enhance the flow of information between the company and such investors. This is one of the aspects in which the influence of the U.S. law and practice has arrived too late in Latin America. Indeed, this recommendation conflicts with empirical demonstration of

²⁴² Most Latin American countries have also adopted mechanisms whereby minority shareholders are entitled to summon a meeting of the general assembly. According to Capaul, minority shareholders in Mexico holding ten percent of a public company’s voting or limited voting shares may call a shareholders’ meeting, while in Bolivia and Colombia the percentage remains at twenty percent. In Brazil and Peru the required number of shares for this same matter is of five percent. Mierla Capaul, *see supra* note 235, at 9.

²⁴³ Article 186 of the General Corporation Law of Mexico and Article 424 of the Colombian Commercial Code; *see also* Article 278 of the Ecuadorian Company Act and 124-1 of the Brazilian Corporation Law No. 6.404, requiring 8 days for notice of meeting.

²⁴⁴ OECD, *White Paper...*, *see supra* note 152, at 16.

²⁴⁵ In Latin America, pension funds are supposed to be a powerful group of domestic investors with a purported influence on corporate governance. According to Iglesias-Palau, “since the early eighties and as the result of radical reforms to local social security systems, pension funds have come to play a leading role in capital markets of many Latin American countries. So far, Chile shows the most interesting experience, with a twenty-year-old system, a very active presence in capital markets and mature regulations” (Augusto Iglesias-Palau, “Pension reform and Corporate Governance: Impact in Chile”, in *Revista Abante*, Vol. 3, No 1, Oct/April 2000, at 112). Moreover, early pension fund reforms in Chile, Argentina, Peru and Mexico gave institutional investors an important role as capital suppliers. Lefort and Walker hold in this regard that “pension reform has triggered capital market and corporate law reforms that have helped to improve overall minority shareholders protection”. (Lefort & Walker, *see supra* note 184, at 50).

this policy's limited effectiveness. "Today, there is relatively little evidence that shareholder activism has mattered. Even the most active institutional investors spend only trifling amounts on corporate governance activism. Institutions devote little effort to monitoring management; to the contrary, they typically disclaim the ability or desire to decide company-specific policy questions (...). Most importantly, empirical studies of U.S. institutional investor activism have found 'no strong evidence of a correlation between firm performance and percentage of shares owned by institutions'²⁴⁶.

The OECD proposes a scheme whereby ADR holders should be granted similar rights to those provided to holders of the underlying shares²⁴⁷. In that manner, the White Paper asserts that ADR holders should also have pre-emptive rights in new share offerings²⁴⁸. It also recommends that national legislation in the country of the issuing corporation should ensure "that the proxy voting system functions equally well for ADR holders as it does for those who hold the underlying shares"²⁴⁹. This recommendation appears to be rather unusual. The legislative process to amend the corporation laws is cumbersome and time-consuming in most of the countries in the region. Changing the voting rights to allow outsiders – like ADR holders – to participate in shareholders' meetings may imply a radical departure from the ownership and capital structure of local corporate law. It may also entail a difficulty to differentiate the voting rights of the ADR depository and those that pertain to their individual holders. Moreover, it seems dubious that the investors acquiring ADRs could have an intention to participate in the decision-making processes of the issuer of the underlying shares. In fact, if the investor were willing to have a saying in corporate affairs, it would appear to be more reasonable for it to directly acquire shares of stock in the corporation. In conclusion, this recommendation does not seem to be realistic, particularly in light of the small number of ADR programs as compared to local issuance of shares. In a general survey of Latin American company laws, there does not seem to be a single country to have adopted this rather odd recommendation.

Regarding the OECD's suggestions addressing the equitable treatment of shareholders, the organization insists that the legal framework should strengthen

²⁴⁶ See Stephen M. Bainbridge, *supra* note 47, at 515.

²⁴⁷ *White Paper*, *supra* note 152, at 16. An American Depositary Receipt (ADR) is a certificate issued by a U.S. depository that represents a number of shares of stock issued by a non-U.S. company. In a number of cases, Latin American corporations have taken advantage of ADR programs in order to access the broader U.S. capital market.

²⁴⁸ "Pre-emptive rights give an existing shareholder the opportunity to purchase or subscribe for a proportionate part of a new issue of shares before it is offered to other persons. Its purpose is to protect shareholders from dilution of value and control when new shares are issued. In modern statutes, pre-emptive rights may be limited or denied". Robert W. Hamilton, *The Law of Corporations*, St. Paul, West Publishing Co., 1987, at 466-467. Most Latin American countries have adopted or recognized pre-emptive rights; see, for example, section 171 of Brazilian Law 6.404 of 1976; section 388 of Colombian Commercial Code, section 153 of Argentina's company act –which allows pre-emptive rights- and section 72 of the General Corporation Law of Mexico.

²⁴⁹ *White Paper*, *see supra* note 152.

minority shareholders' rights in the event of change in corporate control²⁵⁰. These reforms should not only be aimed at allowing investors to make better-informed investment decisions but also to increase the ability of markets to properly price traded shares. Consequently, measures like these will contribute to a climate of confidence, which in turn could be appropriate to foster market development. A clear-cut definition of the precise meaning of a change in corporate control, as well as other events that may be detrimental to minority shareholders, is also advisable. The White Paper recognizes the existence of withdrawal rights within corporate statutes in the region. However, the OECD recommends the inclusion of a more precise definition of the events triggering dissenters' rights and remedies²⁵¹. In fact, corporate statutes should be as clear as possible about the events under which such remedies could be exercised. The OECD also points out to the necessity of introducing mechanisms that allow for proper appraisal of the shares held by stockholders exercising dissenters' rights.

Another recommendation rendered by the OECD is aimed at determining the role of stakeholders in corporate governance issues. Accordingly, such actions as ensuring conformity of corporate officers with legislation related to the rights of stakeholders should be taken. The paper also emphasizes the need to encourage the reporting of illegal or unethical behaviors by corporate officers to the extent that they are in violation of stakeholders' rights.

As explained above, the organization has shown concern about the necessity to enhance the quality and integrity of financial reporting as a means to improve disclosure and transparency²⁵². The White Paper suggests that the regulatory framework concerning the financial reporting process should be evaluated considering the potentiality for the emergence of conflicts of interests. In order to deal with this situation the data that are relevant for the annual reports should be prepared and verified on a timely basis, by means of implementing a division of responsibilities among the

²⁵⁰ The OECD takes into account that "exchange rules and company charters have in practice failed to ensure equitable treatment of shareholders in cases of 'squeeze outs', de-listings, and exercise by shareholders of statutory withdrawal rights". *Id.* A similar opinion is expressed by Holly Gregory, who explains that one of the most notable international concerns regarding corporate governance recommendations is the inability of national rules to ensure the above-mentioned equitable treatment (See Holly Gregory. The globalization of corporate governance in *Directors*, National Association of Corporate Directors (NACD), Washington D.C., August 2001, at 6-14).

²⁵¹ For example, the organization recommends that events such as the transformation of the corporation's business purpose, or a restructuring of its capital stock, should allow for the exercise of dissenter's remedies. See OECD's *White Paper...*, *supra* note 152, at 18.

²⁵² According to Mierta Capaul, "[d]isclosure and transparency refer to the availability, reliability, and timeliness of financial and non financial information to all shareholders. This includes information on the governance structure of the company, how corporate decisions are taken, and what checks and balances are in place to ensure equitable treatment". (Mierta Capaul, *supra* note 235, at 10). Regarding this topic, see also Stephen Yan-Leung Cheung, *et.al*, "Determinants of Corporate Disclosure and Transparency: Evidence from Hong Kong and Thailand", in *China International Conference of Finance (Memories)*, China Center for Financial Research, July of 2006, at 1-44 (explaining the main factors that influence corporate disclosure and transparency in a legal system).

company and taking into consideration the auditing process. The organization insists on the importance of a qualified and independent auditor as well as in the relevance of abiding by international standards for the preparation of financial information.

The OECD is also concerned with the need of a legal framework that creates effective means to obtain accurate information about beneficial ownership and control. This recommendation is grounded upon the difficulty to identify controlling parties in corporations based in countries in which a concentrated ownership structure prevails. These systems are propitious for potential conflicts of interest, related party and insider trading transactions²⁵³. Ownership concentration may thus allow controlling shareholders to undertake business transactions that may be detrimental to the interests of minority shareholders²⁵⁴. Hence, the OECD has recommended the use of a *three-fold template* that sets forth the following mechanisms aimed at identifying beneficial equity owners: (i) up-front disclosure; (ii) imposition of an obligation to keep beneficial ownership and control information, and (iii) creation of a reliable information system. The organization further insists in the importance of allowing interested shareholders to identify all the parties with whom controlling stockholders have a material business relationship.

The White Paper also contains extensive recommendations regarding the duties of the board of directors. As it has already been stressed out, equity ownership concentration in Latin America allows controlling shareholders to exercise a dominant influence over directors. Thus, the OECD deems necessary to foster a legal framework that compels members of the board to strictly abide by their duties of care and loyalty, as a means to protect the interests of *all* of a company's shareholders²⁵⁵. For this

²⁵³ Some countries have already adopted these protective measures. Capaul informs that in Chile, for instance, shareholders holding at least five percent of the outstanding shares may subject a related party transaction to an approval at an extraordinary general meeting (*Id.* at 10). Brazilian Law 6.404 of 1976 contains some provisions concerning conflicts of interest. For instance, article 117 of such law includes within the list of the so-called abuse of power activities the execution by the parent corporation of any contract entered into with the subsidiary directly, through a third party or through a business entity in which the controlling shareholder has an interest". (See Regina Martins Fontes. 'Uso indevido de informação privilegiada', in *Direito Empresarial - Questões contemporâneas em Coletânea*, Singular, 2007, at 4).

²⁵⁴ In regards to the specific situation of Bolivia, Mierta Capaul holds that there is "a widespread perception among Bolivians that the controller of some 'capitalized companies' understates profits or transfers them out of the company through related party transactions or other means". *Id.*, at 9. The same author further states that this perception "has generated an intense debate on how the capitalized companies should be governed to ensure that their activities are conducted in the best interest of the company and all shareholders". *Id.*

²⁵⁵ In most jurisdictions in the Latin American region there is comprehensive regulation, not only on the duties of directors, but also on the liabilities that are imposed upon them (that is the case, for instance, of Colombia, in which Law 222 of 1995 introduced a systematic regime of managers' duties and liabilities. Brazilian law 6.404 of 1976 also regulates this subject in sections 153 to 159). See Stephen Zamora *et al.*, *supra* note 5, at 590. The effectiveness of such provisions is generally limited due to enforceability concerns.

purpose, the organization contends, once again, that minority shareholders should be entitled to appoint board members. This may be accomplished by the use of cumulative voting systems²⁵⁶.

Nonetheless, as it has already been explained, minority-appointed directors will generally lack a veto power on board decisions²⁵⁷. Therefore, imposition of mandatory voting mechanisms such as the one depicted before may fail to effectively protect the interest of minority stockholders²⁵⁸.

As we have analyzed thus far, the OECD's focus appears to be the substantive areas of corporate law that need to be amended in order for corporate governance to be successful in the region. This approach seemingly disregards a simple fact that has been constantly reiterated in this chapter, that is, the comparative sufficiency of corporate law provisions dealing with minority stockholders' rights. The OECD seems to overlook the significance of enforceability, which appears to be the single most important aspect to be improved in most, if not all, Latin American countries. The lack of appropriate and effective judicial remedies, the general inefficiency of the judicial systems, and the time-consuming nature of legal processes result in the uselessness of any positive consecration of substantive rules²⁵⁹. The issue of enforceability of corporate statutes is dealt with in further detail below²⁶⁰.

²⁵⁶ By this method, each shareholder receives a proportionate number of votes to their shareholdings, which at the same time are assigned to one or more candidates. According to Bainbridge, "cumulative voting provides an alternative mechanism for electing the board of directors that can assure board representation for the minority" (See Stephen Bainbridge, *supra* note 47, at 444). Most Latin American legal systems have already adopted mandatory systems for the designation of directors. Such is the case of Mexico (see Walter Frisch Phillip, *Sociedad anónima mexicana*, Tercera edición, Mexico, Ed. Harla 1994, at 375), Colombia (section 197 of the Commercial Code), and Argentina (section 263 of Law 19.550).

²⁵⁷ In fact, establishing compulsory board representation for minority shareholders may have little or no positive effect on a given company's decision-making processes. It could also be held that excessive restrictions may hinder the board's ability to perform. That would be the case, for instance, whenever excessive supermajority requirements are provided by the corporate by-laws. Stephen Zamora has held that "in setting a higher voting majority for certain decisions, corporations should be careful not to hamstring the board from making the normal decisions that are vital to the daily operations of the company". See *supra* note 5, at 589.

²⁵⁸ According to Erik Vermeulen, cumulative voting systems "may be easily eliminated or minimized by the controlling shareholder. For instance, he or she may alter the articles of association or remove the minority shareholders' director without cause and replace him or her with a more congenial person". Erik P.M. Vermeulen, see *supra* note 195, at 105.

²⁵⁹ Within the OECD *White Paper for Corporate Governance* there is, nevertheless, a brief reference to enforceability. The organization lists a number of measures that should be implemented to this end, including: (i) removal of contradictions between rules and laws relating to corporate governance; (ii) achieving an optimal distribution of powers among local courts, supervisory authorities and enforcement mechanisms; (iii) enhancing the political and financial independence of regulatory and supervisory agencies; (iv) providing such agencies with ample powers so as to investigate and solve cases in a manner that fosters public confidence in enforcement and deters rule-breaking; and (v) allowing

3.5 The Modest Impact of Reforms on Corporate Governance for Listed Firms

A comparative survey of the company laws existing in major South American jurisdictions provides a clear demonstration that most common Corporate Governance devices aimed at protecting the interests of minority shareholders against possible expropriation by block-holders are already in place in Commercial and Corporate statutes throughout the region (see Annex C). A fine-tuning of these existing regulations, in order to include more detailed substantial provisions concerning self-dealing, independent directors and certain disclosure requirements is all that will be needed to match international standards on this subject.

The main question that arises in the field of Corporate Governance and more generally in Latin American Company Law is not a new one. Scholars such as Phanor Eder posed it almost six decades ago and still today relates to the reasons why the minute regulation of minority shareholders' rights is largely ineffective in the region. As it should be expected, lack of effective enforcement mechanisms and weak legal infrastructures lead to the virtual uselessness of most substantive law provisions.

The formidable obstacles that these countries will face in order to effectuate an overhaul of their judiciaries make it illusory to expect consistent changes in the short run. Such a delay may not be worthwhile, at least in the field of Company Law. An intermediate solution (which has proven to be efficient in some Latin American countries), may be applied to deal with judicial inefficiency and corruption. It consists in the allocation of substantial supervisory, disciplinary and even judicial powers to administrative agencies such as the Colombian Superintendence of Companies, the Argentine Inspection of Justice or the Chilean Superintendence of Securities and Insurance. As it has been analyzed, the technical expertise of these agencies, as well as the expeditious proceedings they have developed during the last decades, have made them more useful in handling Corporate Law conflicts than ordinary courts. Despite criticism regarding the role of these agencies, their existence is more than justified by the lack of a judiciary capable of resolving complex commercial issues on a timely fashion. An effective and impartial system of corporate arbitration will also need to be implemented as an additional mechanism to resolve Company Law disputes.

supervisory agencies to appear before courts to submit advisory opinions in shareholder-related cases. See *White Paper...*, *supra* note 152, at 30-32.

²⁶⁰ For a table comparing the different corporate governance system of Latin America, see Annex B.

4. Legal Framework for Company Law Reform in Latin America

The optimal Company Law model depends on the specific conditions of each legal system. Substantial differences in the economic models, as well as the variety of legal traditions, give rise to different approaches and various ways to deal with agency problems. However, the common core of Latin American Law, its shared colonial heritage, and the existence of a comparatively homogenous culture could provide an appropriate scenario to set up a plain level field for most of the jurisdictions in this area.

A preliminary aspect that must be taken into account refers to the priority areas of legal reform. Thus far, most efforts have focused on the field of publicly held corporations, and the manner in which the securities markets' liquidity could be enhanced across Latin America. For this purpose, a wave of corporate governance reforms fostered specially by the OECD has affected the regulations of Company Law in all major Latin American jurisdictions. The consequences of these new regulations are still to be assessed. However, recent empirical research suggests that such regulatory changes have had little or no impact on the number of listed companies. Furthermore, securities exchange activity measured through the number of IPOs and other significant transactions proves that no substantial change has taken place after those corporate governance reforms were introduced²⁶¹.

It is clear that the regulation of corporations contained in Commercial Codes and business associations' statutes prevailing in the Latin American region cannot be blamed for the reduced development of the local stock markets. The widespread use of the *sociedad anónima* (stock corporation) as the vehicle to undertake public issuances of securities bears no relationship with the structural factors that determine the lack of a robust and efficient market. In fact, modern corporate governance provisions somehow resemble the regulatory nature of Latin American Corporate Law. A long lasting tradition of directory provisions devised to govern every aspect of a Latin American corporation, including rules concerning notices for annual meetings, strictly regulated voting rights, broad inspection and information rights, mandatory cumulative voting, compulsory auditing committees, and various types of dissenting remedies make of the *anónima*, a classical business form for listed firms. At least in the books, only a few changes are needed to adapt this traditional business entity to modern corporate governance standards.

Other structural factors such as the perceived disadvantages of superior disclosure requirements in publicly held corporations, the elevated costs of compliance

²⁶¹ There were no IPOs or public issuances of stocks of any listed company in the Colombian stock exchange in 2008. In the same year such exchange experienced a reduction of 12% of listed companies. In fact, they went down from 106 in 2007 to 94 in 2008 (See Colombian Financial Superintendence, Communication Letter # 16 of February 13, 2009). A similar situation occurred with the Brazilian securities market as it will be shown in section 5.5 of this book.

concerning securities regulation, the higher opportunities for tax evasion in non-listed firms and the consequent reduction in the spread between financial loans and equity provided by investors in the stock exchanges may well represent discouraging factors for a new listing to take place.

4.1. Shifting the Policy Agenda to the Closely Held Company

A more thorough examination of the region's economic conditions and realities will probably shed light on major structural factors that hinder the development of these countries' securities markets (at least in the field of stock trading). Path dependence concerning concentrated ownership, widespread family control as well as other well-known heavily built circumstances create significant barriers for the creation of vigorous markets.

The amount of resources that has been spent in the assumed need to foster new listings and enhance the liquidity of securities markets in Latin America has not only been excessive, but it may not be conducive to a substantial improvement in the financial conditions of countries that have adopted recommendations ensuing from the proposed amendments to the securities market legal infrastructure.

To be sure, Professors Cooter and Schaefer have suggested that stock issuances and secondary market trading of these securities is not a necessary factor for development in poor countries. Based upon the Chinese and Indian experiences, the authors suggest that economic development in the private sector can be sufficiently financed in poor and emerging countries by banks and other financial institutions (private financing), even in the absence of a developed and liquid stock market²⁶².

It is striking, on the other hand, to realize that only small efforts have been made to amend or repeal the laws and regulations concerning the closely held corporation still anchored in 19th century notions (See Annex D comparing the SAS to traditional business associations in Latin America). From a practical standpoint, it is obvious that non-listed companies are not only the broad majority of all business associations operating in Latin America, but also the most powerful instrument to create employment in developing economies.

4.2 The appropriateness of Legal Transplants

²⁶² Robert Cooter and Hans-Bernd Schaefer discuss the importance for innovation and economic development of three separate stages of finance (relational, private, and public). The second stage is referred to as *private* because it comes from a small group of experts in evaluating innovations in an early stage of development (*Solomon's Knot, How Law can End the Poverty of Nations*, Draft, February 2009, at 8-9).

Even if globalization offers significant opportunities for developing countries, including the gains arising from broader market access, it creates an interdependence that is usually linked with regulatory homogeneity²⁶³. A problem associated with globalization relates to the indiscriminate imposition of international models and schemes for convergence. In some cases, this process takes place without regard to diversity and local traditions²⁶⁴. The increasing presence of international agencies specialized in providing consulting services relating to the convergence of legal institutions may prove challenging. The frequent lack of an appropriate process of adaptation to the economic and cultural realities of the recipient country may very well determine failure of any legal transplant. Such importation of rules of a foreign origin has already taken place in the field of corporations and more specifically in the subject of corporate governance.

The problems associated with legal transplants are well known in Comparative Law. Alan Watson analyzes the basic factors that determine the failure or success of a legal transplant, which include, *inter alia*, linguistic proximities, proper adaptation of relevant statutes, as well as historic and political relationships between the borrower and the lender²⁶⁵. An indispensable process of adaptation encompasses the quest for a common language aimed at determining mutual grounds for understanding between heterogeneous legal traditions and systems. The difficult apprehension of such a language implies the use of functional equivalents, namely, an intelligible translation of notions, which transcends the literal meaning of words and expressions²⁶⁶. Mary Ann

²⁶³ This has been the path followed in the European Union, where the issuance of directives has allowed for the harmonization of several fields of the law, including Company Law. "A series of Directives has the general aim of harmonization of the company laws of the Member States" (M.C. Oliver, *Company Law*, Twelfth Edition, London, The M+E Handbook Series, 1994, at 5). The need for certain harmonization is evident in light of the worldwide dimension of securities markets. "The distinction between local and international financial markets becomes blurred when we consider that firms in a country can issue securities abroad and when international investors can buy shares issued by local firms, either directly or via American depository receipts" (ADR) Fernando Lefort & Eduardo Walker, *The Past and the Future of Domestic Financial Markets in Latin America*, http://www.frbatlanta.org/econ_rd/larg/events/conf2001/walker-lefort_paper.pdf

²⁶⁴ A new trend in cooperation for development embodies the idea that its effectiveness will depend on there being a sense of national policy ownership. Ocampo notes that such principle has won formal acceptance as a guideline by several cooperation institutions including the OECD. Nevertheless, "quite frequently, it is ignored in practice. Indeed, an effort is often made to 'compel' ownership of the policies that international agencies feel are appropriate". José Antonio Ocampo *et al.*, *Globalization and Development, A Latin American and Caribbean Perspective*, Economic Commission for Latin America and the Caribbean, 2003, at 133.

²⁶⁵ See Alan Watson, *Legal Transplants: An Approach to Comparative Law*, 2nd edition, Athens, University of Georgia Press, 1993, at 23. The author further states that obvious fact that, "transplant is the most fertile source of development. Most changes in most legal systems are the result of borrowing" (*Id.* at 95).

²⁶⁶ See Francisco Reyes, *Derecho Societario en Estados Unidos, Introducción Comparada*, 3d Ed., 2006, at 44-45. According to Mary A. Glendon, a *functional approach* "means that legal rules and institutions at some point have to be liberated from the conceptual categories of their home systems, so that they can be seen in terms of the social objectives they serve" (*Comparative Legal Traditions, Texts, Materials and Cases*, 2nd edition, St. Paul, West Publishing Group, 1994, at 12).

Glendon is explicit when referring to the dangers that stem out of simplistic comparisons. According to this author, legal provisions cannot be fully understood without some knowledge of their political, social, and economic purposes. A mere comparison of legal rules may be misleading when it relates to different legal systems subject to conflicting procedural rules and dissimilar legal classifications²⁶⁷.

Prominent authors go as far as considering that it is unfeasible to import rules from a system pertaining to the Common Law tradition into a Civil Law system, due to an assumed lack of compatibility between them. In this regard, Eduardo Favier-Dubois holds that certain Latin American social, religious, and cultural values are antagonistic to those prevailing in Common Law jurisdictions. The author further states that a legal institution that works properly within a country in which an individualistic and protestant philosophy prevails will not be equally useful in countries characterized by gregarious and cooperative behavior. The obvious conclusion of this somehow extreme position is that a defensive attitude vis-à-vis cultural globalization should require an affirmation of local traditions as a means to preserve the national identity²⁶⁸.

The Argentine professor Guillermo Cabanellas adopts a similar approach. According to his perception, there are multiple dangers and difficulties ensuing from foreign intellectual influences in Latin American legal systems. Such a caveat is more relevant when the influence comes from a wrongful interpretation of U.S. legal materials rather than from the construction of continental European statutes and texts. The author

²⁶⁷ Mary A. Glendon, *Comparative Legal Traditions*, St. Paul, West Publishing Group, 1982, at 101. In fact, some authors hold that globalization of different legal systems have had a negative impact reflected in erratic transplants and reforms in some Latin American countries during the XIX century: "Colombia is another example in which we can observe erratic change. In this case, change did not result from the effect the previously adopted corporate law had on domestic affairs, but rather from the eclectic choice of countries from which to borrow corporate law. Colombia first followed the Spanish example and enacted a liberal corporate law in 1853. Unlike Spain, this did not have much impact, mostly because economic development lagged behind so that the private corporation did not take hold in the country. Later, Colombia chose to update the corporate law by following the Chilean model. While this led to some remarkable change in the statutory law, it had no discernible effect on the Colombian economy. The lesson we draw from this analysis is that countries that receive foreign law are frequently unprepared for the changes it brings, leading us to suggest that there is a 'late development' phenomenon in the evolution of legal systems as there is with respect to economic systems" (Katharina Pistor, Yoram Keinan, Jan Kleinheterkamp and Mark West. The evolution of corporate law: a cross-country comparison, in *World Development Report 2002: Building Institutions for Markets*. Worldbank. 2001, at 51-52).

²⁶⁸ Eduardo Favier-Dubois, *Doctrina societaria y concursal*, No. 181, Buenos Aires, 2002, at 825. This opinion coincides with Linda O. Smiddy's comparative analysis on the influence of culture in corporate legal reform in France, in what appears to be cultural differences between Latin and Anglo-Saxon communities. According to this author, a study based on a survey of 15,000 business managers working for companies in Western and Asian industrialized countries showed two very different views of a business corporation. "Americans valued individual opportunity, achievement, and individual qualifications as being more important than group cohesiveness. The French, in contrast, tended to emphasize communitarian concerns". Linda O. Smiddy, "Corporate Reform in France: The Influence of Culture", in 27 *Vt. L. Rev.* 879, at 2.

emphasizes on problems arising out of translations of complex terminology, lack of conceptual equivalences, and structural differences among the concerned systems²⁶⁹.

It is thus clear that an appropriate process of adaptation to the economic and social realities of the recipient country is a determining factor for the success of legal transplants. The importation of rules and regulations is obviously facilitated if both countries (lender and borrower) belong to the same legal tradition. In the case of Latin America, there has been dependency on the codification system in vogue in nineteenth-century continental Europe. This fact has resulted in a continued reliance on the evolution of the French, German and Spanish legislations²⁷⁰. Such dependency is still significant today in various fields of Private Law²⁷¹. Nonetheless, the economic importance of the US, as well as the practical nature of its legal institutions, has determined an undeniable global influence in most fields of the law. Even European scholars have acknowledged this situation. Pierre Mousseron, for instance, has held that the so-called globalization (“mondialisation”) of Corporate Law is the expression chosen to designate an *americanization* of this field of the law²⁷².

²⁶⁹ Guillermo Cabanellas de las Cuevas, in *Derecho Societario en Estados Unidos*, 3d Ed., 2006, *supra* note 90, at 3 (Preface by Guillermo Cabanellas de las Cuevas). A similar approach is exemplified by the adoption of Americanized Corporate Law statutes in Russia. That country’s legislation on this matter provides an example of the problems associated with trans-cultural reform. “Russia’s current corporate code was heavily influenced by U.S. law. It was apparently not significantly based on Russian’s legal tradition and culture. In addition, at the time it was drafted, Russia’s legal and financial institutions did not provide the necessary support for the law. Consequently, in Russia, an innovative and very modern corporate code reportedly languishes in the statute books. The lesson to be learned from the Russian experience is that as we look to other countries for possible avenues of reform, we must consider what would be effective in the context of U.S. history, culture and legal tradition”. Linda Smiddy, *supra* note 268, at 886.

²⁷⁰ For an explanation regarding the codification movement in nineteenth-century Latin America see Boris Kozolchyk, *supra* note 8, at 130-133. This author describes the so-called Latin American codification family, which encompasses three master codes drafted by great jurists: Dalmacio Vélez-Sársfield (1800-1875) for Argentina, Andrés Bello (1781-1865) for Chile, and Augusto Teixeira de Freitas (1816-1883) for Brazil. *Id.* Pursuant to the opinion of Sánchez Cordero, “the climax of this codification movement is without a doubt the Chilean Code Civil, enacted in 1855 and written up by Andres Bello. Bello, of Venezuelan origin and Chilean citizenship continued this trend and completely abandoned the adoption or adaptation of the French Code Civil, in order to address vernacular law. This conception caused this Code civil to have a great influence in the emergent States” (See Jorge Sánchez Cordero, *supra* note 43 at 27). See also Matthew Mirow, *supra* note 4 at 133.

²⁷¹ Regarding codification in Latin America *see, generally*, John Henry Merryman *et al*, *supra* note 83, at 208-220. Schlesinger points out to the so-called exogenous influence, which is particularly noticeable in instances in which legislators have resorted to the *wholesale importation* of foreign law. “Most of the codes presently in force in Latin America are the result of extensive comparative study and eclectic choice among European models”. Rudolf Schlesinger *et al*, *Comparative Law, Cases-Texts-Materials*, 6th edition, New York, The Foundation Press, 1998, at 11. Schlesinger also adds that this process involves the danger (evident in Latin America) that foreign institutions may be copied without sufficient adaptation to local conditions, *id.* at n. 32.

²⁷² Pierre Mousseron, *Droit des sociétés*, 2e édition, Paris, Montchrestien, 2005, at 22. The author lists the causes of such *americanization*. In his opinion, they resemble the ones that propelled the expansion of Roman Law. The language is the first among them. English has become the common vehicle for

This pressure has been increasingly acknowledged in Latin America during the last century²⁷³. In fact, according to Matthew Mirow, the most important change for Latin American Private Law has been turning away from European doctrinal approaches to indigenous materials or even legal literature proceeding from Common Law countries²⁷⁴. Mirow's assertion concerning the shift from European to American sources, is based on a study carried out in various Latin American countries²⁷⁵.

The adoption of U.S. models in Latin American law can be justified by multiple explanations, which range from simple cost-efficient motivations to the more complex perception of legitimacy that is granted to a new legislation if it has been copied from a prestigious legal system²⁷⁶. It follows that nations undergoing political transformations seek prestigious models to give credibility to their newly enacted statutes. According to

business law. This circumstance fosters the Anglo-Saxon legal model to the extent that terminology does not need to be translated and therefore altered upon exportation. The universities are the second cause. Very much alike the journeys that French jurists made to Ancient Rome, legal studies in the Anglo-Saxon world are of a paramount importance today. They constitute the basic credential required to access a legal practice in the field of international business transactions. A last cause relates to the affiliation of local law offices with Anglo-Saxon firms. *Id.*, at 22-23. "Some [Latin American] countries have begun to see a U.S. LL.M as a requisite to the elite firms that deal with international and large national businesses". See Mathew Mirow, *supra* note 4. In regards to the expansion of the Roman legal system, see, generally, Glenn H. Patrick, *Legal Traditions of the World* 125-69, 2nd Ed., 2004 (describing the impact and process of the spread of Roman law throughout Europe). "The Romans dominated, then the national civilians dominated (so out went the chthonic ways), then the world became a zone of influence of civil laws, as the colonization process occurred". *Id.*, at 165.

²⁷³ For instance, according to Stephen Zamora, Mexican Corporate Law not only has borrowed from European laws, but owes much to U.S. influences (See Zamora *et al.*, *supra* note 5, at 567). According to Katharina Pistor, Yoram Keinam, Jan Kleinhederkamp and Mark West, corporate law in Chile, Colombia, Peru and Brazil was highly influenced by the legal systems of France, England, Germany and the United States (See *supra* note 267, at 50).

²⁷⁴ "In addition to, and concurrent with, the prominence of the United States models and influences, international investment in Latin America and the globalization of legal practice have led to sidestepping domestic law and national legal systems". See Matthew Mirow, *supra* note 4, at 187.

²⁷⁵ See Matthew Mirow, *supra* note 4, at 167.

²⁷⁶ Jonathan Miller describes the differences existing among various types of legal transplants in Latin America. In accordance with this taxonomy, the following classes can be distinguished: (1) *The cost-saving transplant*: the motivation arises out of the need to reduce expenses and save time by using a foreign model dealing with the same issues at hand; (2) *The externally dictated transplant*: the incentive stems from a desire to please foreign states, individuals or entities; (3) *The transplant as a vehicle for individual investment*: it is motivated by the presence in the receiving country of individuals interested in the transplanted legal structure so that they can obtain political or economic benefits; (4) *The legitimacy-generating transplant*: the reason underlying the legal transplant is the prestige of the foreign model. See Jonathan M. Miller, *A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process*, 51 AM. J. COMP. L. 839, 845-54 (2003). The prestige can be predicated either of the specific legal institution or of the entire legal system. Miller suggests that governments, foundations and international bodies encouraging legal transplants need to consider their work in light of this typology in order to understand how local dynamics interact with their own goals. See *id.* at 872. 21. *Id.* at 840.

Jonathan Miller, “most countries simply cannot engage in international commerce or expect international investment without moving their legal regimes toward common standards...”²⁷⁷.

In spite of several difficulties arising from the adoption of foreign models, a considerable degree of borrowing is necessary, at least in the fields related to business associations. More than fifty years ago, Phanor Eder pointed out to the need for convergence in this specific subject. This author found notorious similarities among different regulations on Business Associations, due to the existence of comparable economic phenomena and the presence of analogous general concepts. However, Eder also asserted that the higher industrial and financial development of some countries would determine that the backward-looking ones would “tend to be guided in their legislation by the more progressive nations and by the views of their leading authorities”²⁷⁸.

Difficulties also arise from legal translations. The victorious arrival of the Common Law in Latin America and elsewhere is not less overwhelming than the supremacy of the English language across the board. The undisputable reign of this language in the academic scenario is an aspect that must not be overlooked in the field of Comparative Law. The establishment of this new *Lingua Franca* is probably the single most significant contribution for the propagation of the Common Law institutions in Continental Europe and elsewhere. In the field of Private Law, this dissemination of Anglo-Saxon legal institutions is also linked to the preeminent scholar works of the so-called Law and Economics movement²⁷⁹.

A well-known factor leading to the failure of legal transplants arises from the lack of equivalent language and the frequent and misleading presence of the so-called *false synonyms*²⁸⁰. As Keith Rosenn has noted, many English juridical terms, developed for Common Law legal systems, have no Spanish equivalents because the same concepts do not exist within the Civil Law tradition²⁸¹. “The similarity of words disguises important

²⁷⁷ *Id.* at 840.

²⁷⁸ See Phanor Eder, *supra* note 15, at 1.

²⁷⁹ Textbooks like *Economic Analysis of Law*, by Richard Posner are widely diffused in the Latin American academic community. An association for the diffusion of Law and Economics methods was founded nearly a decade ago. ALACDE holds an annual conference in which experts analyze legal institutions in light of functional approaches. See ALACDE’s Internet site. [Online] <http://alacde.org/alacde.htm>

²⁸⁰ *CF.* Rotman, Edgardo, “The Inherent Problems of Legal Translation: Theoretical Aspects”, *Indiana International & Comparative L. Rev.*, 1996, at 189. Apart from precision and certainty, a legal translation “is bound to use abstractions, whose meanings derive from particular changing cultural and social contexts. These contexts generate a certain degree of ambiguity, which increases when the legal cultures and systems are vastly different from each other”. *Id.* Legal translation becomes a greater challenge when the concerned terms come from ancient legal sources, subject to specific historical developments. See Matthew C. Mirow, *supra* note 4.

²⁸¹ Keith Rosenn, *Dahl’s Law Dictionary. Diccionario Jurídico* by Henry S. Dahl, Buffalo, in *Inter-American Law Review*, Vol. 24, Number 3, Spring 1993, at 607-608. The author further states: “even when similar

differences in meaning, and these differences have much to do with intangible aspects of the legal culture”²⁸².

In the specific case of *corporate governance*, to provide only one of many available examples, the manner in which legal translation has been dealt with is both mistaken and striking. Experts in the field have been satisfied with the simplest literal translation that arises from the identical and common Latin roots of the aforementioned two words. Therefore, the Spanish expression *gobierno corporativo* and the Portuguese *governança corporativa* are widely used, irrespective of their misleading meaning in both romance languages. The first aspect to consider is that the term *corporation* has a different legal connotation in countries of a Roman-Germanic tradition as compared to its counterpart in the Common Law world²⁸³. The word *corporación* – at least in those Latin American legislations that follow the Andrés Bello Civil Code of 1855 – relates, generally, to a non-profit entity deprived of any lucrative purpose²⁸⁴. The words that more closely resemble that of the corporation would be *sociedad* or *compañía*²⁸⁵. On the other hand, the word *governance* (*gobierno* or *governança*) has a specific technical meaning, that has been developed by local scholars. Such meaning may not

concepts exist in both languages, English and Spanish juridical terms are often simply functional analogues whose meanings differ in important ways”, *Id.* At 608.

²⁸² See Zamora *et al.*, *supra* note 5, at 77-78.

²⁸³ Corporation would be usually translated as *sociedad* or *compañía*. See Louis A. Robb, *Diccionario de Términos Legales, Español-Inglés e Inglés-Español*, México, Ed. Limusa, 1991, at 151; see also Julio Romañach, *Teach Yourself... Legal Spanish, Bilingual Guide to the Legal Terminology of Laws of Latin America and Spain*, Baton Rouge, Lawrence Publishing Company, 1999, at 308. But see Phanor Eder, *A Comparative Survey of Anglo-American and Latin-American Law*, New York, New York University Press, 1950, at 136 [holding that there is no possible translation for the word *sociedad*]. This term and the ones given to the different types of business organizations are challenging to translate. Keith Rosenn stresses out the complexities of such a task. This author criticizes the wrong translation in Dahl’s Law Dictionary of the *sociedad de responsabilidad limitada* as a limited partnership. More adequately, Rosenn holds that such business entity “is actually a limited liability company whose capital is divided into quotas among a limited number of quota-holders whose liability is limited to unpaid subscriptions or quotas. It can be structured as either a corporation or partnership for U.S. tax purposes, depending upon how the bylaws are drafted”. Rosenn, *supra* note 86, at 613. Conversely, José Ramón Cano Rico, in his trilingual Law Dictionary, provides the English meaning for the Spanish word “corporación”. Obviously, he proposes the appropriate legal translation of *association* instead of the misleading word *corporation* (*Diccionario de Derecho, Español-Inglés-Francés*, Madrid, Ed. Tecnos, 1994 at 46).

²⁸⁴ See, article 641 of the Colombian Civil Code, article 545 of the Chilean Civil Code, article 19 of the Venezuelan Civil Code. See also the following authors: For Colombia, Arturo Valencia Zea, *Derecho Civil*, Vol 1, Bogotá, Ed. Temis, 1994; for Venezuela: Alfredo Morles Hernández, *Curso de Derecho Mercantil, las sociedades mercantiles*, Vol. II, 4th edition, Caracas, Ed. UCAB, 1999; for Chile: Alessandri Rodriguez, Arturo, *Tratado de Derecho Civil*, 7th edition, Santiago, 2005. In regard to the importance of the great nineteenth century codifier Andrés Bello, it has been said that “he was the father of fifteen children”. Matthew Mirow, “Individual Experience in Legal Change: Exploring a Neglected Factor in Nineteenth-century Latin American Codification”, in *Southwestern University School of Law*, Vol. XI, Number 2, 2005, at 301.

²⁸⁵ Hannon warns about the inaccuracy incurred when the term *corporate* is identified with Latin American *sociedades*. It cannot be suggested that Latin American “corporate or corporation law deals with the specific equivalence of the corporation in Latin America”. See P.B. Hannon, *supra* note 92, at 753.

necessarily correspond to the one assigned for the purposes of corporate governance. In the case of Argentine Corporate Law, for example, the term relates exclusively to the legal issues concerning the shareholders' assembly²⁸⁶. In light of these semantic remarks, it appears that an appropriate translation, following the most basic rule of Comparative Law, should have to take into account *functional equivalents* for both words. Although it is too late to change a widespread and somehow practical terminology, a proposed technically neutral translation into Spanish for Corporate Governance could be *organización societaria* (*organização sociétaria*).

Notwithstanding terminology discrepancies as the ones illustrated before, a significant degree of borrowing and harmonization in the field of Company Law in Latin America is as practical as it is necessary²⁸⁷. In fact, the lack of appropriate comparisons with more advanced jurisdictions is one of the main reasons why Latin American legal systems have fallen behind at least in the field of Business Law. The legal framework in these countries is certainly underdeveloped as compared to the more progressive regimes in the world²⁸⁸. Legal transplants in the field of Corporate Law have already taken place in Latin America during the last decades. It is foreseeable that the influence of foreign regulations in the region's Corporate Laws will be further increased. Yet, as it has been suggested, a special caution must be placed in this prospective importation of institutions.

In the specific field of corporate governance for listed firms the pace at which borrowing has taken place is both impressive and problematic. The hasty worldwide diffusion of the American legislation (propelled by broadly publicized scandals of local corporations in the last decade) has left neither room nor time to carefully assess the practical implications of such a complex body of rules in foreign territories. Even in the U.S. the real impact of the Sarbanes-Oxley Act promulgated by Congress in 2001 has not been definitely assessed and conclusively evaluated²⁸⁹. Its practical implications as

²⁸⁶ See Guillermo Cabanellas de las Cuevas, *supra* note 112, at 141-204. See also, Ricardo A. Nissen, *supra* note 119, at 437.

²⁸⁷ "The last century saw, in federal states, like the United States and in supra-national organizations, like the European Union, serious consideration given to the replacement of the current system of corporate regulation with national or supra-national corporate laws". Backer, Larry Catá, *Comparative Corporate Law, United States, European Union, China and Japan*, 2002, at 543.

²⁸⁸ Some important authors apparently tend to classify Latin American Corporate Laws within the same category assigned to African countries: "Other systems of corporate governance are also worthy of study. The governance systems of Latin America, the Indian subcontinent and Africa merit discussion in their own right" (*Id.*, at xxxviii). Another example of this categorization can be inferred from the landmark publication *The Anatomy of Corporate Law*, written by Reiner R. Kraakman and other six reputed authors. Notwithstanding the comparative and international approach adopted in this important book, its explanations are concerned only with European, American and Japanese Corporate Law. There is generally no reference to Latin American legal systems in this fundamental work. See Reiner R. Kraakman *et al.*, *supra* note 177.

²⁸⁹ "It is early days for academic appraisals, but the ones that have been ventured so far tend to the view that costs will exceed benefits. Meanwhile, many of America's businessmen are deeply unhappy, and with reason: the initial costs of the new law have been bigger than expected. And it can be argued that,

a deterrent of inappropriate practices have not been fully verified. In fact, there is a frequent complaint concerning the costs associated with its implementation by firms listed in U.S. stock exchanges²⁹⁰. The situation in Latin America is even less promising. The impact of these measures has not been the subject of substantive analysis. Generally speaking, countries in the region have embraced the new creed of corporate governance, without much regard to economic and cultural local conditions. Not to mention the lack of a careful assessment concerning these new rules' possible implications in terms of costly compliance with bureaucratic and formalistic burdens.

Several countries in the Latin American region have adopted some of the guidelines promoted by the OECD, which seem to resemble to a large extent those adopted in the Sarbanes-Oxley Act (SOX). Nevertheless, in most of these jurisdictions the adoption of this sort of guidelines has been partial. For instance, the following table, prepared by José Ferreira Chagas, shows how Brazilian corporate governance reforms, at least in the traditional segments of the securities market, have not included all the measures and requirements provided in the US for the governance of listed firms (see table 5). However, some of the devices of SOX, such as the obligation to change auditors on a periodical basis, the disclosure of information not recorded on balance sheets as well as the need to certify financial statements have been included in that country's securities regulation.

Table 5
Comparison between Sarbanes-Oxley Act and Brazilian Legislation

Sarbanes-Oxley Act	Brazilian Legislation
Certification by CEO / CFO of annual reports.	Managers and accountants must sign the financial statements. Managers assume responsibility for the accuracy of such statements. Officers or directors who are aware of inaccuracies shall report them to the shareholders.

when it comes to repairing American corporate governance, the law anyway addresses symptoms more than causes" ("Sarbanes-Oxley: A Price Worth Paying?" in *The Economist*, May 19th, 2005). See also Frank Easterbrook, "The Race for the Bottom in Corporate Governance." 95 *Virginia Law Review* 685 (2009), and Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance* (September 25, 2004). NYU, Law and Econ. Research Paper 04-032; Yale Law & Econ Research Paper 297; Yale ICF Working Paper 04-37; ECGI - Finance Working Paper 52/2004. Available at SSRN: <http://ssrn.com/abstract=596101> or doi:10.2139/ssrn.596101

²⁹⁰ John Berlau has held that although Sarbanes-Oxley "was sold as a cure for Enron-like corporate misbehavior, the law mostly fails to target the real wrongdoers and instead punishes all public companies as a class (...). It is innocent small public companies that are really paying an unfair price for Enron's sins". "Puts & Calls: Sarbanes-Oxley 'Reform' Harming Economy", in *Post-Gazette*, November 13, 2005, in www.postgazette.com/pg/05317-605320.htm.

All corporations should have internal auditing committees composed only of independent members.	There is no legal requirement for the formation of committees. However, this issue has been the subject of a recommendation by the Securities Commission (CVM), which is included in its corporate governance booklet. There are auditing committees (<i>conselhos fiscais</i>) whose members are not required to belong to the board of directors. There is no requirement for those members to be “independent”.
Corporations are prohibited from lending to executives.	There are no prohibitions on loans to directors and officers.
Findings arising out of internal control mechanisms must be disclosed in specific reports.	There is no provision for disclosure of internal control findings.
Corporations must inform whether or not they will adopt a code of ethics for senior financial managers. Shall this code not be adopted the listed firm must explain the reasons why it proceeded in that manner.	It is not mandatory to adopt a code of ethics for senior financial managers.
The Securities and Exchange Commission (SEC) has the mandate to issue additional rules for the disclosure of information not recorded on balance sheets as well as concerning “pro forma” data, and relevant adjustments made to the balance sheets.	The corporate governance booklet of the CVM recommends that off balance sheet information be disclosed in explanatory notes. There are neither requirements for “pro forma” information nor for relevant adjustments made to the balance sheets.
The SEC must review the reports filed by registered corporations at least once every three years.	There is no equivalent rule.
Auditors of publicly held corporations cannot provide consulting, or other services prohibited by law, to the firms that they audit.	The CVM prohibits auditors from offering services that may impair the impartiality and independence of their auditing activities.
Corporations will be required to change the auditing partner every five years.	Corporations will be required to change the auditing firms every five years.
SEC has the mandate to issue rules concerning conflicts of interests pursuant to	There is no equivalent under Brazilian Law.

recommendations made by the commissions' analysts.	
Lawyers who know of a legal violation committed by their clients must report it to the legal director or CEO and, ultimately, to the auditing committee or other advisors.	There is no equivalent legal obligation in Brazil.

Source: José Ferrerira Chagas, *Governança Corporativa. Aplicabilidade do Conceito, dos Princípios e Indicadores à Gestão de Pequenas e Médias Organizações*, at 5-6. Available at <http://www.intercostos.org/documentos/085.pdf>

The consequences of emulating foreign legislations in this field cannot be determined at this premature juncture. Nonetheless, as it can be easily demonstrated certain corporations have been deterred from listing their securities in stock exchanges due to the expenses associated to such burdensome regulations. However, the overwhelming reality of Corporate Governance as a worldwide phenomenon cannot be ignored. The influence of proposals such as those prepared by international organizations has changed the Corporate Law landscape at least as it relates to the field of listed firms.

4.3 Structural Transplants and the Good Corporate Judge

A new theory for the importation of Corporate Law provisions has been referred to as the *structural legal transplant*. Pursuant to Katharina Pistor, such concept implies that it is not sufficient for the importation of a rule to merely incorporate into the borrowing country the substantive principles or provisions that work properly in the foreign lending jurisdiction. Along with such substantive norms it is also necessary to incorporate the rules (procedural or otherwise) and factors that cause such provisions to operate properly, including all circumstances that determine its efficiency and enforceability²⁹¹.

²⁹¹ Katharina Pistor *et al.*, "Fiduciary Duty in Transitional Civil Law Jurisdictions", in *Global Markets. Domestic Institutions, Corporate Law and Governance in a New Era of Cross-Border Deals*, New York, Columbia University Press, 2003, at 77-106. Mark J. Roe also clarifies that the quality of corporate law depends on its applicability through a number of core institutions that support it: "To be clear here, I am not speaking simply of corporate law as just the 'law-on-the-books' alone, but as 'law-on-the-books plus the quality of the regulators and judges, the efficiency, accuracy, and honesty of the regulators and the judiciary, the capacity of the stock exchanges to manage the most egregious diversions, and so on" (See Mark J. Roe, *supra* 175, at 167). Roe also suggests a method to measure the quality of the law depending on the lower or higher control premium for every jurisdiction. "If we knew the nation-by-nation average premium for control and could compare it to the value of traded stock, we would have a bottom-line number for the value of control in a firm. In nations where the premium is high, we would surmise corporate law or its enforcement is inferior; in nations where that premium over the price available to diffuse stockholders is low, we would surmise corporate law is superior" (*Id.* at 185). Statistically speaking, the theory can be demonstrated with the cases of the US, where the control premium has been

As a corollary of such theory, any corporate law reform in which a legal transplant is involved should encompass all substantive, procedural and institutional legal and factual circumstances that are necessary to make the transplanted rule work efficiently in the foreign recipient country. Obviously, among these aspects it will be relevant to consider the honesty of judges and their efficiency (measured in terms of enforceability of their final decisions), which are necessary elements for a corporate law system to be effective²⁹². The increasing amount of substantive (non-structural) corporate legal transplants constitutes a serious problem, particularly in developing countries²⁹³. Transplanting substantive legal provisions without importing the corresponding operational and institutional background creates at best a deceptive illusion of a significant change in the legal system while the practical reality remains unaltered.

One such example of an institution that needs to be implemented in the Company Law field is a reasonable corporate adjudication system. Luca Enriques has analyzed the features that in his opinion constitute the so-called *good corporate judge*. The theory is based on the assumption that in order for corporate law to be as useful in real life as on the books, it is crucial for a system to have highly qualified judges available. Such qualification is not restricted to basic legal training in the general areas of procedural and private law, but specifically, in the field of corporate law in theory and practice. Independence is also a very significant aspect in which Enriques emphasizes. In summary, specialized professional qualifications and independence are necessary factors for the corporate judge to apply a comprehensive body of modern corporate law²⁹⁴.

These and other features are supposed to enable the judge to detach herself from the imbedded formalism that characterizes some of the most backward systems pertaining to the civil law tradition. Professor Enriques also points out to the fact that certain legal systems of continental Europe, such as the Swedish and other northern European countries are efficient in the prevention of value shifting transactions and other fraudulent schemes that occur in corporate practice. Opportunistic behavior undertaken by agents (officers, directors, and controlling shareholders) cannot be counteracted only by permanent monitoring, but also requires prompt availability of a *good corporate judge* before whom the abuse can be denounced for the purpose of obtaining an expeditious and final decision.

found to be worth 4% of the firm's value and Italy, where the same premium exceeds 25% of such value. These data are said to be consistent with the quality-of-corporate-law theory (*Id.* at 186).

²⁹² See Rafael La Porta quoted by Luca Enriques, *supra* note 80 at 258-259.

²⁹³ Buscaglia and Daklias, quoted by Luca Enriques, *supra* note 80, at 259.

²⁹⁴ See Luca Enriques, *supra* note 80, at 257-294.

Prominent scholars such as Cooter and Schaefer have held a similar theory. In their opinion, “high quality judges have good education, understand business and markets, do not take bribes, and do not bend to political influence. The power to interpret contracts’ flexibility works better in their hands than in the hands of judges without these strengths”²⁹⁵.

Within the common law tradition, one of the best examples of a *good corporate judge* is the judicial system of the State of Delaware, which along with the substantive provisions contained in the Delaware General Corporation Law, and a qualified bar of corporate lawyers is said to constitute a highly reliable framework to generate confidence in the business entities incorporated in that State²⁹⁶. The State of Delaware’s jurisdiction is, therefore, one of the most specialized Corporate Law judiciaries in the world. The effectiveness of this corporate law judge is measured by two factors: (i) the knowledge and skills in solving complex corporate law problems, and (ii) the ability to produce final decisions within a reasonable timeframe.

For the sake of comparison, it is fair to say that the formalistic procedural and bureaucratic operation of the civil law jurisdictions in Latin America epitomizes the general lack of a *good corporate judge* in the region²⁹⁷. As it has been analyzed above, with the amount and length of procedural obstacles existing in the area, the expectation of a prompt, technical and reasonable resolution becomes elusive. In several jurisdictions in the region, the number of corporate law complaints filed before civil courts is insignificant as compared to, for instance, processes for collection of promissory notes filed before the same jurisdictions.

The enormous obstacles to improve the access to justice in corporate law matters, has forced certain jurisdictions in the area to adopt alternative systems for corporate dispute resolution. The Chilean Corporate Law 20.190 of 2007 sets forth the obligation to subject any dispute arising in the context of this law to corporate arbitration²⁹⁸. Therefore, the ordinary courts are inhibited to adjudicate in corporate law

²⁹⁵ Robert Cooter and Hans-Bernd Schaefer, *supra* note 262.

²⁹⁶ See Alan Palmiter and Francisco Reyes, *supra* note 66, at 77-90, and Roberta Romano, *supra* note 66.

²⁹⁷ Robert Cooter provides an example of a jurisdiction that has devised a system to ameliorate the presence of bad judges. ‘The judges in India’s Supreme Court and the High Court are well educated and independent. They have authority to use the principle of good faith to develop law. In contrast, the lower court judges are poorly educated and too often corrupt. They are not allowed to use the principle of good faith to develop law’. See Cooter, *supra* note 262, at 16.

²⁹⁸ “All conflicts among shareholders, among shareholders and the corporation, its managers or liquidators, or among the corporation and its managers or liquidators, shall be addressed through arbitration (...)” (Art. 441 of the Chilean Commercial Code, as amended by Law 20.190 of 2007). Also, the 2001 Brazilian amendment to the Corporations Law has permitted corporate by-laws to include arbitration as a mechanism for resolving disputes arising between shareholders (Article 109 of Law 6.404 of 1976, as amended by Law 10.303 of 2001. See also Bruno Salama and Vivianne Muller (discussing corporate arbitration in Brazil), *supra* note 80, at 23.

disputes involving a new form of stock corporation (*sociedad por acciones*). Even if this solution may appear to have extreme consequences, it is only a response to the need for an effective system of justice before which complicated corporate law cases can be submitted. Under this recent regulation, the arbitration panel seems to be a *good corporate judge* or at least a *better* court than the ordinary civil jurisdiction.

The suggested Model Act on Simplified Stock Corporations for Latin America provides that conflicts can only be brought before a specialized court of an administrative nature or, alternatively, by arbitration in the manner provided for under the corporate by-laws. As it was thoroughly analyzed above, there are successful examples of a delegation of supervisory and judicial functions to administrative authorities, such as the Colombian Superintendence of Companies and, to a lesser extent, the General Inspection of Justice in Argentina. Due to the obvious risks associated with the concession of judicial powers to officers pertaining to the executive branch of government, it is recommendable to provide specific entry requirements based upon experience and independence for the purposes of appointment and tenure.

4.4 Path Dependence and Company Law Reform

In order to define an appropriate model after which the laws of business associations could be crafted, it is important to bear in mind the practical implications of the so-called theory of *path dependence*. Professors Lucian Bebchuk and Mark Roe describe this theory under two separate concepts: (i) structural path dependence, and (ii) rule-driven path dependence. The former refers to “the direct effect of initial ownership structures on subsequent ownership structures”; the latter is associated with all pre-existent rules applicable to corporations²⁹⁹. The first category is related to analyzing the manner in which *corporate ownership structures* are preserved. Pursuant to this theory, there are five factors that allow for the continuing preservation of an existing economic system. According to Bebchuk and Roe those factors are:

- (i) *Sunk adaptive costs*, i.e., expenses in which firms have incurred in order to adapt with a given set of practices, rules and institutions;
- (ii) *Complementarities*, which relate to the existence of an integrated system of institutions, practices and skills, the value of which could be lost if a significant change were to take place;

²⁹⁹ The initial structure of an economic system has a direct influence on the subsequent choices regarding the prevailing property structures. Two basic factors can be identified with such structural dependence: the first one is based on efficiency; the second relates to rent seeking. Lucian Bebchuk and Mark J. Roe, *supra* note 170. Regarding this topic, see also Lucian Arye Bebchuck, *A Rent-Protection Theory of Corporate Ownership and Control*, National Bureau of Economic Research. Research Working Paper No.7203, 1999 and Katharina Pistor, “Co-determination in Germany: A Sociopolitical Model with Governance Externalities”, in *Employees’ Role in Corporate Governance*, Margaret Blair & Mark Roe, 1999.

- (iii) *Network externalities*, which can be explained as the benefits that stem out of the use of a practice or institution by a significant amount of people. This common use implies a relevant advantage in terms of a reduction of expenses and other costs, and
- (iv) *Endowment effects*, which are associated with the overestimation given to existing institutions and practices by their users. “Players’ having control under an existing structure might affect their valuation of having such control, which would in turn affect the total value that alternative structures would produce”.
- (v) *Multiple optima*. This concept relates to the possibility of operating under several different ownership structures that could yield equally optimal results in each given context³⁰⁰.

Besides the previously mentioned factors, there is another one referred to as *rent seeking*. Such concept is closely associated to the economic benefits that some individuals obtain as a consequence of the preservation of a specific ownership structure. Since such individuals have the power to make the relevant decisions that could determine a change in the ownership structure, the possibility of such a change is, at best, remote. This factor alone may be responsible for the persistence of an economic model (concentrated or diffuse ownership). Even if the initial model is not optimal in terms of benefits for all shareholders, rent seeking may cause it to remain unaltered as long as controlling stockholders retain the power to extract private benefits of control (in excess of the rights conferred by law). In the context of dispersed ownership, directors’ rent seeking is associated with their ability to remain indefinitely in their posts and to enjoy the corresponding corporate perks.

The authors also suggest that rent seeking by controlling majority stockholders in concentrated ownership systems makes it difficult to migrate to a system characterized by diffused stockholding. As a consequence, a majority shareholder who enjoys private benefits of control will be obviously reluctant to undertake an IPO, due to the imminent loss of such benefits. In fact, there will be no incentive for the controlling shareholder (in a corporation characterized by concentrated ownership) to make decisions leading the firm towards a dispersed ownership structure. As a consequence, the parties in charge of the decision-making machinery will retain all private benefits of control.

It must be taken into account that a concentrated ownership structure is not necessarily inefficient from the economic standpoint, since there could be advantages to offset the drawbacks arising from such structure³⁰¹. However, if the advantages arising from a concentrated ownership structure (extraction of private benefits of control)

³⁰⁰ See Mark Roe, *supra* note 88.

³⁰¹ According to McCahery and Vermeulen, such advantages are related with strong ties to local governments and local communities, centralized and efficient decision-making processes, reduction of monitoring expense for minority shareholders (i.e., attenuated agency costs), etc. See Joseph A. McCahery and Erik Vermeulen, *supra* note 154.

exceed reasonable limits and offset all possible economic benefits for the corporation, the system becomes inefficient, as it is clearly the case in Latin America.

Excessive extraction of private benefits of control is pervasive in the so-called inefficient corporate law systems³⁰². Such excessive shifting of value by controlling shareholders or directors does not depend exclusively on the absence of legal protections contained in substantive provisions, but also on the ability to enforce such legal rules. For instance, a comparison between European and Latin American civil law countries may show significant differences in terms of institutional framework and enforceability of corporate laws. Such differences also reflect the existence of controls – or lack thereof – regarding the extraction of private benefits of control³⁰³.

Certain forms of path dependence lay out the basis for some degree of stability in a legal system. This is due to the burdensome processes that are required to introduce radical reforms. In fact, it has been held that such forms of path dependence may give rise to competitive financial and economic systems even under divergent economic circumstances³⁰⁴. A good example of such efficiency is given by the models of dispersed ownership prevailing in the United Kingdom and the United States, where several substantive regulations have been crafted to deal with agency problems arising from the separation between ownership and control³⁰⁵. Positive and negative incentives are set into play in order to align the interests of shareholders and directors. Those devices tend to reduce monitoring expenses, bonding costs, and residual losses stemming from *adverse selection* and *moral hazard*³⁰⁶. The latter situations are associated, in turn, with the information asymmetries present in agency relationships. Such relationships must be structured in a manner in which the agent has the appropriate incentives to enhance the principal's wealth. In the absence of these incentives it is likely for the agent to act opportunistically. This propensity may be caused by the uncertainty regarding the future activity that the agent must undertake, as

³⁰² Ronald Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, August 2005, SSRN Id. No. 784744. Private benefits of control are defined as such that a controlling shareholder can grab from the firm by diverting value away from the firm's stockholders (Mark J. Roe, *supra* note 175 at 176). The obvious consequence of high private benefits of control is explained by the same author in the following manner: "with private benefits of control high, the controller *must* hold onto control, because those benefits cannot be sold (other than by selling the block intact), lest someone else be able to grab those benefits of control" (*Id.* at 177).

³⁰³ *Id.*, at 9.

³⁰⁴ See, for instance, John C. Coffee, 'Law and Market', *supra* note 80 (holding that France – a Civil Law system with concentrated ownership – has at least matched the UK's – a Common Law system with share ownership dispersion – economic performance over the last century).

³⁰⁵ Regarding this topic, see Adolph Berle and Gardiner Means, *The Modern Corporation and Private Property*, New York, Transaction Publishers, 1991.

³⁰⁶ See Michael Jensen and William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 1976, SSRN Id No, 94043. According to these authors, the scope of agency costs may vary from one corporation to another since they depend on factors such as directors' preferences, the discretionary authority that has been granted to them (as opposed to the maximization of the corporation's value), monitoring expenses, bonding expenses, etc.

well as the principal's inability to closely monitor the agent's performance. The basic agency problem arising in the context of dispersed ownership between shareholders and management is usually reflected, among other wrongful activities, in the possibility of obtaining corporate perks, insider trading, excessive executive compensation, and the usurpation of corporate opportunities.

As it will be explained in further detail below, the above-mentioned agency problems are different to the ones existing between majority and minority shareholders. One of the basic distinctions relates to the changes in the incentive structure that takes place whenever the majority's block is reduced. This reduction occurs when the controlling shareholder obtains additional cash through sales of shares in the corporation. According to Jensen and Meckling, as the controlling block shrinks, the agent's incentives (i.e., the controlling shareholder) to search for new opportunities and to engage in creative activities will be hindered, due to the corresponding reduction of private benefits of control. The owner-manager will avoid these stressful efforts that usually include learning new technologies and other time-consuming activities. In doing so, the agent will avoid these personal costs generating an additional profit. This reduced activity on the part of the agent will lead in turn to a substantial loss of value to the corporation and its minority stockholders³⁰⁷. All these situations are frequently observed in family owned corporations in Latin America. The unrestrained appropriation of private benefits of control usually results in a consistent deprivation of minority shareholders' economic benefits.

On the other hand, it must be borne in mind that in certain Western European countries in which capital concentration is also the rule, have achieved high levels of economic development comparable to those existing in dispersed ownership systems³⁰⁸. A plausible explanation for this development may lie in the operation of effective legal mechanisms to counteract the specific type of agency problems that occur in concentrated ownership systems. Henry Hansmann and Reinier Kraakman have emphasized on the specific nature of the agency problems arising in contexts in which there is no separation of ownership and control (*concentrated or block-ownership systems*)³⁰⁹. As it has been explained, in the event of concentrated ownership systems the basic agency problem concerns the tensions between majority and minority stockholders. Consequently, specific mechanisms must be devised in order to align, through several different incentives, the interests of majority and minority stockholders.

³⁰⁷ *Id.* According to Jensen and Meckling, the loss of value stemming out of directors' opportunism will only be sub-optimal or inefficient when compared with a *Coasean World* (in which the agent's performance is complete, without the need to incur in monitoring expenses) or when compared with a hypothetical world in which agency costs were effectively lower than in reality. Nevertheless, all these costs (monitoring, bonding, and residual losses) are an inevitable result in any agency relationship.

³⁰⁸ See Coffee, 'Law and the Market', *supra* note 175.

³⁰⁹ See Henry Hansmann, Reinier Kraakman, *et al. supra* note 177, at 21-29.

The previously mentioned assertions can also be linked with the already mentioned theory of *multiple optima*, whereby competing ownership structures might have equally positive results in different countries³¹⁰. Moreover, every system has an optimal regulatory degree that could be inadequate if it is applied haphazardly to any other economic system. It follows that there might be multiple adequate levels of regulation according to the specific features of each system. This may explain why countries with diverging economic models have attained comparable high levels of economic development.

Most efforts in Company Law reform in Latin America during the last decade have been aimed at improving the framework for publicly held corporations with the expectation of creating a better regulatory environment for a deep and liquid securities market. Law reform for publicly held firms has resulted in significant changes in securities regulation in most major jurisdictions in the area. However, even if the OECD White Paper on Corporate Governance for Latin America has been partially adopted in these countries, the results of such implementation have been at best innocuous and at worst detrimental to the securities markets in the area. The increase in costs of compliance for listed corporations may exceed the reduction in the cost of capital. This is due in part to the formalistic nature of these recommendations and the lack of enforcement mechanisms that could foster their actual compliance. The basic criticism to these corporate governance reforms is based on the extrapolation of a model devised to deal with agency problems germane to ownership dispersion contexts, to countries with highly concentrated capital. The argument draws from the substantial differences on agency problems that arise between shareholders and directors as compared to the relationships between majority and minority stockholders³¹¹. This legislative agenda for Corporate Law disregards a conspicuous economic reality in which closely held corporations normally dominate the landscape of business associations in these countries. A high level of concentrated-ownership in Latin America – which has been described, as the highest in the world³¹² – cannot be counteracted with formalistic recommendations that bear little relationship with the agency problems identified for the area. This is particularly true in the absence of an institutional framework, which could be used to enhance the enforceability of substantive provisions. An adaptation of the theory of path dependence provides an insightful tool to the analysis of Company Law reform for Latin America. Realizing that even in the context of concentrated ownership there can be significant economic growth may be a valuable step towards shifting legislative efforts to the closely held corporation. This will necessarily require a

³¹⁰ Lucian Bebchuk and Mark J. Roe, *supra* note 170.

³¹¹ For an explanation as to the shortcomings of these corporate governance reforms and the inadequacy of many of the solutions recommended by the OECD, see Francisco Reyes, “Corporate Governance in Latin America: A Functional Analysis”, in *Inter-American Law Review*, Vol. 39, No. 2, Winter 2008.

³¹² José Antonio Ocampo and Juan Martín (eds.), Economic Commission for Latin America and the Caribbean (ECLAC), 2003. The same idea is expressed by Jacelly Céspedes and Maximiliano González (*Ownership Concentration and the Determinants of Capital Structure in Latin America* [Online] http://www2.coppead.ufrj.br/engl/images/stories/eventos/048_cspedes_gonzles_molina.pdf).

reshuffling of priorities in the policy agenda. A radical change in the traditional approach will allow for an overhaul of the business association's regulation contained in anachronistic commercial law codes and statutes³¹³. An upgrade in this area can easily be achieved by the introduction of a multifunctional hybrid business form that could coexist and compete with previously created company types. The successful Colombian example regarding the SAS speaks loudly of the benefits that could be obtained if such a step were to be taken.

4.5 The Impact of Company Law for Economic Development

Ownership patterns (dispersed or concentrated) are not the only factors that have to be taken into account for the purposes of comparative company law. A substantial amount of recent academic production on the economic analysis of law draws from the econometric studies of Rafael La Porta, Florencio López-de-Silanes, Andrei Shleifer and Robert Vishny (also known as LLSV). These authors attempted to demonstrate through empirical analysis that the main differences regarding the protection afforded to investors in multiple jurisdictions could be attributed to the legal tradition that each country had inherited (*legal origins theory*)³¹⁴. In a couple of articles published in 1997 and 1998, LLSV held the controversial theory whereby countries belonging to the common law tradition were better endowed with investor protection mechanisms as compared to their civil law counterparts³¹⁵. After analyzing samples taken in 49 countries, LLSV showed that there was a positive correlation between the legal tradition existing in each nation and its level of financial development. Not only did they divide the world into three separate categories, i.e. 1) Common Law; 2) German and Scandinavian Civil Law; and 3) French Civil Law, but they rated the countries included in the first category in the first position and assigned the last one to the French Civil Law systems³¹⁶. According to this research, countries of a Common Law origin had

³¹³ Brazilian Professor Eduardo Secchi Munhoz provides a good summary of what has been suggested. According to this author, structures of control do not necessarily determine the efficiency of corporations. Pursuant to this opinion, this is due to the following reasons: (i) Concentrated ownership systems are predominant all over the world, with the only possible exceptions of the US and the UK; (2) corporate control structures constitute an economic reality that is resistant to change. Hence, it is naïve to imagine that simple amendments to company law will suffice to alter such structures, and (iii) there is not necessarily a positive correlation between a specific structure of control and a corporation's efficiency (See Secchi Munhoz, *supra* note 175 at 131).

³¹⁴ Rafael La Porta, Florencio López de Silanes, Andrei Shleifer, and Robert Vishny, "Law and Finance", *Journal of Political Economy*, Vol. 106, No. 6, December 1998.

³¹⁵ LLSV found a negative correlation between the degree of ownership concentration and the protection afforded to investors in each of the concerned countries. Based on such correlation they concluded that those systems that lacked a sufficient protection were not suitable to support a fully developed securities market. *Id.*

³¹⁶ "Legal rules protecting investors vary systematically among legal traditions or origins, with the laws of Common Law countries (originating in English Law) being more protective of outside investors than the laws of Civil Law countries (originating in Roman Law) and particularly French Civil Law." Rafael La Porta, Florencio López-de-Silanes, and Andrei Shleifer, *The Economic Consequences of Legal Origins*, November 2007, at 2.

grown at a higher rate (4.3% per capita) in comparison with French Civil Law countries (3.18%)³¹⁷. The study suggested, among other conclusions, the convenience of transplanting Common Law-type legal provisions into Civil Law countries. In their opinion, the importance of legal origins in defining investor protection suggests that many rules must be changed in order for an inefficient legal system to adhere to best practices³¹⁸. Notwithstanding LLSV's significant contribution, their conclusions have been vigorously challenged. Although the proposition whereby *law matters* is broadly acknowledged, the legal tradition may not be all that important as the LLSV texts suggest. John C. Coffee points out to at least the following five factors that can be used to challenge the legal origins theory: (i) Even if the analysis assumes the inefficiency of the French legal system, France has experienced a higher economic growth than the United Kingdom during most of the period that runs from 1820 until today. French civil law appears to have been efficient, at least for France; (ii) the statistical data that have been used to prove that Common Law countries have outperformed Civil Law countries is due, to a high extent, to the spectacular failure of Latin American countries during the last century. Even the assertion that Latin American systems belong to the French Civil Law tradition is highly debatable; (iii) The statistical analysis used by LLSV is suspect to the extent that certain critics have held that it has been unduly applied; (iv) There are important examples regarding countries that have reached rapid economic development irrespective of their civil law tradition. Alternatively, there are common law countries that have not been able to reach a high level of economic development; and (v) some authors debate the assertion whereby law could have an importance even comparable to structural factors such as geography, free trade, or colonial heritage.

Coffee concludes, ironically, that the failure of French Civil Law may have arisen from its inception in too many tropical climates, as compared to the common law that was received in more temperate countries³¹⁹. Therefore, it is his opinion that a legal system can have an impact on economic growth as long as an appropriate level of enforcement intensity supplements substantive norms. Such intensity can be measured both at the level of public and private enforcement. The most accurate way to undertake such measurements is by considering the amount of resources allocated to governmental enforcement agencies (*inputs*) and to compare it with the consolidated

³¹⁷ La Porta, *et al.*, quoted by John C. Coffee, *supra* note 80, at 21.

³¹⁸ It follows from this analysis that it would be convenient to undertake the transplant of legal provisions regarding investor protections originating in common law countries. However, Holger Spamann has held that the analysis should not be approached from the standpoint of the legal tradition from which the rules are borrowed. In his opinion, the differences between the civil law and its common law counterpart are not as relevant as the nature of the jurisdiction. For this purpose, the author classifies legal systems between so-called *core* and *peripheric* jurisdictions. In the former, the legislative-making process is endogenous whereas in the rest of the countries the process is exogenous, namely, it is achieved through the importation of legal rules designed in core jurisdictions. Holger Spamann, 'Contemporary Legal Transplants: Legal Families and the Diffusion of Corporate Law', in *Brigham Young University Law Review*, Vol. 2009, No. 6, 2010, at 1813-1877.

³¹⁹ See John Coffee, *supra* note 175, at 26.

amounts that are collected by such agencies (*outputs*). As enforcement intensity increases, the quality of corporate law is also upgraded³²⁰.

For the specific purposes of this book it would be fair to say that legal origins matter, particularly in the field of closely held entities. As it will be studied in further detail later in this text, the outstanding quality of US Corporate Law can be easily appreciated in its higher flexibility, lower degree of formalism and appropriate incentive structure, which fosters entrepreneurship and innovation. The influence of US developments in Corporate Law are evident in France as it can be easily verified after the inception of the 1994 statute on the Simplified Stock Corporation (*Société par Actions Simplifiée*).

4.6 Proposals for Latin American Company Law Reform

4.6.1 Publicly held Corporations

One of the criteria used to determine economic growth consists of measuring capital market development and the creation of new businesses. However, Cooter and Shaefer have held that a vigorous stock market is not necessarily an essential factor for the economic development of poor countries. Using specific examples from economies in transition such as India and China, the author points out to the significant growth attained in those countries within the last decade. In determining the manner in which financing has taken place in these jurisdictions, he observes the relative absence of highly operational systems for publicly traded stocks³²¹.

A brief review of statistical data regarding stock exchanges in Latin America reveals how the stock markets are small, particularly if these data were confronted with statistical information concerning developed economies (see Table 6, showing the number of listed corporations per million inhabitants in Latin America).

³²⁰ *Id.* An objective criterion to assess enforcement intensity in securities markets is closely linked to the so-called bonding premium that arises in the context of cross-listings, where an issuing corporation undergoes an IPO in a foreign jurisdiction with better quality corporate and securities law. There is a direct correlation between the higher or lower enforcement intensity and the amount of the bonding premium. If, for instance, the issuing corporation is originally listed in a jurisdiction with poor corporate and securities laws, listing its securities in the New York Stock Exchange will result in a high premium that can be easily assessed through event studies after information on the cross-listing has been disclosed.

³²¹ See Cooter and Shaefer, *supra* note 262.

Table 6
Number of listed corporations per million inhabitants in major Latin American jurisdictions

Position	Country	Number of listed companies	Population	No. of listed corporations per million inhabitants
1.	Chile	232	16,970,265	13.67
2.	Peru	195	29,164,883	6.68
3.	Argentina	101	40,276,376	2.50
4.	Colombia	86	45,659,709	1.88
5.	Mexico	125	107,431,225	1.16
6.	Brazil	377	193.733.795	1.94

Table prepared with information provided by the World Bank (2009) [online] <http://data.worldbank.org/indicator/CM.MKT.LDOM.NO/countries/1W?display=default>

As it can be easily verified, the amount of IPOs and other public offerings is limited, the market capitalization of listed companies is relatively small as a percentage of GDP (see also Graph 3, showing the percentage of GDP made up by market capitalization) and the number of issuers of securities is small. In fact, since 1970 Africa and Latin America, “are the only regions of the world exhibiting a decline in the number of [listed] firms per million inhabitants. The incredibly low levels of trading activity are also a reflection of the poor state of capital markets in the region. Today, Latin American stock exchanges are among the smallest and least active markets in the world relative to the size of the economies”³²². To provide a specific example, it is illustrative to look at the Colombian case. There are only 94 corporations registered in the Colombian Stock Exchange. Only shares of stock issued by 22 of these companies have significant liquidity. Moreover, no IPOs or any other public issuance of stock took place during years 2008 to 2010. Transactions regarding stock represent only 2% of the total amount of securities traded in the Colombian stock exchange. Regarding the decline in the

³²² Alberto Chong and Florencio López-de-Silanes, *Corporate Governance in Latin America*, Inter-American Development Bank, Research Department, March 2007, at 6. The same authors hold that the capital markets in Latin America “are lagging behind those in the rest of the world (...) a simple look at basic statistics on stock market development puts the region far behind not only developed countries, which may be expected, but also developing and emerging markets. With the notable exception of Chile, there has been little dynamism in the rest of the markets of the region in the last couple of decades. For the case of the larger economies in the region, such as Argentina, Brazil, and Mexico, the growth of markets has not matched that of the economy. Although still far behind most of the world, the region seems to have shown some upward movement in terms of market capitalization as a proportion of gross domestic product (GDP) in the last 15 years. But a more careful look at the numbers shows that the bulk of the increase in recent times is not arising because more firms are entering the market, but rather because some large companies are capturing the market and are cross-listed in foreign exchanges. In sharp contrast to other emerging market regions of the world such as Asia and Eastern Europe, the number of listed firms has plummeted (*id.*, at 6).

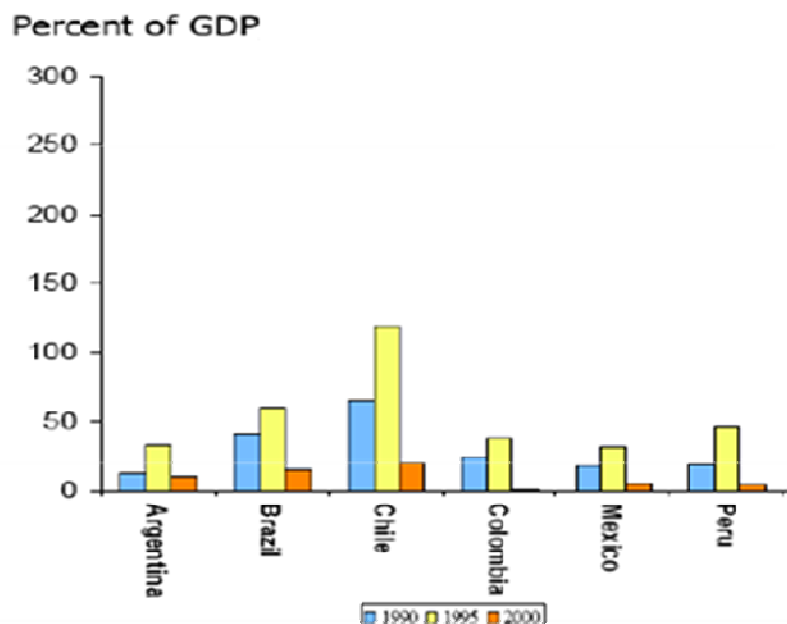
number of publicly held corporations in Latin America, see the *listed domestic companies* World Bank indicator. This index shows that countries such as Brazil exhibit an important reduction in the number of corporations trading their securities in the stock exchange (from 442 listed corporations in 2007, to 377 in 2009); a similar situation occurred in Colombia (from 96 listed companies in 2007 to 86 in 2009) and Argentina (from 107 companies in 2007, to 101 in 2009).

In accordance with what has been said by other authors, “back in the early 1990s, economists and policymakers had high expectations about the prospects for capital market development in emerging economies. This led to significant reforms, including financial liberalization, the establishment of stock exchanges and bond markets, and the development of regulatory and supervisory frameworks. These reforms, together with improved macroeconomic fundamentals and capital market-related reforms, such as the privatization of state-owned enterprises and the shift to privately managed defined contribution pension systems, were expected to foster financial development. Despite the intense reform efforts, the performance of domestic capital markets in many emerging economies has been disappointing. Although some countries experienced growth of their domestic markets, this growth in most cases has not been as significant as the one witnessed by industrialized nations. Other countries experienced an actual deterioration of their capital markets. Stock markets in many developing countries have seen listings and liquidity decrease, as a growing number of firms have cross-listed and raised capital in international financial centers, such as New York and London ...”³²³.

In support of the above-quoted World Bank analysis, graph 3 below compares GDPs for some of the largest economies in Latin America and market capitalization in each of their national stock exchanges, applying for that purpose the international benchmark method.

³²³ Capital market development, Whither Latin America? World Bank [online] at <http://siteresources.worldbank.org/DEC/Resources/CapitalMarketDevelopmentWhitherLACMar2106.pdf>. See also Joseph A. McCahery and Erik Vermeulen, *supra* note 154, at 54.

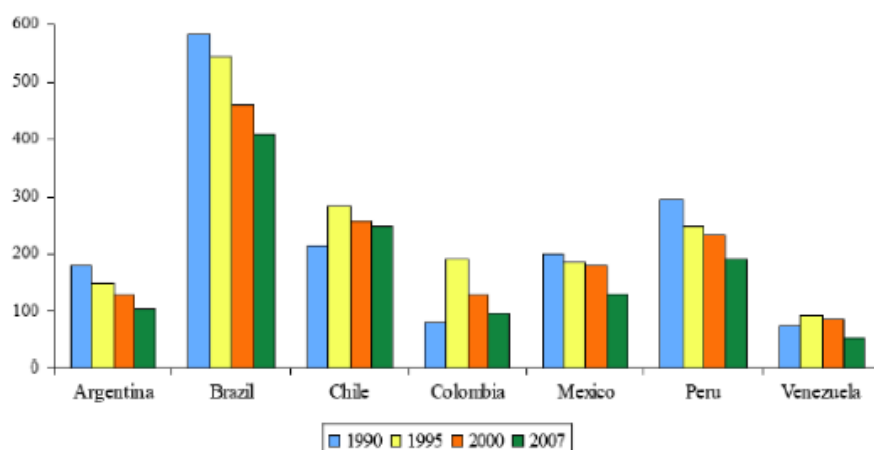
Graph 3
Percentage of GDP made up by market capitalization



Source: Augusto de la Torre, *Emerging Capital Markets and Globalization. The Latin American Experience*, World Bank Publications, 2007

Graph 3 can be analyzed jointly with graph 4, showing the decrease since 1990 in the number of listed firms in Latin American domestic stock exchanges. As it can be observed, there appears to be a coincidence between the wave of corporate governance reforms and the significant decrease in the number of listed firms in every major Latin American jurisdiction. Aside from other macroeconomic factors, a hypothesis can be ventured regarding the increasing costs of compliance (mostly due to multiple requirements of a formalistic nature) without any positive impact on investor confidence. Therefore, these reforms have not resulted in a reduction in the cost of capital. Therefore, despite the significant resources invested in these reforms, the situation of major stock exchanges across the region concerning stock trading has not improved at all.

Graph 4
Number of firms listed in Latin American domestic stock exchanges



Source: Augusto de la Torre, *Emerging Capital Markets and Globalization. The Latin American Experience*, World Bank Publications, 2007

It is fair to acknowledge that certain corporate governance reforms have had some impact as in the case of the São Paulo Stock Exchange (or BOVESPA). In an effort to stimulate the securities market, a special segment of the exchange was created in December 2000. Corporations listed on the so-called *Novo Mercado* of Bovespa are subject to more demanding corporate governance requirements as compared to the minimum standards set forth in Brazilian securities regulations. Corporations listed in this higher segment must adopt corporate rules concerning enhanced shareholder rights, transparency, and a higher level of disclosure.

Along with the Novo Mercado, the Sao Paulo Stock Exchange was reorganized through a multi-tier system that allows firms to choose between different segments. Each one of them is characterized by specific corporate governance requirements. Novo Mercado has the highest standards. In fact, every level is progressively more demanding for the issuing corporations in terms of disclosure and transparency (see Table 7, regarding Corporate Governance Segments of BOVESPA and Graph 5, about New Markets in the São Paulo Stock Exchange).

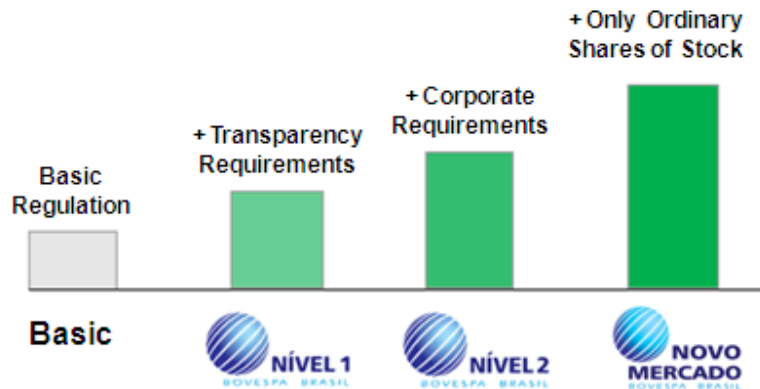
Table 7
Corporate Governance Segments of BOVESPA

Level 1	Level 2 Same requirements as Level 1 plus:	Novo Mercado Same requirements as Level 2 plus:
Maintenance of a free-float of at least 25% of the capital.	Establishment of a two-year unified mandate for the entire Board of Directors, which must have five members, of which at least 20% (twenty percent) shall be	Public share offerings have to apply mechanisms to favor capital dispersion and broader retail access.

	Independent.	
Public offerings have to use mechanisms to favor capital dispersion	In case majority shareholders sell their stake, same conditions granted to them must be extended to common shareholders, while preferred shareholders must get, at least, 80% of the value/conditions (tag along).	Same conditions provided to majority shareholders in the disposal of the company's control will have to be extended to all shareholders (tag along).
Improvement in quarterly reports, including the disclosure of consolidated financial statements and special auditing.	Disclosure of annual balance sheets according to US GAAP or IFRS.	Improvements in quarterly reports, such as the requirement of consolidated financial statements and special auditing.
Monthly disclosure of transactions involving stocks issued by the corporation on the part of the controlling shareholders.	Voting rights granted to preferred stocks in circumstances such as incorporation, spin-off and merger and approval of contracts between the company and other firms belonging to the same holding group.	Compliance with disclosure rules in transactions involving securities issued by the company on the part of controlling shareholders.
Disclosure of an annual calendar of corporate events.	Obligation to launch a tender offer according to market value in delisting events.	Some of these decisions must be approved at the General Shareholders Meetings and need to be included in the corporation's bylaws.
	Admission to the Market Arbitration Panel for resolution of corporate disputes.	

Source: BM&FBOVESPA, available at <http://www.bmfbovespa.com.br/>.

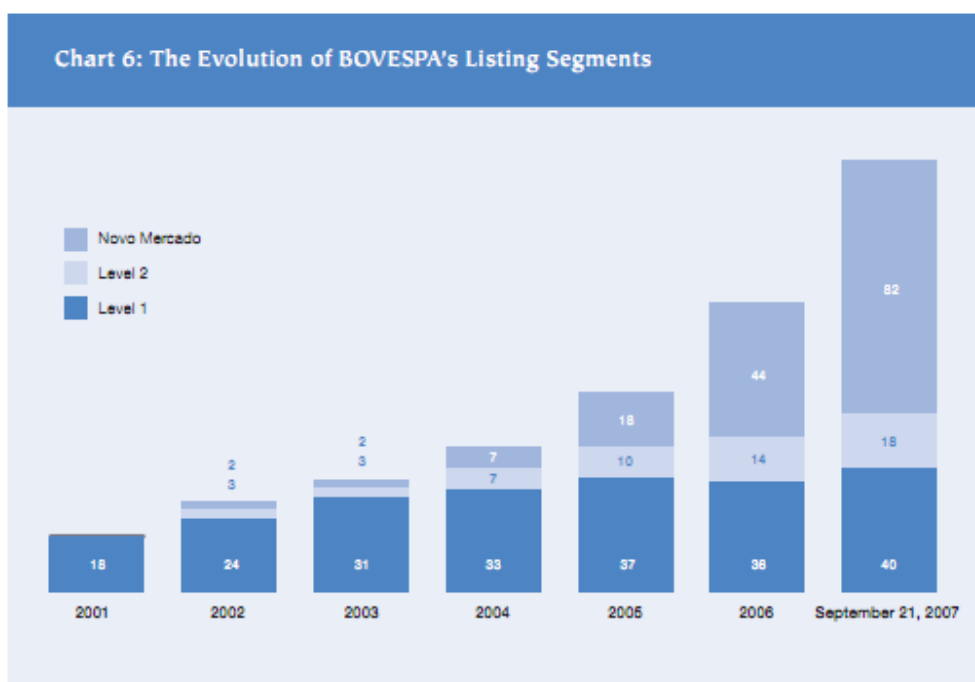
Graph 5
New Markets in the São Paulo Stock Exchange (BOVESPA)



Source: BM&FBOVESPA, available at <http://www.bmfbovespa.com.br/>.

These new segments of the São Paulo Stock Exchange were devised as a mechanism to foster corporate governance practices in Brazil. The graph below shows the relative growth of these segments during the initial years that followed their creation in December 2000.. As it can be observed, the first year, after these reforms were implemented, only 18 corporations were listed in Level 1 and none was listed in either of the other two segments. In 2004, 33 corporations were listed in Level 1, 7 in Level 2, while another 7 were listed in Novo Mercado. By 2007, 40 corporations were listed in Level 1, 18 in Level 2, and 82 in Novo Mercado (see Graph 6).

Graph 6
Evolution of BOVESPA's Listing Segments

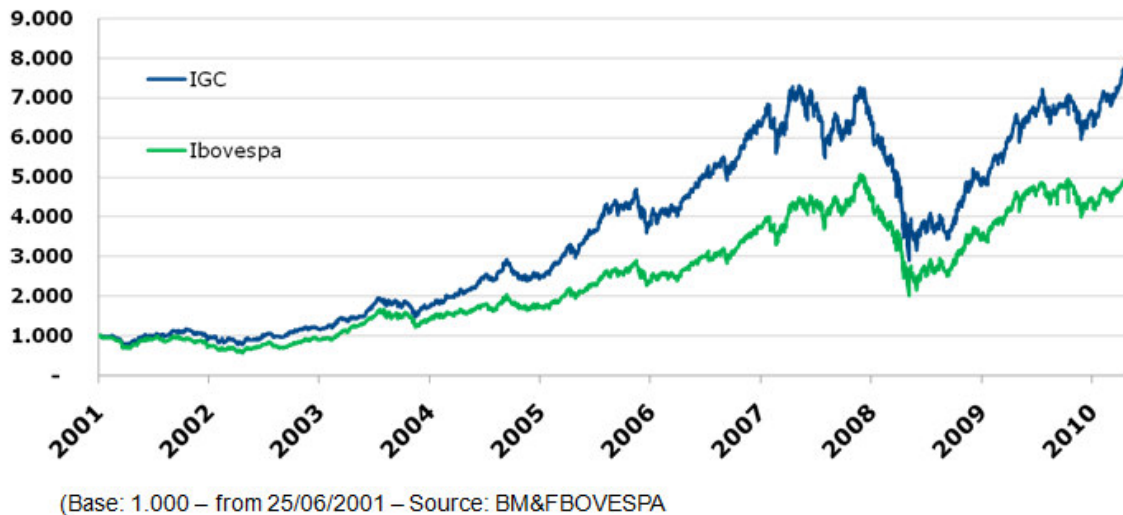


The numbers in the boxes tell how many companies listed on BOVESPA in each listing segment.

Source: Maria Helena Santana et al., *Novo Mercado and Its Followers: Case Studies in Corporate Governance Reform*, p. 19. 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)

An indication of a possible accomplishment of this multi-tier Brazilian system could be reflected in a better performance attributed to stocks of corporations subject to higher corporate governance standards. Graph 7, below, compares the Special Corporate Governance Stock Index (IGC), which measures “the return of a theoretical portfolio composed of shares of companies with a good level of corporate governance” with the BOVESPA Index (IBOVESPA), which represents “the average performance of the main traded stocks and the profile of the cash market operations carried out on BM&FBOVESPA” (See <http://www.bmfbovespa.com.br>). As it can be observed, by the end of 2001 (only one year after the creation of these new segments), shares listed in *Novo Mercado* or classified in either Level 1 or 2 surpassed the main traded stocks in BOVESPA. In summary, the empirical evidence may suggest that the return of stocks of corporations that adopt better corporate governance practices is higher than the profitability of those corporations that only abide by traditional, less demanding standards.

Graph 7
Corporate Governance Index vs. BOVESPA Index

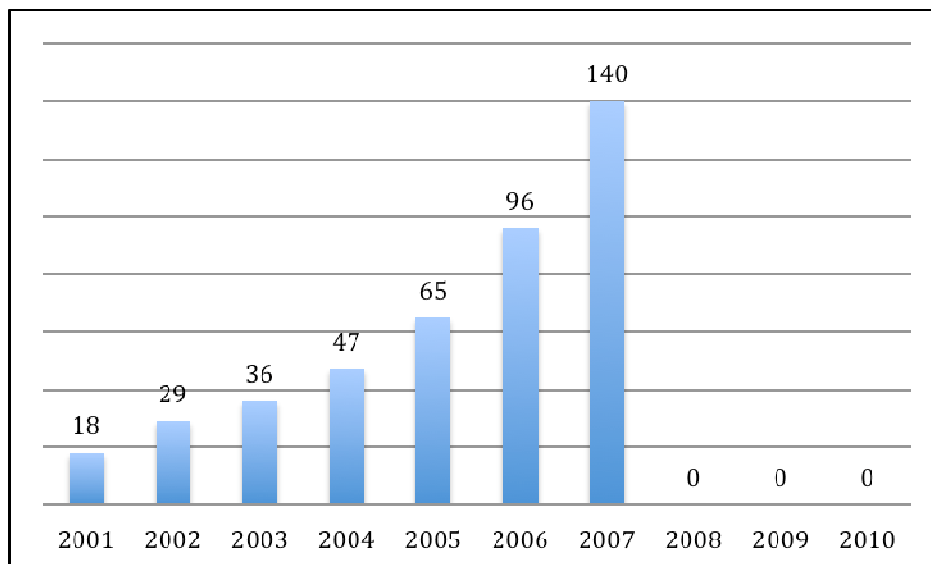


However, even considering the developments related to the Novo Mercado, nearly a decade after its creation the Brazilian Stock Exchange suffered a dramatic downfall in the number of listed corporations in 2008. This situation was mainly caused by the financial crisis that spread around the world after the bankruptcy of Lehman Brothers. This crisis' contagious-effect impacted the Brazilian stock market, especially because of the increasing risk aversion of investors and banks. There was, in consequence, an enormous reversal in foreign and local capitals. As Graph 8, below, shows, the highest number of listings took place in 2007 (140 new corporations were listed). Surprisingly, not a single new corporation was listed in the Sao Paulo stock exchange during the years 2008, 2009 and 2010 (see Graph 8).

It can also be observed that, despite the initial accomplishments attained through the Novo Mercado and, particularly, the dazzling peak reached in 2007, the available data does not allow concluding that Brazil represents an altogether exceptional case within the general landscape of Latin American stock exchanges. This country has also followed the general regional trend characterized by the gradual reduction of listed firms and stock transactions during the last decade.

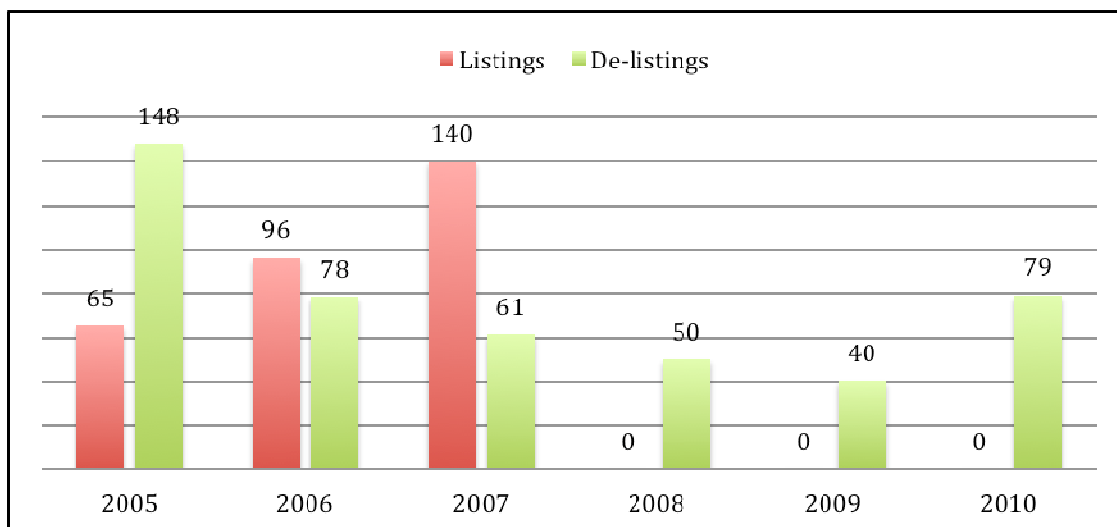
Graph 9, below, consistently shows how, even for Brazil, the number of new listings is generally lower than the amount of delisting on a per year basis. Graph 10 can provide evidence of a declining trend, as it shows the decrease in the number of BOVESPA's listed firms since its peak in 2007.

Graph 8
New Listings in the Brazilian Stock Exchange (until September 2010)



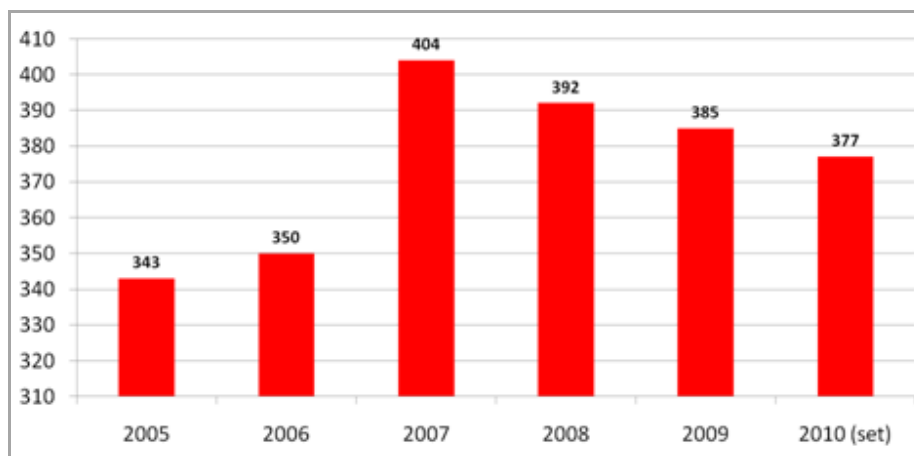
Source: BM&FBOVESPA, available at <http://www.bmfbovespa.com.br/>.

Graph 9
Listing and De-listings in the Brazilian Stock Exchange (until September 2010)



Source: BM&FBOVESPA, available at <http://www.bmfbovespa.com.br/>.

Graph 10
Evolution in the Number of Listed Corporations in BM&FBovespa (until September 2010)



Source: BM&FBOVESPA, available at <http://www.bmfbovespa.com.br/>.

The information contained in the foregoing tables and graphs may suggest that, despite its broad publicity, the *Novo Mercado* has not been entirely successful in its efforts to provide confidence to new investors who may wish to purchase securities in the Brazilian Stock Exchange. In addition, it is clear that after 2007, each passing year fewer corporations are listed in BOVESPA. The assertion whereby the dramatic downfall in the number of listed corporations in the Sao Paulo stock exchange was only a collateral effect of the 2008 financial crisis can be contested on the grounds of recent empirical evidence. In fact, the data concerning listed corporations show that two years after the above-referred crisis, the results are not improving. This empirical reality may suggest that investors' distrust still prevails also in the Brazilian case. This information may also confirm that corporate governance reforms that are focused exclusively on substantive law issues are insufficient to improve the investment climate.

Despite the enormous efforts and economic resources invested to foster reforms that could have deepened the stock markets in the region, the empirical data does not provide evidence of a proportional impact in the development of stock exchanges across the Latin American area. Unprecedented de-listings, decreasing numbers of IPOs, few issuances of stocks by already listed firms, and increasingly concentrated ownership in publicly held corporations demonstrate a failure in the policy agenda. In contrast, the few reforms made in the context of closely held firms have shown enormous success in the recent past. This empirically proven reality suggests the need to shift the policy agenda towards the improvement of the legal framework for closely held companies, instead of devoting additional resources to the development of an ideal model for publicly held corporations, the future of which is, at best, uncertain in this geographical area.

4.6.2 Closely held Corporations

As a general rule, significant innovation has not taken place regarding closely held corporation statutes in the Latin American region. Outmoded notions such as the lack of single member companies, a strict *ultra vires* doctrine, a fixed term of duration, the existence of several formalistic prohibitions supposedly aimed at the protection of shareholders, and a plethora of regulatory provisions better suited for publicly held entities than for small and medium family businesses, are only but a few of the features characterizing an anachronistic regime that needs to be reformed.

Probably the Colombian system in which Corporate Law reform has been underway for the last 15 years could be a good example of a shifting from the rigidities of an *ancien régime* such as the one described above to a reform agenda prioritizing flexibility, contractual freedom and limited liability. The goals advanced in the recent 2008 act introducing the simplified stock corporation (*sociedad por acciones simplificada*) in Colombia, match the contemporary policy agenda which gives prevalence to the so-called hybrid business forms, also known as *uncorporations*³²⁴. The adaptability of hybrid business forms, which can be used as all-purpose vehicles, has led to their introduction in Common Law and Civil Law jurisdictions around the world³²⁵.

The success of legal transplants in the field of closely held firms is significantly facilitated by the homogeneity of agency problems that are present in non-listed firms everywhere. Therefore, dichotomy between diffused and concentrated ownership as well as the corresponding differences in the assessment of agency problems are not relevant in non-listed firms. The optimal incentives to neutralize agency problems in the context of closely held companies could be applied in different jurisdictions, without regard to the economic circumstances prevailing in each country.

4.7 The Model Act on Simplified Stock Corporations for Latin America

³²⁴ See draft legislation for the SAS, prepared by Francisco Reyes in 2006. For the original draft that gave rise to the Colombian law on simplified stock corporations, see Gaceta del Congreso No. 111, Bogotá, April 11 of 2007, at 1-6. This new business entity contains all the features of a modern hybrid business form and has been praised by the local media as “a legal revolution that has changed the face to the manner in which people do business” (See Editorial on *Portafolio Newspaper*, February 4, 2011, available at <http://www.portafolio.com.co/noticias/editorial/editorial-el-exito-de-las-sas>).

³²⁵ See Joseph A. McCahery and Erik Vermeulen, *supra* note 154, at 54. The success of these closely-held business entities is in part explained by their broad contractual flexibility which allows the parties to deal with agency problems. According to the same authors, “we identify a wide range of mechanisms that can be employed to solve the complex and costly contracting and governance problems of the firm. These mechanisms are typically contractual in nature and include ownership structure, the board representation, financial transparency, and adequate information disclosure” (Joseph A. McCahery and Erik P.M. Vermeulen, *Conflict Resolution and the Role of Corporate Law Courts: An Empirical Study*, ECGI Working Paper Series in Law, Working Paper N°.132/2009, August 2009 at 6).

The case for developing new business forms is a strong one in Latin America. Family-owned businesses and closely held companies abound in the region, creating significant demand for entities that allow parties to engage in extensive private ordering. As it has been stressed out, existing business forms have proven to be inflexible to suit the needs of family-owned and multi-owner firms alike. However, most Latin American legislators –much like some of their European counterparts– have been reluctant to develop new hybrid vehicles. Increasing entrepreneurial demand for reform has only recently spurred several initiatives within the region. Such statutory enhancements are currently being outmatched by the introduction of a new business form: the *Sociedad por Acciones Simplificada* (SAS) or Simplified Stock Corporation. Even though it draws upon the French *Société par Actions Simplifiée*, this entity closely resembles the hybrid business entities that have been set in place in the United States and the United Kingdom during the last several years. By providing a mixture of corporate and partnership-like components, the SAS allows for significant contractual flexibility, while still preserving the benefits of limited liability and asset partitioning.

Given the significant advantages that this new type of business association represents for innovation and entrepreneurship, this book proposes the expansion of the Colombian experiment to other jurisdictions in the Latin American area. The common features characterizing the business environment in this region provide grounds to conclude that the benefits obtained in Colombia after the inception of the SAS, could also be attained in other Latin American countries.

Following the Colombian success story the Model Act on Simplified Stock Corporations for Latin America (which is included in this book as Annex 1). This Model Act is not intended to serve as a partial amendment (*patch up reform*) to be introduced to traditional business forms regulated in national codes and statutes, but instead as a separate legislation linked to the existing system³²⁶.

This legislative system has several advantages: The first is that it avoids cumbersome and lengthy discussions with regressive-minded legal operators and other agents that favor ancient local corporate law traditions. Included within these operators, McCahery and Vermeulen mention judges, notary publics, traditional law professors, etc³²⁷. A second advantage of this approach refers specifically to the creation of an internal competition among different business entities embodied in separate statutes. This exercise allows observing entrepreneurial preferences when business people choose among different items offered in the Company Law menu³²⁸. The SAS is

³²⁶ See McCahery and Vermeulen, *supra* note 154.

³²⁷ *Id.*

³²⁸ This competition is already taking place in Colombia after the inception of Law 1258 of 2008 regarding the Simplified Stock Corporation (SAS).

expected to gain a hefty advantage in this competition, owing to its swift process for incorporation and its ample private ordering potential. This competition could ultimately lead to the undoing of the most conservative approaches to Company Law, as *status quo* advocates are forced to relent in their positions when confronted with incontestable economic realities.

4.7.1 General Aspects

The basic framework for this proposed legislation is based upon the following five pillars: (i) Full-fledged limited liability; (ii) Simple incorporation requirements; (iii) Contractual flexibility; (iv) Simple organizational structure; and (v) Fiscal transparency.

Each of these features will be analyzed individually below. However, it must be noted here that even if limited liability is one of the main features of the SAS, the Model Act provides for piercing the corporate veil in order to extend liability to controlling shareholders in the event of fraud or abuse of the corporate form. Such mechanism has to be brought before a specialized jurisdiction or an arbitration panel that will guarantee a more technical and expedited resolution for aggrieved creditors, as opposed to ordinary systems of adjudication handled before civil courts.

Under the simplified stock corporation, shareholders acquire broad flexibility to freely regulate their relationships pursuant to a set of enabling provisions containing off-the-rack housekeeping rules that parties can opt out and replace for tailor-made provisions, if needed. Therefore, shareholder protection can be achieved through devices of a contractual nature. In this manner, the antagonism between majority and minority shareholders may be ameliorated through *ex ante* negotiations. Agency costs will also be reduced as shareholders are able to satisfy their contracting interests by setting up specific provisions on the corporate documents. For this purpose, the model act not only proposes enabling provisions, but also enhances the enforceability of shareholders' agreements. Through the latter device, it is possible to reach certain equilibrium between stockholders by means of sophisticated mechanisms in which rights and obligations can be crafted to carefully determine *a priori* expectations of all corporate participants. Following the incomplete contracts theory, this enhanced freedom of contract complemented by gap filling through an efficient adjudication process is intended to provide an improved conflict-resolution scenario for shareholders.

In accordance with the theory of *structural transplants*, the remedy of specific performance is introduced to allow for the adequate enforcement of these agreements in the event of default. Furthermore, the Model Act incorporates a comprehensive regulation on the *abus de droit* (abuse of rights) theory, which is extrapolated from French case law in which the doctrine has been specifically developed for conflicts concerning Corporate Law. Under this theory, shareholders have the ability to bring judicial actions or arbitration complaints, not only on the grounds of abuses of controlling shareholders, but also concerning the same conduct where it has been deployed by minority shareholders or in the event of abuse in the context of symmetrical block shareholdings (i.e., dual ownership on a 50% - 50% distribution). The abuse of

rights action may give rise to damages for the aggrieved party, as well as rescission of the abusive act. Fiduciary duties of care and loyalty can also be applicable to the officers and directors of the SAS. To complete the scenario of Corporate Law protections, the Model Act allows for the application of the shadow director doctrine, by means of which any person who is engaged in a positive management activity, without being a legally appointed corporate officer or director, can be disciplined under fiduciary duties as if she were acting in such managerial capacity.

The Model Act on Simplified Stock Corporations seeks to remedy the legislative void existing throughout the region concerning hybrid business forms, as well as to reduce transaction costs and provide entrepreneurs with enough flexibility to allow for private ordering in a multi-functional business form, suitable for all kinds of undertakings. Additionally, as each of the features of the proposed SAS is analyzed, the reader will note how this business entity is as useful for local businessmen as it is for foreign investors. This usefulness is especially significant to structure corporate groups in which the SAS can be used to incorporate wholly-owned subsidiaries, irrespective of their size or business activity. Its light structure substantially reduces transaction costs and facilitates their operation.

4.7.2 Specific Aspects

Prior to offering a comprehensive explanation concerning the Model Act on Simplified Stock Corporations for Latin America, it is relevant to stress out that this proposed legislation is not intended to cover all the intricacies that may characterize a complete Corporate Law statute. The Model Act contains enabling provisions (*off-the-rack housekeeping rules*), which, generally, may be opted out by those participating shareholders who have the time and resources to undergo a complete negotiation regarding the formation documents. Such default rules are intended to provide the parties with the most flexible corporate structure available for all kinds of undertakings. Following the most progressive trends, the Model Act sets forth the possibility to contract around such old-fashioned, rigid schemes as the ones existing under the Company Laws of most Latin American jurisdictions. Within the broad scope of contractual possibilities afforded to investors, it is viable to provide for an indefinite term of duration, an unrestricted purpose clause, direct or delegated management, and several types of restructuring alternatives. At the same time, the SAS' shareholders are protected by full-fledged limited liability. This set of default and facilitating provisions allows the parties to define the most convenient contractual framework for investors to carry out virtually any proposed line of business.

The enabling nature of most of the SAS provisions is particularly relevant, due to the ability of parties to freely draft any clauses that may allow them to neutralize the sort of agency problems that usually characterize non-listed firms. By exercising this extensive contractual freedom, shareholders can stay away from standardized corporate contracts. In this manner, creativity and innovation concerning new corporate structures may be fostered.

In any event, when parties are loath to incur the costs of contractual bargaining, the Model Act sets forth ready-made provisions to govern intra-firm relationships. These off-the-rack rules have been laid down following a two-tier system. The first proposed regulatory tier is comprised of provisions designed specifically for the Simplified Stock Corporation, which are contained in the Model Act. The second one remands parties to the statutory rules governing the standard corporate form, as it exists in the statutes or codes of the corresponding country of incorporation. In this manner, in the absence of specifically applicable rules within the Model Act, the parties will resort to supplementary legal provisions concerning stock corporations.

The Model Act on SAS is an attempt to offer practical solutions to the over-regulatory legal framework that has prevailed in the Latin American region. For that reason, it also follows the structural legal transplant approach. In fact, it incorporates innovations not only with regard to substantive law, but also concerning rules of procedure intended to provide access to litigation in reasonable terms for the parties. In addition, a more ample set of procedural rules regarding the resolution of conflicts arising within a simplified stock corporation is proposed in the Model Act on Procedural Rules for the SAS (See Annex B), which will be analyzed in further detail in this chapter.

Although the basic foundations of the Model Act on Simplified Stock Corporations can be found in U.S. laws of business associations, the name chosen for this type of entity has been borrowed from the French legislation on the *Société par Actions Simplifiée* (or SAS). In this manner, there is also a certain level of continuity with the core jurisdiction from which legal transplants came from in most Latin American countries.

4.7.2.1 Rules on the Nature of SAS and Legal Personality

Sections 1° to 4° of the SAS Model Act refer to fundamental aspects already analyzed about this business association form. In the first place, it allows for the creation of the business entity either by the execution of a contract or through the subscription of an incorporation document by the sole shareholder (*unilateral act*).

Versatility was also a main concern in the preparation of this initiative. Therefore, the business entity is either suitable for the formation of small, single-member corporations or large, multi-owner enterprises including entities forming part of corporate groups. The SAS can be used in any venture, irrespective of the number of shareholders that concur to incorporate it or who subscribe shares at a subsequent stage. In fact, neither the entrance nor the exit of stockholders can affect the continuity of the corporate entity, as long as one person remains as a shareholder. In this way, the antiquated rules setting forth minimum and maximum numbers of shareholders are surpassed completely.

Pursuant to the terms of Section 3 of the SAS Model Act, the legal personification of the Simplified Stock Corporation is produced once the document of incorporation (private or public deed) is filed before the Mercantile Registry. Hence, registration of the

simplified stock corporation has a “constitutive” nature. It also determines the regularity of the business association, the benefits arising from asset partitioning, and the liability regime for its shareholders (Section 2). Such liability is limited, as section 2.5 of the Model Act describes: “shareholders will not be held liable for any obligations incurred by the simplified stock corporation, including but not limited to, labor and tax obligations”. Nonetheless, an exception to this rule is contained in section 41, as the corporate veil may be pierced in the specific cases foreseen therein³²⁹.

Since legal personality arises only after the formation documents have been filed, firms that have not met this requirement operate as *de facto* business associations. If the firm has a single member, she will be legally regarded as an *individual merchant* under Section 7 of the SAS Model Act. Therefore, this individual will be held personally liable for any obligations incurred in the course of business. To this effect, Section 7 of the Model Act specifies that if the corporation “has one member, such member will be held liable for all obligations in which the firm is engaged”.

According to what has been stated earlier, the SAS is commercial by its form (i.e., without regard to the objects set forth in the constitutional documents). The commercial nature of this business association is consecrated in Section 1 of the Model Act. In this manner, it is by far irrelevant to consider if the business association’s activities are either civil or mercantile (as it is still frequent in several Latin American Company Law regimes). Consequently, all provisions related to mercantile activities and the qualification as a merchant shall be applicable to the simplified stock corporation irrespective of the business activities that it carries on.

It is necessary to emphasize that the SAS has not been conceived as a listed corporation. Section 4 of the Model Act clearly states that the shares of stock and other securities issued by the simplified stock corporation “shall neither be registered within a stock-exchange, nor traded in any securities market”. The SAS is a business association type designed to structure closely held companies³³⁰. The broad contractual flexibility that allows the parties to provide for rules concerning the squeeze out of shareholders, stocks with multiple voting rights, severe restrictions on stock transfers, among others, may be incompatible with the investor protection guidelines that are

³²⁹ It must be recognized, however, that several features of the Simplified Stock Corporation (SAS) bring it closer to the partnership (*sociedad de personas*). Not in vain, these new company prototypes of business associations have been referred to as “hybrid business forms”.

³³⁰ It goes without saying that a significant dose of legal restrictions is justified when a company turns to the stock market searching for capitals to finance its activity. The protection afforded to shareholders and buyers of debt securities, as well as the need to protect third parties, demand specific safeguards which are not usually attainable through contractual means. In any event, there exists no justification to impose such a heavy burden of protections on small and medium size closely-held corporations, where the objectives are not only different but frequently opposed to those pursued by large issuers of securities.

mandated for listed companies³³¹. For the same reasons, the French SAS statute does not allow the possibility of raising resources originating from private savings in the stock market (*appellation publique à l'épargne*)³³².

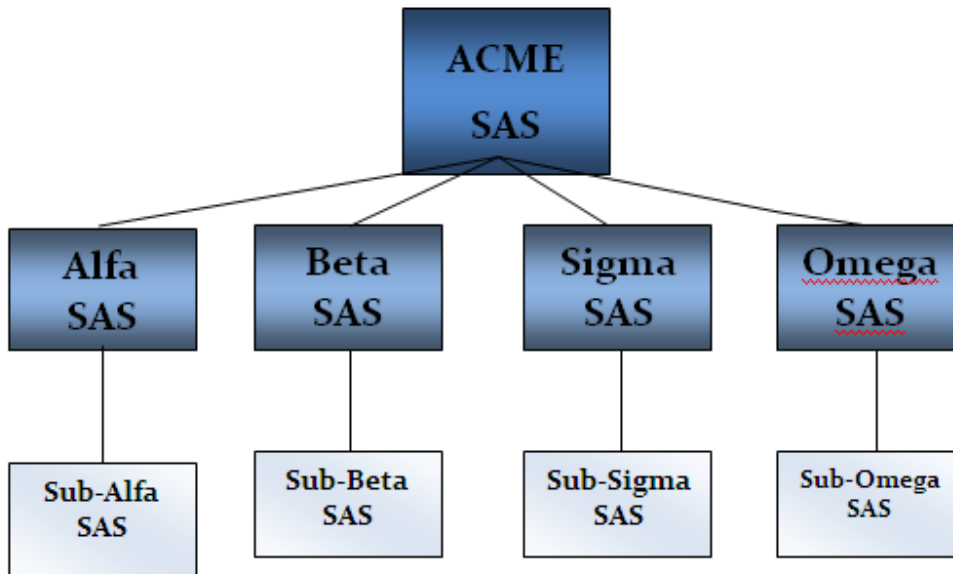
4.7.2.2 Incorporation and Proof of Existence of the Company

The Model Act indicates how the SAS may arise out of a contract or a *unilateral act*. This approach is intended to surpass the old-fashioned discussion, so frequent in Latin America and even in Continental European countries, concerning the so-called one-person corporation. This significant improvement is immensely useful for structuring corporate groups where total control may be centralized in a single parent corporation.

Graph 11 **Example of a Business Conglomerate Structured through a SAS**

³³¹ The possibility of excluding shareholders through squeeze out clauses contained in company by-laws is normally viable in the partnership business type. These contractual devices may entail certain benefits in cases where there exists an interest in binding partners to the economic exploitation envisaged in the corporate purpose; as in the hypothetical where all or some of the partners (or shareholders) undertake an industrial activity (i.e., agree to provide services in favor of the company). In these cases, noncompliance with the concerning obligations may originate the extreme measure of exclusion imposed on the defaulting partner. The procedure that must be followed to exclude a shareholder in the SAS is regulated in section 38 of the SAS Model Act.

³³² It has to be considered, though, that in highly advanced stock markets, there exists the possibility of subscribing certain securities (or credit instruments) issued by closely-held entities (such as the limited liability companies from the United States or LLCs). This alternative poses several difficulties, which should be avoided in scarcely developed markets with a minimum degree of judicial and administrative supervision.



The single head office ACME SAS controls various single member simplified stock corporations (SAS).

Among other aspects, the Model Act intends to reduce administrative and bureaucratic procedures and formalities necessary for the incorporation of a company. The corresponding provisions are aimed at attenuating entry barriers in order to facilitate the creation of new businesses, promote economic formalization and mitigate the impact of transaction costs. Accordingly, the required procedure to set up a SAS is reduced to the filing of the formation document in the country's mercantile registry³³³. Section 5 of the Model Act states that a simplified stock corporation "will be formed by contract or by the individual will of a single shareholder, provided that a written document is granted". Pursuant to the same provision, the formation document "shall be registered before the Mercantile Registry".

Given the significant influence of traditional Civil Codes in the region, Latin American legal systems still grant enormous importance to formal requirements for the

³³³ The contents of the Articles of Incorporation are clearly stated in section 5 of the Model Act, which include: "(1) Name and address of each shareholder; (2) The name of the corporation followed by the words "simplified stock corporation" or the abbreviation "S.A.S."; (3) The corporation's domicile; (4) If the simplified stock corporation is to have a specific date of dissolution, the date in which the corporation is to dissolve; (5) A clear and complete example description of the main business activities to be included within the purpose clause, unless it is stated that the corporation may engage in any lawful business; (6) The authorized, subscribed and paid-in capital, along with the number of shares to be issued, the different classes of shares, their par value and the terms and conditions in which the payment will be made; (7) Any provisions for the management of the business and for the conduct of the affairs of the corporation, along with the names and powers of each manager. A simplified stock corporation shall have at least one legal representative in charge of managing the affairs of the corporation in relation to third parties".

execution of all kinds of business transactions. For that reason, the Model Law on SAS still requires a granting of a public deed in such cases in which certain contributions in kind, such as real estate, are made to the corporation's equity. In those cases, the granting of the public deed will be a mandatory formality. This legal requirement is aimed at adjusting the SAS system to property regimes contained in private law rules in force in most Latin American jurisdictions. The same formality will be required in order to contribute other specific assets for which the public instrument is still needed to formalize the transfer.

Section 7 of the Model Act, provides that if the SAS articles of incorporation have not been filed before the Mercantile Registry, the "purported corporation will be assimilated to a partnership". This regime brings about a number of legal consequences such as the joint and several liability of partners for all the obligations in which the partnership may be engaged.

It is also worth noting that the Model Act also requires the compliance of certain formalities, even if it manages to significantly reduce them in comparison with the complicated and bureaucratic standards that are common in the region. For example, Section 5 lists a set of clauses that must be included in the formation document, and section 6 calls for the Mercantile Registrar to attest to the legality of such provisions before granting registration. Hence, as set forth in paragraph 4 of section 6, registration may only be denied when the requirements of section 5 are not met. In any event, the decision to deny or grant registration must be rendered by the Registrar in the three days following the filing of the documents, and a denial to register may be challenged by the incorporators, as it "shall be subject to a rehearing conducted by the Registrar". Nonetheless, once the corporation has been duly formed, recourses before the Mercantile Register are considerably limited. In particular, Section 6 clearly states that, "challenges will not be heard against the existence of the simplified stock corporation". As it can be noted, these rules are meant to avoid arbitrariness on behalf of local authorities in charge of corporate registration.

As it has been stated, the clauses that must be included in the formation document are listed in section 5, subsections 1 to 7, of the Model Act. It must be noted that some of these provisions have a default application in the event in which no specific stipulation has been made in the corporation's by-laws. Consequently, the formation document is restricted to a few clauses, the content of which generally corresponds to the identification of essential elements of the corporation, such as the consent of the founding stockholders, the amount of capital contributions, the rules relating to the corporation's name and domicile, and the manner in which the corporation will be managed. It goes without saying that shareholders are entitled to agree upon any other valid provision, which they may consider useful to govern their contractual relationships. The flexibility afforded by the Model Act is intended to allow parties either to adopt the standard default corporate structure or, in specific events, to draft specialized contracts.

In fact, the clauses to be included in the formation document reflect the simplifying philosophy and contractual freedom of the proposed type of business

association. These principles are only restricted by the presence of very few mandatory provisions in the SAS Model Act, which must be adopted in the corporate by-laws. For instance, the conversion of the SAS into another type of business entity requires unanimous consent at the shareholders' assembly level. Such demanding requirement is applicable not only when a SAS is converted into another business form, but also when the latter is converted into the former (see section 31 of the Act). Corporate restructurings and SAS conversions will be discussed in further detail in this chapter.

A fitting example to show the SAS' simplifying nature is the possibility it offers for setting up an unrestricted corporate purpose (subsection 5° of section 5) and an unlimited term of duration (subsection 4° of section 5). These provisions are a classical example of legal transplants made from U.S. Corporate Law. As it is widely known, a corporation in all the American states may be created for any lawful business activity. This is also the case concerning the Revised Model Business Corporation Act (R.M.B.C.A.). In fact, in accordance with Section 2.02 of such legislative model, the articles of incorporation need not include either the term of duration or the purpose for which the corporation is being created. In the official comment to this section, prepared by the American Law Institute (ALI), it is stated that "a corporation formed under these provisions will automatically have perpetual duration under section 3.02 (1) unless a special provision is included providing a shorter period. Similarly, a corporation, formed without reference to a purpose clause, will automatically have the purpose of engaging in any lawful business under section 3.01(a). The option of providing a narrower purpose clause is also preserved in sections 2.02 (b) (2) and 3.0.1, with the effect described in the Official Comment to Section 3.01[...]"³³⁴. A clause similar to the previously quoted is also found in Section 102(3) of the Delaware General Corporation Law, for which it suffices to include in the corporate charter that the company shall be entitled to carry out any lawful activity³³⁵.

This approach regarding the purpose clause is found to be more convenient due to efficiency considerations. Such a characteristic determines a meaningful difference in the economic conception of the stock corporation. Within the unrestricted purpose clause system, managers obtain a higher degree of discretionary authority to run the corporation. There is no need to amend the corporation's by-laws every time that a new, different business opportunity arises. This approach, however, is not an easy seller in several Latin American countries due to the all pervasive influence of Civil Codes drafted in the nineteenth Century, which still prevail in the region's company law landscape³³⁶. These codes normally embraced a tight *ultra vires* doctrine³³⁷.

³³⁴ *Model Business Corporation Act Annotated*, adopted by the Committee of Corporate Laws of the Section of Business Law, American Bar Association, 4th Ed. 2008, at 2-12.

³³⁵ For a detailed analysis of the issue at hand, see Timothy Bjur *et al*, *Fletcher Cyclopedia of the Law of Private Corporations*, Revised Volume, New York, CBS, 1993, at 102.

³³⁶ A good example of a backward *ultra vires* doctrine can be found in Section 110, Subsection 4°, of the Colombian Commercial Code. An exception to this approach can be found on the Argentine Law 19,550,

Thus, it is true that broadening the scope of business activities that the corporation can carry on ameliorates the impact of the *ultra vires* theory, which has permeated most Latin American jurisdictions. Indeed, the traditional “specialty theory”, by means of which the partners have to define *ex ante* restricted objects in the foundational documents, has also led to complicated and protracted litigation. The corollary of such specialty theory is closely linked with *ultra vires* concerns, for any act beyond the corporation’s objects is deemed to be null and void. This legal consequence arises from the lack of legal capacity to undertake any activity beyond the purpose clause.

As it is obvious within the SAS, parties can opt out this default provision and set up a restricted purpose clause in the corporate by-laws, defining the specific corporation’s main economic activities that, in turn, will determine the entity’s legal capacity. Pursuant to Subsection 5^o of Section 5 of the Model Act, the parties may provide “a clear and complete description of the main business activities to be included within the purpose clause, unless it is stated that the corporation may be engaged in any lawful business”.

4.7.2.3 Special Rules Regarding Capital Contributions and Shares

One of the most relevant aspects of the proposed statute has to do with the great flexibility afforded to entrepreneurs that intend to make cash contributions to the firm. The SAS can be funded through a variety of channels, which surpass the financing mechanisms available for traditional stock corporations. Even if the SAS cannot undertake public issuances of shares due to its nature as an archetypical closely held entity, the flexibility of its capital structure facilitates the process of raising resources from private actors.

Section 9 of the SAS Model Act can be seen as a departure from the general rule contained in Commercial Codes across Latin America in that it allows entrepreneurs to freely allocate numerical values to the firm’s authorized, subscribed, and paid-in capital. Furthermore, it allows for the payment of the firm’s subscribed capital to take place within a two-year period to be counted from the moment in which the shares were initially subscribed.

It may be argued that for corporations with only one person, the single shareholder’s contribution determines the extent of the corporation’s ability to economically respond vis-à-vis third parties. As a corollary, it may also be argued that the subscribed capital should be paid in full at the inception of the corporation. However,

in which only acts that are “notoriously” outside of the corporation’s objects can be challenged (see Section 58).

³³⁷ This doctrine entails grave consequences in terms of legal certainty for third parties.

it is clear that the absence of immediately available assets is not tantamount to the inability of a corporation to pay its debts as they become due. Even if the subscribed capital has not been fully paid, the single shareholder has taken on an obligation to pay the remaining contributions for which she is responsible. The existence of installments for the capital formation does not affect the company's net worth, which, in any event, will be represented in the corporation's assets as an account receivable against such shareholder.

In addition to capital contributions, the SAS can also issue classes of shares with varying rights as a financing mechanism. Section 9 allows for capital subscription and payment to be carried out under "terms and conditions different to those set forth under the Commercial Code or corporate statute".

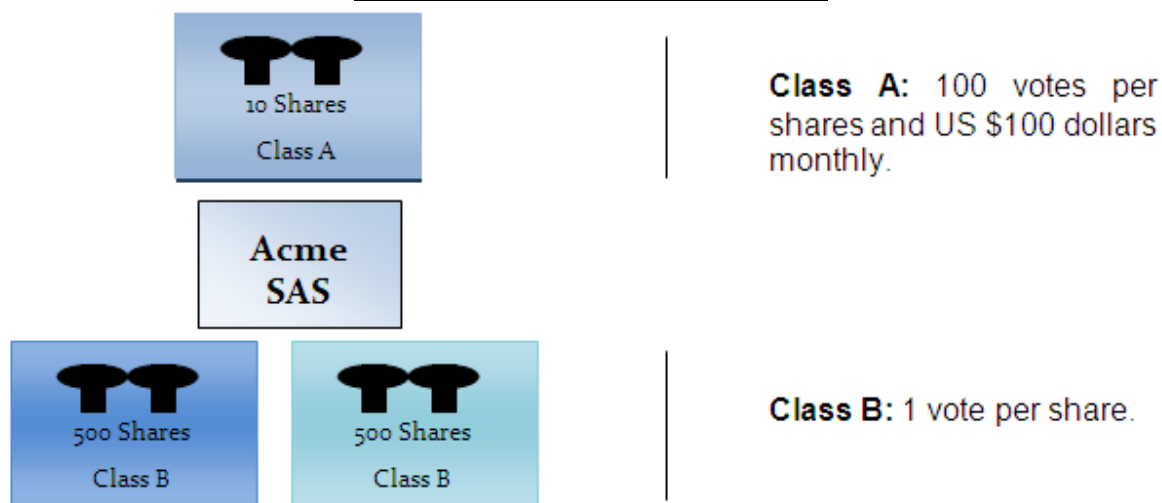
Under Section 10 of the SAS Model Act, firms can also issue "preferred shares with or without vote". This opens up myriad possibilities for entrepreneurs who have traditionally been unable to freely determine the rights carried by shares that are issued in closely held firms.

The Model Act specifies the ability of the corporation to issue classes and series of shares. The difference between these two concepts has obvious practical consequences. Share "classes" refer to varying forms of titles differentiated by the inherent rights provided for each one of them, according to the respective regulation. On the other hand, the "series" identify the successive issue of same class shares, the placement of which has been done in different time periods. Lastly, the same Section contemplates that the company may issue shares "for any consideration whatsoever including in-kind contributions or in exchange for labor contributions pursuant to the terms and conditions contained in the by-laws".

In granting ample flexibility for firms to issue different classes of shares, the SAS Model Act not only favors capital-raising processes but, perhaps more importantly, facilitates the administration of corporate affairs by entrepreneurs. A case in point is Section 10 of the Model Act, which opens the possibility for the firm to issue shares with multiple voting rights. When shares of this class are issued, the firm's by-laws should express the extent of voting rights allotted to each class, with an explicit indication as to the number of votes attributed to each share. This novelty may allow the structuring of "corporate governance" devices useful in certain types of business undertakings. The multiple voting system is widely known in foreign doctrine and advanced company law regimes. To this effect, José Engracia Antunes holds that "numerous stipulations in the by-laws of a firm can derogate the general principle of 'one share-one vote' and, through the majority or casting vote power it creates, attribute the control of that corporation to another one, holding even a minority of the stock of the former. Examples of this are, for instance, cumulative voting shares (*Mehrstimmenrecht*, *actions à vote plural*, *azioni a voto plurimo*), non-voting shares (*actions sans droit de vote*, *azioni*

senza voto), shares without nominal value, proxies, non-transferable shares, voting trusts, golden shares, etc.”³³⁸.

Graph 12
Example of Share Classification



The subscribed capital for Acme SAS is divided in Class A and Class B shares. Holders of Class A shares are entitled to multiple voting rights (100 votes per share), with a preferential dividend which must be paid periodically. Thus, a shareholder with 10 Class A shares shall have 1000 votes.

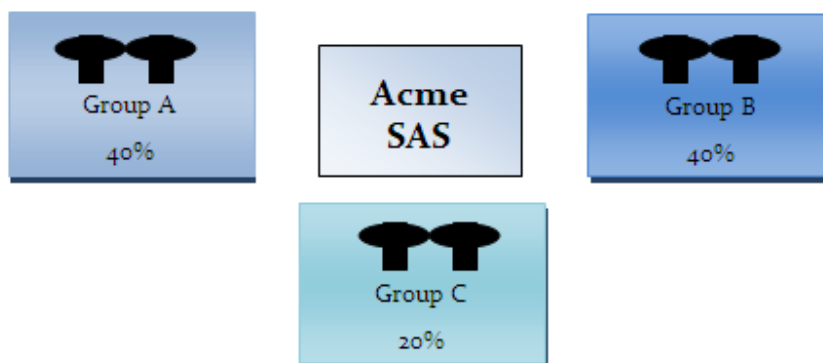
As mentioned before, the possibility of stipulating multiple voting rights in the by-laws of a SAS is a meaningful contribution to the corporate governance of closely held business associations in Latin America. In family businesses, the possibility of having heterogeneous voting structures will facilitate the *ex ante* allocation of power between founding shareholders and family members on the one side, and additional shareholders that enter the business association at a later stage, on the other. It is expected for this valuable instrument to prevent conflicts within the corporation, since it

³³⁸ José Engracia Antunes, *Liability of Corporate Groups, Autonomy and Control in Parent-Subsidiary Relationships in US, German, and EU Law. An International and Comparative Perspective*, Deventer, Kluwer Academic Publishers, 2004 at 119. The same author refers to the so-called “oligarquical clauses” existing in German and Dutch Law, through which a qualified vote is conferred to a certain shareholder for the electing of members of the board of directors or special voting rights in the shareholders’ general assembly. Modesto Carvalhosa also explains the importance of allowing the parties to create multiple types of shares in order to facilitate the corporation’s capitalization. In Brazil, non par stock, which were allowed by Law 10.303, are seen by this author as, “the most revolutionary regulation regarding this topic”, since they have challenged traditional preconceptions concerning the corporation’s capital (*Comentários à Lei de Sociedades Anônimas*, Volume 2, 4th Edition, Sao Paulo, Editora Saraiva, 2009, at 100-101).

allows participants to clearly define the rules of the game in advance, setting forth true expectations for each business participant.

Another innovation contained in the Model Act concerns the possibility of determining maximum and minimum percentages of the firm's voting rights that can be distributed to certain groups of shareholders. This, again, permits the parties to define in advance the manner in which the voting power will be allocated during the lifespan of the corporation. The rule allows for a by-law provision that can restrict the maximum amount of shares owned by a shareholder, usually expressed as a percentage of the total number of stocks outstanding. This may be done through a clause explicitly establishing such limits. It may also be accomplished through the additional expedient of creating separate classes of shares with their own particular limits. For example, in a given firm, Class A shares may provide its holders with the prerogative to exercise 80% of the voting rights whilst Class B stocks may only confer voting rights concerning the remaining percentage (20%). Economic benefits, such as dividend participation, may obey to differing voluntary rules, i.e., be asymmetrical or proportionate, etc.

Graph 13
Example of Percentage Participation regulated in the By-Laws



The shareholders for Acme SAS have created maximum participation limits in the company's capital. For example, Group A as a whole may not be able to hold more than 40% of the shares issued by Acme SAS. The maximum percentage of participation for Group B would be established in 40% and for Group C, 20%.

The Model Act also attempts to curb an ongoing discussion in regional circles regarding the somewhat uncertain prospect of transferring shares to Civil Law trusts (*mercantile fiducia*). Regarding this topic, a segment of the local doctrine holds that it is not possible to transfer shares to a trust, mainly due to the fact that business trusts lack legal personality. Since pursuant to some statutes it is required for shareholders to be *persons*, conveyance of shares to a trust will result in a violation of basic Company Law regulations. In order to avoid this academic debate, Section 12 of the SAS Model Act sets out that any amount of outstanding shares of stock may in fact be transferred to a trust, provided that the trustee is identified in the corporate ledger. Furthermore, the same provision clearly determines that the rights and obligations belonging to the

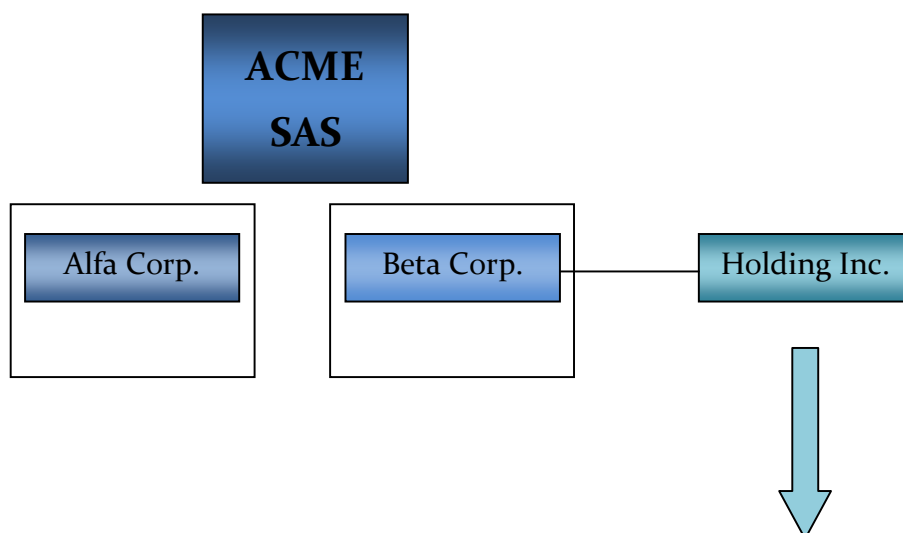
beneficiary will be exercised by the trustee, in accordance with the instructions given out by the settler or beneficiary, in each case.

4.7.2.4 Change of Control in a Corporate Shareholder

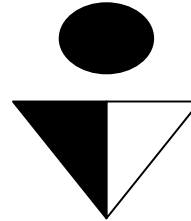
Apart from the aforementioned rules, the SAS Model Act also enhances the effectiveness of rights of first refusal by regulating transfers of control in shareholders of a corporate nature. This rule attempts to address a well-known scheme, which is frequently used to circumvent the right of first refusal in a given firm whereby, instead of directly conveying its shares, a shift of control is effectuated in one of the shareholders that is in turn a business association. Section 16 of the Model Act, which relates to the change of control in the shareholding company, does not seek to prohibit the transfer of shares in companies acting out as SAS shareholders. Its objective is to ensure that shareholders respect the right of first refusal by forcing them to report to the SAS' legal representative any operation by which a purported change in control involving any of the shareholding companies. If such a shift in control occurs, the shareholders' assembly can decide to exclude the firm in which it was effectuated. Obviously, the concerned company can also abstain from undertaking the prospected change of control. In those cases in which a firm is excluded, the Model Act determines that the excluded shareholder will be entitled to a reimbursement of the fair market value of the corresponding shares. In addition, the same article sets out the rule whereby any *breach of the duty to inform* a change in control may result in a 20% reduction "of the fair market value of shares, upon reimbursement" as a sanction.

The possibility of excluding shareholders in this case is a development of the provision contained in Section 38 of the Model Act, under which the "by-laws may contain clauses by virtue of which shareholders may be excluded from the simplified stock corporation". The cited Section puts forward the condition of reimbursing the excluded shareholders' "fair market value of their shares of stock". The exclusion of shareholders is possible as long as it complies with the requirement of majority approval by shareholders, unless "a different procedure has been laid down in the by-laws".

Graph 14
Change of Control in Shareholding Company



Selling of Beta
shares.



Group B, shareholder of Beta Corporation, must inform the legal representative of Acme SAS about the sale of shares to Holding Inc. The SAS shareholders' general assembly may decide the exclusion of Beta Corporation.

4.7.2.5 Company Organization

Simplifying the operation and organic structure of a business entity is one of the goals that can be achieved through the adoption of hybrid business forms.³³⁹ The enabling character of this regulation also gives way to an enormous freedom of organization for the shareholders. Périn holds that within the regulation of the French Simplified Stock Corporation the combination of freedom of contract with the elements of stock corporations constitutes an unprecedented privilege in that country's legal system. For any economic agent, the election of the SAS as a business structure corresponds to the desire of increasing the organization's efficiency by making it suitable to shareholders' necessities³⁴⁰.

The SAS Model Act confers founding shareholders complete freedom over the company's internal organization structure. This regime is meant to lighten the firm's bureaucratic burden by reducing to a minimum its mandatory organs. Section 17 of the Model Act establishes in a very clear fashion that the SAS's structure may be freely defined in its by-laws. "Shareholders may freely organize the structure and operation of a simplified stock corporation in the by-laws". Furthermore, in the absence of specific by-law provisions, "the shareholders' assembly or the sole shareholder, as the case

³³⁹ Regarding this issue, Maurice Cozian's opinion is enlightening concerning the French Simplified Stock Corporation: "Besides the President, the (SAS) by-laws may create collegiate organs, together with all the freedom to choose its name (administration council, director committee, executive committee, etc.), as well as the respective operations and decision making processes (simple majority, qualified majority, unanimity). The appointment systems are very varied: classic election of corporate officers and directors by a defined majority, agreement of two of the largest shareholders, automatic designation by the majority shareholder in the case of unitary direction, alternation, etc. The different forms of internal control in the company also depend on the discretion of the by-laws' drafters".

³⁴⁰ Pierre-Louis Périn, *La Société par Actions Simplifiée: Etudes-Formules*, 3e édition, Paris, Joly Editions, 2008, at 11.

may be, will be entitled to exercise all powers legally granted to the shareholders' assemblies of stock corporations, whilst the management and representation of the simplified stock corporation shall be granted to the legal representative".

4.7.2.6 Shareholders' Assembly

Concerning the regulation provided in the Model Act for shareholders' meetings, Section 43 of the proposed legislation remands to each jurisdiction's relevant provisions (Commercial Codes, Laws, Decrees, or Statutes). On the other hand, in accordance with the already mentioned Section 17 of the Model Act, the powers to steer the corporation shall be exercised by the assembly or the sole shareholder. Meanwhile, managerial functions, including the authority to bind the firm, are left to the corporation's main executive, referred to on the region's legal jargon, as the *legal representative (representante legal)*.

In this manner, the SAS' shareholders' assembly maintains a preponderant role that is reflected in the great variety of powers attributed to it. Therefore, most significant corporate transactions must be authorized by the shareholders duly gathered in the assembly or by the sole shareholder. Specifically, Section 37 of the Model Act confers upon the assembly the power to consider and approve the corporation's "financial statements and annual accounts". Before the corresponding shareholders' assembly meeting its legal representative must submit these documents to the corporation's highest organ. The same Section adds that when dealing with single member corporations, the sole shareholder will approve all the company's accounts and will leave a record of such approval in the company's minutes dutifully filed in the corporate books.

The by-laws may also create other organs such as the board of directors to carry on part of the activities usually performed by the assembly. Committees dependent on the board of directors for auditing, nomination or compensation of directors and officers can also be created as a corporate governance device.

As the corporation's main governing body, the assembly draws the firm's policies, adopts structural decisions (conversions, mergers, split-up, winding up, etc.), approves financial statements, decides on the distribution of dividends, and the creation of reserves. Consistent with the general approach in the Model Act, the cited part of Section 14 is in part a default rule, subject to the parties' will. Therefore, it is viable to allocate some of the corporate powers assigned to the assembly to a different body.

4.7.2.7 Operation of the Shareholders' Assembly

The rules for the operation of the shareholders' assembly also contain meaningful modifications to traditional approaches, as once again the Model Act aspires to decrease unnecessary formalism. To this effect, the proposed changes simplify the existing rules for calling meetings of shareholders, as well as the provisions that govern quorum, majorities, actions without a meeting, etc. This is a very significant change

since it makes away with a series of requirements based on old-fashioned standards, which traditionally paved the road for innumerable lawsuits originating in these purely formalistic aspects.

In order to facilitate the decision-making processes in the SAS, and bearing in mind that it is a useful instrument for foreign investment, the Model Act allows shareholders' assemblies to meet at any specific location, irrespective of the corporation's main domicile. Sections 18 to 23 of the SAS Act regulate requirements such as the calling of meetings, waivers of notice, actions without a meeting, quorum and majority requirements. Due to the non-directory nature of most of the Model Act provisions, the parties may introduce alternative rules in the by-laws. Section 18, clearly states that the "meetings of shareholders may be held at such place as may be designated by shareholders either within or without the corporation's domicile". This default provision can be opted out in those cases where some geographical proximity is deemed appropriate between the shareholders and the territorial circumscription where the assembly is going to be held.

4.7.2.8 Action Without a Meeting (Simultaneous or Successive Communications)

One of the several devices through which the Model Act seeks to facilitate the operation of shareholders' meetings is through the creation of alternative instruments for the adoption of decisions and the simplification of existing mechanisms for this same purpose. The legislative proposal includes mechanisms that facilitate the decision-making processes at the general assembly' level by allowing shareholders to conduct deliberations through telephonic conferences or by means of any electronic communication device. Therefore, videoconferences, electronic messages as well as any other Internet supported system or technology through which the parties can exercise their right to vote are allowed. An additional system for actions without a meeting is allowed when written consents are exchanged among the participating shareholders. Section 19 of the proposed Act allows for meetings "through any available technological devices or by written consent". A provision like this clearly foresees the applicability of any available technological means of communication. The utilization of these devices will only increase through time, as local economies and jurisdictions become more integrated and intertwined. It is also worth noticing that the Model Act avoids bureaucratic legal requirement existing in certain jurisdictions, under which a deputy from a regulatory body is required in order for shareholders' assemblies to be effective³⁴¹.

³⁴¹ An example of this trend can be found in the Colombian legislation, which imposes the presence of a Superintendence of Companies' delegate to supervise actions without a meeting (See section 19 of Law 222 of 1995)

In any event, due to the fact that these rules are enabling rather than mandatory, it will always be possible to stipulate different requirements for actions without a meeting to be effectuated³⁴². In this manner, for instance, requirements such as the participation of holders of 100% of the shares of stock are not applicable. Thus, in order for the decisions to be valid, it suffices to attain ordinary quorum conditions, where half plus one of subscribed shares shall be represented. Nonetheless, a clause setting up a *superquorum* requirement may be recommendable for those cases in which it is not indispensable to guarantee the participation of all shareholders in these kinds of deliberations. In summary, the rigidity of the current regulations in Latin American jurisdictions is attenuated in this subject matter by the introduction of innovative legal rules facilitating shareholders' effective communication and, furthermore, by allowing entrepreneurs to dispense with unnecessary nullifications and other legal sanctions when no damage exists because of such omission.

4.7.2.9 Calling of Meetings

The first innovation the SAS Model Act introduces regarding the calling of meetings is reflected on the enabling nature of the provisions concerning this matter. The Model Act contains rules concerning notice of meetings, the means under which they can be called, and the officers authorized to execute and deliver the relevant notices. Once again, these provisions are of a default character. Thus, the parties can set up alternative mechanisms and define, within reasonable limits, the term between the delivery of such notice and the date when the meeting will be held.

The SAS Model Act also allows for the shareholders to define in the by-laws the corporate organ that will be entitled to formulate the respective notice. Section 20 clearly states that: "In the absence of a stipulation to the contrary, the legal representative shall convene the shareholder's assembly by written notice addressed to each shareholder". The same section sets forth specific requirements for such cases in which structural transactions (such as conversion of the corporation into another form, merger or split-up proceedings), and approval of financial statements have been included in the agenda³⁴³. For each of these corporate actions, the cited provision entitles shareholders to exercise information rights "concerning any documents relevant to the proposed transaction". Such information rights may be exercised during the five days prior to the meeting, unless something different is provided for in the by-laws. The default provision contained in the Model Act determines that the communication be done in writing, which includes any electronic medium (Section 19). This legal term can be expanded but never reduced, given the regulatory nature of this provision. This is

³⁴² Claude Penhoat suggests diverse forms of deliberations that can be used under the French SAS law, including vote cast directly by shareholders who attend the meeting, vote by correspondence, vote by proxy, and any other technique. The same author adds that quorum and majority conditions are freely defined in the by-laws, except for some decisions requiring unanimity. See Penhoat, *Droit des sociétés*, 5^e éd, Paris, AENGDE, 1998, at 303.

³⁴³ One clear example of such provisions is the Colombian *Commercial Code*, Section 424.

one of the few requirements contained in the SAS Model Act of a mandatory nature, the objective of which is to avoid any curbs to the exercise of this right.

To simplify the mechanism for summoning Second Call Meetings, Section 20 of the SAS Model Act determines that in the initial notice for a given shareholders assembly, the date of the Second Call Meeting can be included. This is useful for those cases in which the first meeting is not held due to a lack of quorum. In this way, shareholders will have due notice as to the date in which the second meeting would be held. Pursuant to the same paragraph, the second meeting may not be held prior to ten days following the first meeting, or after thirty days from that same moment. This time window for second call meetings is intended to allow absentees to the First Call meeting to surpass the obstacles that prevented them from attending, and therefore be present in a new opportunity.

The carrying-out of the notice for Second Call of Meeting is characterized, by a simplified quorum regime, where deliberation and decisions are made with any number of shareholders, irrespective of the number of shares being represented. The SAS Model Act provides that the presence of multiple individuals is not necessary for second call meetings to be handled. Thus, in those events in which only one shareholder attends the meeting, such person will be entitled to adopt all corresponding decisions unless the by-laws require for certain decisions to be taken with a qualified majority³⁴⁴. This system is coherent with the special rules regarding quorum and voting majorities that, as will be seen briefly, completely suppress any plurality requirement for the adoption of corporate decisions.

4.7.2.10 Express Waiver of Notice to Meetings of Shareholders

The mechanism regarding the waiver of notice to shareholders' meetings constitutes another innovation in the Simplified Stock Corporation. Under the general regime, omitting the notice of meeting or formulating it inadequately has the potential to disrupt the firm's internal affairs. In practice, the shareholders of a closely held corporation (who are often members of the same family) will not observe the full formalities required for calling a meeting of the shareholders' assembly. However, this breakdown in formalistic proceedings normally does not result in prejudice for the shareholders as they will, in practice, have full knowledge of the dealings undertaken in the assembly. Consequently, it is reasonable to allow them to validate the formerly incurable breach of these formalities for calling meetings of shareholders, through the waiver of notice mechanism. Therefore, if there is sufficient quorum in a shareholders meeting and decisions are taken observing statutory majorities, it will be irrelevant if the absentees were not dutifully summoned, provided that they execute a written waiver addressed to the corporation's legal representative. Such waivers can be given in

³⁴⁴ One example in Latin-American jurisdictions is the provision contained in Section 429 of the Colombian *Commercial Code*.

advance to the meeting or even as an *ex post* expression addressed to the appropriate officer.

The same Section 21 of the SAS Model Act determines that the shareholders may also waive their information rights regarding the affairs referred in Subsection 2° of Section 20 of the Model Act, through the same procedure already indicated above. This provision is also aimed at leaving out the difficulties originated when, for example, the books and records required for the exercise of information rights have not been made available to the shareholders in cases concerning the approval of end-of-year financial statements or structural changes (such as conversions, mergers or split-ups). The legal device is also useful when the information disclosed to the shareholders' assembly differs to some degree as compared with the documents in file for inspection. In these cases, the shareholders can opt to cure such deficiencies as a means to rectify any shortcomings, which would otherwise have made the adopted decisions ineffective.

4.7.2.11 Implicit Waiver of Notice

In the same path of creating a more effective and balanced regime for the SAS than the one existing for other business forms, the Model Act proposes the creation of an implicit validation system for assembly decisions in those cases where the notice of meeting given to all or some of the shareholders present at the assembly has been irregular or nonexistent. Accordingly, the proposed legislation allows for the presumption whereby, even in the absence of an appropriate calling of meeting, the sole verification of any shareholder's attendance to the assembly will be deemed as sufficient evidence of the corresponding waiver of notice. In this particular event, there will be no need for a written notification of such waiver addressed to the legal representative. Nevertheless, section 21 of the cited Act allows present shareholders to demand an appropriate advance notice before the meeting takes place. The provision states that "the attendees in a given shareholders' assembly will be deemed to have waived the right of being convened, unless such shareholders make a statement to the contrary before the meeting takes place".

4.7.2.12 Quorum and Majorities in Assembly Meetings

A major breakthrough achieved in this area concerns the abolition of any plurality requirement (i.e., multiple individuals holding shares of stock) for the configuration of the quorum and voting majorities in any meeting of the assembly. Therefore, irrespective of the number of shareholders, any individual or company who has a majority stake in the meeting will not require the attendance of additional shareholders in order for the assembly to validly make decisions. It is a significant evolution, since some traditional regimes in the Latin American region have remained frozen in nineteenth-century contractual conceptions, which require two or more persons to effectively form the corporate will (see, for instance, article 429 of the Colombian Commercial Code).

This development is also a consequence of the inception of the single member corporation, which obviously implies operational changes in the corporation's internal

organs. Certainly, surpassing a merely contractual approach concerning the corporation also allows redefining the role and *modus operandi* of shareholders' assemblies and boards. This new conception also leads to a more practical and rational functioning of such corporate organs.

The problem referred to above creates important transaction costs in traditional business forms such as the limited liability partnerships (LLPs). In this type of entities, it is complicated to make decisions at the shareholders' assembly level, given the requirement to obtain certain consensus between general and limited partners. This may give rise to deadlocks at the highest level, especially in two-partner firms, even if one of them has a majority percentage. For sufficiently explained reasons, this sort of cumbersome requirements, along with the rules requiring a plurality to incorporate a firm, have lost their meaning in modern Corporate Law systems³⁴⁵.

For the aforementioned reasons, Section 22 of the SAS Model Act establishes that quorum in the shareholders' assembly must consist of a "majority of the shares entitled to vote". With respect to voting majorities, the same section sets forth that decisions shall be taken through the affirmative vote of the majority of shares present in person or represented by proxy at the meeting, unless the by-laws contain supermajority provisions. Other references to this majority vote may be found in Section 14 ("Authorization for the Transfer of Shares"), Section 29 ("By-law Amendments"), and Section 38 ("Shareholder Exclusion"). Meanwhile, references to the requirement of the unanimous vote of shareholders may be found in Section 13 ("Limitation on the Transferability of Shares"), Section 31 ("Conversion into Another Business Form"), and Section 40 ("Special Provisions"). Pursuant to the latter provision, "the legal mechanisms set forth under Sections 14, 38 and 39 may only be included, amended or suppressed from the by-laws by unanimous decision rendered by the holders of all issued and outstanding shares".

Unanimous consent is exceptionally required where decisions of the shareholders' assembly may severely impact the status of minority shareholders, such as in the cases of conversion into another type of entity, inclusion of an arbitration clause, or incorporation of causes for the exclusion of shareholders. With the exception of these restricted subjects, the free will and contractual freedom of the parties also prevails concerning shareholders meetings. In companies with a single shareholder, such person will be entitled to make every decision at the shareholders' assembly level. This sole shareholder must leave written record of the adopted resolutions in properly made entries in minutes inserted in the company's corresponding corporate books.

³⁴⁵ The suppression of the plurality requirement has constituted a real battle for the author of this book for more than a decade: "If the benefits of asset partitioning and limited liability are granted to multi-owner enterprises, there is no reason to deny the same benefits to the single member enterprise. Regarding the Colombian system, it is worthy to add that the referred plurality requirement, instead of facilitating business activities, has hindered them". Francisco Reyes, *Sociedades comerciales...*, *supra note* 266, at 69-70.

No difficulty is expected to arise from the decisions made in those cases in which classes of shares with differing voting rights have been issued. It is evident that in these events the estimation of the required majority is based not only on the number of shares, but also on the number of votes attached to each of the classes of stock issued by the corporation.

4.7.2.13 Shareholders' Agreements

In the field of shareholders' agreements, most Latin American regimes are behind other legal systems. In fact, several contemporary legislations have recognized the possibility of governing the relationships between shareholders under legally binding agreements different from the ones contained in the corporate by-laws³⁴⁶.

The reforms made in 2001 to the Brazilian Company Law reinforced and strengthened the importance of these agreements up to the point that the adopted regime resembles to a large degree the treatment given to them in the United States³⁴⁷. Given the already explained difficulties associated with legal transplants, the importation of Corporate Law provisions from a Civil Law jurisdiction is obviously facilitated. Therefore, in this particular field it is sensible, from a purely practical perspective, to include in the Model Act rules similar to the ones contained in Brazilian Law 10,303, which to a large extent, resemble the US developments concerning shareholders agreements³⁴⁸.

Section 24 of the Model Act allows SAS shareholders to validly execute shareholders' agreements, without there being any limitation with respect to the persons executing them or the matters governed under the agreement. In effect, these agreements may refer to the selling or buying of shares, the preference or restrictions to acquire them, the exercise of voting rights, and the granting of irrevocable powers of

³⁴⁶ Shareholders' agreements may be defined as every understanding, stipulation, or contract intended to regulate the rights associated with shares of stock, especially the right to vote, either through the transfer of shares, by means of a conditional or unconditional mandate given to a third party, or through the shareholders' obligation to exercise the involved rights in a predetermined sense. See Fernando Mascheroni, *et al.*, *Régimen jurídico del socio, derechos y obligaciones comerciales*, Buenos Aires, Ed. Astrea, 1997, at 201.

³⁴⁷ Section 118 of Brazilian Law 6.404 of 1976 (as modified by Law 13.303 of 2001) contains various mechanisms, the purpose of which is to allow for the full enforceability of shareholders agreements.

³⁴⁸ Furthermore, transplanting provisions from a Civil Law legal system may allow for a higher degree of legitimacy. On this point, see Alan Watson, *supra* note 265. For a rather innovative approach to legal transplants, see Holger Spamann who explains that "when the periphery countries do change their law, they may look to their legal family's core countries for guidance, and in so doing partake of some of the particularities of those core countries' regulation. This would create policy similarities within legal families" ("Contemporary legal transplants – Legal families and the diffusion of corporate law", in *The Harvard John M. Olin Fellow's Discussion Paper Series*, at http://www.law.harvard.edu/programs/olin_center/fellows_papers/pdf/Spamann_28.pdf).

attorney to persons in charge of representing the shares in the assembly. It is also possible to include call options, put options, tag along and drag along rights, buy-out agreements, and any other contractual device that the parties may deem appropriate³⁴⁹.

The Model Act also contains several provisions meant to enhance the effectiveness of shareholders' agreements. First of all, the range of these agreements is not restricted to the shareholders' assembly, but may also reach the operations of other corporate organs such as the board of directors. Secondly, Section 24 of the SAS Model Act requires that the agreement be deposited in the offices where the company's management and administration are located. This requirement is intended to provide disclosure of the agreement before the corporation and non-subscribing shareholders. Therefore, in order for an agreement to be fully effective before the company and all shareholders, it must "have been filed with the corporation's legal representative". Also, "shareholders' agreements will be valid for any period of time determined by the relevant agreement, not exceeding 10 years. Such term may only be extended by unanimous consent".

Following the Brazilian corporate legislation, the parties to an agreement must designate a representative to answer questions or provide explanations concerning any of the clauses contained therein. The answers must be recorded in a written document within five calendar days to be counted from the request. This prerogative is oriented to facilitate the agreement's enforceability during the shareholders' meeting. It is also useful in those events where shareholders have included clauses which restrict the negotiation of shares, since it is clear that the corporation will not be entitled to proceed to the respective transfers, unless a waiver is dutifully granted by the same assembly.

Another legal aspect devised to confer full enforceability to the agreements is set forth in Section 24(1), whereby the president of the respective corporate organ will not be allowed to compute any given votes cast in breach of a duly deposited shareholders' agreement. This is a useful device to facilitate the enforceability of these agreements. It is frequent, for instance, that one of the parties who has committed herself to vote for a defined slate for the board of directors, makes the last minute decision of casting the votes for a different one. Under the Model Act, the president of the corporate organ shall abstain from computing such wrongful voting. Due to the fact that the president's intervention may give rise to legal effects different than those expected by the other

³⁴⁹ For a detailed explanation on the drafting of shareholders' agreements, see Francisco Reyes, *supra* note 266, at Chapter VII. Professor Modesto Carvalhosa also suggests some models for shareholders' agreements, emphasizing on the advantages of stipulations regarding corporate control and command. Shareholders' agreements are the base of multiple strategies that can be planned during the corporation's life. It is possible, for example, to find solutions for absenteeism in Shareholders' Assemblies, to arrange for the preservation of control, to entrench the corporation's management and to foster minority shareholders' participation. (See Modesto Carvalhosa. *Comentários à Lei de Sociedades Anônimas*. Vol. 2. *supra* note 338 at 568). Similar practical purposes are explained by Waldirio Bulgarelli, (*Questões Atuais de Direito Empresarial*, São Paulo, Malheiros Editores, 1995, at 194).

subscribing shareholders, the latter are granted the right to seek the specific performance of the obligations contained in the agreement (Section 24(2) of the Model Act).

4.7.2.14 Board of Directors

As it has been repeatedly stressed out, a major aspect in the design and conception of the simplified stock corporations relates to the reduction of formalities and costly requirements for the operations of closely held entities. By facilitating the internal organization of the corporation, shareholders are granted considerable leeway to define the firm's managerial structure.

Most rules contained in traditional statutes in the region have often denoted a restrictive philosophy vis-à-vis the activities of directors and officers, as well as a notorious mistrust towards the board of directors and their members individually considered. The approach undertaken in commercial codes and Company Law statutes across the region is an eloquent example of what has been properly labeled in another context as "Misguided Paternalism"³⁵⁰.

Although the board of directors is not a mandatory organ in the SAS Model Act, it can be included in the corporation's by-laws. In this case, the parties will have ample freedom to determine the number of its members (one or more) and other issues such as the calling of its meetings, quorum, majorities, and specific powers granted to it. A single member board may be useful, especially when the manager is different from the sole director. This system allows shareholders to divide the direct management of the corporation by granting binding authority to the legal representative and oversight powers to the single board member. In corporations with two shareholders and symmetrical capital contributions, it may be a suitable structure because it allows the exercise of reciprocal controls. The Model Act also suppresses the requirement existing in some jurisdictions of having alternates for each board member.

Naturally, there is no restriction as to the maximum number of members that the board may have. It is also possible to create committees dependent on the Board of Directors. This is advisable for corporations of great dimension, where it is convenient to separate certain operations relevant to the corporation in auditing committees, nomination and compensation committees, etc.

In businesses of a smaller dimension, the Board may not be a useful organ. For this reason, Section 25 of the Model Act states that "in the absence of a provision requiring the operation of a board of directors, the legal representative appointed by the

³⁵⁰ See Charles R. O'Kelley and Robert Thompson, *Corporations and Other Business Associations, Cases and Materials*, Second Edition, Boston, Little Brown and Company, 1996, at 48.

shareholders' assembly shall be entitled to exercise any and all powers concerning the management and legal representation of the simplified stock corporation".

For those cases in which the board is created, its members will be elected through cumulative voting, majority voting, or any other method foreseen in the by-laws. The SAS Model Act confers contractual freedom to shareholders in order to define the legal rules regarding their operations. In addition, there are no limits to insert restrictions for accessing the board. This allows shareholders to provide for conflict of interest restrictions in order to set out certain entry barriers to this organ. It would even be feasible to determine that the customary exercise of certain commercial or industrial activities by the person nominated to the board makes this individual ineligible to have a seat in that organ. In any case, as a default rule, and in the absence of a specific regulation in the corporate by-laws, the activity of the Board of Directors will be governed under the rules contained in the Commercial Code or corporate statute.

Under the SAS regime, it is not necessary for shareholders to have proportional representation in the board. This requirement has been rightly considered as inconvenient and impractical in other legal regimes. Professor Stephen Bainbridge presents an interesting analysis on the evolution of board of directors' election systems: "Cumulative voting was very much in vogue in the late 1800s. A number of states adopted mandatory cumulative voting as part of their state constitutions. Others did the same by statute. During the last few decades, however, cumulative voting in public corporations is increasingly falling out of favor. Opponents of cumulative voting argue it produces an adversarial board, which results in critical decisions being made in private meetings held by the majority faction before the formal board meeting. Today, only 8 states have mandatory cumulative voting"³⁵¹. Similarly, Professors O'Kelley and Thompson allude to the manner in which the proportional representation system for electing the board of directors fell into disuse in the United States. "The fall of cumulative voting described above reflects a legislative judgment that corporations normally would be better off if directors do not represent minority points of view or interests"³⁵².

However, pursuant to the Model Act, in those exceptional cases in which cumulative voting or other proportional representation system has been voluntarily stipulated for the election of the board of directors, all shareholders will be entitled to divide their votes, allocating them separately to various candidates or slates. This mechanism allows shareholders to maximize their ability to have a representation in the board and avoids certain restrictions existing in some Latin American countries which require each shareholder to vote exclusively for a single slate³⁵³.

³⁵¹ *Corporation Law and Economics*, *supra* note 47, at 446.

³⁵² See Charles R. O'Kelley; Robert B. Thompson, *supra* note 350, at 295.

³⁵³ In the recent past a few US jurisdictions still provided for mandatory cumulative voting for the election of the board of directors. *Id.*, at 294.

The flexibility afforded in the Model Act to the board of directors is also granted to the regulation of other administrative or auditing collegiate organs or committees that may exist in the corporation. It is expected that the above-mentioned rules will facilitate the internal governance of the firm, as they are more adequate to the structure of closely held business associations.

4.7.2.15 Legal Representation

The only mandatory officer in the SAS Model Act is the so-called legal representative. This institution is similar to the US general manager or CEO. The duty of this officer relates specifically to represent the corporation vis-à-vis third parties. The proposed legislation allows for a SAS' sole shareholder to be the single member of the assembly, the board's only director, and the company's legal representative. In fact, pursuant to the already quoted Section 17 of the SAS Model Act, "where the number of shareholders has been reduced to one, the subsisting shareholder shall be entitled to exercise the powers afforded to all existing corporate organs". On the other hand, Section 26 of the Model Act determines that the simplified stock corporation's legal representation will be "carried out by an individual or legal entity appointed in the manner provided in the by-laws". This specific provision follows closely the French regime on simplified stock corporations³⁵⁴.

The regime proposed by the SAS Model Act allows for legal representation to be regulated in various manners. If the company has a closely held structure with emphasis on personal methods, it is feasible to attribute to shareholders the role of legal representatives in cases in which it is convenient, for some or all of them, to participate directly in management. For corporations of a larger dimension it is possible to exclude shareholders from legal representation, so that temporal and revocable agents may exercise this role³⁵⁵. In this latter case, the designation of the legal representative may be deferred to the assembly or the board of directors, depending on the degree of control that shareholders intend to exercise over the executives representing the company before third parties. The corporation's by-laws will define the system for the designation of legal representatives, as well as the period for which they will occupy those positions³⁵⁶. Section 26 of the Model Act contains a default provision for cases in

³⁵⁴ The French legislation also addresses this issue. The only corporate officer required by law in a simplified stock corporation is the General Director. However, the by-laws shall freely establish the conditions wherein the company will be managed, including the designation and revocation of directors and managers, as well as their number, tenure, and compensation. See Véronique Magnier, *Droit des Sociétés*, 2^{éd.}, Paris, Ed. Dalloz, 2004, at 35.

³⁵⁵ In the absence of an explicit stipulation in the corporation's by-laws, there is no restriction for SAS' shareholders to be appointed as the corporation's legal representatives.

³⁵⁶ Although, according to the "ad nutum revocation" principle concerning managers and directors, it is clear that board members may be removed at any time. Regarding this topic see *Les Administrateurs*

which no comprehensive regulation has been set up in the by-laws concerning the appointment of legal representatives. In this hypothesis, the relevant powers to appoint such officers shall reside with the assembly or the sole shareholder.

The legal representation can be carried out either by one or several officers. In the latter case, the by-laws must determine whether they shall act independently or jointly. The corporate by-laws may also define the existence of contracting restrictions derived from the nature or amount of acts in which they may engage on behalf of the SAS. The lack of an explicit restriction regarding this topic will imply that all powers and authority shall be vested upon these officers, provided that they act within the boundaries set forth in the purpose clause (if it has been determined in the by-laws). Section 26 of the SAS Model Act reiterates the principle according to which, where there are no explicit restrictions on the legal representative's powers, such officer will be allowed to carry on all the acts and contracts directly related to the existence and operation of the corporation.

The Model Act does not require any special qualification or specific nationality for the persons meant to act as legal representatives. It will suffice for them to have legal capacity according to the civil laws existing in each Latin American jurisdiction. At the same time, the corporation's legal representative shall not be required to have residence at the place where the business has its legal domicile.

4.7.2.16 Liability of SAS Managers

The concise nature of the SAS Model Act determines the necessity of providing for the application of a default regime concerning all those matters not specifically covered by it. Accordingly, aside from a few specific rules, the Model Act relies on the general regime on duties and liabilities of directors and officers set forth in the Commercial Codes or relevant Company Law statutes existing in each jurisdiction (section 27)³⁵⁷.

As it is the case concerning other aspects of the SAS, the application of the rules on liabilities of directors and officers contained in the general corporate statute will only take place in the absence of specific provisions set up either in the Model Act or in the corporation's by-laws. Pursuant to the above-quoted section, such liability regime shall

sont Révocables ad nutum, in *The Journal Officiel de la Nouvelle-Calédonie*, June 28th of 2005 [online] [http://www.juridoc.gouv.nc/JuriDoc/JdJ200.nsf/JoncP/2005-03701/\\$File/2005-3701.pdf?openElement](http://www.juridoc.gouv.nc/JuriDoc/JdJ200.nsf/JoncP/2005-03701/$File/2005-3701.pdf?openElement).

³⁵⁷ For example, in Brazil, directors' and officers' liability is governed under sections 138 through 142 of Law 6.404 of 1976. Pursuant to these provisions, managers and directors must act with the care and diligence they would have applied in their own businesses. Concerning this aspect, see J.C. Sampaio Laceda, *Comentários à Lei das Sociedades Anônimas*, São Paulo, Saraiva, 1978, at 190 and Amador Paes de Almeida, *Manual das sociedades comerciais*, São Paulo, Saraiva, 1998, at 262-264. Colombian Commercial Code (article 200) and Law 222 of 1992 (articles 23 to 25) also regulate directors' and managers' duties and liabilities.

be applicable to the “legal representative, the board of directors, and the managers and officers of the simplified stock corporation, unless such provision is opted-out in the by-laws”.

It is relevant to bear in mind that Section 27 attributes liability for breach of fiduciary duties not only to the designated managers or directors, but also to any individual or company engaging in acts related to the SAS daily operations. In this manner, the Model Act introduces the so-called theory of “shadow directors”. In fact, it establishes that any person who is not a dutifully designated manager or director of a SAS, but who “engages in any trade or activity related to the management, direction or operation of such corporation shall be subject to the same liabilities applicable to directors and officers of the corporation”. This system is intended to govern situations in which an individual or company who has not been appointed to any corporate position, intrudes in the day-to-day management of the corporation. Under traditional Corporate Law regimes common in this region, such persons normally escape from any fiduciary duties applicable to directors and officers and, therefore, are shielded from the liabilities in which they would otherwise incur. Given the capital concentration that is commonplace in all Latin American jurisdictions, majority shareholders are usually able to manipulate the corporation’s management without being exposed to any disciplinary measures. The theory of “shadow directors”, thus, permits to extrapolate corporate rules that may have a deterrent effect on the controlling shareholder’s opportunistic behavior.

Furthermore, the SAS Model Act, in Section 27, Subsection 2, introduces the principle whereby the liability of managers and directors can also be extended to an individual or legal entity that may have “apparent authority”, to the extent “that it may be reasonably believed that such persons have sufficient powers to represent the corporation”. In this situation, it is only fair that the corporation be held liable for any transactions entered into with third parties “acting in good faith”.

Probably the main innovation contained in the SAS Model Act regarding managers or directors does not lie with the rules mentioned above, but with the simplified procedure necessary to hold these individuals liable for breach of their fiduciary duties. Under Section 39 of the Model Act, any conflict arising during the corporation’s lifespan involving the SAS’ managers or directors may be subject to arbitration proceedings or to any other alternative dispute resolution mechanism. Additional alternatives provided by the SAS Model Act include specialized judicial or quasi-judicial courts in case the shareholders *ex ante* have not chosen arbitration proceedings. It must also be mentioned that an arbitration clause may only be “included, amended or suppressed from the by-laws by unanimous decision rendered by the holders of all issued and outstanding shares”, as stated in Section 40 of the SAS Model Act.

4.7.2.17 Corporate Auditing Organs

Auditing organs are not obligatorily required under the SAS Model Act. Pursuant to section 28, a simplified stock corporation is “not mandated to establish or provide for

internal auditing organs". Such provision is intended to reduce costs represented in fees and other significant payments that must be made to auditing committees and fiscal auditors.

The underlying philosophy of this deregulation of internal controls is grounded on the uselessness of such organs in closely held companies where their management and direction corresponds to clearly defined majorities. Such is the usual scenario in contexts of high capital concentration, as is the case in all Latin American countries. In this type of companies minority shareholders may benefit from the direct control and supervision usually exercised by majorities over directors and managers (this corresponds to the so-called *free riding* phenomenon)³⁵⁸. The rare cases in which auditing organs are voluntarily appointed in closely held companies could suggest that shareholders generally disregard the usefulness of this sort of corporate organs. The facts show that third parties such as banks, possible acquirers of control, contractors, and other third parties tend to prefer the external auditing system due to their greater independence vis-à-vis the company's management.

4.7.2.18 Bylaw Amendments and Corporate Restructurings

Flexibility is the principle that permeates the SAS Model Act in its entirety. By reducing formalities and facilitating by-law amendments and corporate restructurings, the proposed regulation allows the SAS to adapt to changing circumstances in the business environment. As it has been explained, incorporation of the SAS may be done by virtue of a private document, namely there is no need to grant public deeds before a notary public. In order to maintain symmetry between the incorporation regime that governs the SAS, and the proceedings required for by-law amendments, section 29 of the Model Act determines that once the relevant decision has been approved by majority vote by the shareholders, it will suffice to file it before the mercantile registry in order for the amendment to be effective before third parties.

As it has already been analyzed, an exception to majority voting can be found, however, in certain provisions of the Model Act in which shareholders' unanimous consent is required to adopt specific transactions such as the limitation on the transferability of shares (section 13), the stipulation subjecting each transfer of shares to the assembly's authorization (section 14), the possibility of setting up mechanisms for the exclusion of shareholder (section 38), the adoption of a change of business form (section 31), and the inclusion or amendment of an arbitration clause (section 40). The

³⁵⁸ For Bratton and McCahery, "blockholder systems, like market systems leave management in charge of the business plan and operations. But large-block investments imply a closer level of shareholder monitoring. In addition, the coalescence of voting power in a small number of hands means earlier, cheaper intervention in the case of management failure. The systems' other primary benefit stems from the blockholders' ability to access information about operations. This lessened information asymmetry permits blockholders to invest more patiently." See Bratton and McCahery, *supra* note 154 at 226.

underlying purpose of these restrictions is to protect minority shareholders in those events in which there is a significant risk of abuse or expropriation³⁵⁹.

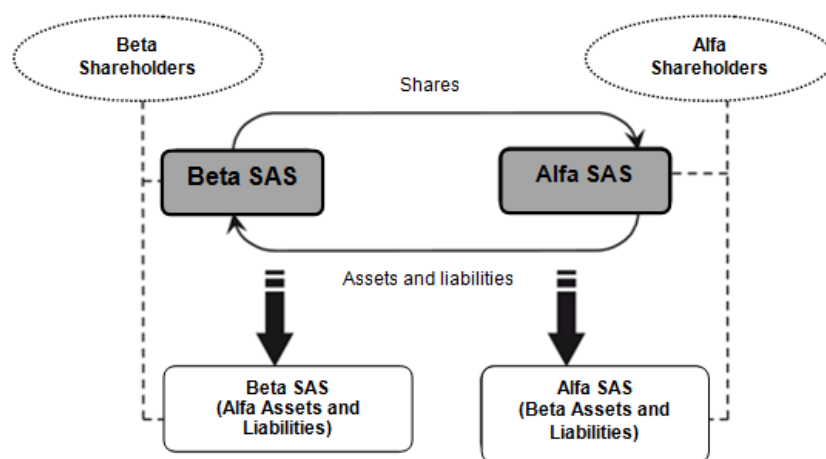
Given the succinct nature of the model act, it is determined that all corporate restructuring transactions (such as the change of business form, mergers and split-offs) shall be governed under the already existing provisions contained in Commercial Codes or Company Law statutes (section 30). Nevertheless, the same provision also includes specific protections granted to shareholders, such as dissenters' rights and appraisal remedies. By means of these devices, a shareholder that votes against the relevant restructuring transaction could be entitled to obtain the reimbursement of her capital contribution ascertained in accordance with its fair market value. For this purpose, the Model Act defines three specific causes that trigger this remedy, to wit: (1) situations in which, as a result of the restructuring transaction, the dissenting shareholder's percentage in the subscribed paid-in capital of the simplified stock corporation has been reduced; (2) events in which the transaction has caused the corporation's equity value to be reduced, and (3) cases in which the free transferability of shares has been constrained.

The Model Act also expands the applicability of dissenters' rights to transactions for the sale of all or substantially all assets of the corporation. This new type of restructuring transaction is regulated in section 32, where it is defined as the event in which "a simplified stock corporation purports to sell or convey assets and liabilities amounting to 60% or more of its equity value". As in any other regulation of this transaction, the corporation whose assets are sold or conveyed does not cease to exist. In fact, the SAS may receive cash or shares of stock from the purchasing company as consideration for the transfer of all or substantially all of its assets. After the transaction takes place, the SAS' general assembly may decide to wind up the corporation, in a manner in which the consideration resulting from the transaction will be distributed among its shareholders on a pro-rata basis. The shareholders may also decide to resume the corporation's economic activities by acquiring new assets or investing its funds in alternative business activities.

The Model Act provides that a sale of all or substantially all assets calls for the approval of the majority of shareholders. As in the cases of mergers and split-up transactions the remedy is applicable whenever the sale or conveyance of assets is detrimental to the shareholders according to any of the three specific causes referred to above.

³⁵⁹ The requirement that a unanimous decision rendered by the shareholders' assembly is necessary for the conversion of the SAS was borrowed from the French legislation. Ripert and Roblot hold that "specific aspects that characterize the simplified stock corporation have led to the adoption of rules that require a unanimous decision rendered by the shareholders for the conversion of any type of business entity into a SAS". G. Ripert and R. Roblot, *Droit Commercial. Les sociétés commerciales*, Tome 1, Volume 2, 18^e Ed., L.G.D.J., at 701.

Graph 15
Example of Sale of Assets



In this transaction, Beta SAS purchases Alpha SAS's assets and liabilities, which are paid through the issuance of shares of stock in favor of Alpha SAS. After the transaction takes place, Beta's equity is composed of its own assets and liabilities, together with Alfa's. The latter will remain as an investor in Beta, and its only asset will constitute its equity: the shares issued by Beta SAS. Alpha's shareholders' assembly may decide to undertake the corporation's dissolution and winding up. In this case, its shareholders will receive as consideration the shares of stock issued by Beta.

Another innovation introduced by the SAS Model Act is the so-called short-form merger³⁶⁰. Pursuant to Section 33 of the cited Act, this restructuring transaction can be accomplished only in those mergers where there is a parent company that owns at least 90% of the outstanding shares of a simplified stock corporation. In these events, the latter may be merged into the former through the sole decision rendered by the managing organs of all the entities involved (i.e. board of directors or officers). This type of merger is an exception to the general rule according to which the assembly is the single corporate organ entitled to make decisions regarding structural changes. Hence the requirement of the absorbing company owning such a significant percentage of the absorbed SAS' capital. Furthermore, to simplify the transaction the decision whereby the administrative organs of the companies involved agree to a short-form merger may be recorded in a private document that must be filed before the Mercantile Registry.

³⁶⁰ The short-form merger was first introduced by Anglo-American Company Law. It is included, for instance, in section 253 of the Delaware Code under the title "merger of parent corporation and subsidiary or subsidiaries". Colombia is the only Latin American country that has adopted short-form merger regulations (See section 33 of Law 1258 of 2008).

4.7.2.19 Dissolution and Winding Up

The rules contained in the Model Act regarding the dissolution of a SAS are similar to those that exist for other types of business entities in most Latin American legislations. Pursuant to section 34, the events of dissolution of a SAS include the following: (1) The expiration of a duration term, if such stipulation has been included in the corporation's by-laws; (2) when the corporation is unable to carry out the business activities provided under the purpose clause; (3) when a compulsory liquidation proceeding is initiated; (4) when an event of dissolution set forth in the bylaws takes place; (5) when a majority shareholder decision is rendered or such decision is made by the will of the sole shareholder; and (6) when a decision to dissolve is rendered by any authority with jurisdiction over the corporation.

The aforementioned events of dissolution of the SAS will be effective from the moment in which the decision to dissolve the corporation or the recognition of the concerning legal cause is filed with the Mercantile Registry. The only exception to this rule is the event in which the duration of the term has elapsed. In this case, the corporation shall be dissolved automatically.

It is relevant to bear in mind that, given the latitude granted to the SAS, there are no causes of dissolution related to the number of shareholders that the corporation may have. As it has already been explained, there is no plurality requirement and, therefore, the SAS can be formed with a single shareholder. Nor is there a limit in the amount of shareholders that the corporation may have³⁶¹. Pursuant to section 35, "events of dissolution consisting on the reduction of the minimum number of shareholders, partners or members in any business form [...] may be cured by conversion into a simplified stock corporation, provided that unanimous decision is rendered by the holders of all issued shares or rights, or by the will of the subsisting shareholder, partner or member".

Section 36 of the Model Act refers to the winding up of the SAS. Such proceeding shall be governed by the same rules applicable to stock corporations in each of the jurisdictions adopting the Act.

³⁶¹ For example, the Brazilian stock corporation and the limited liability company require two or more shareholders or members for their creation (Section 80 of Law 6.404 of 1976 and Section 981 of the Civil Code, respectively). The same occurs in Mexico (Sections 29 and 61 of GLMC), Argentina (Sections 1 and 146 of Law 19.550), and Colombia (Sections 374 and 98 of the Commercial Code, with the clarification that in order for the traditional Colombian stock corporation (*sociedad anónima*) to be formed, a minimum of 5 shareholders is required). In addition to these provisions, the laws of each country provide that a reduction in the minimum number of shareholders constitutes an event of dissolution (See, for Brazil, Section 206 (d) of Law 6.404; for Mexico, Section 229 (IV) of LGSM; for Argentina, Section 94 (8) of LSC; and for Colombia, Section 218 (3) of the Commercial Code).

4.7.2.20 Piercing the Corporate Veil

It has already been stated that the SAS grants shareholders a comprehensive limited liability system. Section 2 of the Model Act is explicit in stating that “shareholders will not be held liable for any obligations incurred by the simplified stock corporation, including, but not limited to, labor and tax obligations”. This section is intended to restrict judicial discretion concerning liability extension based on creative and exorbitant theories.

Nonetheless, whenever the SAS is used as an instrument to perpetrate fraud, joint and several liability may be imposed upon shareholders, directors, and officers (section 41 of the Model Act). The possibility of disregarding the legal entity is not at all uncommon in several Latin American jurisdictions where it has been included in corporate codes and statutes. The Argentine legislation is a good example of the application of this theory³⁶². The Colombian legislation also contains certain provisions that allow for the corporate veil to be pierced³⁶³. There are additional examples in the Brazilian legislation, such as section 50 of the Civil Code, 134 and 135 of the Tax Statute, and section 18 of the antitrust law. All these regulations are based on the idea that limited liability, in spite of its advantages, cannot be preserved when the corporation is used as a conduit or an instrument to perpetrate fraud or circumvent public policy provisions.

The purpose of including a reference to veil piercing in the Model Act is to provide safeguards concerning the possible utilization of the legal entity for unlawful purposes. Hence, liability will be imposed on the responsible parties on the grounds of instrumentality or *alter ego* doctrines. The aggrieved persons shall be entitled to bring a suit against the controlling shareholders or other persons who could have utilized the corporation fraudulently or deceitfully. If the plaintiff prevails, those found responsible for such abuse of the corporate form will be held liable for all obligations related to their activity, as well as for any damages caused to third parties.

It must be emphasized that disregarding the legal entity is an exception to the generally applicable principle of limited liability and can only be effectuated through a legal complaint decided by a specialized judicial or quasi-judicial court or arbitration panel³⁶⁴.

³⁶² See section 54 of Law 19.550.

³⁶³ See sections 61 and 82 of Law 1116 of 2006.

³⁶⁴ See section 39 of the Model Act.

5. The Model Act on Procedural Rules for the Resolution of Conflicts in Simplified Stock Corporations

As it has already been analyzed in this book, in order for a legal transplant to be successful, it is necessary that the importation of substantive provisions be accompanied by procedural reforms aimed at their effective enforceability. Legal changes inspired in foreign developments must be followed by the adaptation of the institutional and procedural framework that should allow for their correct implementation³⁶⁵. An additional element referred to as the *good corporate judge*, is also needed for the appropriate operation of the transplanted corporate law institutions. In effect, the judicial servant's preparation, professional training and independence are essential for the accurate resolution of conflicts arising in any corporation³⁶⁶.

Important lessons concerning structural transplants and the good corporate judge should be learned in Latin America where the rules contained in substantive legal provisions are too often a mere symbolism. This reality is due to a large extent to the grave inefficiencies that characterize these nation's judicial systems. In fact, the bureaucratic and often corrupt nature of these judiciaries not only increases the costs of litigation, but also deters parties from exercising their legitimate rights³⁶⁷.

In accordance with statistical data provided by the World Bank in the *Doing Business 2011 Report*, Latin America occupies the second-to-last place with regard to the number of days it takes for a contract to be enforced (counted from the moment in which a lawsuit is filed). According to the table below, Latin American courts take, on average, 707 days to enforce a contract, while in OECD countries the average is 517. To provide some examples, a proceeding in Argentina lasts an average of 590 days, in Brazil, 616, and in Colombia, 1,346.

³⁶⁵ See Katharina Pistor, *supra* note 291. Concerning the importance of courts in the development of corporate Law McCahery and Vermeulen hold that recent empirical work has pointed out that in an environment that moves towards protecting the minority shareholders' interests, the judiciary plays an important role in enforcing and further developing the corporate governance mechanisms (See *supra* note 325).

³⁶⁶ See Luca Enriques, *supra* note 80.

³⁶⁷ See David Trubek et. al., "The costs of ordinary litigation", in *Law Review*, UCLA, No. 72 (1983-1984), explaining the regressive effect that high costs of litigation can have on the effective enforcement of substantive legal provisions. The authors refer to the slowness and procedural formalism of Latin American jurisdictions as an example of systems where the judicial branch obstructs the enforcement of legal rules.

TABLE 8
Enforcement of Contracts – Procedures, Time and Cost

Economy	Procedures (number)	Time (days)	Cost (% of Claim)
Regions			
Eastern Europe & Central Asia	37.3	402.2	26.7
OECD	31.2	517.5	19.2
East Asia & Pacific	37.3	531.8	48.5
Sub-Saharan Africa	39.1	639.0	50.0
Middle East & North Africa	43.9	664.1	23.6
Latin America & Caribbean	39.8	707.0	31.2
South Asia	43.5	1,052.9	27.2
Latin America (selected economies)			
Colombia	34	1,346	47.9
Brazil	45	616	16.5
Argentina	36	590	16.5
Guatemala	31	1,459	26.5
Mexico	38	415	32.0

Source: World Bank, Doing Business 2011, available at <http://www.doingbusiness.org/data/exploretopics/enforcing-contracts>.

Another problem that is present in most countries of Latin America is the comparative lack of specialized qualifications of those judges that are called to resolve corporate law disputes. It is common for such litigation to take place before so-called ordinary civil courts³⁶⁸. This circumstance scatters the judge's attention when addressing commercial law issues and all too often results in a complete disregard of technical Corporate Law rules and institutions. In addition, when more specialized administrative agencies are legally empowered to construe and apply Company Law

³⁶⁸ In many Latin American jurisdictions, such as Brazil, Argentina or Venezuela, there is no specialized jurisdiction for the resolution of conflicts related to company law. Jurisdiction over disputes involving disputes related to that field are handled before ordinary judges who, as a general rule, have the broadest jurisdiction to adjudicate on any matter that does not fall on the jurisdiction of specialized courts (See for Argentina, section 5(11) of the National Code of Civil Procedure; for Brazil, sections 86 and 100(IV) (c) of the Code of Civil Procedure; for Venezuela, section 44 of the Code of Civil Procedure). Other countries, like Chile or Colombia, have special provisions regarding corporate disputes. In Chile, Law 20.190 of 2007 orders that any conflict related to corporations shall be resolved through arbitration. In Colombia, Law 1258 of 2008 granted jurisdiction to the Superintendence of Companies for the resolution of conflicts involving the SAS.

provisions, legal operators are confronted with contradicting case law produced by civil judges, on one side, and governmental regulations, on the other.

An additional difficulty that can be stressed out has to do with the formalistic nature of this region's judiciaries³⁶⁹. The number of steps required for the enforcement of contracts tends to be exceedingly high. In fact, judicial proceedings in this region require, on average, 40 steps to be completed (see Table 8). This situation clearly contradicts the required agility of commerce and is a one of the most notorious discouraging factors for parties to litigate before local courts.

The abovementioned problems are aggravated by the parties' behavior during a judicial process. In fact, the rules of civil procedure and the judges in these jurisdictions tend to be generally permissive with regard to activities that hinder the proceedings and challenge the rights and privileges of the parties³⁷⁰. For instance, the procedural rights granted to litigants tend to be broad, while the powers and obligations of the judges are restricted and sometimes even subordinated to the course that the parties wish to give to the proceedings³⁷¹. Through abusive maneuvers legal operators often multiply the number of procedures, which in turn results in protracted litigation and prohibitive costs.

In order to overcome these obstacles in the specific field of simplified stock corporations, it is suggested that a specialized proceeding for conflict resolution could be created. This solution, along with the allocation of adjudication powers on a specialized arbitration panel or administrative agency may give rise to Company Law that is not only good in the books, but also in action.

The successful case of Delaware with its specialized judiciary is one of the models that can be imitated. The sophistication of this jurisdiction has definitely played a role in the development of US Corporate Law. It has been properly held that "in the area of corporate and business law, the Delaware Court of Chancery, and the Delaware Supreme Court (which is the appellate court that reviews Chancery decisions) became

³⁶⁹ See also Eduardo Couture, *Trayectoria y Destino del Derecho Procesal Civil Hispanoamericano*, Buenos Aires, Depalma, 1999, at 53, on the main problems of Latin American justice systems, specifically with regard to the lack of celerity and excessive 'procedural rituals'. The formalism of Latin American procedures is also denounced by Jesús González Pérez, who refers to the "barbaric formalism" that for years has taken place in the Spanish and Latin American systems ("El derecho a la tutela judicial efectiva", in *Cuadernos de Gestión Pública Local*, available at http://www.isel.org/cuadernos_l/index.htm).

³⁷⁰ This phenomenon is described by Soledad Antoraz, who explains how procedural rules in the main jurisdictions of Latin America fail to include effective mechanisms for the protection of parties regarding abuse of rights and illegal procedural conducts. This results in the constant alteration or deformation of the proceedings by the parties (See Soledad Antoraz, *El abuso procesal como principio moral*, Chile, Universidad Nacional del Litoral, at 4). See also Jorge Peyrano, "Abuso de los derechos procesales", in *Revista de Doctrina y Jurisprudencia de la Provincia de Santa Fe*, No. 3, Editorial Panamericana, at 265-267.

³⁷¹ See, for Argentina, Chapter IV of the Code of Civil Procedure; for Brazil, Chapter II of the Procedural Code; and for Colombia, sections 37 to 40 and 71 of the Code of Civil Procedure.

influential in developing corporate governance law not only in Delaware, but also in other American jurisdictions whose courts have chosen to follow Delaware case law in resolving governance disputes in companies incorporated in those states³⁷².

McCahery and Vermeulen have also analyzed the importance of the Dutch inquiry proceeding handled by specialized courts to deal with certain Company Law disputes (*enquêterecht* as set out in Articles 2:344-359 of Book 2 of the *Burgerlijk Wetboek* - Dutch Civil Code). These authors argue that, despite being relatively underprotected by statutory rules, investors benefit from easy and affordable access to dispute resolution procedures, such as those provided by the Dutch specialized business court. Furthermore, the grant of injunctive relief provides an incentive for the parties to the lawsuit to seek out settlements and thereby prevent further costly and unwanted litigation³⁷³.

In Latin America, countries such as Chile have also adopted similar legislations. Pursuant to its so-called Law on Corporations, any conflict arising between shareholders, or between shareholders and the corporation, its officers or its auditors, shall be resolved through arbitration (section 44 of Law 20.190 of 2007). This provision excludes the jurisdiction of ordinary courts for the resolution of disagreements involving *sociedades por acciones*. A similar approach was given to Colombia's simplified stock corporation, whose controversies must be solved by the Superintendence of Companies or by arbitration courts, as it has been established in Law 1258 of 2008.

This trend of setting up specialized administrative entities or courts to solve Company Law matters could also prove useful if it were applied to the simplified stock corporation. In effect, taking into account the experience of the above-mentioned countries, this book proposes to complement the substantive provisions concerning the SAS with a Model Act on Procedural Rules for this same type of business entity.

Such procedural rules must be guided by principles of efficiency, speediness and corporate specialization in order to prevent unnecessary delays, abuse of rights, obstruction of justice and excessive formalisms. The Model Act on Procedural Rules is intended to provide simplified stock corporations with a cost-efficient process that guarantees the fulfillment of this entity's substantive regulations. As it will be analyzed

³⁷² Jack Jacobs, "The Role of Specialized Courts in Resolving Corporate Governance Disputes in the United States and in the EU: An American Judge's Perspective", in *OECD Exploratory Meeting on Resolution of Corporate Governance Related Disputes*, Stockholm, 2006, at 7.

³⁷³ McCahery and Vermuelen see *supra* note 325. Another interesting example of a tailor-made procedural mechanism to channel conflicts arising in the context of Corporate Law is the Italian *rito societario* or "corporate proceeding" introduced in 2003. The *rito societario* is a specialized proceeding related to Company Law matters, which was developed in Italy through Legislative Decree of January 17, 2003. This relatively recent legislation modifies several traditional legal institutions of Italian procedural law in order to make them more dynamic in the resolution of this sort of disputes (See Maria Felicetta Esposito, *Il nuovo processo societario*, Università Guglielmo Marconi, 2007, at 4).

below, the Procedural Model Act proposes reforms on several different topics such as the jurisdiction of administrative authorities or specialized courts, procedures, evidence, time limits for each procedural stage, appeals, service of process, and abuse of procedural rights. The Procedural Model Act also provides a flexible structure as it allows the parties to agree on procedural rules different from those contained in its default provisions.

To prevent staying of the proceedings, the Act proposes to simplify the structure of the entire process by reducing the number of hearings and attenuating the level of formalism regarding service of process and appeals. It also intends to modify important aspects regarding the discovery of evidence, by limiting the number of witnesses and expert witnesses that may be presented by the parties. Institutions such as stipulations regarding the allowance of evidence have been extrapolated from Common Law systems in order to expedite the process. This device allows the parties to refrain from producing certain evidentiary materials by simple agreement of the parties.

The Model Act on Procedural Aspects for the SAS is based on the assumption that any action arising within the framework of such business entity shall have to be brought before a specialized court, arbitrator or administrative officer duly trained to resolve Corporate Law disputes.

The proposed SAS' specialized proceeding constitutes a Comparative Law exercise. Therefore, it borrows from various legislations in which it is inspired. In particular, some provisions have been taken from procedural laws of countries such as the United States, France, Brazil, and Italy. The idea to design a process specifically applicable to corporations was taken from the Italian legislation, where the *rito societario* was implemented in 2003³⁷⁴; The provisions regarding discovery of evidence and trial by hearings was inspired by U.S. rules on the topic; the procedures involved and the course of the hearings were taken from the French and Chilean legislations; finally, the anticipated judgment was inspired by the ingenious Brazilian legislation concerning that matter.

5.1 Purpose and Principles

The Model Act on Procedural Rules for the Resolution of Conflicts in Simplified Stock Corporations shall apply to all disputes that may arise on a simplified stock corporation. Section 1 of the Procedural Model Act sets forth that all disputes arising between shareholders, or between them and the corporation, its managers, officers and auditors, and even third parties, will be subject to the special proceeding. Any action aimed at setting aside decisions rendered by the shareholders' assembly or the board of directors shall also be solved through this process. The Model Act -based on the Colombian Law 1258 of 2008- surpasses the old-fashioned academic discussion

³⁷⁴ See Maria Felicetta Esposito, *supra* note 373.

concerning the supposed inability of non-judicial institutions to decide on challenges to decisions rendered by collegiate corporate bodies³⁷⁵.

As it is common in Civil Law legislations, the proposed Act also contains general principles, which are intended to serve as guidelines for its interpretation³⁷⁶. These principles are designed to have a practical application and, therefore, are developed in several provisions of the Procedural Model Act³⁷⁷. Section 2 of the Procedural Model Act is explicit when stating that any conflict that may result from the interpretation or application of the rules contained therein shall always be resolved in favor of celerity and agility of the process.

5.2 Specialized Jurisdiction

Pursuant to the Procedural Model Act jurisdiction to adjudicate any matter involving the SAS falls exclusively with a specialized judicial or quasi-judicial authority (Section 3). The underlying rationale to avoid the ordinary jurisdiction refers to the idea of allowing for cases to be heard by highly qualified officials endowed with technical and professional knowledge in the field of Corporate Law. By expressly preventing other judicial authorities from hearing cases regarding the SAS, the Procedural Model Act is intended to avoid the applicability of other legal provisions that may shift jurisdiction on to other officers.

5.3 Expeditious Filing of a Complaint

In order to facilitate access to litigation for the resolution of conflicts on the SAS, the Procedural Model Act simplifies the requirements for each of the procedures involved. Four main reforms are proposed with regard to the filing and preliminary study

³⁷⁵ As explained by María José Carazo Liébana, it has been traditionally held that any action to challenge decisions rendered by the shareholders' assembly or the board of directors can only be presented before ordinary judges. (*El arbitraje societario*, Madrid, Marcial Pons, 2005, at 137). Some countries even have rules expressly establishing that jurisdiction on these matters shall only fall on judges of the ordinary jurisdiction. For example, in Colombia, section 194 of the Commercial Code sets forth that judges shall have jurisdiction over cases regarding a challenge of decisions rendered by the shareholders' assembly or board of directors. Law 1258 of 2008, for the first time, allowed for arbitration panels to hear this type of legal complaints.

³⁷⁶ The principles contained in the Model Act coincide with the general principles of procedural law and are included in Latin American legislations. In fact, the principles of concentration, celerity, and brevity have been recognized by legal scholars in the region. (See, for Argentina, Fernando de la Rúa, *Teoría General del Proceso*, Editorial Depalma, Buenos Aires, 1991, at 72; see also José Chiovenda, *Principios de derecho procesal civil*, Reus, Madrid, at 129, when referring to the traditional principles of Latin American proceedings).

³⁷⁷ As Ugo Rocco explains, even though Latin American systems establish celerity, concentration and brevity as their guiding principles, the practical implications of such principles tends to be extremely limited (*Tratado de Derecho Procesal Civil. Parte General*, Volume II, Temis and Depalma, Buenos Aires, 1976, at 173). See also, Gimeno Sendra, *Fundamentos del Derecho Procesal*, Civitas, Madrid, 1981, at 221.

of the complaint or petition. First, the substantive requirements and formalities for the presentation of a petition are considerably reduced as compared with traditional statutes. Second, the petition can be filed electronically. Third, the number of documents that must be attached to the petition is significantly condensed. And fourth, the preliminary study and qualification of the petition is made in a summary procedure.

Section 5 of the Procedural Model Act includes only a few basic requirements and provides that the petition only include the most elementary information regarding the parties, the plaintiff's claims and pleadings, the facts of the case and the evidence. It also allows the plaintiff to include, in a single petition, pleadings involving two or more SAS defendants. This provision allows for the accumulation of claims and avoids the cumbersome requirement of having to initiate different proceedings for related controversies. These features facilitate the work of attorneys and reduce the costs of litigation.

Another important reform proposed by the Procedural Model Act is the alternative afforded to plaintiffs for filing their petitions electronically³⁷⁸. The Procedural Model Act proposes the implementation of an *Electronic System for Conflict Resolution of Simplified Stock Corporations*, a device specifically created for procedures involving SAS cases. Through an online website, parties involved in a proceeding before the specialized authority may file complaints, responses to complaints and motions regarding the case as well as have access to information and documents relevant to the proceeding. The website is also intended to provide support for all procedures concerning service of process. Furthermore, any person shall be entitled to have access to databases containing information of adjudicated cases involving simplified stock corporations.

The special process for simplified stock corporations also reduces the number of attachments that must be filed with the complaint. It is, in fact, established that only the documents that are necessary to identify the parties shall have to be presented along with the petition. All other documents, such as evidence materials, must be included in the docket during the hearing for the taking of evidence. When the complaint has been filed electronically, any attachment to it can be presented in the same manner.

³⁷⁸ This is an innovative procedure for the region, as several Codes of Civil Procedure in Latin America require the filing of the complaint in written form (see, for example, section 330 of the Argentinean Civil and Commercial Procedural Code, section 241 of the Draft for a Chilean Procedural Code, section 424 of the Peruvian Civil Procedural Code and section 75 of the Colombian Procedural Code). Exceptionally, section 56 of Chilean Law 19.968 of 2004 authorizes the oral presentation of a suit. However, such system does not include data messages as one of the possibilities for filing a petition, and, in any case, it calls for the recordation of the oral petition in a written document. Pursuant to Tavolari, all jurisdictions in the region require that filing of a suit be done in writing. It is not possible to undergo such procedures electronically (Pia Tavolari, *La fase introductiva y el contrato procesal en el proceso civil latinoamericano*, Chile, Universidad Alberto Hurtado, 2009, at 4).

The preliminary analysis of the complaint shall take place in an expeditious manner. In order to determine if the complaint is admissible the judge must review its conformity with the formal requirements provided in Section 5 of the Procedural Model Act. The dismissal of an action may only take place in one of two cases: 1) when the complaint has been deemed to be inadmissible and the plaintiff does not make the necessary corrections within the time limit, and 2) when the authority does not have jurisdiction over the case. Another innovation introduced with regard to the preliminary analysis of the complaint consists of a presumption regarding the legal standing of all shareholders, officers and directors of the SAS, as well as the SAS itself (Section 4).

5.4 Simplified Procedures

The Procedural Model Act aims at reducing the number of procedures involved, as well as the length of time in which each procedure takes place. Following this philosophy, it provides for the carrying out of only two hearings during the entire proceeding³⁷⁹. During the first hearing all preliminary procedures take place (i.e. mediation between the parties, curing of defects that may exist in the process, rendering of orders concerning discovery of evidence, etc.)³⁸⁰. The second hearing includes the taking of evidence, the presentation of closing arguments and the rendering of the final decision³⁸¹.

Any requests made by the parties for the production or discovery of evidence shall be solved during the preliminary hearing. The *authority* will make a decision concerning admissible evidence on the grounds of its materiality and conduciveness to the matter that being litigated. I will also be entitled to order the disclosure of any probative material in possession of one of the parties, which could be deemed to be pertinent for the issues discussed in the process.

³⁷⁹ This system of oral hearings is somehow inspired on the oral proceedings contained in the Spanish legislation. The so-called *Ley de Enjuiciamiento Civil* adopted in 2000 has incorporated a system of oral hearings, and has limited the number of procedures involved in each of them. This development has been praised by legal scholars (see Mauro Cappelletti, *Proceso, Ideologías, Sociedad*, Ediciones Jurídicas Europa América, Buenos Aires, 1974, at 43 and Eduardo Couture, *Trayectoria y Destino del Derecho Procesal Civil Hispanoamericano*, Depalma, Buenos Aires, 1999, at 54. See also, Fernando Martín, "Oralidad y eficiencia del proceso civil: ayer, hoy y mañana", in *Coloquio Internacional de la Asociación Internacional de Derecho Procesal 'Oralidad y escritura en un proceso civil eficiente'*, Madrid, November 6, 7 and 8 of 2008. Available at <http://www.uv.es/coloquio/coloquio/comunicaciones/pi2mar.pdf>.)

³⁸⁰ The preliminary hearing was crafted following the Model Code of Procedural Law for Latin America. Such Model Code regulates the different procedures that must take place prior to the proceedings. As Pia Tavolari explains, the Model Code incorporates the basic idea of having one preliminary hearing for the following purposes: to conduct mediation proceedings, curing defects, establishing the object of the proceedings, and ordering the production of evidence. (Pia Tavolari, *supra* note 381).

³⁸¹ The oral hearings' system has implications throughout the entire proceeding. Concerning such consequences see Antonio Francoz Rigalt, *La oralidad en el proceso civil*, Codhem, available at <http://www.juridicas.unam.mx/publica/librev/rev/derhum/cont/23/pr/pr14.pdf>, at 35.

The parties will have the opportunity to exhibit any evidence that may have been admitted during the second hearing (see Section 14 of the Procedural Model Act)³⁸². In this final hearing the probative material in the parties' possession will be exhibited as well as any evidentiary documents in the docket. The interrogation of any witnesses will take place at this stage. After all evidence has been taken and all probative material has been presented, each party will have thirty minutes for the delivery of closing arguments. After hearing the parties' final presentation the *authority* will render the corresponding decision.

It is important to emphasize on the fact that the Procedural Model Act limits deferrals that may take place during both hearings. This restriction is intended to limit the hearing's duration to one day. Likewise, the absence of any of the parties, generally, will not be a pretext for delays.

5.5 Restrictions on Admission of Evidence

Latin American procedural legislations are characterized by permissive evidentiary rules³⁸³. This flexibility often results in abuse of rights by the parties and their attorneys, as they all too frequently use the requests and production of evidence stages as a mechanism to delay the process and complicate the proceedings³⁸⁴. This is why the special proceeding for simplified stock corporations is meticulous with the rules regarding probative material. Certain provisions are included in the Procedural Model Act to prevent the pervasiveness of useless formalisms and to force the parties into carefully assessing that will be presented during these proceedings. In general, the proposed legislation includes four main proposals regarding this topic.

The first one refers to the procedural opportunity given to the parties to request evidence to be considered in the process. In effect, such opportunity is limited to the petition and its response, as the parties may only list the evidence that they will produce or request the judge to order, at this stage. Furthermore, any piece of evidence that is not directly related to the object of the dispute shall be instantly dismissed. Likewise, the

³⁸² The rules contained in the Model Act regarding *discovery* were inspired by US law. One of the manners in which Common Law countries apply this procedural institution is through *pretrial discovery*. This mechanism is adopted, which has been adopted in the Model Act, can be defined as a "phase where relevant information about facts is discovered and expert consultants are deposed" (Jiong Gong and Preston McCafee, *Pretrial Negotiation, Litigation and Procedural Rules*, available at <http://www.mcafee.cc/Papers/PDF/PretrialNegotiation.pdf>).

³⁸³ See, for Argentina, Chapter V of the Civil and Commercial Procedural Code; for Brazil, Chapter VI of the Civil Procedural Code; for Venezuela, Chapter II of Title II of the Civil Procedural Code; and for Colombia, Title XIII of the Civil Procedural Code.

³⁸⁴ Some Latin American authors explain the existing deficiencies in the regulations regarding means of evidence in the region's jurisdictions. See, for example, Santiago Sentis Melendo, *La prueba. Los grandes temas del derecho probatorio*, Ejea, Buenos Aires, 1979, at 9-12. See also, Cristián Maturana, "Un moderno sistema probatorio para el proceso civil", in *Revista del Colegio de Abogados de Chile*, No. 24, 2002.

number of witnesses that each party will be entitled to depose during the second hearing will be restricted to a maximum of three. The production of evidence through an inspection or physical examination of exhibits may exceptionally take place solely in those cases in which there exists no additional mechanism by means of which a certain fact can be proven.

A second recommendation concerns the production of documentary evidence. Civil Law jurisdictions tend to use outdated systems for the authentication of documents that have to be granted before notary publics in order to have any weight in a judicial proceeding. As a result of these formalisms the costs of litigation are increased and the ability to challenge substantial evidence on the grounds of irrelevant authenticity issues is exponentially intensified. For these reasons the Procedural Model Act adopts a presumption of authenticity for all documents presented as evidence, whether they are originals or copies (section 19). Likewise, Section 20 of the Procedural Model Act is an attempt to introduce the long-awaited recognition of contemporary means of communication in procedural law by granting sufficient evidentiary weight to any electronic document presented as evidence during the proceedings.

A third proposal concerning evidence is related to the production of evidence taking place through an *in situ* inspection of books and records. The Model Act on Procedural Rules is aimed at reducing this sort of evidentiary mechanism. The logistics that are associated with these inspections tend to be expensive and time-consuming. Latin American procedural regulations often require, in order for the in order to search examination of books and records, that the judge and all concerned parties be present at the place in which the alleged facts took place. The SAS Model Act on procedure provides for the *in situ* inspection of books and records only under exceptional circumstances. It does not require the parties to be present during the examination, as only the party who requested it should be obliged to attend. In addition, it will be this party's responsibility to record or film the examination, in order to be able to present it as evidence during the hearing for the taking of evidence.

The last recommendation proposed by the Procedural Model Act in the field of evidence is related to the adoption of evidentiary stipulations³⁸⁵. This means that the *authority* shall have to admit as evidence any fact or circumstance concerning the existence of which there has been an agreement between the parties. The Procedural Model Act also provides that stipulations shall be duly recorded in writing. Once the document has been executed, the stipulations will be informed to the authority, for it to decide on their validity. If the stipulations are deemed to be valid, they will be taken into consideration by the authority when ordering the production of evidence. The procedural

³⁸⁵ According to Hugo Alsina, one of the fundamental rules of a modern procedural system consists on the judge's obligation to admit as evidence those proven facts on which all the parties have agreed upon (*ubi partes sunt concordēs nihil ab iudicē*)" (*Tratado teórico práctico de Derecho Procesal Civil y Comercial, Parte General*, Buenos Aires, Ediar, 1956, at 101).

moment in which parties can agree on evidentiary stipulations is the preliminary hearing³⁸⁶. To prevent any violations to due process, the Procedural Model Act requires that all plaintiffs and defendants present in the preliminary hearing expressly acquiesce with regard to the evidentiary stipulations.

Another procedural institution refers to the shifting of the burden of proof. In accordance with traditional rules of Civil Proceeding, each party is required to bring the evidence to prove the facts supporting any claims or defenses during the process³⁸⁷. There are, however, situations in which one of the parties is in a better position to provide a determined evidentiary piece. At the same time, the party interested in using such evidence in support of certain claims or defenses may find it extremely difficult to gain access to any means needed to produce it. The Procedural Model Act provides that the *authority* shall be entitled to order a shift on the burden of proof by demanding the disclosure of the concerned evidence to the party who can produce it in the easiest possible manner³⁸⁸. For that purpose, the authority will take into consideration the specific circumstances surrounding the facts to be proven or the peculiar situation of the party to whom the burden is shifted.

5.6 Simultaneous Service of Process

The SAS proceeding explicitly authorizes service of process by contemporary means such as e-mail. Here again, the SAS procedural regulation is based on the advantages of technology. It also reduces the use of obsolete mechanisms for notification such as announcements posted in bulletin boards or the sending of summoning tickets. Because these antiquated systems are characterized by their slowness, the Procedural Model Act proposes that service of process may also be made electronically. However, the proposed legislation does not altogether remove these traditional systems from the process, as there is awareness of structural obstacles that exist in Latin America and other developing regions which hinder the penetration of Internet and other technologies³⁸⁹.

³⁸⁶ According to Alfonso Zambrano, evidentiary stipulations favor expeditious proceedings. "By exempting the need to prove certain facts, the objective of having a brief oral hearing is achieved, as less probative material must be produced". (Alfonso Zambrano, *Las convenciones probatorias*, available at http://www.alfonsozambrano.com/doctrina_penal/211109/dp-convenciones_probatorias.pdf).

³⁸⁷ See, for example, for Argentina, sections 377 and 549 of the Civil and Commercial Codes of Procedure; for Brazil section 333 of the same Code; for Venezuela, section 506 of the Procedural Civil Code; for Peru, section 196 of the Procedural Code; and for Colombia, section 177 of the Code of Civil Procedure.

³⁸⁸ Concerning this procedural institution see Jorge Mosset Iturraspe, "Responsabilidad médica en pro de la justicia", in *Responsabilidad por daños en el tercer milenio*, Buenos Aires, Abeledo-Perrot, at 679. See also Jorge Peyrano and Julio Chiappini, "Lineamientos generales de las cargas probatorias 'dinámicas'", in *Cargas probatorias dinámicas*, Rubinzal-Culzoni Editores, Santa Fe, 2004, at 19-20.

³⁸⁹ Notwithstanding the rapid diffusion of electronic commerce, cellular communications and other technologies, it is a fact that the Internet has not penetrated Latin America to an extent similar of highly developed nations. In effect, in 2010 only 34.8% of the population in Latin America had access to

Besides the introduction of the electronic service of process, another important innovation of the Procedural Model Act consists of the abolition of the system of *successive notification*, which is replaced in the proposed legislation for a method of simultaneous notification³⁹⁰. To explain this recommendation it is relevant to bear in mind that service of process in many Latin American jurisdictions requires the plaintiff to undergo a successive sequence of notifications until the defendant is eventually informed concerning the initiation of the process. Therefore, for instance, the judge or court will start by attempting to summon the defendant through a personal notification. If the defendant cannot be found within a legally predefined number of days, another type of summoning will be attempted (such as the publication of an edict). In summary, if a type of notification fails, the other systems provided in procedural laws will have to be successively exhausted. This approach normally results in unnecessary delays, particularly when there are several defendants³⁹¹. The Model Act on Procedural Rules solves these inconveniences by proposing that all mechanisms of notification be tried at once (*simultaneously*) in such a manner that, after thirty days the party to which the summons are addressed will be conclusively presumed to have been notified.

Because of the oral nature of most proceedings in the SAS Model Act, service of process during the course of a hearing constitute an important type of notification. Therefore, any decision rendered during a hearing is considered to have been notified to all parties at the same moment. An additional type of notification referred to as service through the parties' tacit behavior, is regulated in Section 32 of the Procedural Model Act, that reads as follows: "In any event in which a party behaves in a manner that could allow the authority to infer that such party has knowledge of the decision that was to be served, such party will be considered to have been tacitly served". This conclusive conduct shall cure all defects that may have occurred in the process of service"³⁹².

5.7 Exceptional Nature of Appeals

It is not unlikely for litigants in Latin America to take advantage of all kinds of recourses and appeals as a mechanism to delay proceedings, create uncertainty and

Internet. In many countries of this region, less than 30% of the population has access. According to statistics provided by the U.S. Census Bureau, Nielsen-Online, ITU and other sources, in countries such as Bolivia, Internet has only penetrated 11% of the population, in Ecuador, El Salvador and Guatemala, only 16%, and in Honduras, only 12%. See *Latin American Internet Usage Statistics*, available at <http://www.internetworldstats.com/stats10.htm>.

³⁹⁰ This is explained, for example, by José Chiovenda in *Principios de derecho procesal civil*, Reus, Madrid, at 129 and by Francesco Carnelutti, in *Cómo se hace un proceso*, Editorial Temis, Bogotá, 2007.

³⁹¹ See, for Venezuela, sections 215 to 233 of the Civil Procedural Code; for Peru, sections 157 to 161 of the Civil Procedural Code; and for Colombia, sections 314 to 330 of the Civil Procedural Code.

³⁹² Generally, service by tacit behavior of the parties is only permitted in specific circumstances. Such is the case of Colombia, where such type of notification is only permitted in the cases contained in section 330 of the Civil Procedural Code.

confusion, or to avoid the rendering of a final decision for the longest possible period³⁹³. The required balance between due process and swiftness is not an easy one when there is so much abuse of procedural guarantees and very limited disciplinary controls by the judge. As it has been repeatedly held in this book, such deplorable reality has resulted in a virtual denial of justice and a general unwillingness to litigate essential civil law disputes before the ordinary judiciary. In the specific field of Company Law it goes without saying that processes for the adjudication of simple matters that may take years and even decades, like the ones existing in many Latin American countries, require extreme legislative solutions. The urgent need to provide efficient solutions for conflict resolution is inconsistent with an excessive emphasis in procedural rights. This cannot be understood as a proposal for the disregard of basic democratic guarantees, individual rights or due process concerns. On the contrary, the existence of hasty methods for the judicial, arbitral or administrative solution of company law disputes reinforces the idea of a more functional and truthful democratic system for this region.

For the reasons mentioned above, the Procedural Model Act consecrates an appellate right only when circumstances of an exceptional character have taken place. A first development in this respect relates to the inability to appeal decisions of a procedural nature (for example, an order to summon the parties to a hearing). As their name indicates, the objective of such decisions is merely to propel the different stages that form part of the process. They do not encompass decisions on the cause of action or object of litigation and, therefore, the right of the parties to appeal seems to be unnecessary.

Furthermore, on the Procedural Model Act's approach, even decisions on the merits of the case are not necessarily subject to appeal before a superior judge or administrative officer. The proposed legal reform recommends, as a general rule, a single instance process. Certainly, any final decision can be challenged before the same authority that rendered it. But the right to have the decision reviewed by another person shall only be available when the monetary amount at stake warrants the additional waiting period that such a review will demand (section 28). Such exceptional appeal must be presented before the same authority that rendered the judgment, orally and during the final hearing, and, if granted, the hierarchical superior of the authority that rendered the initial decision shall resolve it.

The procedure for the special appeal contained in section 29 is simple and concrete. Since the superior can only render the final decision based on the procedural acts that have already taken place and the documents that are already included in the docket, and because no new evidence or pleadings may be introduced at this stage of the proceedings, the time frame for the appeals enormously reduced.

5.8 Anticipated Judgment and Summary Decision

³⁹³ Such is the case described by Soledad Antoraz and Jorge Peyrano, *supra* note 370.

An important innovation contained in the Procedural Model Act is the institution referred to as *anticipated judgment* (Section 9). If, during the preliminary study of the complaint, the authority finds that the pleadings and facts alleged by the plaintiff are fundamentally similar to those of a case that has been previously resolved by the authority, and in which the same officer decided against the plaintiff, all the stages of the SAS proceeding will be omitted, and a final decision will be rendered emulating the previous one. The *anticipated judgment* has been expressly taken from the Brazilian legislation, and its success is due to the expeditiousness with which cases have been resolved³⁹⁴.

It is important to note that under the Procedural Model Act an *anticipated judgment* can only take place when the previous decision of a similar case has been made in favor of the defendant. This is the reason why service of process to the party that will benefit from the decision (the defendant) will not be strictly necessary, as the judgment will only provide advantages for such party and, accordingly, there will be no need for any answer on the defendant's behalf.

Another rule similar to the anticipated judgment is the possibility granted to the authority in charge of the proceedings to render a summary decision, as regulated in section 15. The Procedural Model Act endows the specialized authority with the power to omit procedures and render a decision on the merits at any moment during the process, provided that the evidence collected to that point suffices to support such a decision. The proposed rule is based upon the *res ipsa loquitur* doctrine, which establishes that whenever the evidence unequivocally supports the pleadings and facts alleged by one of the parties -making the production of additional evidence futile-, the authority may dispense with unnecessary procedural stages and render a final decision on the merits of the case. Such decision is, nevertheless, subject to the recourse and appeal provided for under sections 27 and 28.

5.9 Abuse of Rights, Alternative Procedural Provisions and other Rules

Under the title "Miscellaneous Provisions" the Procedural Model Act proposes relevant changes to Latin American laws, including the following issues: 1) regulations

³⁹⁴ This rule is contained in Section 285-A of Brazil's Federal Code of Civil Procedure, as modified by Law 11.277 of February 7, 2006. Sérgio Ricardo de Arruda Fernandes explains that the possibility of rendering an immediate judgment is due to the "favoring of celerity of the process, as it permits the quick resolution of conflicts when the matter discussed has already been resolved by the judge in a decision that is against the plaintiff's pleadings" ("Considerações sobre a regra do artigo 285-A e o julgamento de mérito liminar", in *Revista da EMERJ*, vol. 9, nº 34, 2006, at 304 and 311). For an additional explanation regarding this institution, see Guilherme Prado Bohac de Haro, in *O Milagre da Interpretação: Como o "Modo de se ver" um Dispositivo Pode Salvá-lo ou Levar À Sua Ruína - Um Estudo Com Base No Art. 285-A, Do CPC*, available online at <http://intertemas.unitoledo.br/revista/index.php/ETIC/article/viewFile/2451/1975>.

banning abusive acts during the proceedings; 2) possibility to agree on alternative provisions regarding the different stages involved in a proceeding; and 3) a five-year statute of limitations.

With regard to acts through which the parties deploy an abusive exercise of their procedural rights, Section 34 of the Model Act introduces the possibility of redress through payment. Therefore, whenever the authority finds that one or more parties have incurred in such unlawful conduct, the authority will be entitled to impose fines to the responsible party.

As the nature of the Procedural Model Act is to guarantee an expedited and simple process, it allows the parties to propose modifications concerning the rules contained therein. In fact, pursuant to Section 35, the parties to any case governed under such Model Act may propose to the authority procedural alternatives regarding the manner in which the process will take place. This petition could be viable even in those cases where as a result of the proposed modification the order of proceedings provided for under Chapter II of the Act will be modified. If the authority considers that the proposals are useful for the purposes of expediting the process, it will approve the suggested changes and proceed to undertake any required modifications in order for the process to continue as proposed by the parties³⁹⁵.

As in any other procedural law, the Model Act on the SAS proceeding includes a clause regarding the statute of limitations. Section 41 of the Act proposes a five-year term for the expiration of the right to litigate issues related to the SAS. This time frame is found to be sufficient for concerned parties to make valid claims concerning their substantive rights before the judiciary. A statute of limitation setting a longer period for rights to elapse could give rise to uncertainty regarding consolidated legal situations. Since there is frequent discussion concerning the statute of limitations' initiation date, the Model Act proposes a number of guidelines determining the commencement date for each type of case involving the SAS. Accordingly, as set forth in Section 40, the time prescribed in the Model Act shall be counted in accordance with the following rules:

1. If the cause of action, claim or issue is related to the piercing of the corporate veil, abuse of rights, or liability of SAS officers, directors and shadow directors, the term prescribed herein shall initiate from the moment in which the abusive or fraudulent act occurred.
2. If the cause of action, claim or issue involves the challenging of a decision of the shareholders' assembly or board of directors, the term prescribed herein shall initiate from the moment in which such decision was rendered.

³⁹⁵ Ramiro Podetti explains the trend to allow the parties to voluntarily agree on specific proceedings, provided that such agreements do not affect public policy (*Teoría y técnica del proceso civil y trilogía estructural de la ciencia procesal civil*, EDIAR, Buenos Aires, 1963, at 234-236).

3. If the cause of action, claim or issue involves the performance of obligations contained in a shareholders' agreement, the term prescribed shall initiate from the moment in which such obligation was to be performed.

As a corollary to the analysis concerning the Model Act on Procedural Rules for the Resolution of Conflicts in Simplified Stock Corporations, it must be said that the proposed proceedings could become a tailor-made process highly suitable to the parties' needs and the specific circumstances surrounding litigation in the context of closely held entities. It would be expected that the flexibility, simplicity and expeditiousness surrounding such proceeding could greatly facilitate the enforcement of substantive provisions contained in the SAS Model Act.

6. THE SIMPLIFIED STOCK CORPORATION: AN EMPIRICAL DEMONSTRATION

The enactment of Colombian Law 1258 of 2008, by means of which the Simplified Stock Corporation (SAS by its acronym in Spanish) was created, has been by far the most successful Colombian company law reform in the last several decades. The implementation of the SAS has given rise to a certain degree of competition among the different types of business associations that exist in the country's commercial legislation. The inception of the new business form allows entrepreneurs to choose between a traditional legal regime characterized by old-fashioned, backward regulations and the new modern corporate type of entity. Certainly, the new business vehicle, which is useful for all purposes, has represented, since the law was enacted, a gradual wither away from the Colombian business association types existing prior to Law 1258 of 2008. The comparative inferiority of traditional business association types formerly used to structure closely held companies makes their future use unnecessary. Scholars and business people have acknowledged the undeniable practical advantages offered by the SAS alike. This assertion is evident in light of the exponential growth of the simplified stock corporation in Colombia.

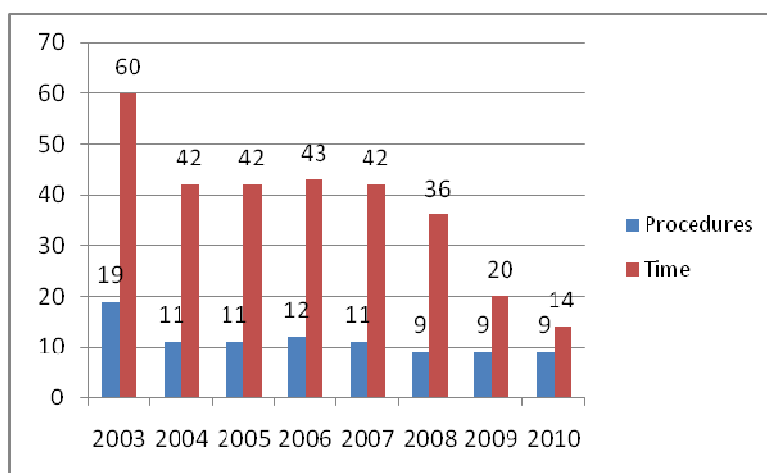
The Colombian Simplified Stock Corporations have attracted the attention of international institutions such as the World Bank. In its report entitled *Doing Business in Colombia 2010*, it holds that "the recent introduction of a new 'simplified stock company' (*Sociedad por Acciones Simplificada*, S.A.S.) is rapidly changing the way that entrepreneurs register their small and medium-sized enterprises. Law 1258 of December 2008, which created this new type of company, allows entrepreneurs greater flexibility in starting their business: companies can now be created by a private deed and they can have an unrestricted corporate purpose. This reform does not directly impact the *Doing Business* start-up indicator, but it does represent an important change in Colombian company law"³⁹⁶.

Pursuant to data provided in the report, during the last two years Colombia has made significant progress in reducing the steps required for the incorporation of new business entities. In fact, whereas in 2008 Colombia was ranked 82 within the "Ease of

³⁹⁶ See: http://www.doingbusiness.org/reports/subnationalreports/~/_media/fpdkm/doing%20business/documents/subnational-reports/db08-sub-colombia.pdf Some local organizations also have provided interesting insights as to the broad acceptance of the SAS in Colombia. According to the Bogotá Chamber of Commerce, entrepreneurs incorporated under this business form have not found any difficulties to obtain credit from financial institutions (See Bogotá Chamber of Commerce, *Perfil económico y jurídico de la SAS en su primer año*, Bogotá, Cámara de Comercio, 2010 at 47). Likewise, insurance companies have not been reluctant to deal with simplified stock corporations. In fact, pursuant to the assertion made by the Colombian Association of Insurance Law (ACOLDESE by its acronym in Spanish), during 2009 the insurance *premia* for performance insurances and bonds granted to simplified stock corporations was not higher as compared to the same insurances granted to other types of business associations (ACOLDESE, *Análisis de cifras comparativas en el Mercado de seguro contemporáneo, memorias del décimonoveno encuentro de ACOLESE y FASECOLDA*, Bogotá, November, 2010 at 12).

Starting a Business” list (where 183 economies in the world are compared), in 2009, Colombia had climbed up to number 74. For 2010, the country achieved an outstanding position within this indicator: in fact, it was ranked 39 in the list of 183 evaluated economies (see <http://www.doingbusiness.org/rankings>). The World Bank’s measurement regarding the time needed to start a business was also upgraded. Graph 16 shows the improvement of this economy over the last few years (especially in 2008 and 2009) both in number of procedures and in time it takes to start a business.

Graph 16
Starting a Business in Colombia – Required Time and Procedures



Source: The World Bank, Historical Report (Colombia)
<http://www.doingbusiness.org/custom-query/colombia>

As it can be noticed, apart from a reduction in the number of procedures, the time for starting a business in Colombia substantially decreased since 2008. The legal framework set up for the simplified stock corporation has reduced superfluous formalities such as the public deed of incorporation granted before notary public. Therefore, a so-called private document suffices for the purpose of registration of a SAS. Given the recognition of data messages as private documents (which appears in Law 527 of 1999, based on the UNCITRAL model act on electronic commerce), it is possible to incorporate these business entities online. In fact, the well-established principle of functional equivalence allows for a private party to express her will through electronic mechanisms and to bind herself by means of an electronic signature.

This functional and legal assimilation has allowed the main Chambers of Commerce of Colombia to introduce systems for online incorporation of simplified stock corporations. This can be considered a revolutionary step in Latin American Company Law, since no other jurisdiction in the region has gone so far in the modernization of its legal infrastructure. As of September 2010, the Bogotá’s Chamber of Commerce introduced its online incorporation system for simplified stock corporations. The process

is heavily supported by *Certicámaras*, a digital signature certification authority, endowed with all the technological equipment required to provide high standards of security in electronic transactions. The process for the incorporation of a SAS can be accomplished in just one or two hours under complete legal certainty conditions and technical security. The process can be achieved from any computer and the founding shareholders need not assume the costs of legal services³⁹⁷.

The Chamber of Commerce's website provides six steps for the incorporation of a SAS. Before starting, the applicant must create an account by entering name, identification number, and e-mail address (where all notifications will be sent). This allows the user to save the information and return to the process after temporarily abandoning it. In the first step of the process, the user is directed to a link where all the information relevant for registration can be verified (such as the availability of a corporate name and the applicable uniform international industrial code [UIIC]). The applicant will also be redirected to the website of the National Tax Bureau (*DIAN*), where issuing of a tax identification number can be requested. In the second step, the required forms must be filed, including the articles of incorporation, for which a model is made available. Model articles of incorporation expedite the process and guarantee that registration will not be denied for absence of basic elements of the business association. Next, the incorporator must pay the registration rights. Payment may be made online through an electronic service provider. The fourth step calls for the applicant to submit a request for the issuing of a digital signature by *Certicámaras*. Up to five digital signatures can be issued, free of charge. This step is crucial for the prevention of fraud. In fact, the certification authority verifies the identity of the petitioner in advance to the granting of the digital signature by accessing personal and financial information in eight different databases. The future signee also receives a security password (private key) to access and use the digital signature safely. In a fifth step, the applicant uses the digital signature to sign the incorporation document giving validity to the transaction. The whole process is completed when the Chamber of Commerce reviews the documents and registers the corporation³⁹⁸.

This innovative mechanism has resulted in a faster and economically viable incorporation process. Because this system is still at an initial stage, further developments are required to expedite other processes, such as the registration of officers, bylaws, amendments, dissolution, etc. The Chambers of Commerce must aim at setting up a virtual platform whereby users can have access to the Mercantile Registry's database and find all relevant information concerning registered corporations before the Chambers of Commerce including, inter-alia, corporate name, status,

³⁹⁷ See the Bogota Chamber of Commerce's official website at <http://serviciosenlinea.ccb.org.co/sas/default.aspx>

³⁹⁸ Id. A similar process has been implemented by the Medellin Chamber of Commerce where it is also possible to undergo the entire incorporation steps on line. See: <http://www.camaramedellin.com.co/Cámaraenlínea/ConstituciónvirtualdeSAS/tabid/590/Default.aspx>

purpose clauses, bylaws, names and identification numbers of officers, and amount of paid-in capital. Just as the SAS has triggered the electronic incorporation process, its success will stimulate the modernization of the Mercantile Registry.

6.1 Consolidated Empirical Data for the Entire Country

The reaction of the business community to the new regulation on Simplified Stock Corporations has surpassed all expectations³⁹⁹. In its second anniversary, over 52,000 SAS have been created all over the country. As Tables 9 and 10 show (regarding the formation of new business entities between December 2008 and November 2010), the SAS has acquired the highest level of importance within local business associations. The data not only show the impressive acceptance of the SAS during this period, but also the progress made by this company type *vis-à-vis* the previously existing ones. As a result, while in its first month (December 2008) the percentage of SAS only reached 7.42% of the total number of business associations registered, by November 2010 this company type already represented 83.6% of all registered companies. This trend has remained in 2010. As showed in Table 10, the percentage of SAS during its second year has ranged between 70 and 84% of the total amount of new registrations.

These data seem to indicate the quick understanding the business community has demonstrated towards the SAS regulation, and particularly, concerning the legal requirements for its incorporation. The figures speak loudly about the significant weight that local businesspeople assign to the principle of freedom of contract, which characterizes the new company type.

Table 9
Registered companies during the SAS's first year, as compared to other types of business associations

	2008	2009											
	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Single Member Enterprises	336	473	487	347	340	289	213	205	167	170	147	145	83
Stock Corporations	484	306	333	274	240	226	182	220	182	151	172	164	138
Partnerships	0	1	0	0	0	0	0	1	0	0	0	1	0

³⁹⁹ Data for this section (consolidated for the entire country) has been obtained directly from the Confederation of Colombian Chambers of Commerce, CONFECAMARAS by its Spanish acronym. The corresponding charts and graphs have been developed for this book using the same information.

Limited Partnerships by Stocks	41	30	20	27	23	13	16	26	10	19	18	9	22
Limited Partnerships by quotas	111	60	77	60	69	66	52	57	38	59	48	50	41
Limited Liability Companies	1024	1500	1630	1280	1142	971	871	891	669	763	650	424	255
SAS – Simplified Stock Corporations	160	293	629	1019	1184	1424	1544	2054	1773	2316	2183	1872	1551
TOTAL	2156	2663	3176	3007	2998	2989	2878	3454	2839	3478	3218	2665	2090
Percentage of SAS	7,4 %	11%	19,8 %	33,9 %	39,4 %	47,6 %	53,6 %	59,4 %	62,4 %	66,6 %	67,8 %	70,2 %	74,2 %

Table 10⁴⁰⁰

Registered companies during the SAS's second year, as compared to other types of Business Association

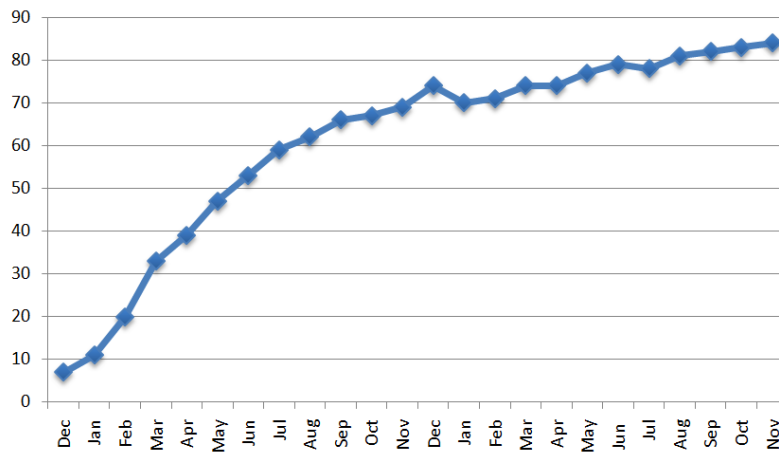
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Single Member Enterprises	172	191	189	139	139	143	120	133	128	92	103
Stock Corporations	105	128	127	119	123	131	143	110	114	128	111
Partnerships	1	0	1	0	0	0	0	0	0	0	0
Limited Partnerships by Stocks	10	6	17	15	14	14	9	11	15	16	20
Limited Partnerships by Quotas	45	57	74	36	38	42	52	44	44	43	42
Limited Liability Companies	660	836	725	623	506	447	460	469	450	363	314

⁴⁰⁰ Id.

SAS – Simplified Stock Corporations	2422	3091	3364	2817	2879	3069	2923	3448	3718	3411	3262
Total	3469	4350	4551	3795	3733	3891	3755	4242	4511	4101	3900
Percentage of SAS	69,8 %	71,1%	73,9%	74,2 %	77,1%	78,9%	77,8%	81,3%	82,4%	83,2%	83,6 %

Graph 17, below, reflects the evolution of SAS since 2008, by comparing the percentages of registered Simplified Stock Corporations for each month.

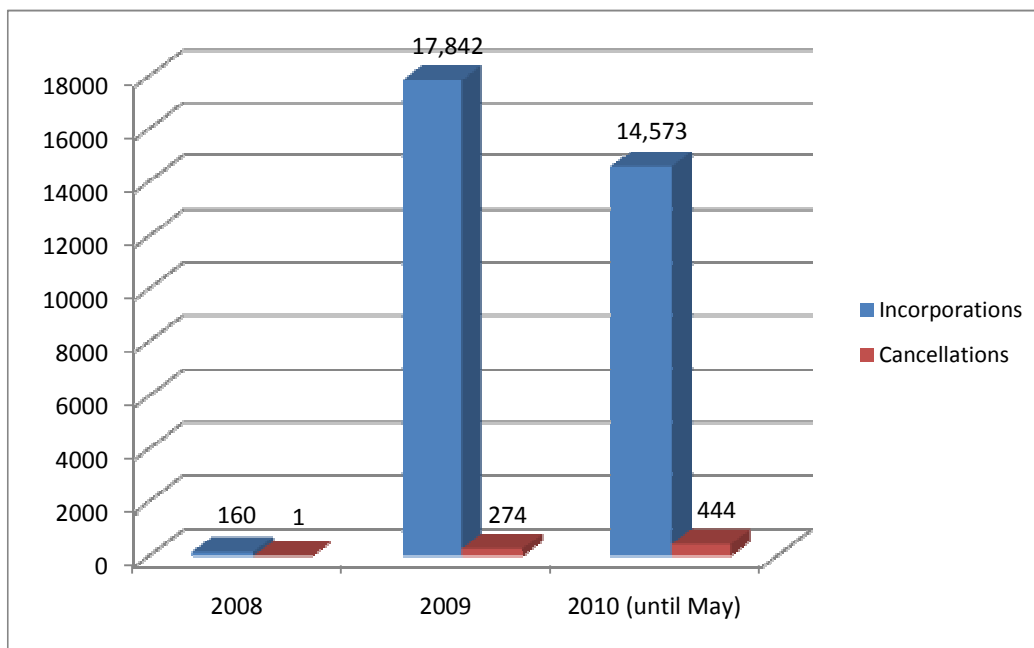
Graph 17⁴⁰¹
Evolution of SAS (2008-2010)



Another comparison that must be drawn, and which shows the success of this type of business entity, is that between the number of incorporations and the number of SAS cancellations. Graph 18 illustrates how, in 17 months, only 2% of SAS registrations have been cancelled. In fact, out of a total of 32,575 registrations that had been granted until May 2010, only 719 had been cancelled.

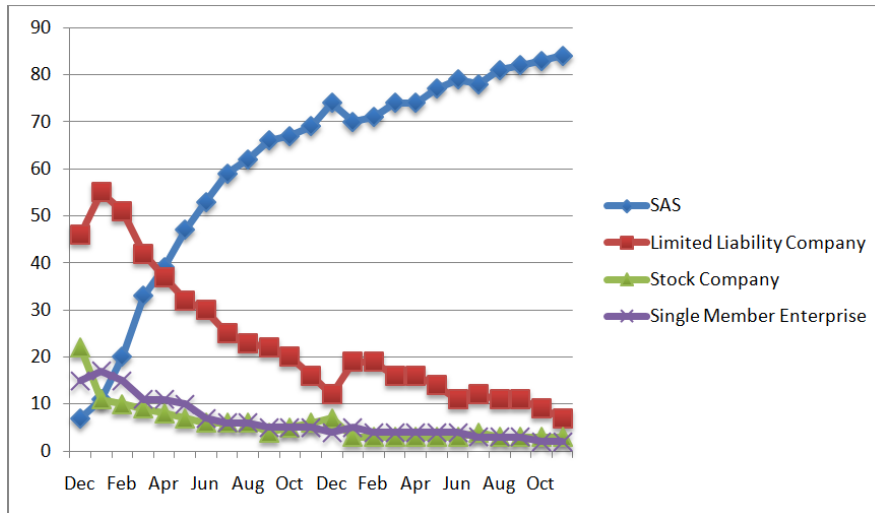
Graph 18
SAS Incorporations and Cancellations (until May 2010)

⁴⁰¹ Id.



Before the enactment of the SAS statute, entrepreneurs were bound to use the traditional types of business associations regulated under the Commercial Code. These business forms were the general partnership (*sociedad colectiva*), the limited liability company (*sociedad de responsabilidad limitada*), the limited partnership (*sociedades en comandita simple y por acciones*), and the stock corporation (*sociedad anónima*). The statistics show the downfall of these *traditional* entities, as well as the rise of the SAS. In particular, it is observed that since April 2009, the simplified stock corporation became the favorite company type in Colombia, surpassing even the limited liability company (See Graph 19). The latter was, since its inception in 1937 and until that moment, the most widely used company type in Colombia.

Graph 19
Evolution of Company Types (2008-2010)



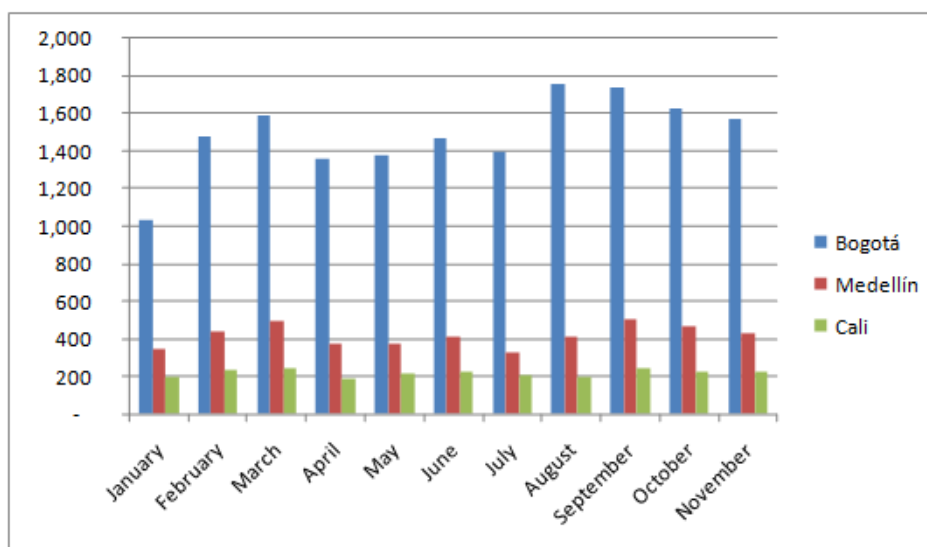
It is also relevant to review the growing acceptance of the new type of entity in the main cities of Colombia. The data clearly show that the cities where most companies are incorporated are Bogotá, Medellín, and Cali. These are the largest cities in the country (in that order). Table 11, which consolidates information of 56 cities throughout Colombia, shows that 70% of the new business associations registered in the chambers of commerce were created in those three main urban centers. In fact, out of 17,842 SAS incorporated in Colombia in 2009, 70% were registered in the above-mentioned cities (See Graph 20).

Table 11⁴⁰²
Simplified Stock Corporations (SAS) registered in Colombian cities during 2009

CITY	NUMBER OF INCORPORATED SAS	NATIONAL LEVEL PERCENTAGE
Bogotá	8054	45%
Medellín	2981	17%
Cali	1378	8%

Graph 20
SAS Incorporations in Colombia's Main Cities – 2010

⁴⁰² Id.



6.2 Comparative Analysis Concerning SAS Incorporated in Colombia's Largest Cities

This section describes the manner in which entrepreneurs have taken advantage of the SAS' main features. It analyzes the behavior of business people concerning Simplified Stock Corporations created in the cities of Bogotá and Medellín during the first year following the enactment of the SAS regulation⁴⁰³. The analysis is based on a total sample of 15,212 corporations of this type, of which 10,252 were registered before the Bogotá Mercantile Registry and 4,960 were filed before the Medellín Chamber of Commerce.

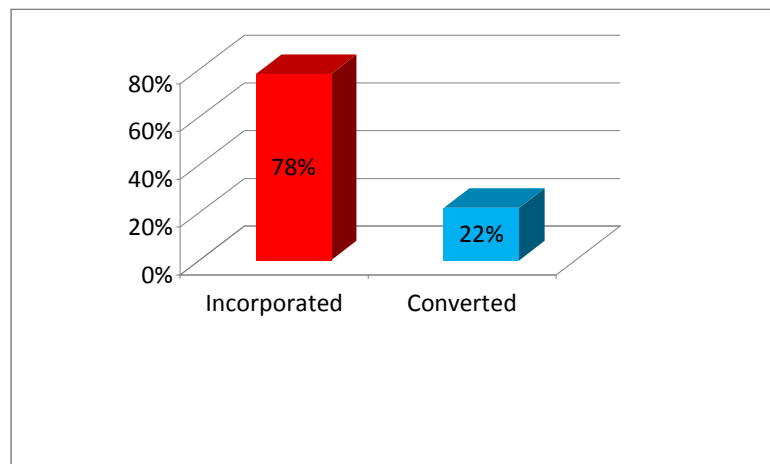
The study is focused on nine variables, which cover some of the most relevant features of the simplified stock corporations' legal framework. The empirical data are intended to measure the economic impact of the new corporate form, as well as its widespread use by business enterprises of varying dimensions. It is also intended to demonstrate the significant impact that a reduction in transaction costs and entry barriers has on small businesses. It is expected that through the SAS enterprises of a reduced dimension can have the necessary access to formality that otherwise would be extremely expensive. The appreciation shown by all sorts of entrepreneurs for the values of flexibility and contractual freedom is also evident in the sample.

6.2.1 Incorporation *Ex Novo* and Conversion into SAS

⁴⁰³ For the following graphs and tables, it is important to note that data regarding the simplified stock corporations registered in Medellín, has been directly obtained from that city's Chamber of Commerce. Data for Bogotá is taken from the already quoted publication entitled *Perfil Económico y jurídico de la SAS en su primer año*, see supra note 365, at 7-48.

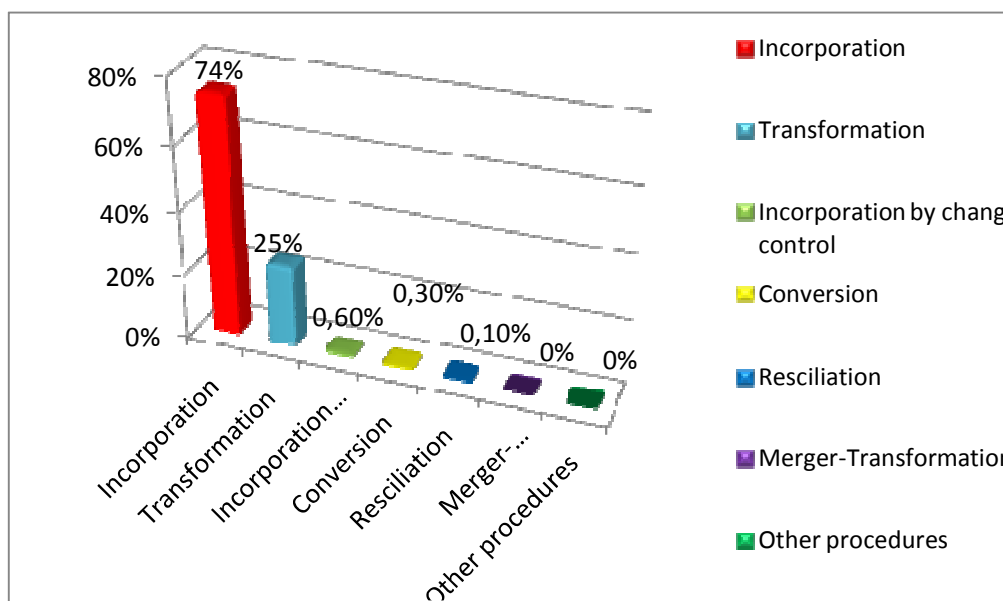
The data submitted for year 2009 by the chambers of commerce of Bogotá and Medellín concerning new registrations of simplified stock corporations, show that approximately 80% of these filings correspond to new entities (*ex-novo creation*). The remaining 20% refers to entrepreneurs that were operating under the cloak of traditional business association forms and have decided to switch into the SAS by means of conversion⁴⁰⁴. The fact that in a single year nearly 3,000 entities of a traditional business type (mainly LLCs and Stock Corporations) migrated to the newly introduced entity, reflects the usefulness of the SAS even for well-established companies (See Graphs 21 and 22). It is foreseeable that in the near future several companies will take quick advantage of the SAS regulation and undergo the transition to the new business entity.

Graph 21
Bogotá - Incorporations vs. Conversions



Graph 22
Medellín- incorporations vs. conversions

⁴⁰⁴ For the specific case of Medellín it has been found that out of 4,960 SAS, 74% were created *ex novo*. It is noteworthy to stress out that in that city the rate of conversions into SAS exceeded 25% of analyzed cases. The willingness of business people to migrate towards the SAS shows that the new business form responds with better tools to market necessities.



6.2.2 Private Documents and Public Deeds of Incorporation

The simple process of incorporation provided in Law 1258 of 2008 is one of the greatest advantages of the SAS. It differs considerably from the traditional cumbersome steps that were needed to set up a stock corporation in the recent past⁴⁰⁵. The reduction of formalities has been understood as a significant leap towards the formalization of small and medium enterprises. In fact, legal personality in the SAS arises upon entry in the registrar's office of the incorporation document. There is neither a requirement to execute public deeds nor to publish any notices in legal periodicals nor to obtain any governmental authorization in order for the legal personality to be conferred on the new entity.

It is not surprising that most processes for the incorporation of new simplified stock corporations have been made through the use of so-called private documents (as opposed to public deeds of incorporation). To be sure, in 2009 97% of the incorporations were made in the Medellín Chamber of Commerce by the filing of a private instrument⁴⁰⁶. The case for Bogotá is similar with more than 93% of the

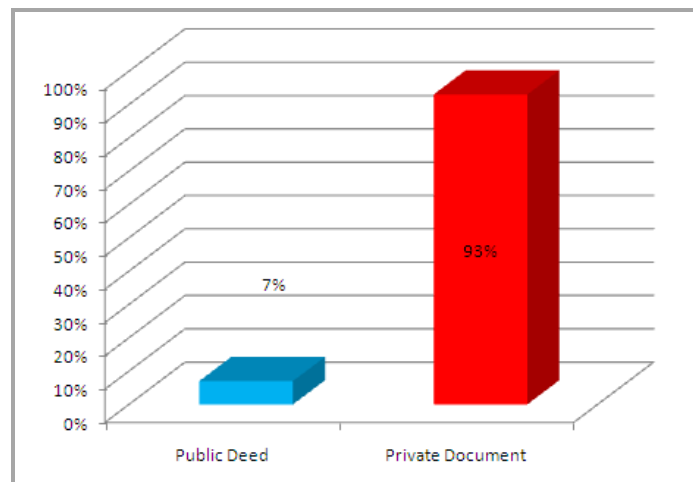
⁴⁰⁵ Phanor Eder held decades ago that in Latin America "the process of incorporation is, from our point of view, exceedingly complicated and cumbersome [...] In spite of these cumbersome formalities and restrictions, business has adjusted itself to them". See Eder, *supra* note 15, at 36. It seems like many of these problems still remain in most of the Latin American jurisdictions.

⁴⁰⁶ The data for Medellín show that 75% of the incorporations were carried out through simple private documents; 20% were created by filing of an actual copy of the shareholders' assembly minutes; 2% came into existence through the filing of an excerpt of such minutes, and only 3% were incorporated by means of a public deed. Accordingly, 97% of the cases correspond to private document.

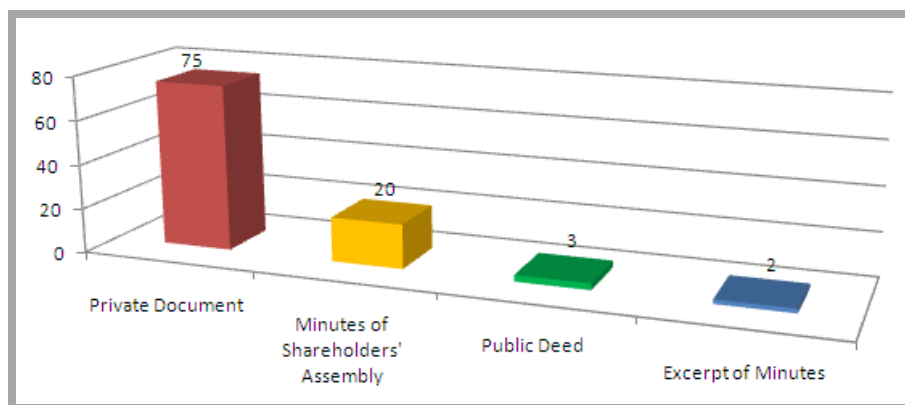
incorporations carried out during the same year through private instruments (See Graphs 23 and 24).

The fact that the immense majority of SAS incorporators have not used notarized deeds demonstrates that private parties are not concerned with the supposed higher level of legal certainty that notaries promote as the main advantage of their services in Latin America.

Graph 23
Bogotá - Private Document vs. Public Deed



Graph 24
Medellín SAS – Incorporation Mechanisms



6.2.3 Term of Duration

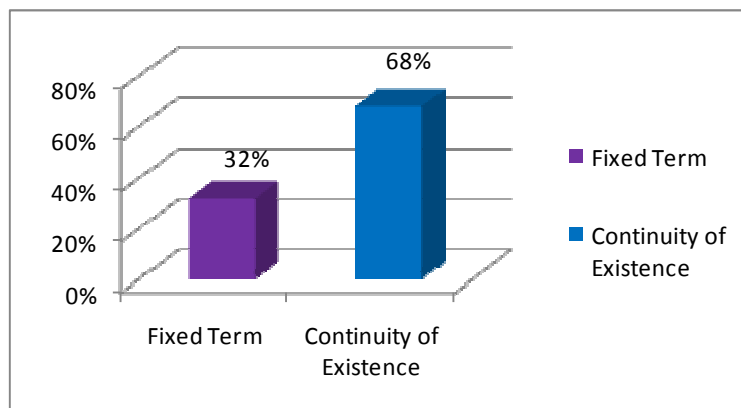
Although it may appear to be a minor improvement in the corporation law system, the possibility of providing an unlimited term of duration is a significant innovation in the region. Many Latin American jurisdictions still follow the capricious XIX century requirement to establish in the formation document a fixed term defining the

corporation's life span. The default provision in the SAS legislation is aimed at the opposite direction: in the absence of a specific provision in the corporation's by-laws, it would be assumed that the entity has been created for an unlimited duration.

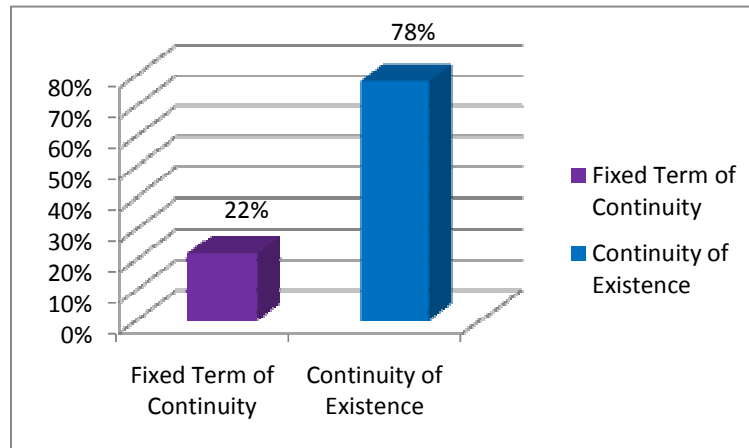
Business people in Colombia's main cities have started to get acquainted with the new advantages arising from this regulation. In Medellín, the incorporators of newly formed or converted simplified stock corporations have found the possibility of stipulating a continuity of existence to be a convenient option. In fact 78% of the companies registered before that city's Chamber of Commerce took advantage of this new feature of the SAS legislation. The figures for Bogotá are similar in this respect. Approximately 70% of new SAS provided for the system of continuity of existence (unrestricted term of duration) in their corporate by-laws (See Graphs 25 and 26).

It is likely that in the future the traditional clause concerning the fixed term of duration may become a rarity in the simplified stock corporations' scenario. However, given the enabling nature of the SAS statute, a few entrepreneurs are still entitled to provide for limited duration. This clause may prove useful particularly in cases in which the corporation's scope is restricted to a certain undertaking for which an unlimited term could be less convenient.

Graph 25
Bogotá Term of Duration



Graph 26
Medellín - Term of Duration

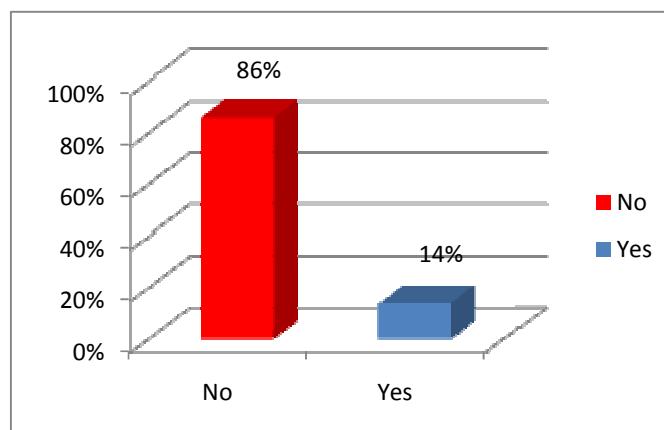


6.2.4 Board of Directors

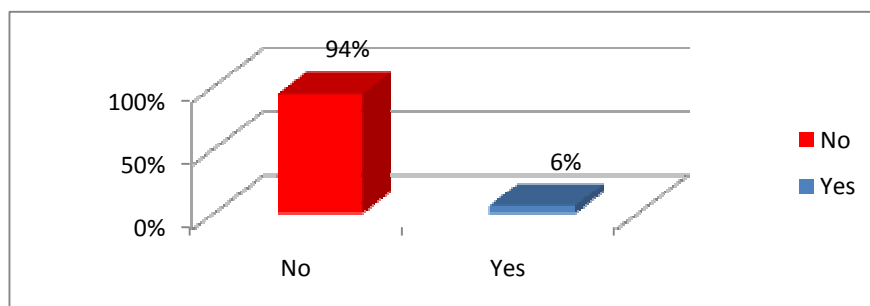
One of the most salient features of the SAS legislation is the shareholders' ability to directly manage the day to day operations of the corporation (i.e., the possibility of operating without a board as set forth in Article 25 of Law 1258). In this sense, the simplified stock corporation has a more "personal" outlook than the traditional stock corporation. Given the fact that delegation of management on a board of directors is not strictly necessary in the SAS, it is reasonable to expect for these corporations to be created without such administrative body. The data for Medellín and Bogotá show that in most by-laws of registered SAS, the provision for direct management was included. In effect, boards of directors were only created in a few cases (See Graphs 27 and 28).

It is expected that the existence of a board of directors will be restricted either to large simplified stock corporations or to those more sophisticated multi-owner undertakings, in which corporate governance arrangements may be necessary to set up checks and balances in order to allocate different levels of control among shareholders.

Graph 27
Bogotá - Board of Directors



Graph 28
Medellín - Board of Directors



6.2.5 Fiscal Auditors

Almost sixty years ago, Phanor Eder criticized the minute regulation of auditors in all Latin American jurisdictions. This author expressed a sense of amazement at the variety of names that were used by national legislators to designate them: *síndico*, *comisario*, *revisor fiscal*, *junta de vigilancia*, etc.⁴⁰⁷. After all these decades, few changes have been introduced to improve this bureaucratic scenario. The difficulties to reform this specific field lies mainly in the pressures exercised by interest groups representing the accounting profession. Therefore, to a large extent, rent seeking by this professional group has determined the maintenance of the *status quo*. An auditing system based on a mandatory legal requirement and not on the specific needs of shareholders has resulted in an expensive and not always useful internal control.

Article 28 of the SAS regulation reduced the number of events in which it is mandatory to appoint a fiscal auditor. This is the first step towards a definitive suppression of any mandatory auditor in this type of entity. Certainly, in small and medium size simplified corporations it is not mandatory to appoint a fiscal auditor⁴⁰⁸.

The research shows that since Law 1258 of 2008 does not require the appointment of a fiscal auditor in SMEs, many new SAS have omitted the clauses regarding the presence of such accounting officer. That is the case in both cities. In fact, nearly 94% of the new incorporations in Medellín did not include a comptroller. Likewise, in the Bogotá Chamber of Commerce, the number of new simplified stock

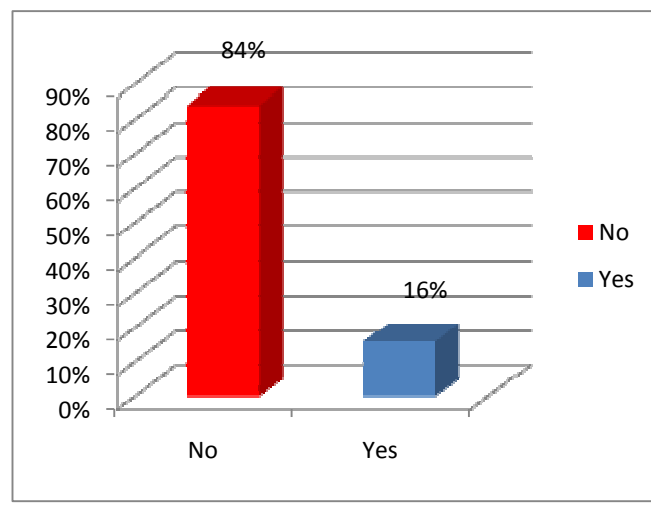
⁴⁰⁷ See Eder, *supra* note 15, at 226.

⁴⁰⁸ Article 13 of Colombian Law 43 of 1990 provides the obligation of electing a fiscal auditor only when the corporation attains a medium-size dimension, measured in the amount of assets or income referred to by the same act.

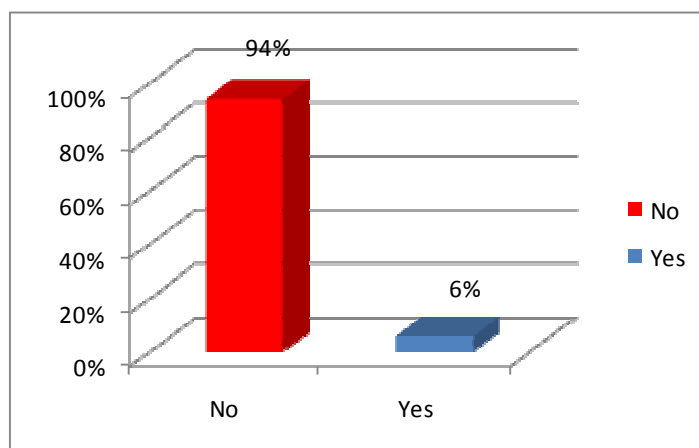
corporations that included the fiscal auditor reached a mere 84% (See Graphs 29 and 30).

The above-referred figures show unequivocally that the usefulness of this institution is doubtful. During the four decades in which it has existed in this country, the scope of its monitoring activity has been, at best, purely formalistic. The significant transaction costs arising from this requirement would justify its suppression in a future reform.

Graph 29
Bogotá – Fiscal Auditors



Graph 30
Medellín – Fiscal Auditors



6.2.6 Common Shares of Stock vs. Other Types of Equity Securities

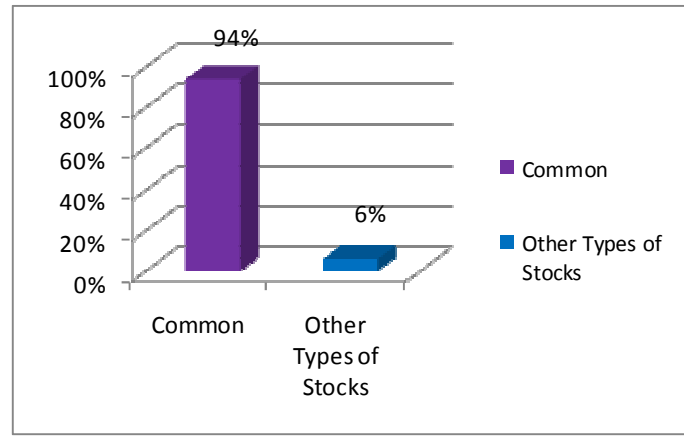
Law 1258 of 2008 expanded the palette of stock types the SAS can issue. Certainly, article 10 of the statute explicitly allowed the introduction of several classes and series of stocks, surpassing the antiquated taxonomy that harnessed the ability of corporations to issue non-traditional equity securities. These new classes of stock include, *inter alia*, the following: (1) Preferred non-voting stocks; (2) Stocks with multiple voting rights; (3) Stocks with fixed dividend; and (4) Stocks for the payment of services.

A significant number of simplified stock corporations registered in Medellín and Bogotá have started to include in their constitutional documents classes of stocks of varying types. In accordance with the data provided by the Chamber of Commerce of Medellín, 11% of the SAS that filed their by-laws in that city took advantage of the classification of stocks and included new devices to facilitate the corporation's capitalization. The remaining 89% made exclusive use of common stocks. Bogotá's entrepreneurs are also starting to use different types of equity securities in the SAS. The statistical data show that in 6% of the cases, non-traditional classes of stocks were stipulated in the newly formed corporations' by-laws (See Graphs 31 and 32).

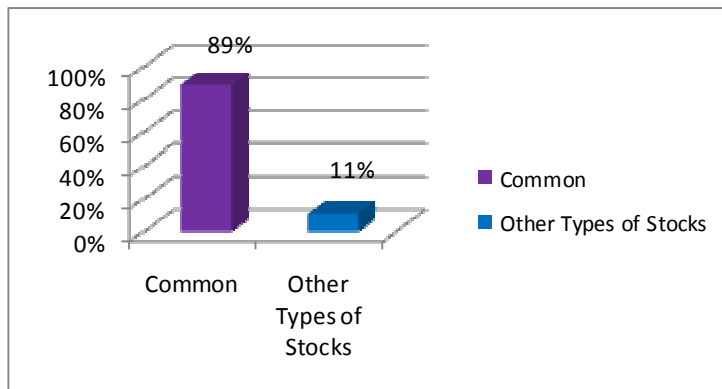
On a related aspect, it has to be borne in mind that previous regulations (more appropriate for listed corporations than for closely held entities) consecrated the one share one vote rule. Multiple voting rights were altogether forbidden under the Commercial Code provisions. Law 1258 opened up the gates for shares with multiple voting rights. In this manner, the new legislation allowed the presence of so-called golden shares. This device is particularly useful in the context of family-owned businesses in which the corporation's founders can retain control regarding the basic affairs in which the corporation is involved, whilst the remaining shareholders may be deprived of voting rights, or at least be granted a restricted ability to decide on the corporation's main issues (See Graphs 33 and 34).

The empirical data show that this sort of multiple voting stocks is not yet as popular as should have been expected, probably due to the lack of knowledge concerning the different possibilities that this new system affords. It appears that these new types of securities shall require an instructional process in order for entrepreneurs and their advisors to start using them in their corporate practice.

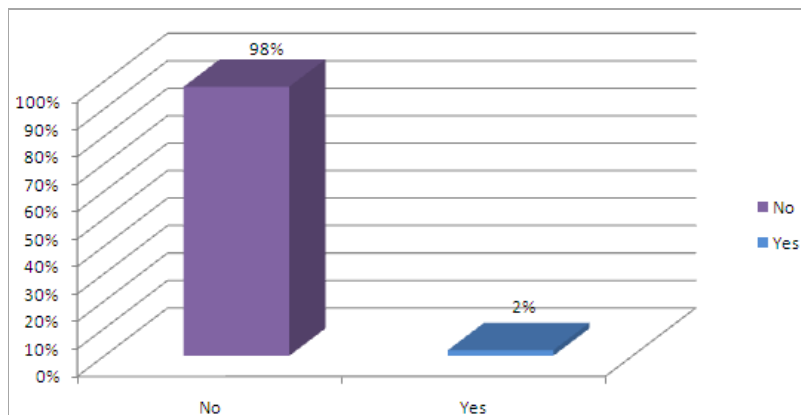
Graph 31
Bogotá – Types of Stocks



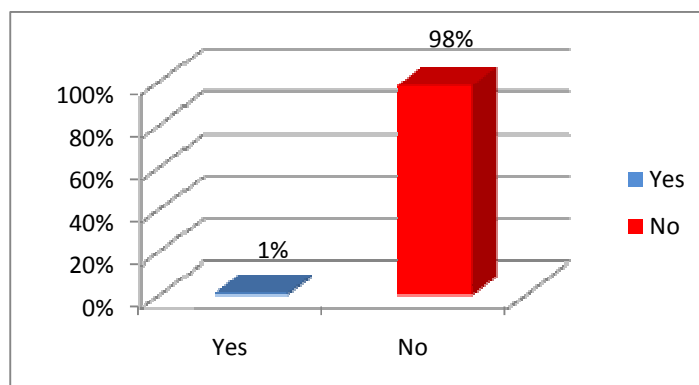
Graph 32
Medellín – Types of Stocks



Graph 33
Bogotá – Stocks with Multiple Voting Rights



Graph 34
Medellín - Stocks with Multiple Voting Rights



6.2.7 Dimension of SAS

Another important aspect in this analysis refers to the dimension of the SAS created during the first year after the inception of this statute. In spite of its name, the simplified stock corporation is particularly fitted for complex enterprises. In effect, since private ordering is virtually unlimited in its regulation, the possibility of setting up complicated contractual arrangements becomes viable as a means of setting up tailor-made, high-level corporate governance schemes. It is not surprising that several large corporate groups have migrated to the SAS structure in order to lay out a better organizational design.

In order to technically assess the dimension of the newly incorporated simplified stock corporations, a legal criterion that takes into account the size of the Colombian economy has been used for the purposes of this study. Pursuant to Article 2 of Law 905 of 2004, *micro-enterprises* are units of economic exploitation, the total assets of which are set below 501 current legal minimum wages (CLMWs). Small enterprises range from 501 to 5,000 CLMWs; medium size enterprises are those between 5,001 and 30,000 CLMWs. Finally, large enterprises are those in which the amount of assets exceeds 30,000 current legal minimum wages⁴⁰⁹.

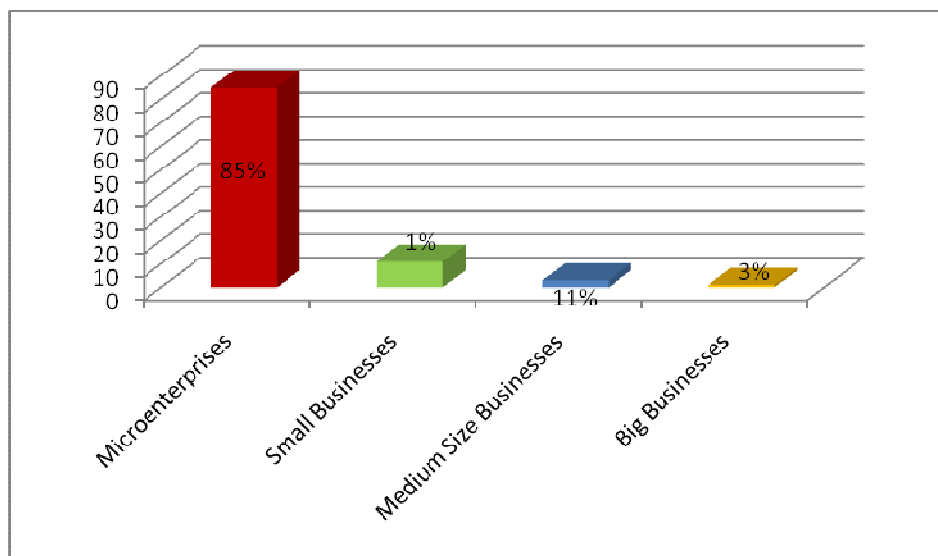
⁴⁰⁹ For 2010 the monthly minimum wage, net of additional labor benefits required by law, amounted to 515.000 Colombian pesos (about US\$260 per month). Therefore, micro-enterprises are those businesses with assets below US\$130,260; small enterprises range from US\$130,260 to US\$1,300,000; medium size enterprises are those between US\$1,300,260 to US\$7,800,000; finally, large size enterprises are those in which the amount of asses exceeds US\$7,800,000.

Taking into account the classification criterion already explained, the analysis shows that most new simplified stock corporations are so-called *micro-enterprises* (95% for Medellín and 85% for Bogotá) seeking to formalize their business activities (See Graphs 35 and 36).

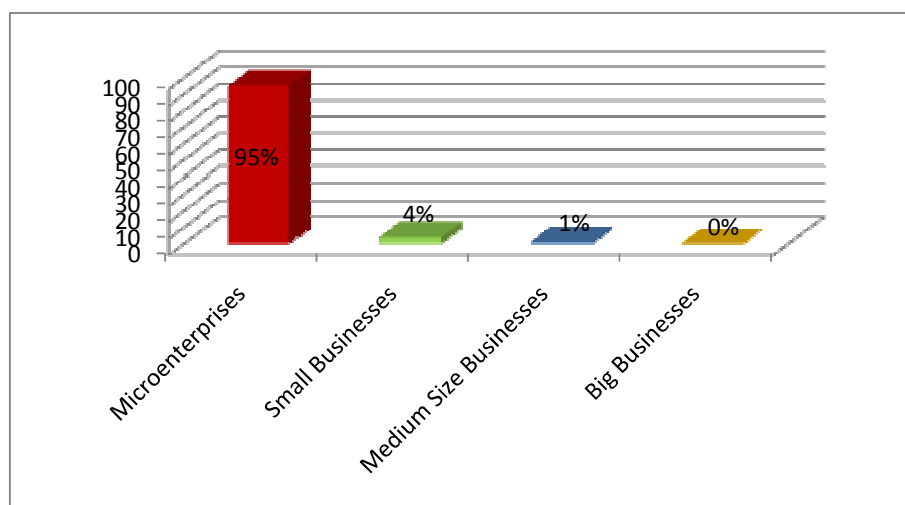
These figures are conclusive evidence that an increasing number of business people and professionals alike are getting access to the formal economy. Such formalization is one of the underlying policy objectives of the regulation on SAS. In fact, given the high percentage of informality in the Latin American countries (higher than 50% in the Andean Region), it is crucial to reduce entry barriers in order to allow these economic units to participate in a more suitable environment in which innovation and growth can be facilitated. At the same time, as soon as these entities are incorporated, it is more likely for workers affiliated with the formal business unit to enjoy the minimum benefits afforded by labor laws; third parties have access to basic disclosure of financial information and commercial publicity; local and national governments can collect additional taxes; and, more importantly, the new registered corporations can have access to credit given by financial institutions.

The reduced amount of corporations of a large dimension incorporated under the SAS business form (only 4 out of 4,960 in the case of Medellín, which represent 0.1% of total incorporations) does not imply in any manner that the new type of entity is not appropriate in this range of undertakings. It rather reflects the general financial scale of start-ups, which by their own definition are, generally speaking, firms of a modest capital dimension. On another perspective, the figures show the usefulness of the SAS even in the context of non-listed large corporations. The case for Bogotá allows considering the importance that the simplified stock corporation also has in the large business niche. About 1% of the SAS analyzed in this city were enterprises of a large dimension. In a sample of about 10,000 entities, this percentage represents 100 large corporations created in only one year. Medium-size enterprises have also been channeled up through the SAS. Again, following the general financial structure of business associations in Colombia, they represented 1% of the observed sample in Medellín and 3% in Bogotá (See graphs 35 and 36).

Graph 35
Bogotá – Enterprise dimension



Graph 36
Medellín – Enterprise Dimension



6.2.8 Purpose Clause

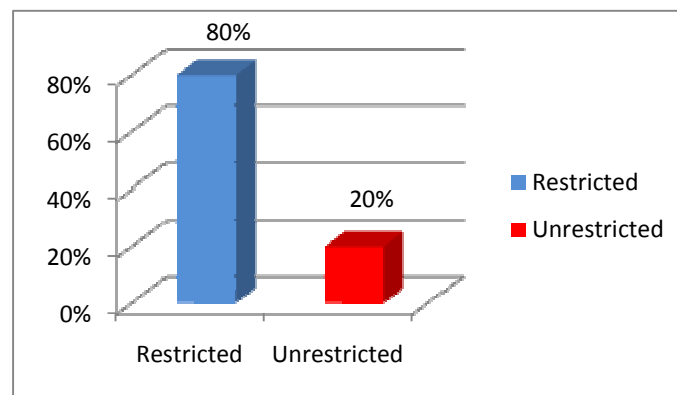
Following a very strict *ultra vires* principle, previous Corporate Law regulations required for any corporation to set out a restricted purpose clause in the by-laws. Any act beyond the objects set forth in such clause was deemed to be void and null. Law 1258 of 2008 has given the parties to the corporate contract considerable leeway to define the business activities that shareholders are willing to undertake under the corporate name. Therefore, the purpose clause can be restricted or unrestricted. Pursuant to article 5-5 of the afore-mentioned law, unless the corporation's by-laws

specifically restrict the purpose clause, the objects shall be unrestricted⁴¹⁰. This improvement can be significant, since it allows managers to freely undertake any sort of business activities. It also avoids continuous amendments of the corporation's by-laws, which under the specialty doctrine need to be modified every time that there is a change in its economic endeavors.

Notwithstanding the obvious usefulness of this sort of contractual provision, the data show that business people do not seem to be prepared to take advantage of this new system. Only with a slight variation between Bogotá and Medellín, entrepreneurs by and large still prefer a restricted corporate purpose. In fact, the empirical results reflect that in the majority of incorporated SAS, the by-laws included a limited specialized purpose clause (See Graphs 37 and 38).

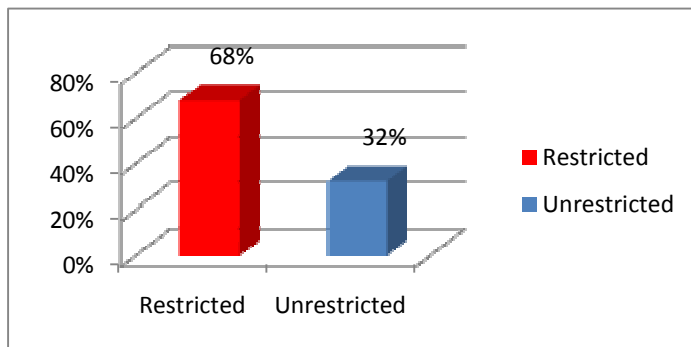
It is reasonable to expect, however, that this trend could be reversed insofar as a broader diffusion of the benefits arising from the unrestricted purpose clause is made and a better understanding of this new system is spread out. In particular, changes in preconceptions of bureaucratic financial institutions and governmental officers with which corporations have to deal on a daily basis, may bring about an increase in the use of unrestricted purpose clauses in simplified stock corporations' by-laws.

Graph 37
Bogotá – Purpose Clause



Graph 38
Medellín - Purpose Clause

⁴¹⁰ This possibility was first introduced in Law 222 of 1995 for the single member enterprise.



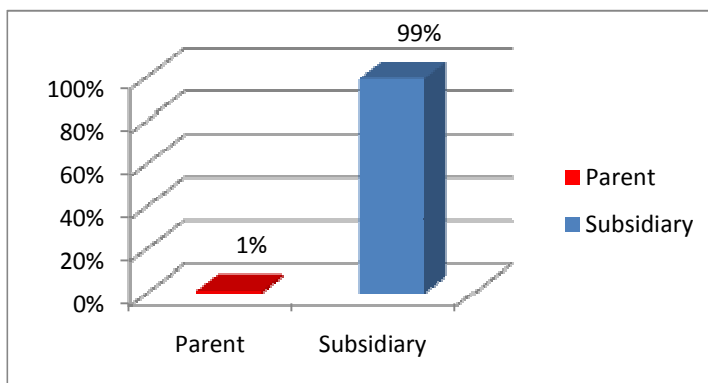
6.2.9 Parent-Subsidiary Relationships

Another relevant aspect in this survey relates to the possibility of exercising corporate control through the simplified stock corporation. The obtained data are not clear yet about the formation of corporate groups, in which parent entities could be formed under the SAS type. Although there is a legal obligation to disclose if such a relationship exists before the Mercantile Registry, it is not clear if the concerned corporations are in full compliance with such disclosure requirement.

According to the collected data, only 2% of the analyzed corporations have declared a controlling relationship concerning one or more subsidiaries. Even if there is no available information to corroborate this fact, it is likely that most of the SAS identified as parent corporations can be older companies originally created under the cloak of traditional business forms that have been recently converted into SAS (See Graphs 39 and 40).

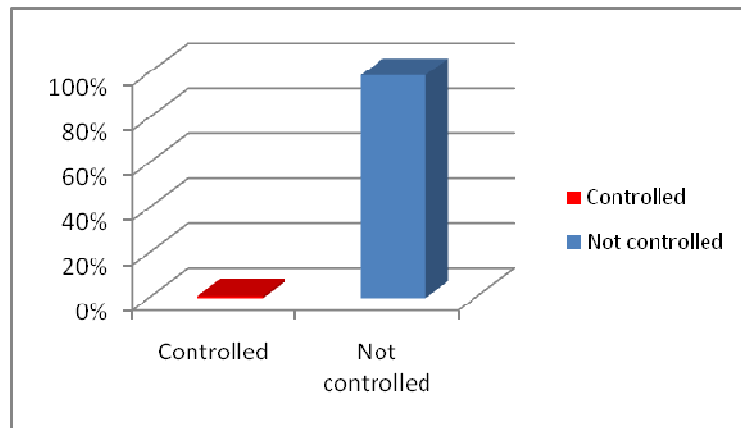
With regard to the existence of secondary domiciles, the analyzed data show that, thus far, none of the registered SAS has opened any branches in Medellín.

Graph 39
Medellín - Parent-Subsidiary Situations



Graph 40

Medellín - Controlling Relationship



6.3 Criticism to Legal Reform in Latin America

As it has been consistently held along this book, formalism and rigidity that characterizes current rules in Latin America does not conform to the agility of trade and the needs of contemporary economies. Therefore, measures such as the adoption of hybrid business forms like the simplified stock corporation can have a positive impact in local economies. The evidence obtained after the inception of Colombian Law 1258 of 2008 is eloquent concerning the favorable repercussion it has had in that country's economy.

The idea whereby the Latin American legal systems need an overhaul in order to update antiquated and obsolete legal provisions (using US-type legislations as a model), is not shared by all scholars. For instance, Professor Jorge Esquirol has criticized comparative law approaches in which the point of departure is the inadequacy of Latin American Law to cope with current social and economic realities. In fact, Esquirol considers that a *failed law* discourse is common in scholarship concerning this region in which reformers highlight deficiencies in the legal systems. Pursuant to this scholar, law's failure in Latin America is the standard background for projects of law reform over the past half century of international development assistance to the region. Viewed this way, Latin America's failed law is principally a discourse facilitating legal change. Professor Esquirol also holds that such approach also denies much of any value to existing law anywhere in the region. "The latter may consist of different legal policies, local interests expressed in law, accumulated investments in specific legal institutions, or other considerations of the sort. Consequently, this failed law formula for reform is a harmful device. It undermines state law and institutions while simultaneously purporting to support them. It keeps a range of questions off the table, depriving all of the Americas of any real engagement with the pre-reform options embodied in the law

of Latin American states. And, it weakens the position of many Latin Americans within international legal politics”⁴¹¹.

According to Esquirol, Latin American legal systems are normally characterized by the failure of their three main axes: (1) A failure in the functioning of the system (functional failure); (2) A legal failure, and (3) a failure in the politics adopted by each State. As a consequence of these problems, a so-called *structural failure* is usually concluded⁴¹². The author further states that a generalization is made by which defects that may be found (to a greater or lesser extent) in all systems are exaggerated to make them look graver in the Latin American context, so that the introduction of reforms to the system appears to be urgent⁴¹³. Esquirol emphasizes in arguments made by scholars such as the obsolescence of legal doctrines, the disparity between law-in-the-books and law-in-action, the oppressive widespread formalism, the extensive control of legal elites, the inefficiency of rules and institutions, and the subjectivity of law makers⁴¹⁴. However, according to the author, such catastrophic scenario does not show an accurate depiction of the countries in this region.

Four objections must be made to professor Esquirol’s analysis. First, there does not seem to exist sufficient empirical evidence concerning the supposed comparative advantages of the legal systems in this area, particularly, in the field of business law. On the contrary, objective measurements provided by multinational institutions are demonstrative of severe defects in the manner in which these systems operate. The World Bank data, as well as several econometric measurements prove that typical features present in this region prevent greater economic development as compared to other countries. For example, the inefficiency of some State institutions, as well as the excessive formalism, determines a greater difficulty for Latin American countries to attract investment. This explains the poor ranking attained by the region in this worldwide sample⁴¹⁵.

⁴¹¹ See Jorge Esquirol, “The Failed Law of Latin America”, in *The American Journal of Comparative Law*, Vol. 56, 2008, at 75.

⁴¹² *Id.*, at 80-84.

⁴¹³ Pursuant to Esquirol, a number of discursive images concerning Latin America are typically used, e.g., obsolescence, inflexibility, cultural inappropriateness, economic inefficiency, and corruption. (*Id.*, at 124).

⁴¹⁴ Professor Esquirol’s criticism is made in various aspects. One of them (which is of great importance to this book) is that related to the economic analysis of law. The author holds that “the contribution of law and economics to the rhetoric of failed law –both in terms of public institutions and legal rules- obscures other alternatives to this agenda. The region’s detractors base their case on claims to reality or, more scholarly, empirical observation. They argue the very real shortcomings of these systems, their lack of effective enforcement, their susceptibility to corruption, their misalignment with societal characteristics, and their inability to promote economic development. (...) Under the optic of law and economics, government institutions are replaced by market-enhancing criteria –laissez-faire by default and U.S. sphere institutions by proxy- but have little to do with the choices that would be supported by many national societies.” (*Id.*, at 111).

⁴¹⁵ In previous chapters, different sources have been provided showing how the Latin American legal systems are affected by problems in several areas. For example, the region performs poorly in the

This situation is partially reflected in these countries' socioeconomic reality. In fact, if the critiques made to Latin American legal systems by comparative law scholars were unwarranted, like it is suggested, there would be no apparent reason for the region's economic failure. Professor Esquirol's approach seems to lack sufficient empirical evidence to support it. Furthermore, it seems to disregard available information that, for one, consistently reflects the region's basic problems and, for another, shows how well-conceived legislative change can produce a positive effect in these countries' economies. As it has been showed in this book, it is clear that the well-identified problems affecting Latin American systems are not merely rhetorical. The empirical data analyzed in this chapter are an eloquent demonstration that structural reforms can result in significant transformations in the region.

A second objection that must be made is the fact that, even if it is true that the problems described for Latin America may be present in other legal systems, such pitfalls are undoubtedly exacerbated in this region. Certainly, all jurisdictions have, to a greater or lesser extent, problems that affect their appropriate functioning and, thus, must be corrected. Nonetheless, the facts show that formalism, inefficiency, and other detrimental issues constitute a particularly serious problem in all developing nations and, definitely, are accentuated in the Latin American region, as most objective empirical analysis will show. The comparisons made in this book between Latin America, Europe, North America, and other OECD countries are conclusive as to the extent of the drawbacks usually attributed to the countries located south of the US.

A third objection must be made to Professor Esquirol's argument whereby there are substantial differences among the various Latin American jurisdictions which, in his opinion, result in the inability to provide generalized diagnosis and solutions for all the countries in the area⁴¹⁶. While it is true that the Latin American region has not adopted an integrated system, like the European Union, similar features may be identified across all these countries, due to their shared historical origins and similar political and economic structures. Consequently, even if each of these states has its separate legislation, their geographical and historical proximity allows scholars and multilateral institutions alike to refer to the *Latin American region*, as if it were a single territorial unit. Such convenient generalization can be made without prejudice of identifying the peculiar features characterizing each jurisdiction. The approach undertaken in this book shows how it is plausible to analyze the common problems germane to the Latin American system, in order to propose solutions that can be later adapted to each countries' specific legislative reality.

enforcement of contracts (with regard to time, costs and number of procedures), as well as in the processes for execution of business transactions (as shown in Chapter II).

⁴¹⁶ See Jorge Esquirol, *supra* note 423, at 84 to 86.

The final objection that must be made to Esquirol's well-presented arguments refers to the idea that critiques to Latin American legislations are basically made as a means to legitimize reforms in the region. The truth, however, is that such assessments, more than a vehicle to *legitimize* such reforms, are a necessary *justification* for them. They provide the objective reasons to support appropriate and urgent reforms to the legal infrastructure. Obviously, in the absence of problems and in the presence of quasi-perfect institutions there seems to be no room for substantial reforms. An ongoing process of revision is always needed, even in well-developed legal systems. Such revisions and the work of reform committees are normally propelled by extensive criticism of a country's legal framework. In the alternative, legislative conformism and a vigorous defense of the local legal regime is usually the key for the perpetuation of inefficient legal institutions.

For the above-mentioned reasons, the assessment made by Professor Jorge Esquirol does not seem to be justified, at least in the area of business law. To consider that most critiques made to the Latin American system are rhetorical, and to hold that its main purpose is to legitimize structural reforms, may disregard what empirical evidence clearly demonstrates. In fact, any argument that does not permit criticism to current legislative approaches, and which aims at maintaining legal systems as they are today, will only harm the region. The analysis proposed in this book, along with the data provided in this research show that the existing legislations may in fact be improved. Any process for legal change will be heavily thwarted if criticism to current systems were to be, in turn, criticized. Hence, founded criticism could have the impact of effectuating change in fundamental aspects that must be revised. As it has been shown in this chapter, reforms help accelerate growth and development in local economies.

7. CONCLUSION

The main literature produced on the subject of Latin American Company Law throughout the past decade is to a large extent descriptive in nature. Although most of the key issues and obstacles to introduce appropriate Company Law reforms have been identified, the lack of a Comparative Law approach seems to be the common characteristic in most articles on the topic. Indeed, proper methods of comparison demand extreme care regarding aspects such as translations, the nature and extent of legal transplants, and an in-depth analysis of the differing economic models that prevail in each region. Above all, special emphasis has to be placed concerning the gap existing between law-in-the-books and its practical application.

A good example of complicated and erroneous legal transplants can be observed in the specific context of Latin American Corporate Law and Securities Regulation. Several aspects of corporate governance, which have been designed for publicly held corporations operating in systems such as those in the US and the UK, are frequently extrapolated for their importation into scenarios characterized by concentrated ownership structures like those prevailing in Latin American countries. Frequently, transplanted rules usually deal with problems existing in contexts of ownership dispersion. Accordingly, the underlying concern in such regulation relates to the need to ameliorate the discrepancy of interests between those pursued by shareholders as opposed to managers. Corporate governance rules that arise in this context are aimed at the alignment of such interests. It is natural, therefore, that most devices sought to deal with this particular agency problem are oriented towards the granting of certain appointment rights, the ability to vote concerning major corporate decisions, and the imposition of managers and directors' liabilities arising from the breach of the duties of care and loyalty. These rights and remedies are useful even in those systems in which there is no capital dispersion like the one existing in the US and England. However, they are insufficient to deal with corporate governance issues that exist in block-holding systems.

The starting point to redefine the policy agenda should be the underlying economic model in Latin American countries. This analytical framework allows for the determination of the most frequent agency problems present in business corporations in the region. Taking into account the high degree of concentrated ownership that prevails across Latin American countries, solutions should be devised in order to counteract the potentiality for oppression of minority shareholders at the hands of block-holders particularly in the field of closely held entities.

The theory of structural transplants is useful for the introduction of a system that is based upon two pillars. The first pillar is composed of enabling statutes that allow parties to opt out default legal provisions. Private ordering facilitates the creation of tailor-made rules appropriate for closely held entities. Such freedom of contract contributes to achieving a higher degree of completeness in the corporate contract. The second pillar concerns procedural provisions that are intended to increase the degree of enforcement intensity so that gap filling by arbitrators, judicial authorities and other

entities is facilitated. The model act on simplified stock corporations for Latin America is an attempt to incorporate modern trends into legal systems characterized by a formalistic and antiquated structure in which regulatory provisions prevail to an overwhelming extent.

The extremely successful empirically measured result of Colombian Law 1258 of 2008 (with more than 55,000 simplified stock corporations created in only two years) clearly suggests that businesspeople prefer flexibility to old-fashioned, misguided paternalism. The goals advanced in the 2008 Colombian act, match the contemporary policy agenda which gives prevalence to the so-called hybrid business forms, also known as *uncorporations*. The adaptability of hybrid business forms, which can be used as all-purpose vehicles, has led to their successful introduction in Common Law and Civil Law jurisdictions around the world.

The success of legal transplants in the field of closely held firms is significantly facilitated by the homogeneity of agency problems that are present in this kind of business entities everywhere. Therefore, dichotomy between diffused and concentrated ownership as well as the corresponding differences in the assessment of agency problems are not relevant in non-listed firms. The optimal incentives to neutralize agency problems in the context of closely held companies could be applied in different jurisdictions, without regard to the economic circumstances prevailing in each country.

The Model Act on Simplified Stock Corporations for Latin American is complemented by the proposal of an ancillary proceeding specifically designed to facilitate litigation concerning disputes that may arise in the context of such business entities. The recommended Procedural Model Act is characterized by a supple structure intended to allow for rapid enforcement of the SAS' substantive provisions.

Naturally, the required balance between due process and swiftness is not an easy one when there is so much abuse of procedural guarantees and very limited disciplinary controls by local judges. Such deplorable reality -which is common in Latin America-, has resulted in a virtual denial of justice and a general unwillingness to litigate essential civil law disputes before the ordinary judiciary. In the specific field of Company Law it goes without saying that processes for the adjudication of simple matters that may take years and even decades require extreme legislative solutions. The urgent need to provide efficient measures for conflict resolution is inconsistent with an excessive emphasis in procedural rights. This assertion cannot be understood as a proposal for the disregard of basic democratic guarantees, individual rights or due process concerns. On the contrary, the existence of hasty methods for the judicial, arbitral or administrative solution of company law disputes reinforces the idea of a more functional and truthful democratic system for this region.

The Model Act on Procedural Rules for the Resolution of Conflicts in Simplified Stock Corporations could become a tailor-made process highly suitable to deal with the specific circumstances surrounding litigation in the context of closely held entities. It would be expected that the flexibility, simplicity and expeditiousness surrounding such

proceeding could greatly facilitate the enforcement of substantive provisions contained in the SAS Model Act.

Annex A.
Model Act on the Simplified Stock Corporation

Chapter I
General Provisions

Section 2. Nature.- The simplified stock corporation is a for profit legal entity by shares, the nature of which will always be commercial irrespective of the activities set forth in its purpose clause.

Section 3. Limited Liability.- The simplified stock corporation may be formed by one or more persons or legal entities.

Shareholders will only be responsible for providing the capital contributions promised to the simplified stock corporation.

Except as set forth in Section 41 of this Act, shareholders will not be held liable for any obligations incurred by the simplified stock corporation, including, but not limited to, labor and tax obligations.

There shall be no labor relationship between a simplified stock corporation and its shareholders, unless an explicit has been executed to that effect.

Section 4. Legal Personality.- Upon the filing of the formation document before the *Mercantile Registry* [*include the name of corresponding company registrar's office*], the simplified stock corporation will form a legal entity separate and distinct from its shareholders.

Section 5. Inability to Become a Listed Entity.- the shares of stock and other securities issued by a simplified stock corporation shall be registered within a stock exchange, nor traded in any securities market.

Chapter II
Formation and Proof of Existence

Section 6. Contents of the Formation Document.- A simplified stock corporation will be formed by contract or by the individual will of a single shareholder, provided that a written document is granted. The formation document shall be registered before the *Mercantile Registry* [*include the name of corresponding company registrar's office*], and set forth:

- (1) Name and address of each shareholder;
- (2) The name of the corporation followed by the words "simplified stock corporation" or the abbreviation "S.A.S.";
- (3) The corporation's domicile;

- (4) If the simplified stock corporation is to have a specific date of dissolution, the date in which the corporation is to dissolve;
- (5) A clear and complete description of the main business activities to be included within the purpose clause, unless it is stated that the corporation may engage in any lawful business;
- (6) The authorized, subscribed and paid-in capital, along with the number of shares to be issued, the different classes of shares, their par value, and the terms and conditions in which the payment will be made;
- (7) Any provisions for the management of the business and for the conduct of the affairs of the corporation, along with the names and powers of each manager. A simplified stock corporation shall have at least one legal representative in charge of managing the affairs of the corporation in relation with third parties.

No additional formalities of any nature shall be required for the formation of the simplified stock corporation.

Section 7. Attestation.- The *Mercantile Registrar [include the name of corresponding company registrar's office]* shall attest to the legality of the provisions set forth in the formation document and any amendments thereof.

The Registrar shall only deny registration where the requirements provided under Section 5 have not been met. The decision rendered by the Registrar shall be issued within three days after the relevant filing has been made. Any decision denying registration will only be subject to a rehearing conducted by the Registrar.

Upon the approval of a formation document by the Mercantile Registrar, challenges will not be heard against the existence of the simplified stock corporation and the contents of the formation document will constitute the simplified stock corporation's by-laws.

Section 8. Assimilation to Partnership.- Where a formation document has not been duly approved by the *Mercantile Registrar [include the name of corresponding company registrar's office]*, the purported corporation will be assimilated to a partnership. Accordingly, partners will be jointly and severally liable for all obligations in which the partnership is engaged. If the partnership has only one member, such member will be held liable for all obligations in which the partnership is engaged.

Section 9. Proof of Existence. The certificate issued by the *Mercantile Registrar [include the name of corresponding company registrar's office]* is conclusive evidence as regards the existence of the simplified stock corporation and the provisions set forth in the formation document.

Chapter III

Special Rules Regarding Subscribed, Paid-in Capital and Shares of Stock

Section 10. Capital Subscription and Payment.- Capital subscription and payment may be carried out under terms and conditions different to those set forth under the *Commercial Code or corporate statute [include the name of the relevant Code, Decree, Law or Statute]*. In any event, payment of subscribed capital shall be made within a period of two years to be counted from the date in which the shares were subscribed. The rules for subscription and payment may be freely set forth in the by-laws.

Section 11. Classes of Shares.- The simplified stock corporation may issue different classes or series of shares, including preferred shares with or without vote. Shares may be issued for any consideration whatsoever, including in-kind contributions or in exchange for labor, pursuant to the terms and conditions contained in the by-laws.

Any special rights granted to the holders of any class or series of shares shall be described or affixed upon the back of the stock certificates.

Section 12. Voting Rights.- The by-laws shall depict in full detail the voting rights corresponding to each class of shares. Such document shall also determine whether each share will grant its holder single or multiple voting rights.

Section 13. Share Transfers to a Trust.- Any shares issued by a simplified stock corporation may be transferred to a trust provided that an annotation is made in the corporate ledger concerning the trustee company, the beneficial owners and the percentage of beneficial rights.

Section 14. Limitation on the Transferability of Shares.- The by-laws may contain a provision whereby the shares may not be transferred for a period not to exceed ten years, to be counted from the moment in which the shares were issued. Such term can only be extended by consent of all the holders of outstanding shares.

Any such limitation on share transferability shall be described or affixed upon the back of the stock certificate.

Section 15. Authorization for the Transfer of Shares.- The by-laws may contain provisions whereby any transfer of shares or of any given class of shares will be subject to the previous authorization of the shareholders' assembly, which shall be granted by majority vote or by any supermajority included in the by-laws.

Section 16. Breach of Restrictions on Negotiation of Shares.- Any transfer of shares carried out in a manner inconsistent with the rules set forth in the by-laws shall be null and void.

Section 17. Change of Control in a Corporate Shareholder.- The by-laws may impose upon an incorporated shareholder the duty to notify the simplified stock corporation's legal representative about any transaction that may cause a change in control regarding such shareholder.

Where a change in control has taken place, the shareholders' assembly, by majority decision, shall be entitled to exclude the corresponding incorporated shareholder.

Aside from the possibility of being excluded, any breach of the duty to inform changes in control may subject the concerned shareholder to a penalty consisting of a 20% reduction of the fair market value of the shares, upon reimbursement.

In the event set forth in this article, all decisions concerning the exclusion of shareholders, as well as the determination of any penalties, shall require an approval rendered by the shareholders' assembly by majority vote. The votes of the concerned shareholder shall not be taken into account for the adoption of these decisions.

Chapter IV Organization of the Simplified Stock Corporation

Section 18. Organization.- Shareholders may freely organize the structure and operation of a simplified stock corporation in the by-laws. In the absence of specific provisions to this effect, the shareholders' assembly or the sole shareholder, as the case may be, will be entitled to exercise all powers legally granted to the shareholders' assemblies of stock corporations, whilst the management and representation of the simplified stock corporation shall be granted to the legal representative.

Where the number of shareholders has been reduced to one, the subsisting shareholder shall be entitled to exercise the powers afforded to all existing corporate organs.

Section 19. Meetings.- Meetings of shareholders may be held at any place designated by the shareholders, whether it is the corporate domicile or not. For these meetings, the regular quorum provided in the by-laws will suffice, pursuant to Section 22 hereof.

Section 20. Meetings by Technological Devices or by Written Consent.- Meetings of shareholders may be held through any available technological

device, or by written consent. The minutes of such meetings shall be drafted and included within the corporate records no later than 30 days after the meeting has taken place. These minutes shall be signed by the legal representative or, in her absence, by any shareholder that participated in the meeting.

Section 21. Notice of Meeting.- In the absence of stipulation to the contrary, the legal representative shall convene the shareholders' assembly by written notice addressed to each shareholder. Such notice shall be made at least five days in advance to the meeting. The agenda shall in all cases be included within any notice of meeting.

Whenever the shareholders' assembly is called upon to approve financial statements, the conversion of the corporation into another business form, or mergers or split-off proceedings, shareholders will be entitled to exercise information rights concerning any documents relevant to the proposed transaction. Information rights may be exercised during the five days prior to the meeting, unless a longer term has been provided for in the by-laws.

Any notice of meeting may determine the date in which the Second Call Meeting will take place, in case the quorum is insufficient to hold the first meeting. The date for the second meeting may not be held prior to ten days following the first meeting, nor after thirty days from that same moment.

Section 22. Waiver of Notice.- Shareholders may, at any moment, submit written waivers of notice whereby they forego their right to be convened to a meeting of the shareholders' assembly. Shareholders may also waive, in writing, any information rights granted under Section 20.

In any given shareholders assembly and even in the absence of a notice of meeting, the attendees will be deemed to have waived their right of being summoned, unless such shareholders make a statement to the contrary before the meeting takes place.

Section 23. Quorum and Majorities.- Unless otherwise specified in the by-laws, quorum to a shareholders' meeting will be constituted by a majority of shares, whether present in person or represented by proxy. Decisions of the assembly shall be taken by the affirmative vote of the majority of shares present (in person or represented by proxy), unless the by-laws contain supermajority provisions.

The sole shareholder of a simplified stock corporation may adopt any and all decisions within the powers granted to the shareholders' assembly. The sole shareholder will keep a record of such decisions in the corporate books.

Section 24. Vote Splitting.- Shareholders may split their votes during cumulative voting proceedings for the election of directors or the members of any other corporate organ.

Section 25. Shareholders' Agreements.- Agreements entered into between shareholders concerning the acquisition or sale of shares, preemptive rights or rights of first refusal, the exercise of voting rights, voting by proxy, or any other valid matter, shall be binding upon the simplified stock corporation, provided that such agreements have been filed with the corporation's legal representative. Shareholders' agreements shall be valid for any period of time determined in the agreement, not exceeding 10 years, upon the terms and conditions stated therein. Such 10 year term may only be extended by unanimous consent.

Shareholders that have executed an agreement shall appoint a person who will represent them for the purposes of receiving information and providing it whenever it is requested. The simplified stock corporation legal representative may request, in writing, to such representative, clarification as regards any provision set forth in the agreement. The response shall be provided also in writing within the five days following the request.

Subsection 1.- The President of the shareholders' assembly, or of the concerned corporate organs, shall exclude any votes cast in a manner inconsistent with the terms set forth under a duly filed shareholders' agreement.

Subsection 2.- Pursuant to the conditions set forth in the agreement, any shareholder shall be entitled to demand, before a court with jurisdiction over the corporation, the specific performance of any obligation arising under such agreement..

Section 26. Board of Directors.- The simplified stock corporation is not required to have a board of directors, unless such board is mandated in the by-laws. In the absence of a provision requiring the operation of a board of directors, the legal representative appointed by the shareholders' assembly shall be entitled to exercise any and all powers concerning the management and legal representation of the simplified stock corporation.

If a board of directors has been included in the formation document, such board will be created with one or more directors, for each of whom an alternate director may also be appointed. All directors may be appointed either by majority vote, cumulative voting, or by any other mechanism set forth in the by-laws. The rules regarding the operation of the board of directors may be freely established in the by-laws. In the absence of a specific provision on the by-laws, the board will be governed under the relevant statutory provisions.

Section 27. Legal Representation.- The legal representation of the simplified stock corporation will be carried out by an individual or legal entity appointed in the manner provided in the by-laws. The legal representative may undertake and execute any and all acts and contracts included within the purpose clause, as well as those which are directly related to the operation and existence of the corporation.

The legal representative shall not be required to remain at the place where the business has its main domicile.

Section 28. Liability of Directors and Managers.- All *Commercial Code* [include the name of the relevant Code, Decree, Law or Statute] provisions relating to the liability of directors and managers may also be applicable to the legal representative, the board of directors, and the managers and officers of the simplified stock corporation, unless such provision is opted-out in the by-laws.

Subsection 1.- Any individual or legal entity who is not a manager or director of a simplified stock corporation that engages in any trade or activity related to the management, direction or operation of such corporation shall be subject to the same liabilities applicable to directors and officers of the corporation.

Subsection 2.- Whenever a simplified stock corporation or any of its managers or directors grants apparent authority to an individual or legal entity to the extent that it may be reasonably believed that such individual or legal entity has sufficient powers to represent the corporation, the company will be legally bound by any transaction entered into with third parties acting in good faith.

Section 29. Auditing Organs.- A simplified stock corporation shall not, in any case, be legally mandated to establish or provide for internal auditing organs [include the name of corresponding auditing entity, e.g., fiscal auditor, auditing committee, etc.].

Chapter V

By-Law Amendments and Corporate Restructurings

Section 30. By-law Amendments.- Amendments to the corporate by-laws shall be approved by majority vote. Decisions to this effect will be recorded in a private document to be filed with the *Mercantile Registry* [include the name of corresponding company registrar's office].

Section 31. Corporate Restructurings.- The statutory provisions governing conversion into another form, mergers and split-off proceedings for business

associations will be applicable to the simplified stock corporation. Dissenters' rights and appraisal remedies shall also be applicable.

For the purpose of exercising dissenters' rights and appraisal remedies, a corporate restructuring will be considered detrimental to the economic interests of a shareholder, *inter alia*, whenever:

- (1) The dissenting shareholder's percentage in the subscribed paid-in capital of the simplified stock corporation has been reduced;
- (2) The corporation's equity value has been diminished, or
- (3) The free transferability of shares has been constrained.

Section 32. Conversion into Another Business Form.- Any existing business entity may be converted into a simplified stock corporation by unanimous decision rendered by the holders of all issued rights or shares in such business form. The decision to convert into a simplified stock corporation shall be registered before the *Mercantile Registry* [*include the name of corresponding company registrar's office*].

A simplified stock corporation may be converted into any other business form governed under the *Commercial Code* [*include the name of the relevant Code, Decree, Law or Statute*] provided that unanimous decision is rendered by the holders of all issued and outstanding shares in the corporation.

Section 33. Substantial Sale of Assets.- Whenever a simplified stock corporation purports to sell or convey assets and liabilities amounting to 60% or more of its equity value, such sale or conveyance will be considered to be a substantial sale of assets.

Substantial sales of assets shall require majority shareholder approval. Whenever a substantial sale of assets is detrimental to the interests of one or more shareholders, it shall give rise to the application of dissenters' rights and appraisal remedies.

Section 34. Short-form Merger.- In any case in which at least 90% of the outstanding shares of a simplified stock corporation is owned by another legal entity, such entity may absorb the simplified stock corporation by the sole decision of the boards of directors or legal representatives of all entities directly involved in the merger.

Short-form mergers may be executed by private document duly registered before the *Mercantile Registry* [*include the name of corresponding company registrar's office*].

Chapter VI Dissolution and Winding Up

Section 35. Dissolution and Winding Up.- The simplified stock corporation shall be dissolved and wound up whenever:

- (1) An expiration date has been included in the formation document and such term has elapsed, provided that a determination to extend it has not been approved by the shareholders, before or after such expiration has taken place;
- (2) For legal or other reasons, the corporation is absolutely unable to carry out the business activities provided under the purpose clause;
- (3) Compulsory liquidation proceedings have been initiated;
- (4) An event of dissolution set forth in the by-laws has taken place;
- (5) A majority shareholder decision has been rendered or such decision has been made by the will of the sole shareholder, and
- (6) A decision to that effect has been rendered by any authority with jurisdiction over the corporation.

Whenever the duration term has elapsed, the corporation shall be dissolved automatically. In all other cases, the decision to dissolve the simplified stock corporation shall be filed before the *Mercantile Registry [include the name of corresponding company registrar's office]*.

Section 36. Curing Events of Dissolution.- Events of dissolution may be cured by adopting any and all measures available to that effect, provided that such measures are adopted within one year, following the date in which the shareholders' assembly acknowledged the event of dissolution.

Events of dissolution consisting on the reduction of the minimum number of shareholders, partners or members in any business form governed under the *Commercial Code [include the name of the relevant Code, Decree, Law or Statute]* may be cured by conversion into a simplified stock corporation, provided that unanimous decision is rendered by the holders of all issued shares or rights, or by the will of the subsisting shareholder, partner or member.

Section 37. Winding Up.- The simplified stock corporation shall be wound up in accordance with the rules that govern such proceeding for stock corporations. The legal representative shall act as liquidator, unless shareholders appoint any other person to wind up the company.

Chapter VII Miscellaneous Provisions

Section 38. Financial Statements.- The legal representative shall submit financial statements and annual accounts to the shareholders' assembly for approval.

In the event that there is a single shareholder in a simplified stock corporation, such person shall approve all financial statements and annual accounts and will record such approvals in minutes within the corporate books.

Section 39. Shareholder Exclusion.- The by-laws may contain causes by virtue of which shareholders may be excluded from the simplified stock corporation. Excluded shareholders shall be entitled to receive a fair market value for their shares of stock.

Shareholder exclusion shall require majority shareholder approval, unless a different procedure has been laid down in the by-laws.

Section 40. Conflict Resolution.- Any conflict of any nature whatsoever, excluding criminal matters that arises between shareholders, managers or the corporation may be subject to arbitration proceedings or to any other alternative dispute resolution procedure. In the absence of arbitration, the same disputes will be resolved by (*include specialized judicial or quasi-judicial tribunal*).

The decisions rendered by the tribunal are final and shall not be subject to appeals before any court.

Section 41. Special Provisions.- The legal mechanisms set forth under Sections 13, 14, 38 and 39 may only be included, amended or suppressed from the by-laws by unanimous decision rendered by the holders of all issued and outstanding shares.

Section 42. Piercing the Corporate Veil.- The corporate veil may be pierced whenever the simplified stock corporation is used for the purpose of committing fraud. Accordingly, joint and several liability may be imposed upon shareholders, directors and managers in case of fraud or any other wrongful act perpetrated in the name of the corporation.

Section 43. Abuse of Rights.- Shareholders shall exercise their voting rights in the interest of the simplified stock corporation. Votes cast with the purpose of inflicting harm or damages upon other shareholders or the corporation, or with the intent of unduly extracting private gains for personal benefit or for the benefit of a third party shall constitute an abuse of rights. Any shareholder who acts abusively may be held liable for all damages caused, irrespective of the judge's ability to set aside the decision rendered by the shareholders' assembly. A suit for damages and nullification may be brought in case of:

- (1) Abuse of majority;
- (2) Abuse of minority; and

(3) Abusive deadlock caused by one faction under equal division of shares between two factions.

Section 44. Cross-References.- The simplified stock corporation shall be governed:

- (1) By this Law;
- (2) By the formation document, as amended from time to time; or
- (3) By statutory provisions contained in the *Commercial Code* [include the name of the relevant Code, Decree, Law or Statute] governing stock corporations.

Section 45. Promulgation.- This Act shall be effective as of the date of its promulgation and it repeals any and all statutes, acts, codes, decrees, or provisions of any nature that are inconsistent with this Act.

Annex B.
**Model Act on Procedural Rules for the Resolution of Conflicts in
Simplified Stock Corporations**

Chapter I
General Provisions

Section 1. Purpose. The purpose of this Act is to provide the procedural rules that shall apply to the resolution of conflicts arising within a simplified stock corporation, as provided in Law *[include name or number of the Act that regulates the simplified stock corporation]*.

All conflicts that arise between shareholders, or between them and the corporation, its managers, officers, auditors or third parties, including those related to the abuse of rights, piercing the corporate veil, liability of shadow directors and officers, shareholders' agreements, and decisions rendered by the shareholders' assembly or the board of directors, shall be subject to the special proceedings regulated in this Act.

Section 2. Principles. The following principles shall prevail in the special proceedings regulated herein: concentration, celerity, and brevity.

The principle of concentration requires that each step in a proceeding consolidate as many procedural acts as possible. A deferral of a proceeding may take place only under exceptional circumstances.

The principle of celerity requires that all procedures take place in the shortest amount of time. All decisions, measures, agreements, and, in general, any action that reduces the time frame of a proceeding, shall be preferred.

The principle of brevity requires that in a proceeding, the act that requires the least amount of procedures shall be preferred.

Section 3. Jurisdiction. The *[include name of the administrative authority or specialized court in charge of proceeding]* (hereinafter, referred to as "the authority") will have judicial powers with regard to any proceeding concerning the simplified stock corporation.

The *[include name of the administrative authority or specialized court in charge of proceeding]* shall have exclusive jurisdiction over such proceedings.

Section 4. Legal Standing. Legal standing shall be presumed with regard to shareholders and officers in any proceeding involving a simplified stock

corporation, as well as with regard to the corporation itself. Third parties may provide summary evidence as proof of their legal standing.

Chapter II Procedures

Section 5. *Petition.* The special proceeding for simplified stock corporations shall be deemed to have commenced with the filing of a complaint or petition. Such petition must contain: the name of the parties, the claims and pleadings, a brief description of the facts, a listing of the probative materials to be used as evidence, the legal foundations for each claim, the plaintiff's address and e-mail address for notification purposes, and the assumed defendant's address and e-mail for the same purpose.

A single petition may include all the pleadings involving one or more simplified stock corporations.

The anticipated evidence and documents that are in possession of the plaintiff are, under no circumstance, required to be attached to the petition as an exhibit. The mere listing of such evidence will suffice for all legal purposes.

Section 6. *Filing of the Petition.* The petition that complies with the above-mentioned requirements may be filed in writing or through a data message sent to the *Electronic System for Conflict Resolution of Simplified Stock Corporations* that will be created by *[include name of the administrative authority or specialized court in charge of proceeding]*.

If the petition is filed in writing, the authenticity of such document shall be presumed, provided that it has been executed by the plaintiff or her legal representative. If the petition is filed as a data message, the rules contained in *[include name or number of the act or rule that regulates e-commerce and data messages]* shall apply.

Section 7. *Preliminary Study of the Petition.* Within three days following the date in which the petition has been filed, the *[include name of the administrative authority or specialized court in charge of proceeding]* will determine if it complies with all legal requirements and will decide on its admissibility or inadmissibility.

If such authority finds that the petition complies with all legal requirements, it will be admitted. If the petition does not comply with the requirements provided for in this law, the aforementioned authority shall declare its inadmissibility and order the plaintiff to make the necessary corrections. The appropriate corrections will have to be undertaken within the next five days following the date in which the request was made.

An action may be dismissed only when the plaintiff has not made the necessary corrections within the aforementioned period, or when the authority has determined that it has no jurisdiction over the issues brought before it under this Act.

Section 8. *Preliminary Measures.* In proceedings regarding the specific performance of obligations contained in a shareholders' agreement, the authority will be entitled to issue preliminary injunctions immediately after determining the admissibility of the complaint. In all other proceedings, the authority will only be allowed to issue such injunctions after service of process has been made.

Section 9. *Anticipated Judgment.* If during the preliminary analysis of the petition the authority finds that the pleadings and facts brought forward by the plaintiff are fundamentally similar to the pleadings and facts that have been the matter of a previous dismissal by such authority, the authority shall dispense service of process to the defendant and render immediately a final decision or judgment on the merits of the case by resolving the matter in the same terms in which it was done in the previous case.

Should the plaintiff bring a motion to set aside the judgment, the authority shall decide, in no more than five days, if the decision will be revoked. In this case the proceedings will continue pursuant to the provisions of this Act. If the authority rejects the motion, the judgment shall be definitive, unless the special appeal contained in Section 28 shall be applicable.

Section 10. *Service of Process.* The petition shall be admitted by an order rendered by the authority. Service of process to the defendant or defendants shall take place in accordance with section 29 of this Act. Along with the service of process, notification of the petition shall also take place.

Section 11. *Notice to the Corporation and Joint Litigation.* Notice concerning the commencement of proceedings shall be sent to the corporation or corporations involved in the complaint. It will be the corporation's legal representative duty to inform all shareholders, officers, directors, and auditors of the action that has been initiated before the authority. Any persons who may have an interest in the matter will be entitled to become a party to the process by filing a written statement in support of the plaintiff's pleadings, or bringing an opposition to them. Such statements must be filed within the five days following the notice given to the corporation.

The notice to the corporation shall also be published in the *Electronic System for Conflict Resolution of Simplified Stock Corporations* on the same date that it is sent to the corporation.

Section 12. *Response to Complaint.* After the expiration of the five-day term referred to in Section 11 above, the defendant or defendants shall have five additional days to provide a written response to the petition. Such answer may also be presented through a data message. The response shall include a response to all pleadings and claims included in the petition, as well as the defendant's counterclaims and legal defenses, a listing of the evidence, and the correct address and e-mail address for notifications (in the event that those presented by the plaintiff are incorrect).

Grounds for dismissal related to formal requirements shall only be heard in the preliminary hearing.

Section 13. *Preliminary Hearing.* Within the following five days after the expiration of the term referred to in Section 12 above, the authority shall summon the parties to a preliminary hearing in order to conduct mediation proceedings, curing any defects that may exist in the process, and make all determinations concerning the requests for evidence. The parties shall attend the hearing in person, or through their legal representative.

The preliminary hearing will be subject to the following rules:

1. *Opening.* The hearing will commence at the time provided in the summons. If any of the parties is unable to attend the hearing due to force majeure, such event shall have to be argued in advance to the commencement of the hearing. The hearing may be postponed only once. In this case, the new hearing shall take place within the five days following the initial date.
2. *Mediation.* Once the hearing has started, the parties will be asked if an agreement to resolve the issues has been reached or, in the alternative, if they have agreed on a method to solve the matter. In case the parties have reached an agreement, the authority shall verify its validity and approve it (if the case may be). If the parties have agreed on a method to solve the dispute, such procedure shall be validated by the authority.

If after the mediation has been conducted the parties fail to reach an agreement, the hearing will continue.

3. *Curing Defects in the Process.* The authority shall interrogate the parties on the defects that are deemed to affect the process. Immediately afterwards, the authority shall adopt the necessary measures to cure the defects in order to prevent nullities within the proceedings.

4. *Pleadings*. Subsequently, the parties will be entitled to present their pleadings and defenses before the authority.
5. *Requests for Discovery and Production of Evidence*. In the following stage of the preliminary hearing, the parties shall produce the evidence in their possession. The first to disclose the evidence will be the plaintiff, followed by the defendant.

After the production of evidence, the parties will have the opportunity to present the evidentiary stipulations governed under section 23 of this Act.

Subsequently, the authority will solve all requests for production of evidence that have been made by the parties.

Afterwards, the parties will be ordered to produce evidence, which will be ascertained by the authority taking into account its relevance and conduciveness to the purposes claimed by each party.

The hearing referred to in this section shall take place in one single day. It may, however, be deferred once or several times, provided that such deferral does not exceed three hours.

As soon as the hearing is concluded, the authority shall summon the parties to a new hearing for the taking of evidence, the presentation of closing arguments, and the rendering of the final decision.

Section 14. *Hearing for the Taking of Evidence*. After the commencement of the hearing, the taking of evidence shall take place in the following manner:

1. The deposition of expert witnesses designated by the parties shall be taken first. The authority may interrogate them on the issues that are not clear. The parties shall also be entitled to interrogate or refute them.
2. All records concerning evidence taken by *in situ* inspection of books and records conducted by the parties or their legal representatives shall be shown during the hearing.

After the evidence has been taken, each of the parties will provide the closing arguments by means of an oral presentation not to exceed 30 minutes. Subsequently, the authority will render the final decision orally.

After rendering the decision, the authority shall hear any requests for the special appeal contained in section 28 of this Act.

The hearing referred to in this section shall take place in one single day. It may, however, be deferred once or several times, provided that such deferral does not exceed three hours.

Section 15. *Summary Decision.* If at any juncture during the process the authority finds that there is sufficient evidence from which a definitive and unequivocal decision can be made, it may omit any subsequent procedural stages and render a final decision or judgment on the merits of the case.

Chapter III Special Provisions Concerning Evidence

Section 16. *Procedural Moment for the Request of Evidence.* All evidence that the parties may wish to present during the proceeding shall be either listed or requested in the petition or its response. A request for the production of evidence cannot be made in any other stage of the proceedings.

Section 17. *Prohibitions.* The authority shall only admit or authorize the production of evidence that is pertinent, useful and conducive to the pleadings and defenses of the parties. A request for the production of evidence that has only an indirect or relation with the case shall be dismissed.

The authority shall not hear more than three witnesses for each of the parties.

The production of evidence by physical examination of exhibits shall only be ordered under exceptional circumstances. It shall be permitted only in the event that the alleged fact cannot be proven by any other means.

Section 18. *Reading of Documents.* Under no circumstances shall the actual reading of documentary evidence be required in any hearing. Access to such documents shall be permitted through the exhibits included in the docket.

Section 19. *Presumption of Authenticity of Originals and Copies.* All documents produced as originals or copies that contain the signature of the plaintiff, the defendant, their attorneys, the legal representative or any officer or manager of the corporation, shall be presumed to be authentic.

Section 20. *Electronic Documents.* Data messages shall be considered probative material under the terms of law [*include name or number of the Act that regulates e-commerce and data messages*].

Section 21. *Deposition of Expert Witnesses.* The deposition of all witnesses shall be taken orally. Rebuttals can only take place in the hearing regulated under section 14 of this Act.

In the case of expert witnesses, summary proof of the technical or scientific ability, skill or knowledge on the subject upon which the witness has been called to testify, will suffice. Such proof concerning the expert witness' qualifications must be presented during the interrogation of the expert witness conducted by the authority.

Section 22. *Evidence through in situ inspection of books and records.* Once the authority has ordered the production of evidence by an inspection carried out in a specifically designated place pursuant to section 14-2 of this Act, the party who requested it shall be responsible for carrying out the corresponding inspection, recording or filming the examination in an appropriate medium and assuming all costs that such procedure may demand.

The authority shall not be required to attend the inspection, as the recording will suffice. The other party will be entitled to attend the examination, for which it must previously and timely be informed as to the date and time in which the inspection will take place.

Section 23. *Stipulations Concerning Evidence.* During the hearing for the taking of evidence, the parties may agree on the facts and circumstances that are to be considered proven in the case. For these facts and circumstances, the production of evidence will not be necessary.

The stipulations shall be duly recorded in writing, and must contain the signature of all plaintiffs and defendants or their legal representatives. Once the document has been executed, the stipulations will be informed to the authority for it to decide on their validity. If the stipulations are deemed to be valid, they will be taken into consideration by the authority when ordering the production of evidence.

Stipulations that are contrary to facts that are evident in the proceeding shall be deemed to be invalid by the authority.

Section 24. *Burden of Proof.* Each of the parties will be bound to prove the existence of the facts that support their claims and defenses. Nevertheless, when one of the parties is in a difficult position to produce evidence regarding a specific fact, whilst another party is in a better position to produce it, the authority may shift the burden of proof to the party with the ability to provide such evidence.

The shift in the burden of proof must be duly informed in the hearing for the taking of evidence.

Chapter IV Time Limits and Deadlines

Section 25. *Waiver of Time Limits.* The parties may, in all cases, renounce, expressly or implicitly, to the time limits and deadlines of a proceeding.

An implicit waiver of a time limit takes place when it can be inferred from the conduct of the parties that they do not wish to exhaust the time period that the law provides as when writings are filed by the parties before the time limit has elapsed.

Section 26. *Observation of Time Limits.* Time limits and deadlines shall be strictly observed and complied with by the parties and the authority.

Chapter V Appeals

Section 27. *Motion to Set Aside Decisions of Authority and other Appeals.* Orders or resolutions and decisions rendered by the authority regarding procedural aspect are not subject to appeal.

All other decisions rendered by the authority will only be subject to a motion to have them set aside by the same officer. Such motions shall have to be presented within three days after the challenged decision has been rendered or notified, as the case may be. The authority will have a five-day term to decide on these motions. Nevertheless, If the challenged decision is rendered in the course of a hearing, the motion to have it set aside will have to be presented and resolved during the same hearing.

Section 28. *Special Appeal before a Superior.* Under special circumstances provided for in this act, the final decision may be appealed before [*include name of the highest administrative or specialized judicial authority with jurisdiction over the issues*].

The appeal shall have to be presented orally in the hearing where the final decision is rendered. In that same hearing, the authority shall decide if the recourse is to be granted. The appeal will only proceed if the amount at stake exceeds [*include amount in local currency*].

Once the appeal has been granted, the party filing the recourse will have to file the appeal in writing within the following five days. Immediately afterwards, the authority will remand the entire docket to [*include name of the highest administrative authority or specialized court with jurisdiction over the issues*] in order to be resolved.

The final decision resolving the special appeal may only be rendered on the grounds of the written appeal filed by the objecting party, and the proceedings that have already taken place. New evidence will not be admitted at this stage.

Chapter VI Service of Process

Section 29. *Service of Process Types.* Service of process may take place under any of the following means: through personal notification, by publication, by the parties' tacit behavior, service during a hearing, and service by e-mail or any other data message.

Service through personal notification and service by publication shall be made as provided by *[include name or number of procedural act or rules that regulate service of process]*. In any event, service by publication will always be included in the authority's website.

Service by e-mail shall be made by sending the respective order or decision through an e-mail address that is certified by the authority as the official address for the purposes of service of process.

Section 30. *Service Concerning Resolution that Admits the Complaint.* The resolution whereby the petition for the initiation of a proceeding is admitted shall be served simultaneously to all the involved parties through any of the service of process mechanisms described in the preceding section.

Section 31. *Service of Other Resolutions or Decisions.* Orders or decisions different from the resolution whereby the petition for the initiation of the proceeding is admitted shall be served by publication or by e-mail. However any decisions or order rendered during a hearing, including the final decision, shall be understood to have been served in the same hearing.

Section 32. *Service through the Parties' Tacit Behavior.* In any event in which a party behaves in a manner that could allow the authority to infer that such party has knowledge of the decision that was to be served, such party will be considered to have been tacitly served.

Section 33. *Waiver of Defects Regarding Service of Process.* In any case in which a defect in the service of process has been detected, the affected party will be entitled to send a written statement to the authority waiving any such defect that may have occurred.

Chapter VII

Miscellaneous Provisions

Section 34. *Abuse of Rights.* Whenever the authority finds that the parties have behaved in an abusive manner during the process, will be entitled to impose fines to the party responsible for such abuse of rights.

Section 35. *Alternative Procedural Provisions.* The parties to any case governed under this law may propose to the authority procedural alternatives regarding the manner in which the process will take place, even if such proposals modify the order that has been provided in Chapter II of this Act.

If the authority considers that such proposals are relevant, that they will have a positive impact in expending the process, it will approve the suggested changes and proceed to undertake any required modifications in order for the process to continue as proposed by the parties.

Section 36. *Stay of Proceedings.* Any act performed by the parties with the objective of staying or delaying the process shall be considered as a serious indication of noncompliance and will be used against such party. If the authority becomes aware of such acts, it will adopt the necessary measures to counteract them in order for the proceeding to continue in the most expedited fashion.

Section 37. *Recording of Hearings.* All hearings must be recorded by any accepted technological which are considered appropriate according to the circumstances.

Minutes for each hearing must be drafted in which at least the following aspects must be included: time and date, type of hearing, the name of the persons who participated in the hearing, any adjournments that could have taken place, a description of proceedings, decisions, recourses and appeals that might have been presented by the parties.

Section 38. *Decisions Made by the Authority.* Decisions made by the authority shall be included in resolutions or orders that may have a substantive or procedural nature. The decision by which the case is resolved is referred to as the final decision or judgment.

Section 39. *Prohibitions.* Preliminary exceptions and amendments to the pleadings, defenses, or petitions shall not be permitted in this proceeding.

Section 40. *Statute of Limitations.* The statute of limitations applicable to any action regarding the special proceeding for the simplified stock corporations will elapse in a term of five years.

The time prescribed herein shall be counted in accordance with the following rules:

1. If the cause of action, claim or issue is related to the piercing of the corporate veil, abuse of rights, or liability of SAS officers, directors and shadow directors, the term prescribed herein shall initiate from the moment in which the abusive or fraudulent act occurred.
2. If the cause of action, claim or issue involves the challenging of a decision of the shareholders' assembly or board of directors, the term prescribed herein shall initiate from the moment in which such decision was rendered.
3. If the cause of action, claim or issue involves the performance of obligations contained in a shareholders' agreement, the term prescribed shall initiate from the moment in which such obligation was to be performed.

Section 41. *Application of additional Rules.* Any issue that is not specifically regulated in this law will be governed under the *[include name or number of act or rules of civil procedure]*.

Annex C
Corporate Governance Legal Provisions in Major South American Jurisdictions

Country	Shareholders' Assembly	Shares of stock	Directors and Officers	Directors' and officers' liability	Auditors	Dissenters' Rights	Corporate Distributions	Disclosure
<i>Venezuela</i> (Commercial Code and Capital Markets Law) (References are to the Commercial Code, unless otherwise indicated)	1. Summons must be made 5 days in advance (Arts. 277, 278, 281) 2. Voting and Quorum provisions (Art 273) 3. Supermajority requirements (Art. 280)	1. Ordinary and preferential shares may be issued (Art. 292) 2. No voting stock may be issued (Art. 292) 3. One share, one vote rule is not mandatory (Art. 292)	1. Elected by the shareholders' assembly (Arts. 253, 275) 2. Cumulative voting is not mandatory 3. Voting restrictions (Art. 286) 4. Conflict of interest regulation (Art. 269)	1. Joint and several liability (Art. 266) 2. Causes for liability (Arts. 243, 244)	1. <i>Comisario</i> (Arts. 304-311)	1. Right to withdraw (Art. 282)	1. Minimum dividend distribution requirements in public corporations (Arts. 115, 116 of the CML) 2. Share Reacquisition (Art. 263)	1. Right to examine books and records (Art. 284)
<i>Colombia</i> (Commercial Code, Law 222 of 1995 and Law 964 of 2005)	1. Summons must be made 15 days in advance (Arts. Art 424, 419 C. Co.) 2. Voting and Quorum provisions (Art. 68 of Law 222)	1. Ordinary and preferential shares may be issued (Arts. 381, 382 C. Co.) 2. Non-voting stock may be	1. Elected by the shareholders' assembly (Arts. 434, 436 C. Co.) 2. Cumulative voting is mandatory (Art. 197 C. Co); public companies may use	1. Joint and several liability (Art. 200 C. Co) 2. Causes for liability (Art. 200 C. Co) 3. Judicial actions (Art. 24 y 25 of Law 222)	1. <i>Revisor fiscal</i> (Arts. 203-217 C. Co)	1. <i>Derecho de retiro</i> (Arts. 12-17 of Law 222) 2. Appraisal remedies (Arts. 15, 16 of Law 222)	1. Minimum dividend distribution requirements (Arts. 155, 454, 455 C. Co) 2. Share Reacquisition (Arts. 396 C. Co and 42 of	1. Right to examine books and records (Art. 422 C. Co)

	3. Supermajority requirements (Arts. 155, 197, 388, 455 C. Co. and 3 of Law 222)	issued (Art. 61 of Law 222) 3. One share, one vote rule is mandatory (Art. 381 C. Co.) 4. Voting restrictions were in effect until 1995 (Art. 428 C. Co)	other methods if they enhance minority participation (Art. 39 of Law 964) 3. Voting restrictions (Art. 185 C. Co.) 4. Fiduciary duties and conflict of interest regulation (Art. 23 of Law 222)				law 964)	
Ecuador (Company Law)	1. Summons must be made 8 days in advance (Art. 278) 2. Voting and Quorum provisions (Arts. 279, 280, 283) 3. Supermajority requirements (Art. 282)	1. Ordinary and preferential shares may be issued (Arts. 181, 183) 2. No voting stock may be issued (Art. 183) 3. One share, one vote rule is mandatory (Art. 183)	1. Elected by the shareholders' assembly (Art. 273, 275) 2. Cumulative voting is not mandatory (Art. 299) 3. Voting restrictions (Art. 285) 4. Fiduciary duties and conflict of interest regulation (Arts. 303-305)	1. Joint and several liability (Art. 297, 298) 2. Causes for liability (Art. 298) 3. Judicial actions (Art. 314) 4. Conflict of interest regulation (Art. 300)	1. <i>Comisarios</i> (Art. 316)	1. <i>Derecho de retiro</i> (Art. 377) 2. Appraisal remedies (Art. 377)	1. Minimum dividend distribution requirements (Arts. 155, 454, 455) 2. Share Reacquisition (Art. 205)	1. Right to examine books and records (Art. 290)

<p>Brazil (Law No. 6.404 of 1976, as modified by Law No. 10.303 of 2001)</p>	<p>1. Summons must be made 8 days in advance (Art. 124) 2. Voting and Quorum provisions (Art. 125, 129) 3. Supermajority requirements (Art. 136)</p>	<p>1. Ordinary and preferential shares may be issued (Arts. 15-17) 2. No par stock may be issued (Art. 11) 3. One share, one vote rule is mandatory (Art. 110) 4. Voting limitations may be established (Art. 110)</p>	<p>1. Elected by the shareholders' assembly (Arts. 122, 132) 2. Cumulative voting is mandatory in some cases (Art. 141) 3. Fiduciary duties and conflict of interest regulation (Arts. 153-157)</p>	<p>1. Joint and several liability (Art. 158) 2. Causes for liability (Art. 158) 3. Judicial actions (Art. 159)</p>	<p>1. <i>Conselho Fiscal</i> (Arts. 161-165)</p>	<p>1. <i>Direito de Retirada</i> (Art. 136) 2. Appraisal remedies (Art. 136)</p>	<p>1. Minimum dividend distribution requirements (Art. 202) 2. Share Acquisition (Art.)</p>	<p>1. Right to examine books and records (Art. 133)</p>
<p>Chile (Law 18.046 of 1981)</p>	<p>1. Summons must be made in 3 different newspaper ads (Art. 59). 2. Voting and Quorum provisions (Art. 61) 3. Supermajority requirements (Art.</p>	<p>1. Ordinary and preferential shares may be issued (Art. 20) 2. No voting stock may be issued (Art. 21) 3. One share, one vote</p>	<p>1. Elected by the shareholders' assembly (Art. 31) 2. Cumulative voting is mandatory (Art. 66) 3. Fiduciary duties and conflict of interest regulation (Arts. 42-</p>	<p>1. Joint and several liability (Arts. 45, 133) 2. Causes for liability (Art. 45, 50, 89) 3.</p>	<p>1. <i>Inspectores de cuentas</i> (Art. 51) and/or external auditors for public corporations (Art. 53)</p>	<p>1. <i>Derecho de retiro</i> (Arts. 69 bis, 70) 2. Appraisal remedies (Art. 69 bis)</p>	<p>1. Minimum dividend distribution requirements (Art. 79) 2. Share Acquisition (Art. 27)</p>	<p>3. Examining books and records (Art. 54) General disclosure art. 46</p>

	67)	rule is mandatory (Art. 21) 4. Voting limitations may be established (Art. 21)	44)					
Argentina (Law 19.550 of 1972 and Decree 677 of 2001) (References are to Law 19,550, except quoted otherwise)	1. Summons must be made 10 days in advance (Art. 237) 2. Voting and quorum provisions (Art. 243, 244) 3. Supermajority requirements (Art. 244)	1. Ordinary and preferential shares may be issued (Arts. 216, 217) 2. No voting stock may be issued (Art. 217) 3. One share, one vote rule is not mandatory (there is a limit of up to 5 votes per share) (Art. 216)	1. Elected by the shareholders' assembly (Art. 255) 2. Cumulative voting is mandatory (Art. 263) 3. Fiduciary duties and conflict of interest regulation (Arts. 271-273)	1. Joint and several liability (Art. 200, 274) 2. Causes for liability (Arts. 200-274) 3. Judicial actions (Art. 276-279)	1. <i>Síndicos</i> (Arts. 284-297), and <i>Consejo de vigilancia</i> (Arts. 280, 281) <i>Comité de auditoria</i> (auditing committee) formed by 3 directors (required only for listed corporations (Art. 15 Decree 677/01)	1. <i>Derecho de receso</i> (Art. 245) 2. Appraisal remedies (Art. 245)	1. No minimum dividend distribution requirements 2. Share Acquisition (Art. 220)	1. No direct rights to examine books and records (only if the corporation has no <i>síndicos</i>) (Art. 284)

Annex D

The SAS Compared to Traditional Business Associations in Latin America

	Colombia	Brazil		Mexico		Argentina	
Type of Business Association	<i>Sociedad por Acciones Simplificada</i> (Simplified Stock Corporation)	<i>Sociedade anônima</i> (Stock Corporation)	<i>Sociedade de responsabilidade limitada</i> (Limited Liability Company)	<i>Sociedad anónima</i> (Stock Corporation)	<i>Sociedad de Responsabilidad Limitada</i> (Limited Liability Company)	<i>Sociedad anónima</i> (Stock Corporation)	<i>Sociedad de Responsabilidad Limitada</i> (Limited Liability Company)
I. Freedom of contractual stipulation	Full freedom of contract (Sections 10, 11, 13, 14, 16 of Law 1258).	Several legal provisions are of a regulatory nature, (public order). Private ordering could be severely restricted					
II. Number of shareholders needed for incorporation	Only 1 shareholder needed. No cap on number of shareholders (Section 1, Law 1258 of 2008).	Two or more shareholders required (Section 80-I, Law 640).	Two or more shareholders are required (Section 981 of the Civil Code).	Two or more shareholders are required (Section 89-I GLMC).	Two or more shareholders are required. Maximum: 50 shareholders (Section 61 GLMC).	Two or more shareholders are required (Section 1, Law 19.550).	Two or more shareholders are required. Maximum: 50 shareholders (Sections 1 and 146 of Law 19.550).

<p>III. Dissolution caused when shareholders are reduced to one.</p>	<p>Not applicable</p>	<p>Corporation must dissolve when shareholders are reduced to one (Section 206- I d of Law 6404).</p>	<p>Corporation must dissolve when shareholders are reduced to one (Section 1.033- IV of the Civil Code).</p>	<p>Corporation must dissolve when shareholders are reduced to one (Section 229-IV of GLMC).</p>	<p>Corporation must dissolve when shareholders are reduced to one (Section 94- 8 of Law 19.550).</p>		
<p>IV. Formation Process</p>	<p>Simple incorporation by private document filed before the Mercantile Registry (Section 5 of Law 1258).</p>	<p>Incorporation requires public deed or resolution rendered by all shareholders (Section 88 of Law 6404) Registration before the mercantile registry is also required (Section 94 <i>Id</i>).</p>	<p>Incorporation by public deed or private document (Section 997 of the Civil Code). Registration before the mercantile registry is also required (Section 998-1 <i>Id</i>).</p>	<p>Incorporation subject either to public deed or public subscription process. (Section 90 of GLMC). Registration before the Mercantile Registry is also required (Section 2 <i>Id</i>).</p>	<p>Incorporation requires public deed and filing before the Mercantile Registry (Sections 2 and 5 of GLMC).</p>	<p>Public deed required, (Section 165 of Law 19.550) as well as registration before the Mercantile Registry. (Section 5 <i>Id</i>). An additional registration before the General Inspection of Justice (GIJ) is required for corporations based in the Buenos Aires Province. (Resolution No. 13/06 GIJ)</p>	<p>Incorporation either by public deed or private document. (Section 4, Law 19.550). In the absence of public deed an authorization rendered by the Judge in charge of Mercantile Registry is required. (Section 5 <i>Id</i>). Companies in the Buenos Aires Province must obtain an additional authorization by the General Inspection of Justice (GIJ) (Resolution No. 13/06 GIJ).</p>

V. Purpose clause and exercise of company powers	A broad purpose clause is allowed. <i>Ultra vires</i> doctrine generally not applicable (Section 5-5 of Law 1258).	Specific activities must be set forth in detail in purpose clause (Section 2-2 of Law 6404). Legal capacity restricted to purpose clause. <i>Ultra vires</i> doctrine fully applicable. (Section 154 <i>Id.</i>).	Specific activities must be set forth in detail in purpose clause. Legal capacity limited to the purpose clause. <i>Ultra vires</i> doctrine applicable. (Sections 997-II and 1.015 of the Civil Code).	Specific activities must be set forth in detail in purpose clause. Legal capacity limited to the purpose clause. <i>Ultra vires</i> doctrine applicable (Section 10 of GLMC).	Specific activities must be set forth in detail in purpose clause. <i>Ultra vires</i> doctrine applicable (Sections 11-3 and 58 of Law 19.550).
VI. Duration	Freedom to set up a perpetual duration (Section 5-4 of Law 1258).	A fixed term of duration must be set forth in the by-laws. Dissolution will ensue upon its expiration (Section 206-I-a of Law 6404).	A fixed term of duration must be set forth in the by-laws (Section 997-II of the Civil Code). Upon the expiration of the term, the company shall dissolve (Section 1.033-1 of the Civil Code).	A fixed term of duration must be set forth in the by-laws (Section 6-IV of GLMC). Dissolution will ensue upon its expiration (Section 229-I of GLMC).	A fixed term of duration has to be provided (Sections 10-a-6 and 94-2 of Law 19.550). Dissolution ensues upon its expiration (Section 95 of Law 19.550).

VII. Capital contributions and minimum capitalization	No minimum capitalization required. Freedom to determine capital and contributions (Section 9 of Law 1258).	Cumbersome procedure is required for the appraisal of contributions in kind (Sections 7 and 8 of Law 6.404).	Contributions in labor are not allowed (Section 1.055-2 of the Civil Code).	Min. capitalization of \$50,000,000 pesos is mandatory (Section 89-II and III of GLMC).	Min. capitalization of \$3,000,000 is mandatory (Section 62 GLMC). Public subscription is prohibited (Section 63 <i>Id</i>) At least 50% of capital must be subscribed upon incorporation (Section 64 <i>Id</i>).	Capital must be fully subscribed upon registration. Minimum capital contribution is fixed (Section 186 of Law 19.550). Cash contributions must be at least 25% of capital. (Section 187 <i>Id</i>).	Capital must be fully subscribed upon registration. Cash contributions must be at least 25% of capital (Section 149 of Law 19.550).
VIII. Paid-in capital	Payment of contributions can be deferred for two years (Section 9 of Law 1258). No need to pay any amount of capital upon incorporation	At least 10% of subscribed capital shall be paid upon incorporation (Section 80-II of Law 6404).	No specific regulation.	20% of subscribed capital shall be paid upon incorporation (Section 89-III of GLMC). In kind contributions shall be fully paid upon incorporation (Section 89-IV <i>Id</i>).	No specific regulation.	Payment shall not be deferred for more than two years (Section 166-2 of Law 19.550).	Cash contributions must be fully paid in two years (Section 149 of Law 19.550).

IX. Division of Capital	Freedom to establish different classes and series of shares, i.e., ordinary shares, preferential shares, non-voting shares, shares with multiple voting rights, and shares with fixed dividends (Section 10 of Law 1258).	Only common, preferred or "usufructuary" shares are allowed (Sections 1, 15, 16 and 17 of Law 6404).	Capital divided into quotas (Section 1.055 of the Civil Code)	Ordinary shares, shares with limited voting rights and special shares are allowed (Sections 111 and 112 of GLMC).	Capital divided into quotas (Section 62 of GLMC).	Ordinary shares, preferred shares and shares with multiple voting rights are allowed (Section 163 of Law 19.550).	Capital divided into quotas (Section 146 of Law 19.550).
X. Transfer of Shares or Quotas	Shares are freely negotiable (Section 13 of Law 1258).	Shares are freely negotiable (Section 36 of Law 6404).	Quotas are negotiable under certain conditions (Section 1.057 of the Civil Code).	Shares are freely negotiable (Section 130 of GLMC).	Transferability of quotas subject to majority approval of quota-holders (Section 65 of GLMC).	Shares are freely negotiable (Sections 214 and 215 of Law 19.550).	Quotas are negotiable under certain conditions (Section 153 of Law 19.550).

<p>XI. Restrictions on conveyance of shares or quotas</p>	<p>Several types of restrictions may be imposed in by-laws, including right of first refusal, prior approval of board or shareholders, absolute restriction to sell, etc. Limitations are not of a regulatory nature (Section 13 of Law 1258).</p>	<p>A few transfer restrictions can be set forth in by-laws (Section 36 of Law 6404).</p>	<p>Restrictions may be imposed on transfers to third parties, i.e., 25% of the quota-holders can block a quota transfer (Section 1.057 of the Civil Code)</p>	<p>Some restrictions may be imposed in by-laws, i.e., right of first refusal (Section 132 of GLMC).</p>	<p>Conveyance of quotas is severally restricted Preemptive right is applicable on additional capitalizations. Right of first refusal also viable (Sections 68 and 72 of GLMC).</p>	<p>Certain restrictions can be set forth in by-laws, i.e., right of first refusal (Section 194 of Law 19.550).</p>	<p>Right of First refusal may be set forth in by-laws (Section 153 of Law 19.550).</p>
<p>XII. Specific devices to protect shareholders</p>	<p>Comprehensive abuse of right regulation. Decisions rendered in bad faith can be annulled. Shareholders are liable for damages arising from abusive acts (Section 43 of Law 1258).</p>	<p>Abuse of right regulation applicable particularly in the context of corporate groups (Sections 11, 116 and 117 of Law 6404).</p>	<p>No specific regulation on abuse of right</p>	<p>Certain regulation on abuse of right by founding shareholders (Section 104 of GLMC).</p>	<p>No specific regulation on abuse of right</p>	<p>Certain regulation concerning abuse by founding shareholders (Section 185 of Law 19.550).</p>	<p>No specific regulation</p>

XIII. Action without a meeting	Action without a meeting and by written consent is viable for boards and shareholders' assemblies (Section 19 of Law 1258).	No specific regulation		No specific regulation	Voting by mail available under certain circumstances (Section 82 of GLMC)	No specific regulation	
XIV. Shareholders' agreements	Freedom to execute all sorts of shareholders' agreements. (Section 24 of Law 1258).	Shareholders' agreements are viable (Section 118, Law 6.404).	No specific regulation	No specific regulation		No specific statutory regulation. Viable under principle of contractual freedom and case law (See, Carlos Sanchez vs. Banco Avellaneda S.A. (LL 1983-B-257, 9, 22, 1982, Commercial Chamber) (Section 1137 of the Civil Code).	
XV. Enforceability of shareholders' agreements	Full enforceability of shareholders' agreement through expeditious proceeding (Section 24 of Law 1258).	Enforceable vis-à-vis third parties if registered before corporate officers (Sections 118-1 and 118-10 of Law 6404).	No specific regulation	No specific regulation		Enforceable if filed before the mercantile registry (Sections 5 and 167 of Law 19.550).	
XVI. Remedies of specific performance	Specific performance of obligations set forth in agreements before specialized court is allowed (Section 17 of Law 1258).	Specific performance available only before ordinary judiciary (Sections 141-4 and 159 of Law 6404).	No regulation on specific performance of shareholders' agreements.	No regulation on specific performance of shareholders' agreements.	No regulation on specific performance of shareholders' agreements.	No regulation on specific performance of shareholders' agreements.	No regulation on specific performance of shareholders' agreements.

XVII. Conflict Resolution	Possibility to establish on the incorporation document, arbitration and other alternative means (Section 40 of Law 1258).	Arbitration clause must be included or else the ordinary jurisdiction will solve conflicts (Section 3 of Law 9.307).		Arbitration clause must be included or else the ordinary jurisdiction will solve conflicts (Section 1423 of the Commercial Code).		Arbitration clause can be included in by-laws (Sections 736 and 739 of the Civil and Commercial Procedure Code).	
XVIII. Management	Contractual freedom to structure management (Section 17 of Law 1258).	Voluntary two tier structure (Administrative Council and/or Board of Directors) (Section 138 of Law 6404).	Management can be carried out by directors or directly by shareholders (Section 1.060 of the Civil Code).	Management carried out by directors (Sections 10 and 142 of GLMC).	Management can be carried out by directors or directly by shareholders (Sections 10, 40 and 74 of GLMC).	Management delegated to Board of Directors (Section 255 of Law 19.550).	Management can be carried out by directors or shareholders directly (Section 157 of Law 19.550).
XIX Board of Directors	Board is not mandatory (Section 25 of Law 1258).	Board is a mandatory organ (Section 138 of Law 6404). At least three members. (Section 140 <i>Id.</i>).	Not mandatory (Section 1.060 of the Civil Code).	A Board of Directors is mandatory (Section 143 of GLMC).	Not mandatory (Section 74 of GLMC).	Board is a mandatory organ (Section 255 of Law 19.550).	Not mandatory (Section 157 of Law 19.550).
XX. Board Powers	Full freedom to establish Board's powers (Section 24 of Law 1258).	Powers are determined by statute (Section 142 of Law 6404).	Not applicable.	No specific regulation.	Not applicable.	By-laws shall regulate the Board's powers (Section 260 of Law 19.550).	Can be provided in by-laws (Section 157 of Law 19.550).

I. Duties and Liabilities of Directors and Managers	Duties of care and loyalty applicable to directors, officers and "shadow directors" (Section 27 of Law 1258). Comprehensive regulation on conflicts of interest (Decree 1925 of 2009)	Duties of care and loyalty applicable to directors and officers (Sections 153,154, 155, 157 and 158 of Law 6404). Conflicts of interest also regulated (Section 156 of Law 6404). Regulation on liability of directors (Sections 1.017 and 1.020 of the Civil Code).	Duties of care and loyalty, not extensive to shadow directors (Section 1.011 of the Civil Code)	Conflicts of interests must be informed. (Section 156 of GMLC) Specific regulation on weak performance of managers (Section 274 of GLMC) Directors jointly liable for damages (Sections 158 and 160, of GLMC).	No specific regulation.	Duties of care and loyalty applicable to directors and officers. Not extensive to shadow directors (Sections 58 and 276 of Law 19.550).	Duties of care and loyalty applicable to directors and officers. Not extensive to shadow directors (Section 58 of Law 19.550).
XXII. Representation	Full contractual freedom. It can be carried out by one or more persons (Section 26 of Law 1258).	It is carried out by any director (Section 144 of Law 6404).	It is carried out by any director (Section 1.022 of the Civil Code).	It is carried out by any director (Section 10 of GLMC).		It is carried out by the chairman of the board (Section 268 of Law 19.550).	Carried out by managers (Section 157 of Law 19.550)
XXIII. Appointment and removal of managers	Freedom to stipulate specific regulation concerning the appointment and removal of managers (Section 17 of Law 1258).	Managers can be removed at any time (Sections 140 and 143 of Law 6404).	Managers can be removed at any time (Section 1.063 of the Civil Code).	Managers can be removed at any time (Section 142 of LGSM).	Managers can be removed at any time (Section 74, GLMC).	Managers can be removed at any time (Section 256 of Law 19.550).	Managers can be removed at any time (Section 157 of Law 19.550).

XXIV. Fiscal Auditor	Only required for large corporations (Section 28 of Law 1258).	Mandatory Fiscal Council formed by 3 or more members (Section 161 of Law 6404.)	By-laws may include the existence of a Fiscal Council (Section 1.066 of the Civil Code).	"Comisarios" are always required by law (Section 164 GLMC).	A Surveillance Committee may be appointed, composed either of shareholders or outsiders (Section 84 GLMC).	By-laws may include it. Mandatory for corporations with a capital exceeding the amount fixed by the executive branch (Section 280 of Law 19.550).	By-laws may include a Fiscal Committee. It is mandatory for corporations with a capital exceeding the amount fixed by the executive branch (Section 158 of Law 19.550).
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INDEX OF TABLES AND GRAPHS

TABLES

1. Starting a Business: Procedures, Time, Cost, and Minimum Capital - Latin America Compared to Good Practice Economies – **Section 2.**
2. Enforcing contracts – Global Rank – **Section 2**
3. Average premium for “well governed” companies – **Section 3.**
4. Ownership Concentration in Latin America – **Section 4.**
5. Comparison between Sarbanes-Oxley Act and Brazilian Legislation
6. Number of listed corporation per million habitants in major Latin American jurisdictions – **Section 5.**
7. Corporate Governance Segments of BOVESPA – **Section 5.**
8. Enforcement of Contracts – Procedures, Time and Cost – **Section 5.**
9. Registered Companies during the SAS’s first year, as compared with other types of Business Association 51 – **Section 6.**
10. Simplified Stock Corporations (SAS) registered in Colombian cities during 2009 – **Section 6.**

GRAPHS

1. Ease of Starting a Business Global Rank – Latin America Compared to Good Practice Economies – **Section 2.**
2. Informal Sector as a Percentage of Total Occupied Urban Population – **Section 2.**
3. Percentage of GDP made up by market capitalization – **Section 5.**
4. Number of firms listed in Latin American domestic stock exchanges – **Section 5.**
5. New Markets in the São Paulo Stock Exchange (BOVESPA) – **Section 5.**
6. Evolution of BOVESPA's Listing Segments – **Section 5.**
7. Corporate Governance Companies' Stocks vs. Main Traded Stocks in BOVESPA
8. New Listings in the Brazilian Stock Exchange – **Section 5.**
9. Listing and De-listings in the Brazilian Stock Exchange (until September 2010) – **Section 5.**
10. Evolution in the Number of Listed Corporations in BM&FBovespa (until September 2010) – **Section 5.**
11. Example of a Business Conglomerate Structured through a SAS – **Section 5.**
12. Example of Share Classification – **Section 5.**
13. Example of Percentage Participation regulated in the By-Laws – **Section 5.**
14. Change of Control in Shareholding Company – **Section 5.**
15. Example of Substantial Sale of Assets – **Section 5.**
16. Starting a Business in Colombia – Required Time and Procedures – **Section 6.**
17. Evolution of SAS (2008-2010) – **Section 6.**

18. SAS Incorporations and Cancellations (until May 2010) – **Section 6.**
19. Evolution of Company Types (2008-2010) – **Section 6.**
20. SAS Incorporations in Colombia's Main Cities – 2010 – **Section 6.**
21. Bogotá - Incorporations vs. Conversions – **Section 6.**
22. Medellín- incorporations vs. conversions – **Section 6.**
23. Bogotá - Private Document vs. Public Deed – **Section 6.**
24. Medellín SAS – Incorporation Mechanisms – **Section 6.**
25. Bogotá Term of Duration – **Section 6.**
26. Medellín - Term of Duration – **Section 6.**
27. Bogotá - Board of Directors – **Section 6.**
28. Medellín - Board of Directors – **Section 6.**
29. Bogotá – Fiscal Auditors – **Section 6.**
30. Medellín – Fiscal Auditors – **Section 6.**
31. Bogotá – Types of Stocks – **Section 6.**
32. Medellín – Types of Stocks – **Section 6.**
33. Bogotá – Stocks with Multiple Voting Rights – **Section 6.**
34. Medellín - Stocks with Multiple Voting Rights – **Section 6.**
35. Bogotá – Enterprise dimension – **Section 6.**
36. Medellín – Enterprise Dimension – **Section 6.**
37. Bogotá – Purpose Clause – **Section 6.**
38. Medellín - Purpose Clause – **Section 6.**
39. Medellín - Parent-Subsidiary Situations – **Section 6.**
40. Medellín - Controlling Relationship – **Section 6.**

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