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# Latin American Company Law

## *A New Policy Agenda: Reshaping the Closely Held Entity Landscape*

VOLUME II

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# Preface

*Francisco Reyes*

The wave of legal reforms in the field of closely held companies has ushered in a new era in the evolution of business entities all over the world. The rise of the so-called hybrid business forms, also known as "uncorporations," has demonstrated that flexible, versatile vehicles can be easily inserted into deeply diverse jurisdictions. A combination between partnership-type features and corporate characteristics is said to be the key for the success of these innovative vehicles. Furthermore, the Common Law or Civil Law tradition prevailing in each country has not been an obstacle for the extensive adoption of this type of business form. In fact, the flexibility inherent to entities of this nature facilitates the implementation process in countries with different legal traditions.

Moreover, the success of legal transplants in the area of closely held firms is significantly aided by the homogeneity of agency problems that are present in this sort of firms everywhere. Certainly, the main issue that requires attention in the field of non-listed entities is the potentially abusive behavior of majority shareholders, who are often inclined to expropriate their minority counterparts. Therefore, in the particular field of non-public corporations the dichotomy between diffuse and concentrated ownership and the resulting differences in the identification of the relevant agency problems become irrelevant. Additionally, the economic circumstances prevailing in each country—measured for these purposes by the higher or lesser degree of capital concentration of the securities markets—do not affect the type of incentives required to deal with agency problems germane to closely held companies.

It is suggested here that most of the evils that afflict Latin American Company Law could be dealt with by introducing a simple change in the legal infrastructure for closely held entities. For this purpose, an alteration of the incumbent policy agenda, mainly focused on the development of vibrant stock markets, will also be needed. A recommended first step could be the adoption of hybrid business forms in order to replace antiquated regulations applicable today to closely held entities in this region.

The adoption of the new Simplified Stock Corporation Law in Colombia in 2008 has already changed the closely held entity landscape in this country by displacing backward-looking notions traditionally imbedded in Latin American Company Law. The empirical analysis contained in this book clearly suggests that a simple, yet comprehensive change in the legal framework can significantly contribute to the formalization of thousands of enterprises that otherwise would remain in absolute informality. To this effect, the reduction in the size of the 'shadow economy' has been linked to several different measures of economic growth across developed and emerging jurisdictions.

This publication analyzes the basic aspects of Latin American Company Law and includes the theoretical foundations for a proposed legal reform in this field. It also sets out the central elements required for the introduction of a model act on closely held com-

panies for Latin America. The proposal of a uniform statute concerning simplified stock corporations is accompanied by a suggested procedural reform that could add enforceability to the substantive provisions contained in the proposed model act. This last reform aims to reduce the wide gap that exists in Latin America between the law in the books and the law in action.

The book is divided in six chapters. The first chapter 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. The *numerus clausus* approach that prevails in statutes and Commercial Codes in this region lacks the adaptability and contractual flexibility required by entrepreneurs to regulate their business relations.

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: (a) the rigidities arising from the codification of Company Law in the region, which make it difficult for policy makers to rapidly undertake law reforms; (b) the public order nature of most company law provisions, by which private parties are unable to define optimal contractual structures; (c) the dichotomy of corporation Law in Latin America that creates confusion as to the legislation applicable to a business entity—a reminiscence of nineteenth century approaches that should be abolished; and (d) the dogmatism concerning the contractual nature of Company Law, which is yet another expression of a backward conception that hinders legislative improvement. 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 obstacle for the enforceability of any additional agreements executed by the shareholders.

Further topics in Chapter 2 relate to the several exceptions to the principle of limited liability that Constitutional Courts and other tribunals have created. The overwhelming formalities for incorporation that exist in these countries are also analyzed, 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 ineffectual and at worse detrimental to the corporate law systems in the region due, among other reasons, to the increase in the costs of compliance for listed firms. At the same time, a critique is posed 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 legal reform in Latin American Company Law. The focus there is on the importance of shifting the policy agenda from public corpora-

tions to closely held entities. For that purpose, the importation and adaptation of rules from advanced jurisdictions is recommended. The underlying theory is that the optimal incentives to deal with agency problems in the context of closely held companies could be equally applied in differing jurisdictions. The same chapter also includes a comprehensive explanation on the Model Act on Simplified Stock Corporations for Latin America.

Chapter 5 proposes an additional Model Act on Procedural Rules for the Resolution of Conflicts in Simplified Stock Corporations. This recommendation relates to an ancillary proceeding specifically devised to facilitate litigation concerning disputes in the context of such business entities. The recommended Procedural Model Act features a supple 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 improve the manner in which business is conducted in the region. The statistical data presented in this chapter suggest that 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 information gathered for the research 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 these entities.

The final section 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 regional 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.

It is the author's expectation that this book will serve the needs of those interested in exploring the basic aspects of Latin American Company Law from a comparative perspective. I will be satisfied if this new approach to an almost unchartered domain of scholarship proves useful as a starting point for new and more detailed academic explorations in this increasingly relevant field of Comparative Business Law.

November, 2012