International Lawyer

Volume 46 | Number 4 | Article 3

2012

Aligning Corporate Governance Private Regulation with the Public Interest: *A Look at the Pitfalls of the Brazilian Takeover Private Regulation*

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Abstract

The recognition of corporate governance as a consequential aspect for adequate investor protection and the development of both capital markets and the economy as a whole, the fundamental differences between governance arrangements that seem useful to controlled and widely held companies, and how to deal with such matters in view of the increasing use of private regulatory measures form the cornerstone of this article. This article draws on an example of the private regulation of takeovers in Brazil and argues that regulation of the capital market, be its origin public or private, must pay attention to the corporate ownership structures that dominate the jurisdiction in which the rules are to be applied. The alignment of corporate governance private regulatory measures with the public interest is argued to be fostered once one duly considers that corporate governance arrangements work differently in environments of concentrated or dispersed ownership structures.

Introduction

It is widely recognized that international economic governance nowadays involves not only states and international organizations but also private actors, whose activity as norm-makers has been gaining importance over the years.[1] Although significant in terms of the number of fields regulated and its efficacy, the role played by private regulation, however, is not always aligned with the public interest. The possible disconnection of such regulation from public policies raises questions in terms of the accountability and the legitimacy of such private regimes.

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1. *See* Jan M. Smits, Maastricht-HiiL Chair on the Internationalisation of Law, Hague Inst. for the Internationalisation of Law, Private Law 2.0: On the Role of Private Actors in a Post-National Society 11 (Nov. 30, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1779042.

This is a matter of concern in the international arena when one talks about transnational private regulation, but its importance should not be undermined in national domains either. This assertion will be made clear by the case study presented here, which refers to the regulation of corporate control transactions in Brazil.[2]

As in many continental European countries, concentrated control is the most common ownership structure among listed corporations in Brazil.[3] Nevertheless, it has recently been argued that this scenario is undergoing important changes, especially due to the so-called "*Novo Mercado*," a segment of the São Paulo Stock Exchange (named *BM&FBovespa*).[4] Companies listed on the *Novo Mercado* must comply with higher standards of corporate governance practices, one of which is to issue common shares exclusively.[5] After being restrained from issuing preferred shares, it becomes much more expensive to acquire or keep full control of a company. Therefore, there is an incentive for the emergence of wider corporate ownership structures.

The shy, but persistent, moves towards ownership dispersion raises the possibility of hostile takeovers taking place, which was non-existent until recently due to the high levels of ownership concentration. The absence of rules specifically aimed at dealing with the matter, such as those found in American state takeover laws[6] or in the European Takeover Directive,[7] left space for private regulation. The mere presence of private regulation is not considered per se problematic, especially because the Brazilian capital market is used to self-regulatory measures, and the *Novo Mercado* is a successful example. The problem is that private takeover regulation has proven to be deceptive, as explained in detail below, and does not work in the public interest of fostering the market by protecting investors.

This illustrates the challenges posed by private regulatory regimes and the need for coordination between these regimes and public policies. The Brazilian example will show how even an environment characterized by a healthy self-regulatory scheme may suffer

2. For purposes of this article, "corporate control transactions" means the transaction between the company's shareholders and a person who aims to acquire a certain number of the target company's shares that allows him or her to exercise control power over a Brazilian company. Brazil's Corporate Law defines a controlling shareholder as a shareholder who (i) holds the ownership of shares that permanently assures the holder of a majority of votes in shareholders' meetings and the power to elect a majority of the members of the management, and (ii) actually uses such power to direct the corporate activities and to guide the operations of the company. Lei No. 6,404, de 15 de Dezembro de 1976, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976, art. 116 (Braz.).

3. For empirical research, *see* Andre Carvalhal da-Silva & Ricardo P.C. Leal, *Corporate Governance, Market Valuation and Dividend Policy in Brazil* 2-3 (Coppead Working Paper Series, Paper No. 390, 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=477302; Eduardo Schiehll & Igor Oliveira dos Santos, *Ownership Structure and Composition of Boards of Directors: Evidence on Brazilian Publicly-Traded Companies*, 39 REVISTA DE ADMINSITRAÇÃO DA UNIVERSIDADE DE SÃO PAULO [ADMIN. J. SÃO PAULO U.] 373, 377 (2004) (Braz.); Ricardo P.C. Leal & Andre Carvalhal-da-Silva, *Corporate Governance and Value in Brazil (and in Chile)* 1 (Inter-American Development Bank, Latin American Research Network, Working Paper No. R-514, 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=726261.

4. Erica Gorga, *Changing the Paradigm of Stock Ownership from Concentrated Towards Dispersed Ownership: Evidence from Brazil and Consequences for Emerging Countries*, 29 NW. J. INT'L L. & BUS. 439, 447 (2009).

5. *Corporate Governance*, BM&FBOVESPA, http://www.bmfbovespa.com.br/en-us/markets/equities/companies/corporate-governance.aspx?idioma=en-us (last visited Jan. 4, 2013).

6. *See* Richard Hall, *United States Takeover Guide*, INT'L BAR ASS'N (May 12, 2009), http://www.ibanet.org/Search/Default.aspx?q=takeover%20guide.

7. Directive 2004/25, of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L 142/12).

from inefficiencies in terms of lack of adequate attention to the multiple affected stakeholders. It will also indicate the importance of regulating corporate governance matters—either through public or private means—with a view towards the specific ownership structures in place in a given market.

In view of the above, this article is structured as follows: Section I broadly addresses the emergence of private corporate governance regulatory regimes in the transnational arena and the necessity of their interaction with the state. Section II briefly evokes arguments on the importance of aligning corporate measures to the ownership structures of public companies and uses the example of the regulation of corporate control transactions. Section III explains the Brazilian rules on control negotiations, puts forward the challenges posed by the emergence of widely held companies, and explores the emergence of private regulation on the subject, which is mainly influenced by certain foreign regulations. Section IV draws on the importance of the relationship between the corporate governance tools and the corporate ownership structure, explains the inadequacy of the aforementioned private takeover regulation, and considers ways in which to synchronize the successful example of self-regulation in the Brazilian capital market legal system with the public interest of promoting a trustworthy capital market.

I. The Rise of Corporate Governance Private Regulation as a Transnational Feature and the Role of the State

The privatization of norm-making capacities has become increasingly common among regulatory initiatives on corporate governance. Accompanying the lack of frontiers of corporate activity, the proliferation of transnational corporate governance codes, codes of conduct, standards, rules, and codes of best practices raises questions as to the classification of such documents as law or norms with binding force.[8]

Sometimes considered a consequence of globalization, the transfer of public functions to corporate actors is a reality in various fields, including financial, corporate governance, and environmental regulation.[9] Assumed to be a result of the extensively mentioned inability of the state to deal with matters that go beyond its specific territory, corporations create rules and fulfill important regulatory roles even in the absence of a mandate from public authorities. This use of self-regulation as a norm-making procedure brings about theoretical questions in terms of the validity, democratic legitimacy,[10] completeness, and

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8. Peer Zumbansen, *'New Governance' in European Corporate Law Regulation as Transnational Legal Pluralism*, 15 EUR. L.J. 246, 253-54 (2009); Michael Torrance, *Persuasive Authority Beyond the State: A Theoretical Analysis of Transnational Corporate Social Responsibility Norms as Legal Reasons Within Positive Legal Systems*, 12 GER. L.J. 1573, 1573-74 (2008) (investigating if transnational normative systems may be considered part of positive legal systems); *see also* Joanna Benjamin & David Rouch, *The International Financial Markets as a Source of Global Law: The Privatisation of Rule-Making?*, 2 L. & FIN. MARKETS REV. 78, 80 (2008) (arguing that refusing to consider private regulation as law would indicate the adoption of a formal definition of the term instead of a functionalist one).

9. *See e.g.*, Martin Herberg, *Global Legal Pluralism and Interlegality: Environmental Self-Regulation in Multinational Enterprises as Global Law-Making*, *in* RESPONSIBLE BUSINESS – SELF-GOVERNANCE AND LAW IN TRANSNATIONAL ECONOMIC TRANSACTIONS 16, 17-18 (Olaf Dilling, Martin Herberg & Gerd Winter eds., 2008); Benjamin & Rouch, *supra* note 8, at 80.

10. A. Claire Cutler, *Private International Regimes and Interfirm Cooperation*, *in* THE EMERGENCE OF PRIVATE AUTHORITY IN GLOBAL GOVERNANCE 23, 32-33 (Rodney B. Hall & Thomas J. Biersteker eds., 2002);

enforcement of such norms that is aggravated by the possibility of a de-territorialized and informal process of norm production.[11]

This is one facet of the so-called private global norm-production,[12] or, more recently, transnational private regulation,[13] which accounts for sets of rules, codes, practices, standards, and similar frameworks created by non-state actors who exercise regulatory authority that may, or may not, have been previously awarded to them by international or national law.[14] The emergence of transnational norm production reflects a change in the regulatory environment, in which private actors gain importance and play fundamental roles and where rules are formed by both hard and soft law.

The norms on corporate governance are among the most famous forms of transnational private regulation.[15] The recent proliferation of corporate governance codes, both in national and transnational arenas,[16] indicates the diversity of norm-setting processes and actors. Corporate governance codes usually embrace a production of norms that do not necessarily account for domestic territories, especially with regard to business activities, which, in a globalized world, are no longer restricted to national borders.

The modification of the style of regulation is, in part, related to the globalization of corporate governance. The prominence of the subject on a worldwide basis, along with the integration of markets and the activity of multinational corporations as global players, facilitated the emergence of private norm-setting in an arena that is not defined by state boundaries. Reflected in an increasingly noticeable private regulation, this change represents a challenge for governments but not necessarily a lack of importance of the state.[17]

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see Carola Glinski, *Bridging the Gap: The Legal Potential of Private Regulation*, *in* RESPONSIBLE BUSINESS, *supra* note 9, at 41, 43 (fair and pluralistic decision-making procedures are pointed as substitutes for the lack of democracy in the private regulation); Julia Black & David Rouch, *The Development of the Global Markets as Rule-Makers: Engagement and Legitimacy*, 2 L. & FIN. MARKETS REV. 218, 223-27 (2008) (addressing legitimacy criteria for private regulation).

11. Gralf-Peter Calliess, *Lex Mercatoria: A Reflexive Law Guide to an Autonomous Legal System*, 2 GER. L.J. 17 (2001), *available at* http://www.germanlawjournal.com/index.php?pageID=11&artID=109 (mentioning that these are the standard positivist objections to the reflexive approach on a new *Lex Mercatoria*). For research conducted by the Hague Institute for the Internationalization of Law on these issues, *see Private Transnational Regulatory Regimes*, EUR. UNION INST., http://privateregulation.eu/ (last visited Jan. 12, 2013).

12. Gunther Teubner coined this term. *See* Gunther Teubner, *Breaking Frames: The Global Interplay of Legal and Social Systems*, 45 AM. J. COMP. L. 149, 157 (1997).

13. Transnational law, apart from been understood as a field of lawmaking, has lately been conceived as a method that involves a mixed nature of regimes that is neither equal to public nor private international law. *See* Peer Zumbansen, *The Next 'Great Transformation'? The Double Movement in Transnational Corporate Governance and Capital Markets Regulation*, *in* KARL POLANYI, GLOBALISATION AND THE POTENTIAL OF LAW IN TRANSNATIONAL MARKETS 181, 203-04 (Christian Joerges & Josef Falke eds., 2011); *see also* Peer Zumbansen, *Transnational Legal Pluralism*, 10 TRANSNAT'L LEGAL THEORY 141 (2010); Fabrizio Cafaggi, *New Foundations of Transnational Private Regulation*, 38 J.L. SOC'Y 20, 21 (2011).

14. Cafaggi, *supra* note 13, at 21.

15. *See e.g.*, GRALF-PETER CALLIESS & PEER ZUMBANSEN, ROUGH CONSENSUS AND RUNNING CODE: A THEORY OF TRANSNATIONAL PRIVATE LAW 248-77 (2010) (devoting an important chapter to transnational corporate governance); Zumbansen, *supra* note 13, at 181; *see also* Eva Kocher, *Codes of Conduct and Framework Agreements on Social Minimum Standards – Private Regulation?*, *in* RESPONSIBLE BUSINESS, *supra* note 9, at 67, 67-86 (referring mainly to transnational rules on corporate social responsibility).

16. For a long list of individual country's corporate governance codes, see *Index of Codes*, EUROPEAN CORP. GOVERNANCE INST., http://www.ecgi.org/codes/all_codes.php (last visited Jan. 2, 2013).

17. John W. Cioffi, *Governing Globalization? The State, Law, and Structural Change in Corporate Governance*, 27 J.L. SOC'Y 572, 587, 598-600 (2000); *see also* Thomas McInerney, *Putting Regulation Before Responsibility:*

One aspect that points to the state's role is the enforceability of private regulation as a means of guaranteeing that commitments made on private regulatory domains cannot be disregarded without bearing the consequences. The recognition that obligations established by self-regulatory measures are rarely enforced has led scholars to advocate for the need to create binding international rules on certain aspects of corporate governance, which should subsequently be internally adopted by nation states, and as a result, would become enforceable.[18]

But this is not the only aspect that suggests the state's importance when dealing with private regulation. Both in transnational and in domestic environments, private norm-making may involve questions of acute public interest, such as social, environmental, and financial issues that call for state consideration. As highlighted by Saskia Sassen, there is no need to overcome, or interest in overcoming, the nation state, especially in view of the embedded nature of the global sphere in the national arena.[19] Subjects that embrace both the national and the global arenas should be addressed through solutions that take into consideration an allied composition of both spheres. Hence, even in cases where the state no longer directly engages in economic regulation, it should be part of the process.[20] This means that, in many circumstances, there is a need to walk away from the dual distinction between domains that are either fully private or fully public to reach one that is composed of both parts.

To apply these observations to the multi-layered norm-setting processes of corporate governance rules means the pursuit of corporate goals and the norms envisaged to regulate their achievement might not harm the public policy goals of the regulated area. Therefore, although the existence of private authority must be recognized, and, in many cases, praised, there is still a pressing need to guarantee that private regulation embraces a high level of accountability with a wider range of values and interests.[21]

Private regulation of corporate governance matters is commonly connected to a broad array of standards, principles, and lists of best practices. Although most of the corporate governance rules are designed to be used in the major epicenters of economic globalization, they end up being adopted in less central areas, which account for completely differ-

Towards Binding Norms of Corporate Social Responsibility, 40 CORNELL INT'L L.J. 171, 172, 183 (2007) (arguing the importance of the state especially as a driver of economic development and that voluntary self-regulation "should supplement not supplant state regulation").

18. Engobo Emeseh, Rhuks Ako, Patrick Okonmah & Lawrence O. Obokoh, *Corporations, CSR and Self-Regulation: What Lessons from the Global Financial Crisis?*, 11 GER. L.J. 230, 258 (2010) (advocating for a global regulation on corporate social responsibility matters).

19. Saskia Sassen, *The State and Globalization*, *in* THE EMERGENCE OF PRIVATE AUTHORITY IN GLOBAL GOVERNANCE 91, 91-92 (Rodney Bruce Hall & Thomas J. Biersteker eds., 2002).

20. *Id.*

21. Edward J. Balleisen mentions the lack of "meaningful accountability to the values and concerns of a larger democratic majority" as one of the most relevant critiques raised by the detractors of self-regulatory measures. Edward J. Balleisen, *The Prospects for Effective Coregulation in the United States: A Historian's View from the Early Twenty-First Century*, *in* GOVERNMENT AND MARKETS: TOWARD A NEW THEORY OF REGULATION 443, 460 (Edward J. Balleisen & David A. Moss eds., 2010).

ent economic and social settings.[22] In such cases, these regulatory regimes do not seem sufficient, and, consequently, require a level of state participation.[23]

It is worth mentioning that this is not an attempt to affirm the sole importance of state power or to deny legal pluralism, but to recognize the latter and to address the questions raised in view of the lack of a state monopoly in lawmaking.[24] Drawing on private regulation as a feature of global legal pluralism, identifying the existence of normative authority beyond the state, *and* the role played by corporations and other private actors in current economic life, this article attempts to explore the necessary interaction between private and state actors in order to assure that interests other than those of the private sphere are being adequately handled.[25] In a way, this means assuring the social re-embedding[26] of private regulatory measures.

Social scientists have been thinking of measures that foster confidence in private regulation as a measure capable of promoting public goals. In such cases, private regulatory instruments could be considered adequate policy tools.[27] The review of literature dealing with the topic falls outside the purposes and limits of this study, but its claims support the argument presented here. Representing a challenge to the conception that normative authority must be centered exclusively in the state, the outsourcing of regulatory authority to private actors should be aware of the mechanisms that assure a commitment from non-governmental regulators to the public interest. The desired regulatory outcomes must be kept in view. In other words, law beyond the state that is represented by the private appropriation of norm-making authority must not be distant from the axiological perspective that involves norm-setting processes.

II. The Need for Alliance Between Corporate Governance Measures and Ownership Structure: The Example of Regulation of Corporate Control Negotiations

During the last few decades, corporate governance has become a topic of mainstream concern among scholars, policy-makers, and executives. As a result, its content is defined both by the aforementioned private regulation and by the various national regulatory frameworks. In modern times, it is broadly recognized that corporate governance may

22. The North Atlantic systems are known as the center of gravity for the creation of such rules. *See* Sassen, *supra* note 19, at 98-99.

23. This is exactly what is underneath the adoption by Brazilian companies of their own takeover rules, as detailed *infra* in Section III(C).

24. *See* Gunther Teubner, *Global Bukowina: Legal Pluralism in the World Society*, *in* GLOBAL LAW WITHOUT A STATE 3, 3 (Gunther Teubner ed., 1997). As for the plurality of legal orders with a view on how legal pluralism engages with legal globalization, see Ralf Michaels, *Global Legal Pluralism* 3 (Duke Law Sch. Pub. Law & Legal Theory Research Paper, Paper No. 259, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1430395.

25. The importance of giving a voice to public concerns in the transnational law-making arena and the difficulties involved have been already emphasized. *See* Gralf-Peter Calliess & Moritz Renner, *Transnationalizing Private Law - The Public and the Private Dimensions of Transnational Commercial Law*, 10 GER. L.J. 1341, 1343 (2009).

26. For comments on the social re-embeddness in view of the private international law field, *see* Horatia Muir-Watt, Private International Law as Global Governance: Beyond Schize, from Closet to Planet (2011) (unpublished paper), *available at* http://works.bepress.com/horatia_muir-watt/1.

27. Balleisen, *supra* note 21, at 463.

affect the value and performance of firms and may also promote reliable capital markets and economic development.[28]

At the same time, the pervasiveness of a certain level of uniformity in topics of corporate governance around the world reminds us of the need to pay attention to the specificities of the actual place where the rules are applied. One needs to recognize that similar norms might have strikingly dissimilar results depending on the characteristics of the market in which the norms are put in place.[29]

It has recently been argued that the efficiency and appropriateness of many governance measures are intimately related to the ownership structure of the given market where they are to be implemented.[30] This means that a company's ownership structure affects the ways in which corporate governance arrangements are applied,[31] and thus, governance measures intended to guarantee good governance of widely held companies rarely suit their controlled counterparts.

In fact, a public company with dispersed ownership, initially described by Berle and Means,[32] may not be considered a worldwide pattern.[33] The causes of a specific design of

28. *See, e.g.*, Alexander Schaub, *Corporate Governance in Europe: An Address*, 69 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT [RABEL J. COMP. & INT'L PRIVATE L.] 619, 620 (2005) (Ger.).

29. The functionalist approach of some corporate scholars also led to the conclusion that what might look like a harmonization in the adoption of some best practice rules is actually a "fausse convergence," if one considers the way each rule works in jurisdictions where different ownership structures prevail. *See* Paul Davies et al., *Beyond the Anatomy*, *in* THE ANATOMY OF CORPORATE LAW – A COMPARATIVE AND FUNCTIONAL APPROACH 305, 312-13 (Reinier Kraakman et al. eds., 2d ed. 2009).

30. Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1263-64 (2009); Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking U.K. Rules to Continental Europe*, 11 U. PA. J. BUS. L. 135, 139 (2008) (discussing specific considerations of takeover regulation).

31. Eddy Wymeersch, *Shareholder(s) Matter(s)*, *in* FESTSCHRIFT FÜR KLAUS J. HOPT ZUM 70. GEBURTSTAG AM 24. AUGUST 2010: UNTERNEHMEN, MARKT UND VERANTWORTUNG [IN HONOR OF KLAUS J. HOPT'S 70TH BIRTHDAY ON AUG. 24, 2010: BUSINESS, MARKET, AND RESPONSIBILITY] 1565, 1580 (Stefan Grundmann et al. eds., 2010) (adopting such an approach in what concerns the use of the "one share one vote" principle); Jeffrey N. Gordon, *The Rise of Independent Directors in Italy: A Comparative Perspective*, *in* LA SOCIETÀ PER AZIONI OGGI: TRADIZIONE, ATTUALITÀ E PROSPETTIVE [JOINT STOCK COMPANY TODAY: TRADITION, NEWS & PERSPECTIVES] (Paola Balzarini, Giuseppe Carcano & Marco Ventoruzzo eds., 2007) (sharing the same belief about the importance of ownership structure, especially in view of independent directors regulation).

32. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 2 (1933).

33. *See, e.g.*, Julian Franks & Colin Mayer, *Corporate Ownership and Control in the U.K., Germany, and France*, 9 J. APPLIED CORP. FIN. 30 (1997) (indicating that there are two types of ownership and control structures, the first being an outsider system that corresponds to dispersed ownership, such as what is found in the United States and UK, while the second refers to a insider system characterized by a considerable level of ownership concentration, even among listed companies. The latter would be the case of Continental Europe and of Brazil). The same authors argue that the difference in ownership structures is due to the fact that each structure is better suited to different types of corporate activity. Julian Franks & Colin Mayer, *Ownership and Control*, *in* TRENDS IN BUSINESS ORGANIZATION: DO PARTICIPATION AND COOPERATION INCREASE COMPETITIVENESS? 171, 171-72 (Horst Siebert ed., 1995). For a critical review of the famous law and finance scholarship aiming at explaining such differences that of John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 4-6 (2001); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); and Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. POL. ECON. 1113, 1116 (1998).

corporate ownership, either concentrated or dispersed, have been thoroughly investigated. As for the reasons for certain ownership arrangements, an over-regulation thesis has argued that the rise of the separation of ownership and control in the United States was not caused by economic-efficiency concerns, but instead, was the result of strict regulation against concentration and bank participation in corporations.[34] Dissimilarly, Rafael La Porta et al. claim that ownership concentration is the consequence of the absence of regulation capable of conferring adequate investor protection, and they strongly associate dispersed ownership to common-law legal systems.[35] The Path Dependence Theory presented some years later emphasized the importance of private benefits of control for the maintenance of high levels of ownership concentration,[36] and also explained why the consequences of inefficient regulation would be able to remain, thereby reinforcing the role of history in the shape of law.[37] Adopting a different approach, John C. Coffee, Jr. believes that, although law matters, legal and political apparatuses do not precede, but, instead, follow a change, and that the autonomy of the private sector and its private institutional structures were fundamental to the enlargement of dispersed ownership.[38]

Although this is a subject of indisputable importance, it is not among the purposes of this article to discuss the causes for the increase of dispersed or concentrated ownership structures in a given market. But, it seems crucial to recognize the existence of different patterns and to make sure that the specificities of each are taken into account when rules of corporate governance are designed. In this sense, it is argued here that shareholder structure patterns should never be overlooked by those creating corporate and capital market laws and regulations, especially if one accepts the importance of a consistent regulatory structure for the development of a strong securities market.[39]

One of the governance areas that may prove this statement, and therefore deserves further investigations, refers to the regulation of control acquisition transactions. The differences between friendly and hostile control transactions—frequent in companies with concentrated and widely held control, respectively—are substantial, and the rules to be applied in each case should reflect the dissimilarity.

On top of these concerns should be the fact that the basic agency conflict concerning companies with dispersed and concentrated capital is strikingly different. While a key feature of widely held corporations is the principal-agent problem between shareholders and managers, controlled companies usually suffer from conflicts of interests and abusive acts of controllers vis-à-vis the interests of the company and the minority shareholders.[40]

34. *See generally* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1996).

35. La Porta et al., *Legal Determinants*, *supra* note 33, at 1131-32; La Porta et al., *Law and Finance*, *supra* note 33, at 1116.

36. *See* Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* 26 (Harvard Law and Econ. Discussion Paper, Paper No. 260, 1999), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=168990.

37. Lucian A. Bebchuck & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 139-54 (1999).

38. Coffee, *supra* note 33, at 5.

39. *See* Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781 (2001).

40. This is widely known as the main governance problem of Brazilian public companies. *See* Alexandre Di Miceli da Silveira & Armando L. Dias Jr., *What is the Impact of Bad Governance Practices in a Concentrated Ownership Environment?*, 7 INT'L J. DISCLOSURE & GOVERNANCE 70, 71 (2010).

In addition, during control transactions, some agency issues are intensified. On one hand, in companies with a diffuse ownership structure, the parties involved in the shares transfer (shareholders and acquirer) are not the same as those in the actual control transfer (board and acquirer).[41] This gives rise to distorted incentives for the management to use its power to support or to obstruct the transactions according to its own interests, instead of those of the shareholders.[42] On the other hand, in cases of concentrated ownership, the transaction between the former and the new controller might happen in disregard of the interests of other stakeholders.[43] When selling its shares, the former controller might have no incentive to care about the company's destiny or the quality of its future governance, but only to consider its own profit-maximizing interest.[44] By paying attention to the dissimilarities of the main conflict in one case and the other,[45] the importance of distinguishing between dispersed and controlled companies and the rules to be applied becomes conspicuous.

In what specifically concerns the regulation of control negotiations, the study of the takeover rules currently in force in a variety of legal systems shows that control transactions of widely held companies may be approached in various ways and through diverse legal measures. Some of the different approaches can be detected by looking at the strikingly contrasting European and American experiences and regulations.

For example, one of the instruments found in both the U.K. City Code on Takeovers and Mergers and the European Takeover Directive is to set a board neutrality rule, according to which the target company's management may not take any action that could possibly frustrate the success of the hostile takeover offer, unless the shareholders approve the action during a shareholders' meeting.[46] Another possible measure refers to the mandatory bid.[47] The mandatory bid requires the acquirer of corporate control to launch a tender offer on all outstanding shares. A certain percentage of a public company's voting capital is legally established to constitute control and, once it is achieved, an offer on the remaining shares must be announced for an equitable price and must correspond to the highest amount paid for the controlling shares.[48]

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41. Paul Davies & Klaus J. Hopt, *Control Transactions*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, *supra* note 29, at 225, 227-28.

42. *Id.*

43. *Id.*

44. *See* Leo E. Strine Jr., Lecture & Commentary, *The Social Responsibility of Boards of Directors and Stockholders in Charge of Control Transactions: Is There Any "There" There?*, 75 S. CAL. L. REV. 1169, 1170 (2002).

45. For an exploration of this difference in detail, see Davies & Hopt, *supra* note 41, at 227-29.

46. It is also known as the "no-frustration" rule (as set forth in Rule 21.1 of the City Code). *See* Joseph A. McCahery, Luc Runneboog, Peer Ritter & Sascha Haller, *The Economics of the Proposed European Takeover Directive*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 575 (Guido Ferrarini, Klaus J. Hopt, Jaap Winter & Eddy Wymeersch eds., 2004).

47. The use of a mandatory bid in the event that a specific threshold of stock ownership is acquired dates back to 1972, when it was first introduced by the British City Code. Rolf Skog, *Does Sweden Need a Mandatory Bid Rule?: A Critical Analysis*, *in* SEURF STUDIES 2: THE EUROPEAN MONEY AND FINANCE FORUM 7 (Morten Balling ed., 1997). It is now set forth by Article 5 of the Takeover Directive as a rule of mandatory transposition into national laws by the Member States. Directive 2004/25, of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L 142/12) art. 5.

48. This reflects the principle of equal treatment of shareholders. *See* Jan Wouters, Paul van Hooghten & Matias Bruyneel, *The European Takeover Directive: A Commentary*, *in* THE EUROPEAN TAKEOVER DIRECTIVE AND ITS IMPLEMENTATION 3, 14 (Paul van Hooghten ed., 2009); *see also* Klaus J. Hopt, *European Takeover Regulation: Barriers to and Problems of Harmonizing Takeover Law in The European Community*, *in* EUROPEAN

Yet another possibility, famous for being used in the United States, is to award the management a high level of freedom to maneuver.[49] Directors are allowed an active role and must stand up for the company's long-term interests when dealing with a takeover attempt.[50] There is no absolute prohibition to undertake defensive measures, and they are not expected to accept an offer based solely for maximizing shareholder profits.[51] The freedom afforded to directors authorizes them to take defensive measures, provided they are taken in observation of their fiduciary duties and are in the best interests of the company.[52] The business judgment rule is applied with some adjustments, and managers are to act on good faith and to guarantee that the measures undertaken are proportional to the threat posed by the attempt to acquire the control.[53]

In general terms, these are some of the arrangements aimed at protecting investors during a takeover attempt. The approaches adopted in Europe and the United States are outstandingly different.[54] In order to take such experiences into consideration and consider takeover regulation in a country such as Brazil, which presents a singular legal, social, and economic framework, one needs to bear in mind that Brazil's corporate ownership structure is mainly concentrated and was historically erected as such.[55] As a consequence, the legal measures envisaged to be applied to cases in which there is no controlling shareholder should not be considered as a regulatory model for companies whose control is exercised by a specific shareholder or group of shareholders.[56]

The aforementioned board neutrality rule provides a clear example of this. If, in widely held companies, the mandatory shareholders' approval of any defensive measure to be taken by the management aims at attacking the agency problem between directors and investors, the same rationality does not apply to control transactions of controlled firms where the agency problem, as mentioned earlier, is between the controller and the minor-

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TAKEOVERS – LAW AND PRACTICE 165, 179 (Klaus J. Hopt & Eddy Wymeersch eds., 1992) (critically analyzing the use of the principle as the basis for the mandatory offer).

49. *See* John Armour & David Skeel Jr., *Who Writes the Rules for Hostile Takeovers, and Why? - The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1727 (2007).

50. *Id.* at 1734.

51. *Id.* at 1735.

52. *See* Armour & Skeel, Jr., *supra* note 49, at 1729; Nikolaos Andronikos, *A US lawyer's perspective on the EU Takeover Directive*, *in* COMMON LEGAL FRAMEWORK FOR TAKEOVER BIDS IN EUROPE 42, 45 (Dirk Van Gerven ed., 2008).

53. For a critical comment on this topic, see Paul L. Davies, *The Regulation of Defensive Tactics in the United Kingdom and the United States*, *in* EUROPEAN TAKEOVERS, *supra* note 48, at 195, 204.

54. Regarding the origin of the differences in takeover regulations in the United States and the United Kingdom, with the United Kingdom influencing European rules, see Armour & Skeel, Jr., *supra* note 49 (addressing the differences as a matter of public choice and arguing that self-regulatory and shareholder protective rules were adopted by the United Kingdom as a result of the influence of institutional investors, while the managers were benefited by the American judicial lawmaking system that makes it difficult for shareholders to influence the rules). For comparison, see William Magnuson, *Takeover Regulation in the United States and Europe: An Institutional Approach*, 21 PACE INT'L L. REV. 205 (2009). *See also* Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171 (2006); Stefanie Denzel, DIE NEUTRALITÄTSPFLICHT IM EUROPÄISCHEN ÜBERNAHMERECHT – EIN VERGLEICH MIT DEM US-AMERIKANISCHEN SYSTEM DER MODIFIED BUSINESS JUDGMENT RULE [THE OBLIGATION OF NEUTRALITY IN THE EUROPEAN TAKEOVER LAW – A COMPARISON WITH THE U.S. SYSTEM, THE MODIFIED BUSINESS JUDGMENT RULE] (2005).

55. For details, *see infra* Section III.

56. As detailed in Section III(C), this is the main problem when Brazilian public companies adopt private regulations.

ity shareholders. In companies that have concentrated control, the controller owns a sufficient percentage of voting rights, which guarantees power over the company's activities, even if the controller does not own the majority of the shares. Thus, a shareholders' meeting decision on possible defensive measures does not serve the purpose of protecting investors because, in practice, the decision belongs to the controller. In fact, granting the shareholders (meaning, at the end of the day, the controller) this decisional power may cause even more damage to minority investors. But this will not occur in situations where minority shareholders hold a considerable percentage of voting shares, make actual use of their voting rights, and certain defensive measures requiring a supermajority are adopted.

But at the same time that a neutrality rule is not compatible with a concentrated environment, leaving managers to decide possible defensive measures might also not provide an adequate regulatory solution. In many companies with a concentrated ownership structure, the board often acts under direct orders and without questioning the decisions taken by the controlling shareholder.[57] In such circumstances, granting authority to the managers and letting them decide the appropriateness of the takeover attempt will not solve the conflict unless an accurate independence rule is in place and duly enforced over the managers.[58]

This is only a brief illustration of what is implied here: takeover regulation, as a corporate-governance measure, must always consider the ownership structure of the public company. In the case of Brazilian capital markets, whose details will be presented next, there is a clear need for rules that are attentive to a very heterogeneous scenario that is characterized by a majority of controlled companies, and a possible growing number of widely held corporations, most of which still have a shareholder owning a large percentage of the voting capital.

III. A Case Study: The Brazilian Takeover Regulation

Before going through the regulation of control transactions in Brazil, it is important to say a few words about the ownership structure of public companies listed in the Brazilian capital market. Controlled companies have historically dominated this market. In contrast to what might be found in foreign public policies concerning the organization of large firms,[59] to a great extent, Brazilian law stimulated the concentration of private economic power. During the twentieth century and especially during the military dictatorship, the incorporation of large publicly traded companies was strongly encouraged by a public policy aimed at strengthening the national market. One of the declared purposes of

57. Klaus J. Hopt, *Comparative Company Law*, *in* THE OXFORD HANDBOOK OF COMPARATIVE LAW 1161, 1166 (Mathias Reimann & Reinhard Zimmermann eds., 2006).

58. The importance of corporate governance rules that guarantee board independence has already been highlighted elsewhere. *See* Sheila C. Neder Cerezetti, *Administradores independentes e independência dos administradores: regras societárias fundamentais ao estímulo do mercado de capitais brasileiro* [*Independent Directors and the Independence of Directors: Fundamental Corporate Rules for Stimulating the Brazilian Capital Market*], *in* TEMAS DE DIREITO SOCIETÁRIO E EMPRESARIAL CONTEMPORÂNEOS [THEMES OF CONTEMPORARY CORPORATE AND BUSINESS LAW] 571 (Marcelo V. von Adamek ed., 2010).

59. For an explanation on the American structure of large public firms, which is mainly based upon shareholders' dissociation from managers and control, see Roe, *supra* note 34.

the Corporate Law of 1976 (Law n. 6,404) was to fortify national conglomerates,[60] thereby favoring the enhancement of concentrated ownership patterns.

As a result, the governance structure of Brazilian public corporations is characterized by the presence of strong controlling shareholders, managers who are usually subservient to the controller's interests, and almost no participation of other stakeholders in business decisions.[61] Here, the historical roots and political decisions largely explain the reasons why concentrated ownership is not an exception, but the rule.

The ownership design in such terms led to a regulation of control transactions focused mainly, if not solely, on the control negotiations of controlled companies, as detailed below.[62] But the recent emergence of companies with less concentrated corporate capital has brought about the need for regulation capable of dealing with a new and quite different reality—a regulation of corporate control that is attentive to a new form of corporate ownership structure.

The response to such need, if aimed at improving the mechanisms for investor protection during control transactions, should be aware of what has already been argued here, i.e. measures that enhance investor protection in companies with a controlling shareholder, which constitute the majority in Brazil, frequently present a different level of importance than in widely held firms. At the same time, any sort of rule addressing the issue needs to consider the experience observed up to now in a system that holds a distinctive trait of private regulation, as described below.[63]

A. A State Regulation Focused On Private Negotiations Of Corporate Control

The predominance of highly concentrated companies in Brazil is reflected in the absence of rules regarding hostile takeovers. In fact, the Brazilian legal framework on control transactions is specifically designed to deal with private negotiations of previously existing corporate control.

Due to the prevalent concentrated ownership structure, in contrast to what is found in the United States or in the United Kingdom, bids do not take place before the control acquisition or as a means to it; instead, they occur as a consequence of control-transfer private deals.[64] Indeed, pursuant to Article 254-A of the Brazilian Corporate Law,[65] the transmission of shares representing the control of a public company triggers the duty to

60. The jurists responsible for writing the project of the Corporations Law, José Luiz Bulhões Pedreira and Alfredo Lamy Filho, call attention to such purpose, explaining that the law was approved under the belief that the institutionalized macro-enterprise should be officially stimulated. ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, DIREITO DAS COMPANHIAS [COMPANY LAW] 775, 796-97 (2009).

61. According to Calixto Salomão Filho, the main problem is not so much the highly concentrated ownership of Brazilian companies, but the fact that the controller is legally erected as a legitimated center of power. Calixto Salomão Filho, *Organização Interna: Estrutura Orgânica Tríplice [Internal Organization: Triple Organizational Structure]*, *in* O NOVO DIREITO SOCIETÁRIO [THE NEW CORPORATE LAW] 89, 98 (4th ed. 2011).

62. *See infra* Section III(A).

63. *See infra* Section III(C).

64. To a certain extent, this is or used to be the case in some countries of Continental Europe as well. Eddy Wymeersch, *Problems of the Regulation of Takeover Bids in Western Europe*, *in* EUROPEAN TAKEOVERS, *supra* note 48, at 95, 101-103.

65. In a free translation, the article reads as follows:

launch a bid on the remaining voting shares for at least 80 percent of the price paid for the control shares.[66] The acquirer of the control of a publicly traded company must launch a public tender offer, known as an OPA (*oferta pública de ações*), which constitutes either a condition precedent or subsequent to the transfer of control and must cover all shares with permanent voting rights that are issued by the company.

The requirement of compulsory tender offers satisfies two goals. The first is the distribution of part of the controlling premium to the minority shareholders, and the second is to provide an opportunity for investors to exit in the event that the control shift is not desirable to them.

It is worth mentioning that the mandatory bid is, in many respects, different from the one provided in the above-mentioned European Directive. The duty to launch the offer is not related to the direct or indirect acquisition of a specific percentage of voting shares but to the transmission of corporate control.[67] There is, therefore, a need for a change in the holder of the control power for the tender offer to occur. The holder of the control power is understood as a shareholder who: (i) holds the ownership of shares that permanently assure the holder of the majority of votes in shareholders' meetings and the power to elect the majority of management; and (ii) actually uses such power to direct corporate activities and to guide the operations of the company.[68] The absence of a threshold indicating the clear meaning of control power has, on one hand, the disadvantage of making the mandatory bid less predictable and of raising exalted discussions about the application of the rule.[69] On the other hand, not having a rigid standard makes it possible to embrace de facto transfers and to avoid abuses.

> "Article 254-A. The direct or indirect transfer of control of a publicly traded corporation can only be effected under the condition that the purchaser agrees to conduct a tender offer to acquire the voting shares owned by the remaining shareholders. The offer price for such shares shall be at least eighty per cent (80%) of the amount paid for the voting shares comprising the controlling block. First Paragraph. Transfer of control shall be understood as the transfer, whether direct or indirect, of shares comprising the controlling block, of shares subject to shareholders' agreements and of securities convertible into voting shares, assignment of share subscription rights and other rights related to securities convertible into shares which result in the transfer of corporate control."

For a full translation of Brazil's Corporate Law, *see The Commission*, Comissão de Valores Mobiliários [Sec. & Exchange Comm'n Brazil], www.cvm.gov.br (last visited Jan. 17, 2013).

66. In its original text, Article 254 of the Corporate Law required all minority shareholders to receive equal treatment in case of acquisition of a company's control, which means that they should be offered the same price paid for the shares representing the control. *See* Viviane Muller Prado & Bruno M. Salama, *How Are Shareholders of Listed Companies Protected in Brazil?* 7 (2008), *available at* http://www.ppge.ufrgs.br/giacomo/arquivos/gov-corp/prado-salama-2008.pdf. This rule was erased in 1997, as the government intended to facilitate control transactions of state-owned companies. *Id.* The reform of 2001 brought back the so-called tag-along rights, but restricted it to common shares and to the minimum price of 80 percent of the price paid for controlling shares. *Id.*

67. *See* Lei No. 6,404, de 15 de Dezembro de 1976, Diário Oficial da União [D.O.U.] de 17.12.1976 (Braz.).

68. *Id.* art. 116.

69. Such discussions are very usual in cases involving sales of control and the mandatory OPA in Brazil. The recurrent legal debates about the applicability of the rule to a variety of cases points to the lasting uncertainty involving the subject. The uncertainty is especially common in cases where corporate control is shared among various shareholders and one or more shareholders sell their stake. *See, e.g.*, CVM, RJ2005/4069, Diretor-Relator: Pedro Olivia Marcillo de Sousa, 11.4.2006, *available at* http://www.cvm.gov.br/port/

The broad idea of a mandatory bid rule relates to the intention of protecting non-controlling shareholders[70] by giving them the opportunity to sell their shares at the same or similar price to that paid for the controlling shares. As a consequence, the control premium is shared with the minority shareholders, who also have an opportunity to leave the company if the former presumed trustworthy controller decided to sell or transfer his power over the corporation. Therefore, the introduction of a compulsory tender offer in Brazilian law reflects a political choice that considers non-controlling shareholders as co-owners of at least a part of the premium for corporate control. It also suggests that efficiency arguments, such as the indication that mandatory offers may discourage the development of a market for corporate control, are neither the only, nor the most important concern.

But in Brazil, the mandatory bid rule refers only to the transfer of control and not its acquisition. The acquirer is not required to launch a public offer unless the control is purchased from a pre-existing controlling shareholder. Thus, investors are only protected in situations of concentrated ownership structures.

In a concentrated environment, one may understand the reasons why only a friendly sale of pre-existing control triggers a compulsory tender offer. In fact, a hostile takeover is only possible if the company does not have a stable controlling majority shareholder. Nevertheless, once the benefits of widespread ownership have been recognized, and given the existence of a movement towards dispersion, the Brazilian capital market would only benefit from a comprehensive discipline of takeovers that embraces not only transfers, but also simple acquisitions of control.

There is yet another problem in requiring the compulsory tender offer only in cases where control is acquired from a former controlling shareholder. This approach, in contrast to what may be found in Europe, does not discourage the creation or the strengthening of concentrated-ownership structures because it does not require a compulsory-tender offer when a certain significant percentage of the voting capital is acquired by a person or a group acting together. At the same time, conversely, providing for mandatory offers in terms of private regulation as described below might also contribute both to the creation of inequalities and entrenchment of controlling shareholders.[71]

In addition to the above-described regulation of friendly control acquisition transactions, Brazil's Corporate Law also provides for voluntary bids devised to obtain control of a public company.[72] The acquisition of controlling shares by voluntary public offers is not widely used, precisely because of the highly concentrated ownership structures of most of the publicly traded companies.

descol/respdecis.asp?File=4788-0.HTM; CVM, RJ 2007/7230, Director-Relator: Eli Loria, 11.7.2007, *available at* http://www.cvm.gov.br/port/infos/CopesulEli.pdf.

70. As to whether investors need to be protected, *see* Wymeersch, *supra* note 64, at 351, 356-57. *See also* Klaus J. Hopt, *American Corporate Governance Indices As Seen From a European Perspective*, 158 U. PA. L. REV. PENNUMBRA 27, 30 (2009) (commenting, from the European perspective, that European corporate law has always reflected that it is necessary to protect minority shareholders because the majority of companies have a controlling shareholder).

71. *See infra* Section III(C).

72. *See* Lei No. 6,404, de 15 de Dezembro de 1976, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976, art. 257 (Braz.).

Regulation on this topic has also been put forward by the Brazilian Securities Commission (*Comissão de Valores Mobiliários* - CVM). The CVM *Instrução* (Instruction) n. 361 dealing with control transactions was recently amended. One of the most important changes refers precisely to voluntary public offers that may be launched in an attempt to acquire control of a company. More protective rules have been approved for partial offers, which certainly represent a regulatory advancement, especially with regard to the rights of shareholders in widely held corporations.

In spite of such improvements, to date, the Brazilian legal framework is not in a position to deal with transactions over non-stable control of public companies. In fact, neither of the two most common legal techniques provided for by takeover regulations, namely, the compulsory tender offer in the event of mere acquisition (and not transfer) of the corporate control and the defensive measures, is mentioned either by Brazilian corporate law or by other public regulations.

In fact, the Brazilian system does not impose limits on the adoption of defensive measures by a target company wishing to resist a hostile takeover. Although some transactions are forbidden, such as the one that prevents the company from acquiring its own shares, their application is not restricted to cases of takeover attempts, and they are not aimed at avoiding a protective tactic by the target company. This does not mean, however, that directors are considered free to take any actions to frustrate the control shift. In Brazil, the powers granted to directors are usually not as extensive as they may be in other countries. Many measures may only be adopted through a decision taken by the shareholders, and, in any case, managers are required to act under fiduciary duties and in the strict interest of the company, although the fiduciary duties are not as strongly enforced as one might expect.[73] Similarly, Brazilian corporations do not face limitations, such as those of the so-called breakthrough rule, which neutralizes some defensive devices (restrictions on the transfers of shares and voting rights) provided in the bylaws of a target company or in shareholders' agreements.[74]

B. The Shy Movement Towards Dispersed Ownership Structures and the Prospect of Unregulated Hostile Takeovers

The existence of widely held companies in a given market opens room for hostile takeovers and asks for a normative response. Conceiving of adequate regulation involves de-

73. Modesto Carvalhosa, *The Brazilian Experience With Respect to Tender Offers*, 3 J. COMP. CORP. L. & SEC. REG. 103, 109 (1981).

74. The breakthrough rule is a measure provided by the European Directive. *Commission Staff Working Document: Report on the Implementation of the Directive on Takeover Bids*, at 7, SEC (2007) 268 (Feb. 21, 2007), *available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf. It is an optional rule, which means that the Member States may decide if they want to adopt it. *Id.* As indicated in the Report,

> the vast majority of Member States have not imposed (or are unlikely to impose) the breakthrough rule, but have made it optional for companies. Breakthrough is expected to be imposed only by the Baltic States. None of the other countries will oblige their companies to apply this provision in full. Therefore a mere 1% of listed companies in the EU will apply this rule on a mandatory basis.

Id.

ciding whether takeovers are to be incentivized,[75] hindered, or treated neutrally, while still granting adequate protection to the shareholders.[76]

Regulators in jurisdictions that are dominated by concentrated ownership structures may not disregard the arguments for and against the introduction of takeover-friendly rules when they regulate the control of a public corporation. Such takeover-friendly rules, which are aimed at promoting an active market for corporate control in a country characterized by concentrated ownership and private benefits of control, may either: (i) cause companies with a concentrated ownership to become less likely to shift to a widespread structure because the controller will not be willing to lose its benefits and leave the available control of the company in an active market for a third party to acquire it and enjoy such private benefits of control; or (ii) make concentrated ownership less attractive when a market for corporate control is in place and could help to reduce the high managerial costs of dispersed structures.[77]

Given the historical origins of Brazilian corporate law and the protection and even encouragement of concentrated ownership structures, the choice to make concentrated ownership less attractive does not seem to give hope for the future adoption of diffuse ownership. Indeed, the almost complete absence of diffusely owned public firms is not duly explained by the threat posed by the high agency costs, which are not even an object of concern given the unquestionable power exercised by controlling shareholders over the directors and officers.[78]

Due to structural features—i.e., the highly concentrated ownership structure of publicly traded companies—the simple idea of a market for corporate control could not be advocated in Brazil until recently. The threat of a hostile takeover and the mechanisms available to face it were not a matter of concern for either managers or corporate law specialists. The presence of concentrated stockholders worked as an obstruction to the occurrence of such movements. This means that, by being highly concentrated, control becomes incontestable.

75. Stimulating the market for corporate control by providing takeover instruments is one of the possible regulatory approaches. The availability of regulatory mechanisms to facilitate takeover bids is deemed beneficial by some authors. *See, e.g.*, *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, at 19, (Jan. 10, 2002), *available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf. The alleged benefits of such an approach include the exploitation of synergies by the enterprises involved, the advantages of selling the shares for more than the market price, and the removal of managers who are unable to efficiently conduct the company. *See id.*; *see also* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965) (famously praising the benefits of a market for corporate control, especially against managerial inefficiency).

76. There are many theories that argue for the benefits of the existence of a market for corporate control and the efficiencies of takeovers. *See, e.g.*, Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation*, *in* EUROPEAN TAKEOVERS, *supra* note 48, at 3 (presenting explanations for takeovers and regulatory implications). For a critical approach of policies directed at maximizing the frequency of takeovers, *see* John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984).

77. *See* Allen Ferrell, *Why Continental European Takeover Law Matters*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE, *supra* note 46, at 561, 564-65; *see also* José M. Garrido Garcia, *Company Law and Capital Markets Law*, 69 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT [RABEL J. COMP. & INT'L PRIVATE L.] 761, 774 (2005).

78. An empirical research study showed that the election of independent directors among Brazilian public companies is inversely proportional to the concentration of control. *See* Schiehll & Santos, *supra* note 3, at 378.

Thus, the corporate governance system in Brazil distinctly differs from its American or British counterparts.[79] Even when compared with systems characterized by control concentration, such as many continental European countries, the dissimilarities persist. Dissimilarities exist not only because minority stockholders are still granted good protection in such countries, in spite of the typical concentrated ownership structure,[80] but also because it is possible to identify a considerable amount of widely held companies.[81] Until 2005, there were no widely held public corporations in Brazil, and only 1 percent of publicly traded companies may be considered as widely held.[82] Given this scenario, Brazil faces very singular problems, and, instead of dealing with agency issues between managers and shareholders, Brazil's corporate law struggles against conflicts of interests and abuses involving the controller.

Considering the specifics of the Brazilian market and the extremely small number of potential targets, no public hostile offer has succeeded to date. Although there are a considerable number of listed companies and negotiations taking place on the Brazilian stock market, only a very small number of corporations may be considered an actual target of a hostile takeover.

Even though the data explains why, up to now, hostile takeover regulation has not been among the topics regulators have considered, it should not represent a barrier to further evolution of law on this matter. Given the emergence of some listed companies with widespread capital on the Brazilian market, especially in the listing segment called *Novo Mercado*,[83] there is an urgent call for discussions and regulation on this subject.

The recent market developments call for fast but well thought out responses, which can both keep up with the new reality and protect the interests of stakeholders deemed important by the Brazilian corporate governance system.

To sum up, given the near inexistence of hostile takeovers, the legal framework currently in force does not include rules related to hostile takeovers. For example, there are no rules related to the use of anti-takeover measures by the target company's board of directors or the consequences of the acquisition of a relevant amount of voting shares. This lack of regulation may have been considered reasonable until now because the mar-

79. *See generally* John Armour, Jack B. Jacobs & Curtis J. Milhaupt, A Comparative Analysis of Hostile Takeover Regimes in the US, UK and Japan (with implications for Emerging Markets) 2, 87 (Colum. L. & Econ. Working Paper No. 377, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1657953.

80. *See* Mark J. Roe, *Corporate Law's Limits*, 31 J. LEGAL STUD. 233, 257 (2002) (showing that concentrated ownership is not always a clear and sole sign of poor corporate law and bad protection of minority shareholders). *See also* Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp & Mark D. West, *Innovation in Corporate Law*, 31 J. COMP. ECON. 676 (2003) (arguing convincingly against the theory that better corporate law and minority shareholder protection is necessarily related to common law systems and presenting an analysis based on the capacity of legal systems to innovate).

81. The presence of some widely held companies led most of the Continental European countries to regulate (sometimes by self-regulation) hostile takeover attempts during the twentieth century. *See* Wymeersch, *supra* note 64. In the beginning of the 1990s, Theodor Baums reported a total of eighty widely held and traded companies in Germany. THEODOR BAUMS, TAKEOVERS VS. INSTITUTIONS IN CORPORATE GOVERNANCE IN GERMANY 2 (1992).

82. ALEXANDRE DI MICELI DA SILVEIRA, GOVERNANÇA CORPORATIVA NO BRASIL E NO MUNDO – TEORIA E PRÁTICA [CORPORATE GOVERNANCE IN BRAZIL AND THE WORLD – THEORY AND PRACTICE] 179,183 (2010) (referring to data collected in 2009).

83. *See* Gorga, *supra* note 4, at 447.

ket historically has been composed of companies with highly concentrated ownership structures, and, as such, there was no space for a market for corporate control. But considering the recent suggestions that this scenario may be changing, in addition to actual attempts of hostile takeovers,[84] an overall concept for regulating the market for corporate control becomes of crucial importance.

The functional development of Brazilian capital markets depends on a framework capable of disciplining the change of control and of ensuring investor protection in both situations. On one hand, the current alleged movement towards dispersed ownership among publicly traded companies in Brazil demands a detailed takeover regulation; on the other hand, the indisputable great majority of public companies have a controlling shareholder and should be sustained by clear rules regarding the stakeholders' rights in the event that the controller decides to sell his or her shares.

Such regulation gains even more importance if one considers the content of some provisions on anti-takeover measures recently included in the bylaws of some publicly traded Brazilian companies. The movement towards private regulation is addressed in the next section.

C. The Private Regulation of Hostile Takeovers and Its Inconsistencies

As mentioned above, private regulation has become a recurrent way of dealing with the lack of, or the limitations of, public regulation. In both transnational and domestic environments, the norm-production by private actors has both gained importance and, at the same time, raised concerns. Private regulation occurs in a variety of forms, including guidelines, codes of conduct, standardization through contracts, and organizational rules, such as corporate bylaws.

The absence of both satisfactory and timely regulation regarding takeover attempts fostered the emergence of private rules. Some companies listed on the *Novo Mercado* segment of *BM&FBovespa*[85] amended their bylaws to include anti-takeover measures currently known as "Brazilian poison-pills."[86] "Brazilian poison pills" require a tender offer to be launched for all outstanding shares whenever a certain percentage of the company's voting capital is obtained. The threshold is often set at 20 percent of the voting shares,[87] and the remaining shareholders must be offered a significant premium.[88] The obligatory payment of usually much more than the trading price of the stocks works as a

84. The famous and first case of a hostile takeover attempt in Brazil was over the control of Perdigão S.A. by its biggest competitor, Sadia S.A., in 2006. The takeover was not successful because holders of a large amount of shares did not agree with the price offered. After three years, the two companies ended up integrating their activities, but this was not due to a takeover, but an Association Agreement signed by both parties. *See* CVM, RJ2009/4691, Incorporação de ações envolvendo Companhia Aberta [Merger of Shares Involving a Listed Company], 8.6.2009, *available at* http://www.cvm.gov.br/port/descol/respdecis.asp?File=6584-1.HTM. Another well-known case refers to the acquisition of control of GVT (Holding) S.A. by Vivendi S.A. in 2009. But although there was a battle for the control, this may not be deemed a classic hostile acquisition. Actually, the former controllers of GVT agreed to sell their shares to Vivendi, which represented almost 30 percent of GVT's voting capital, and other shares were also acquired through private agreements with other groups of important investors. The Spanish group *Telefónica* tried to acquire the control through a hostile takeover attempt but failed in the face of private negotiations conducted by Vivendi.

85. For further details, *see infra* Section IV(A).

86. *See* Gorga, *supra* note 4, at 480.

87. This is the case of more than half of the companies that adopted a poison pill provision. *Id.* at 481.

relevant disincentive not only against attempts to gain control, but also against obtaining a certain level of concentration.

It is worth mentioning that such bylaw provisions were clearly influenced by the European takeover rules, which, as mentioned above, also contemplate a mandatory tender offer in the event of control attainment. This shows yet another complicated feature of some private regulatory regimes, namely, the transplantation of rules with no concern regarding their adequacy to the reality and needs of the importer country's system.

In a jurisdiction dominated by companies that are not truly widely held but have a main shareholder or group of controllers that might be easily identified, the bylaw provisions setting forth "poison pills," under the laudable argument of allegedly offering protection to ownership dispersion, are paradoxically a means to help the controllers maintain their stock positions by making any threat to their positions unreasonably expensive. In cases where the acquisition of a certain percentage does not actually mean the acquisition of corporate control—because this is detained by one or more shareholders bound through a shareholders' agreement—the mandatory bid rules serve the purpose of protecting controllers at the cost of posing disincentives to transactions that could otherwise be beneficial to both the company and its stakeholders.

This means that by privately adopting a mandatory bid rule, companies with a distinct controlling shareholder can make use of a legal device created for widely held corporations. As a consequence, instead of improving investor protection, the rule safeguards the controllers who are then shielded from the risk of losing their power over the corporation.

The scenario becomes even more disturbing if one considers that private regulation is meant to be self-preserving, in the sense that the mandatory bid provisions are accompanied by bylaws that obligate the shareholders who vote in favor of removing the mandatory bid provisions from the bylaws to launch a mandatory offer to acquire all shares issued by the company. Some investors have questioned the validity of such provisions, and, as a result, the CVM has declared that they are not aligned with the corporate law and decided that no sanctions would be applied to shareholders that fail to launch an offer after having voted to abolish the "poison pills."[89] Interestingly, since 2011, companies listed on the *Novo Mercado* have been prohibited from including in their bylaws any sort of burden on shareholders who vote in favor of eliminating the "poison pills."[90]

In light of the fact that private stipulation of "poison pills" became a relatively common practice, an attempt was made to regulate the subject under the self-regulatory means of

88. The price paid by the acquirer in such mandatory offers varies from company to company. In some of them, it might refer to a percentage of the share issuance price or of the stock market price. *See, e.g.*, Bylaws of Lojas Renner S.A., art. 43, ¶ 2 (Mar. 30, 2009), *available at* http://www.mzweb.com.br/renner/web/arquivos/EstatutoSocial_30032009_ing.pdf. In others, it might be equal to the highest stock market price during a certain period of time, the highest price paid by the acquirer at any time, or be dependent on the company's EBITDA. *See, e.g.*, By-Laws of Natura Cosméticos S.A., art. 2, ¶ 2 (Aug. 5, 2009), *available at* http://natura.infoinvest.com.br/enu/2259/EstatutoSocialConsolidado.2009.08.05.eng.pdf.

89. *See* CVM Parecer de Orientação [Legal Opinion] n. 36/2009 (Comissão de Valores Mobiliários, 29 de Junho de 2009) [Securities and Exchange Commission], June 29, 2009), *available at* www.cvm.org.br.

90. This reflects an amendment to the Novo Mercado Listing Rules, to which a majority of the listed companies agreed. *See Confira o Resultado da Proposta de Alteração Dos Regulamentos do Novo Mercado, Níveis 1 e 2* [*Check the Result of the Proposed Amendment of the Listing Rules of the Novo Mercado, Level 1 and 2*], BM&FBOVESPA, http://www.bmfbovespa.com.br/empresas/pages/100909NotA.asp (last visited Jan. 3, 2013).

the *Novo Mercado* Listing Rules.[91] But most of the companies listed on the *Novo Mercado* did not agree to amend such rules to set forth a mandatory bid in the event that a certain percentage of the voting capital was achieved.[92]

Strikingly, and a strong indication of the misuse of the mandatory bid rule by Brazilian companies with concentrated ownership structure, one case of dispute over the matter became famous when a new controlling shareholder questioned the application of the "poison pill" provision, alleging that in cases of control acquisition from a former controller, the legal mandatory bid rule, and not the one provided by the bylaws, should be respected. After having acquired the control power from a former controller, which meant the achievement of the threshold of voting shares set forth in the bylaws as triggering the mandatory bid, the new controller wanted to respect only the less burdensome rule contained in Article 254-A of the Corporate Law.[93] According to such a biased interpretation, the bylaws are not applied to cases of direct control acquisition from a former controller, but only to situations of acquisitions from multiple shareholders.[94]

The private regulation described here could be seen as an effort to adopt clear rules and to fill a lacuna caused by the lack of public ruling after an important change in the ownership structure of some Brazilian publicly traded companies. But in this case, private governance benefits a small group of shareholders involved in the delicate situation of a hostile takeover and overlooks the interests of other constituencies. The consequences of the adoption of the "poison pill" provisions show the urgency of approving a detailed takeover regulation, equally capable of dealing with both hostile and friendly acquisitions, and the need to consider all the stakeholders' interests.

When conceiving this indispensable regulation, regulators should bear in mind that the mandatory bid rule is a reasonable measure in cases of genuine ownership dispersion. When a controlling shareholder is in place, this mechanism might not always satisfactorily benefit all the company's constituencies.[95]

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91. *See id.*

92. Sixty out of ninety-three companies who voted on the subject did not agree with the inclusion of such mandatory bid rule in the Novo Mercado Listing Rules. *Id.* On the other hand, sixty-eight companies agreed that the Listing Rules should forbid bylaw rules setting forth the mandatory bid. *Id.* Given such contradictory results on the adoption of a mandatory bid rule, BM&FBovespa consulted once again the companies listed in Novo Mercado on the subject. After the new polling, the prohibition of adoption of a mandatory bid rule was not adopted in the new version of the Listing Rules. *See* BM&FBovespa anuncia resultado da retomada da audiência restrita do processo de revisão do regulamento do Novo Mercado [BM&FBovespa Announces the Results of the Resumed Hearing on the Amendment of the Listing Rules of the Novo Mercado], BM&FBOVESPA, http://www.bmfbovespa.com.br/empresas/pages/BMFBOVESPA-anuncia-resultado-da-audiencia-restrita-10-11-03.asp (last visited Jan. 17, 2013).

93. The case was brought before the Market Arbitration Panel (CAM - Câmara de Arbitragem do Mercado). *See* Yuki Yokoi, *Droga de Pílula*,76 REVISTA CAPITAL ABERTO 22, 26 (2009).

94. This is different from what derives from the Takeover Directive, which allegedly inspired the poison pill rules and whose mandatory bid rule applies in cases of hostile takeover as well as in sales of controlling blocks. Under the European rule, all sorts of acquisitions trigger the duty to launch a mandatory bid. *Cf.* Davies & Hopt, *supra* note 41, at 260.

95. For previous comments on what regulatory response could better meet Brazil's market needs and characteristics, *see* Sheila C. Neder Cerezetti, *A Aquisição de Controle de Companhias Abertas no Brasil: Por uma Disciplina Atenta às Diferentes Estruturas Acionárias [The Acquisition of Control of Public Companies in Brazil: Towards a Discipline Aware of Different Stockholding Structures]*, 1 MITTEILUNGEN DER DEUTSCH-BRASILIANISCHEN JURISTENVEREINIGUNG [GERMAN-BRAZILIAN LAWYERS ASSOCIATION] 15, 27-28 (2011).

IV. Aligning Private Regulation with the Public Interest: The Reinforcement of Best Practices of Corporate Governance by Taking the Patterns of Ownership Structure into Account

As mentioned above, private regulation plays an important role when it comes to corporate governance.[96] Some factors are believed to be important for the success of private mechanisms of regulatory governance.[97] First of all, private actors must be committed to the regulatory purposes, receive sufficient resources, enjoy institutional autonomy, and be given clear regulatory missions. Apart from these needs, public authorities must efficiently oversee the activities of the private actor and receive adequate information about them.[98] To do so, the state must have a qualified staff able to appraise the performance of private actors. It is also important that non-governmental regulators face the threat of losing their powers to the public authorities in the event of misconduct and that a degree of transparency is guaranteed, so third parties can also assess the regulatory activity.[99]

Some sort of public interaction seems, therefore, to be advantageous. Dealing with the limits of private regulation allows public regulation to convey its recognized benefits, while still keeping its shortcomings in mind.[100]

An example of a private self-regulatory measure in the Brazilian capital market serves as evidence of the importance of the above-mentioned private commitment to public regulatory goals. As detailed in the next section, the creation of a special listing segment in the *BM&FBovespa* stock exchange, the *Novo Mercado*, effectively promoted the consolidation of best practices of corporate governance and fostered investor protection. In contrast to what occurred in the case of the aforementioned takeover private regulation, the creation of the *Novo Mercado* through self-regulatory measures represents a laudable case of alignment between private regulation and the public good.

A. *Novo Mercado*: Corporate Governance Self-Regulation

The self-regulatory experience of the Brazilian capital markets is a successful example of the alignment of self-regulation with public concerns. Brazilian stock exchanges, private entities that might be incorporated as associations or corporations, are afforded self-regulatory powers to be exercised in the public interest.[101]

An interesting self-regulatory experience can be found in the case of the *BM&FBovespa* stock exchange segment called *Novo Mercado*, an institutional initiative aimed at fostering a dynamic capital market through reinforcement of best practices of corporate govern-

96. *See supra* Section III(C).

97. Edward J. Balleisen & Marc Eisner, *The Promise and Pitfalls of Co-Regulation: How Governments Can Draw on Private Governance for Public Purpose*, *in* New Perspectives on Regulation 127, 129 (David Moss & John Cisternino eds., 2009).

98. *Id.*

99. *Id*, at 120.

100. Markets do not always produce optimal outcomes. This asks for a certain degree of government regulation. *See* Joseph E. Stiglitz, *Government Failure vs. Market Failure: Principles of Regulation*, *in* Government and Markets, *supra* note 21, 13, 16-18 (Edward Balleisen & David A. Moss eds., 2010).

101. Art. 1, VI, *Regulamento, Resolução* CMN N 2.690/2000, de 28 de janeiro de 2000 [CMN Resolution No. 2690/2000, Jan. 28, 2000], *available at* https://www3.bcb.gov.br/normativo/detalharNormativo.do?N=100016877&method=detalharNormativo.

ance.[102] It was formed at the end of 2000 and is composed of companies that voluntarily commit themselves to higher standards of corporate governance and disclosure than those legally imposed both by corporate law and by regulations issued by *CVM*.[103] Although admission to the *Novo Mercado* is based upon a voluntary request by each company, once an agreement of admission is signed between the company and *BM&FBovespa*, the requirements of the listing segment are legally-binding.[104]

As is the case with other private regulatory regimes, the *Novo Mercado* was created after it became clear that the desired outcomes—in this case, the improvement of best practices of corporate governance—would not arise from legislative sources.[105] After many attempts to modify the Corporate Law to include rules that fostered investor protection and allowed the growth of the capital markets failed, the private sector decided to take initiative.[106]

Created under the assumption that stricter levels of corporate governance, reflected mainly in the one-share-one-vote rule and in requiring more information to be disclosed to the market, would advance investor interest[107] and benefit the performance of companies,[108] it has so far attracted 125 companies,[109] most of them new publicly traded companies[110] and not companies that migrated from *BM&FBovespa's* traditional listing segment.

102. BM&FBovespa, *Novo Mercado: Governança Corporativa* [*Novo Mercado: Corporate Governance*], BM&FBOVESPA, 1, 3 (2009), http://www.bmfbovespa.com.br/pt-br/a-bmfbovespa/download/Folder_Novo Mercado.pdf. Apart from *Novo Mercado* that introduces the stricter degree of best practices of corporate governance, *BM&FBovespa* carries two other listing segments of special corporate governance compliance (Level 1 and Level 2), as well as the regular *BM&FBovespa* market. *Id.* at 3.

103. *Id.* at 3-4.

104. *See id.* at 3.

105. Calixto Salomão Filho, *Structural Analysis of Corporate Law: A Developing Country Perspective*, *in* BUSINESS, MARKET, AND RESPONSIBILITY, *supra* note 31, at 1292.

106. *Id.*

107. In fact, studies show that better corporate responsibility performance leads to better access to financing. *See* Beiting Cheng, Ioannis Ioannou & George Serafeim, *Corporate Social Responsibility and Access to Finance*, STRATEGIC MARKETING J. (forthcoming), *available at* http://ssrn.com/abstract=1847085.

108. BM&FBovespa, *supra* note 102, at 3. The assumption that stricter levels of corporate governance will advance investor interest and benefit companies' performance has been deemed correct by recent studies. *See* Leandro S. S. de Oliveira & David F. L. Santos, *Desempenho e Volatilidade dos Índices de Governança Corporativa da BM&F BOVESPA* [*Performance and Volatility of the BM&FBOVESPA Indexes of Corporate Governance*], 1 REVISTA DE ADMINISTRAÇÃO, CONTABILIDADE E SUSTENTABILIDADE [J. MGMT., ACCT. & SUSTAINABILITY] 52, 52 (2011); Zoltán B. Geocze, *Níveis Diferenciados de Governança Corporativa e o Efeito Sobre o Risco de suas Ações* [*Levels of Corporate Governance and the Effect on the Risk of its Shares*], REVISTA DE FINANÇAS APLICADAS [J. APPLIED FIN.] 1, 2 (2010). *See also* Alexandre Di Miceli da Silveira, Lucas A. B. de C. Barros & Rubens Famá, *Atributos Corporativos, Qualidade da Governança Corporativa e Valor das Companhias Abertas no Brasil* [*Corporate Attributes, Corporate Governance Quality and Value of Listed Companies in Brazil*], 4 REVISTA BRASILEIRA DE FINANÇAS [BRAZILIAN J. FIN.] 1, 1 (2005) (although not based only on data related to companies listed on the *Novo Mercado*, it shows a positive and significant influence of corporate governance quality on firms' market values); Antonio G. de Carvalho & George Pennacchi, *Can a Stock Exchange Improve Corporate Behavior? Evidence from Firms' Migration to Premium Listings in Brazil* 18 J. CORP. FIN. 883 (2012) (indicating that companies listed in the special segments of *BM&FBovespa* witnessed positive abnormal returns to shareholders and an increase in the trading volume of non-voting shares).

109. In accordance with data available from BM&F Bovespa as of January 16, 2012. *Novo Mercado* [*New Market*], BM&FBOVESPA, http://www.bmfbovespa.com.br/cias-listadas/Empresas-Listadas/BuscaEmpresa Listada.aspx?indiceAba=2&seg=NM&Idioma=en-us (last updated Dec. 29, 2012, 4:08 PM).

110. Gorga, *supra* note 4, at 449.

Apart from increasing shareholder rights, such as exit rights and the amounts to be received upon exiting, the *Novo Mercado* Listing Rules require companies to accept arbitration as a conflict-resolution mechanism, which represents a faster and high-quality instrument for the investors.[111] Another distinctive feature refers to the enhancement of full disclosure, which requires companies to provide more information to the market than what is required by the Corporate Law.

The commitment to issue only voting shares, together with the duty to maintain a minimum free float of 25 percent of the capital, is believed to make it more difficult for controlling shareholders to maintain excessively high levels of ownership concentration, thereby favoring both dispersion and strengthening of the capital market.

It is interesting to note that the self-regulatory experience of the *Novo Mercado* testifies to the relevance of private regulation's effects and influence on public regulation. For example, the public norms regulating the investment activities of pension funds set forth different limits of equity investment by pension funds, which vary depending on the degree of compliance of the invested companies with the corporate governance rules.[112] The higher the acquiescence with best practice rules by the company, the higher the percentage of the pension fund's resources is authorized to be allocated to it. Companies listed on the *Novo Mercado* are so well-regarded that securities issued by them might answer for up to 75 percent of a pension fund's assets, while the securities of a public company traded in the regular *BM&FBovespa* (*i.e.*, one that duly complies with the Corporate Law and the *CVM* regulations but does not adhere to higher levels of corporate governance) may account for only 35 percent of the pension fund's portfolio value.[113]

This is a clear sign of the intersection between public and private regulation. It shows the reliance of the state on private norm-setting and illustrates its positive impact on the national regulatory framework. It leads to public awareness of the possible benefits of self-regulatory measures that take its commitment to public policies concerning the relevant regulated area seriously.

Such an experience also helps maintain the hope that an adequate and far-reaching public regulation in Brazil might follow the norm-setting generated by private actors, as was the case in the United States and the United Kingdom where self-regulatory measures created the basis for a transparent market, which afterwards was thoroughly better structured through public initiatives as well.[114]

B. Fostering the Public Interest Through a Reliable System of Corporate Governance

Given the strong role that a dependable corporate governance framework plays in the growth of the economy, social development in general, and the improvement of capital

111. BM&FBovespa, *supra* note 102.

112. *See* Resolução CMN N ° 3792/09, de 24 de Setembro de 2009 [CMN Resolution No. 3792/09, Sept. 24, 2009], *available at* https://www3.bcb.gov.br/normativo/detalharNormativo.do?method=detalharNormativo&N=109082281.

113. Resolução CMN N ° 3792/09, art. 36.

114. Coffee, Jr., *supra* note 33, at 28-29, 82 (arguing that "the past could again become prologue," meaning that the history of United States and United Kingdom could provide a hint on the advancement of market in other countries).

markets in particular, understanding the best techniques to organize a reliable system should be one of the priorities of Brazilian capital market public policy.[115]

In fact, the explicit aim of the Brazilian Corporate Law was to create the necessary legal framework for strengthening the capital market. According to the *Exposição de Motivos* (Explanatory Memorandum) of the Corporate Law,[116] the aim of advancing the capital market was to be achieved based upon the principle of investor protection.[117] A strong capital market and respect for shareholder rights are, therefore, the two pillars of the Brazilian corporate legal system.

Such a system might be organized through public and private regulation, as the granting of self-regulatory powers to the stock exchange denotes. Common to both public and private regulation must be the ability to care for the creation of institutions capable of assuring investor welfare and market credibility. Be they public or private, regulatory instruments must pay attention to the vast list of stakeholders as well as to the objectives of corporate governance regulation, which are far from being solely related to private matters.[118]

If corporate governance systems are now composed of public, private, national, and transnational norms, there is no uniform or sole set of rules regulating the subject. Considering the importance of the topic, such normative plurality might raise concerns, especially in what refers to the overall legal scheme alignment with the public interest of consolidating a trustworthy and accessible capital market.[119]

115. *See id.* at 68 (defending the protection of investor confidence as a priority of public policy, especially because the stock markets can be seen as an instrument to foster economic growth).

116. *Exposição de Motivos* [*Explanatory Memorandum*] is the document where the reasons for introducing a bill and the purposes of the bill are explained. *See Exposição de Motivos* N° 196 [Explanatory Memorandum No. 196], do Ministério da Fazenda [Ministry of Finance], 24 de Junho de 1976 [June 24, 1976], ¶ 4, *available at* http://www.cvm.gov.br/port/atos/leis/6404_Exposicao.asp.

117. In the original Portuguese, the relevant part of the *Exposição de Motivos* n.° 196 [Explanatory Memo. No. 196] read as follows:

> O Projeto visa basicamente a criar a estrutura jurídica necessária ao fortalecimento do mercado de capitais de risco no País, imprescindível à sobrevivência da empresa privada na fase atual da economia brasileira. A mobilização da poupança popular e o seu encaminhamento voluntário para o setor empresarial exigem, contudo, o estabelecimento de uma sistemática que assegure ao acionista minoritário o respeito a regras definidas e eqüitativas, as quais, sem imobilizar o empresário em suas iniciativas, ofereçam atrativos suficientes de segurança e rentabilidade.

See id.

118. The famous Berle-Dodd debate on the purpose of the public corporation indicates that while some scholars argue that the company shall solely serve the interest of shareholders (shareholder primacy theory), others believe that the corporation has a profit-making function and a social function (stakeholders' theory). For the original arguments of each of the doctrines, see A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). For an interesting critical approach of the shareholder primacy idea, see Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002). The Brazilian corporate legal system is based on the principle that the company shall be managed in the interests of a broad range of constituencies (shareholders, workers, and the community where the corporate activities are performed). This legislative option should inspire and work as a guide to all other sorts of corporate regulations.

119. For comments on the public interest in the regulation of capital markets in Brazil, *see* Sheila C. Neder Cerezetti, *Regulação do Mercado de Capitais e Desenvolvimento* [*Regulation of Capital Markets and Development*], REGULAÇÃO E DESENVOLVIMENTO [REGULATION AND DEVELOPMENT] 190 (C. Salomão Filho ed., 2012).

Indeed, the interface between private regulatory systems and state-issued law is especially challenging when it touches the public interest.[120] With reference to private regulation—including the private regulation of corporate governance—it is worth mentioning that control over its legal effects is not only related to the necessary consensus among the parties in charge of approving a new set of rules, but also to the protection of the overall interests affected by private regulation, including the broad spectrum of the public interest.[121]

A good criterion for dealing with the multiplicity of norm-setting in corporate governance might be related to the aforementioned indispensable attention to the ownership structure of the market in which regulation is to be applied as well as to the effects on the extension of investor protection that some specific governance arrangements may guarantee. This means that an essential feature of corporate governance rules, be their origin private or public, is their coherence with the patterns of the ownership structure of the market where they are to be applied.

Taking the Brazilian scenario as an illustration, it must be recognized that, in spite of very relevant structural changes, the dispersed ownership has not yet proved to be a reality. This does not mean, however, that one may undermine the presence of some widely held companies or the need for detailed studies regarding the adequate corporate governance framework to be applied to them. Consequently, the creation of regulations meant to deal with the new actors should always take into consideration the singularities of the highly concentrated corporate ownership structure common to the other players. The thoughtful consideration of the ownership structure is hence a way of aligning the norms to the two aforementioned public purposes of the corporate legal system.

The presence of widely held companies gives rise to a large number of new concerns. In the absence of a definite and constant allocation of power in the hands of one shareholder or a precise group of shareholders, the corporate system is faced with the challenge of dealing with novel subjects as well as with matters which, although already previously important, have, to date, proven difficult to address effectively. The first one, i.e., the unprecedented matters, was illustrated here by the rules on hostile takeovers, while an example of the second may be found in the mandatory election of independent directors.[122] In both cases, comparative studies are useful to shed light on areas of major concern and to provide possible responses to the questions likely to be raised in legal systems that have already faced the emergence of widely held companies.[123]

The aforementioned example of the takeover rules currently in force in Brazil speaks in favor of the relevance of taking ownership structures into account when creating corpo-

120. *See* Olaf Dilling, Martin Herberg & Gerd Winter, *Introduction: Private Accountability in a Globalising World*, *in* Responsible Business, *supra* note 9, at 1-3.

121. Glinski, *supra* note 10, at 44.

122. The rules regarding a company's management gain importance when a definite and influential controlling shareholder is no longer in place. This subject has been investigated elsewhere. *See* Cerezetti, *supra* note 58.

123. As it is now well established, there is no worldwide useful governance practice, and no absolute legal structures that could be considered adequate to every legal system. This conclusion is especially critical for comparative studies, since being unaware of it may lead to conclusions and suggestions of transplantation of legal arrangements that although useful in some countries may end up being detrimental in others. Consequently, it is not herein argued that transplantation of arrangements should be put in place, but only that one may learn from the experience of others.

rate governance rules. Indeed, as detailed in Section III(C) above, the "poison pills" private regulation is not aligned with the public interest of advancing reliable capital markets precisely because it completely disregards the specific characteristics of the Brazilian concentrated corporation environment. Instead of regulating the subject in view of this reality, the private rules in force strengthen the position of the controllers, exacerbate the unbalance and conflicts between the controlling and the minority shareholders, and promote distrust in the capital market as an investment option.

In view of these circumstances, it becomes clear that there is a misuse of the normative authority by the companies that adopted the "poison pill" rules. Any sort of takeover regulation, while trying to improve the mechanisms for investor protection during control transactions, should be aware that the measures that enhance investor protection in companies with widely held ownership are frequently not relevant, and even detrimental, if applied in jurisdictions composed of highly concentrated corporations.[124]

It should be noted that some of the countries that faced this same challenge ended up adopting rules initially designed to deal with a mainly dispersed environment. This was the case of continental Europe where the E.U. Takeover Directive corresponds, and to a large degree, to some of the British City Code rules, even though, in contrast to British listed companies, many Continental European companies have highly concentrated ownership structures.[125] This means that measures once envisaged to protect the investors of widely held corporations were embraced by dissimilar systems, which in some countries, has arguably led to undesired results, such as the entrenchment of controlling shareholders.[126] Given that the ownership patterns of Brazilian companies resemble some of their continental European counterparts, Brazil should learn from their experiences while trying to establish its own legal takeover framework.

This article has suggested that both the existing legislation *and* private regulation do not fully protect stakeholders in any of the situations described above; neither when the transaction refers to the control of controlled companies, nor when it relates to widely held firms.

Although extremely relevant, facing all aspects of public policy choices with regard to takeover attempts and suggesting regulatory paths vis-à-vis takeovers is outside the scope of this article and has already been articulated elsewhere.[127] The message to be conveyed here is that any sort of corporate governance regulation—be it public, private, or hybrid—can only be deemed accurate once it is aligned with the public interest of creating a trustworthy environment in which the broad array of interests embraced by the corporation is protected. And this purpose is much more easily achieved if the design of the corporate governance rules takes into consideration the ownership structure patterns of the place in which they are to be applied.

124. *See* Bebchuk & Hamdani, *supra* note 30, at 1263-64, 1266, 1270 (arguing that the impact of corporate governance arrangements is intimately related to the corporate ownership structure).

125. Ventoruzzo, *supra* note 30, at 168.

126. "What becomes unacceptable, however, is when rules that protect incumbents are either erroneously or intentionally presented as designed to benefit minority investors." *Id.* at 172.

127. *See* Cerezetti, *supra* note 119, at 24, 27.

V. Conclusion

The recognition of corporate governance as a consequential aspect for the provision of adequate investor protection, the development of capital markets and the economy as a whole, the fundamental differences between the governance arrangements that seem to be useful to both controlled and widely held companies, and how to deal with such matters in view of the increasing use of private regulatory measures have formed the cornerstone of this paper.

The article has tackled some of the challenges posed by a special form of regulation, namely, those created by private actors. The dissemination of public functions to private authorities, especially through the assignment—both explicit or as an effect of the lack of regulation—of law-making tasks is a move with global dimensions.

It was argued here that it is important to pay attention to corporate ownership structures, distinguishing between good governance practices for controlled and widely held firms. This was considered to be of essential significance both for public and private forms of regulation. Refusing to do so may avoid the benefits that an adequate environment of investor protection creates for the development of the capital market and the economy as a whole.

Aiming at proving this, this article has drawn on the example of takeover regulation in Brazil, in both its private and public expressions. It has shown that, although the Brazilian law disciplines both voluntary offers to the acquisition of corporate control and the consequences of a control sale, it lacks a hostile takeover rule. It was also argued here that this absence was considered as reasonable until recently because widely held companies did not exist in Brazil, consequently, hostile takeovers were impracticable. But the recent changes in the concentrated ownership scenario, which hopefully will be enlarged in the long-term, have brought about the need for an entirely new perspective on the matter, along with detailed regulation capable of dealing with companies characterized by both widespread and concentrated capital. In view of the lack of such regulation, private parties have adopted rules of their own that have become known as "Brazilian poison pills" and were, to a certain extent, inspired by the European Takeover Directive. But norms generated by private actors in this case have proved to be biased and have not worked in the best interest of advancing a reliable capital market. In fact, this conclusion derives precisely from the fact that such rules disregarded the ownership structures of the regulated companies, which were mainly concentrated, thereby reflecting arrangements created to be applied to widely held firms.

As a consequence, it has become clear that the privatization of norm-making capacities in this case, in contrast to what happened in another important self-regulatory Brazilian experience—namely, the *Novo Mercado* listing segment of the *BM&FBovespa* stock exchange—did not give rise to satisfactory outcomes, not because it was a manifestation of private regulation, but because its purposes were not aligned with the public policy that supports the regulated subject.