

Atualidades

PROXY SOLICITATION AND SHAREHOLDER DIRECTOR NOMINATIONS IN BRAZIL: A COMPARATIVE ANALYSIS OF INSTRUÇÃO CVM N. 481/2009

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Abstract

This paper analyzes Article 28 of the Instrução CVM n. 481/2009, enacted by the Brazilian Securities and Exchange Commission (CVM) on December 2009. Article 28 provides the right for shareholders to include nominees for the board of directors in the company's proxy material.

The Instrução CVM n. 481/2009 is the first rule about proxy solicitation ever enacted in Brazil. It was released after a promising trend of ownership dispersion in the Brazilian Novo Mercado, wisely spotted by the Brazilian regulatory agency.

The provision, culturally shocking for a country historically used to majority control, came to light exactly at the same time that the U.S. securities market was struggling with the SEC proposal on Facilita-

ting Shareholder Director Nomination. That proposal is still under discussion, having produced, so far, a vast and interesting debate on the subject.

Such rich material about shareholders' rights, voting and proxy soliciting, resulted in an irrecusable invitation to confront what was being elaborated on in Brazil in this regard – Article 28 of Instrução CVM n. 481/2009 – with what is being synthesized in the U.S. right at this moment.

The coincidence of momentums provides, in fact, a unique opportunity to highlight the differences between both countries' regulatory approaches and to examine the Brazilian rule in light of a much more tested proposal, looking for its weaknesses, strengths, and possible ways to optimize its application or to improve its instructions.

In this sense, Item 1 of the paper presents the current state of the Brazilian capital market, the context in which the Instrução CVM n. 481/2009 was elaborated on, the provision in Article 28, and the proposed comparative approach of this work. Item 2 analyzes and confronts the regulation of both countries, generally and specifically concerning the shareholder director nomination. Item 3 concludes the paper arguing that although the straightforwardness of the Brazilian provision may be compatible with the current stage of the country's capital market, its superficiality may result in a dangerous net of improper incentives for opportunistic investors if the trend of ownership dispersion is confirmed in the future.

1. Introduction¹

1.1 The Brazilian market: a history of concentrated control under transformation

Concentrated control is the history in Brazil and it is still reality. The vast majority of Brazilian companies is closely held and owned by an individual, or family, who is the absolute controller.

A different trend, however, may be identified among the publicly-traded corporations in the BOVESPA's Novo Mercado,² a premium segment with higher corporate governance standards.³

1. Artigo escrito como requisito para a conclusão do seminário em Direito Societário Comparado e do Mestrado em Regulação Financeira e do Mercado de Capitais da Faculdade de Direito da Universidade de Georgetown. Elaborado sob a orientação do Prof. Robert Haft e apresentado em abril de 2010.

2. The Novo Mercado, created by BOVESPA in 2002, and based on the Frankfurt's Exchange *Neuer Market*, is considered a successful self-regulation experience, attracting the majority of new IPOs in the country and unquestionably contributing to the current development of the Brazilian capital market. It started in 2002, with two issuances. In 2004, there were five additional companies in the Novo Mercado. In 2005, the total was 18. In 2006, there were 44 companies, 92 in 2007, 99 in 2008, 105 at the end of 2009, and 106 so far this year. For

Out of the 106 companies⁴ listed on the Novo Mercado, at least 65 do not have majority control. And of these companies, the largest shareholder owns on average 26.23% of the shares, which shows an unprecedented level of ownership dispersion for Brazilian standards.⁵

This is an impressive number even if compared exclusively with the universe of listed corporations, in which the largest shareholders owns on average 71% of the voting shares.⁶

The level of dispersion seen among the companies in the Novo Mercado conveys very important information because these companies, even though small in number,⁷ represent an important stake of the Brazilian market.

Their aggregated market value exceeds US\$300 billion (R\$ 544 billion) or

more information about the Novo Mercado: Maria Helena Santana, Melsa Ararat, Petra Alexandru and Burcin B. Yurtoglu, *Novo Mercado and its Followers: Case Studies in Corporate Governance Reform*, 2008, (available on www.ifc.org).

3. The companies traded in the Novo Mercado are required to have only voting shares. Preferred shares, without full voting rights, are the norm on the Brazilian capital market and still represent the majority of trading volume in the country. The prohibition of non-voting shares in the Novo Mercado is evidently one of the factors contributing to the controlling power dispersion.

4. www.bmfbovespa.com.br/empresas/boletim_empresas_janeiro10.asp#Est1.

5. For a complete picture of the ownership dispersion in the Brazilian Market: Erica Gorga, *Changing the paradigm of stock ownership from concentrated towards dispersed ownership? Evidence from Brazil and consequences for emerging countries*, available at http://scholarship.law.cornell.edu/clscops_papers/42.

6. Andre Carvalhal-da-Silva and Ricardo P. C. Leal, *Corporate Governance and Value in Brazil (and in Chile)*, available at <http://ssrn.com/abstract=76261>.

7. Brazil has more than 5 million companies or equivalent forms of business organizations in activity. Less than 0.5% are corporations (circa 25,000). Among the corporations, only 433 are publicly traded. Of the 433, 106 are in the Novo Mercado (sources: www.dnrc.gov.br; www.bmfbovespa.com.br; and www.ibge.gov.br).

23.7% of the total BOVESPA capitalization in January, 2010.⁸ That value is even more representative considering that Petrobras and Vale do Rio Doce, the two most valuable Brazilian companies, which are not traded on the Novo Mercado, together have a market value of US\$ 317 billion (R\$ 572 billion).⁹

More than a sensitive part of the country's industry, those companies are also mainly responsible for keeping the Brazilian capital market in motion. The Novo Mercado is currently the hallmark of the nation's securities market, being at one time its strongest marketing element, the place where most of the investors are turning to, and a stage on which the country's corporate personality is being defined.

It means that a trend of controlling power dispersion among the companies in the Novo Mercado is much more than a simple economic curiosity. It means that a significant part of the Brazilian corporate market is marching toward a reality that is structurally different than that by which the rest of the country's companies are surrounded.

In a nation where the corporation law is defined exclusively at a federal level, taking into account the historic patterns of its corporate environment, and where all the lawmakers and judges are culturally used to the concentration establishment, such an ownership dispersion trend puts the stability of the capital markets in line for a collision with the current legal system.¹⁰

8. www.bmfbovespa.com.br/empresas/boletim_empresas_janeiro10.asp#Est1.

9. www.bmfbovespa.com.br/informe/default.asp.

10. For an explanation of the Berle & Means concept of management control and the economic march towards the "collective capitalism", through the eyes of the Brazilian doctrine and under the influence of the country's corporate reality, see Fábio Konder Comparato and Calixto Salomão Filho, *O Poder de Controle na Sociedade Anônima*, 5th ed., pp 71-79 (see also Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Pro-*

And the issue is no longer merely theoretical.

In 2006, the Brazilian chilled and frozen food producer Sadia issued a public bid for purchasing the control directly from shareholders of its main competitor Perdigão. It was the first hostile takeover attempt in Brazil's history, made possible because, at the time, Perdigão was controlled by a group of pension funds representing 49% of the company's voting stock. The bid, however, was rejected by the minority shareholders.

Three years later, in 2009, the Spanish Telefonica issued a public bid for 100% of GVT's shares, challenging an amicable tender offer for the shares previously made by the French company Vivendi. GVT's largest shareholder had no more than 15% of the company's shares. The dispute was finally won by Vivendi, which acquired the control of GVT through a series of private agreements.

Neither case represented a major confrontation with the current legislation, mostly because of their particular outcomes.

The situation, however, has put regulators and academics on alert regarding the potential conflicts between the corporation reality and the legal system that may arise as a result of this first time ever attempt at dispersion in the Brazilian capital market.

Three main reactions, among others, can be mentioned to exemplify the fact.

First, in a recent paper, the Professor of the University of São Paulo, Eduardo Secchi Munhoz, argued that the current regulation regarding the acquisition of control in Brazil (specially Article 254-A of the Brazilian Corporation Law) works only

partly, p. XX). For a hint of the ideology and market structure surrounding the elaboration of the Brazilian Corporation Law, see Fábio Konder Comparato, "Anteprojeto de lei de sociedade por ações", in *RDM* 17/119; Fábio Konder Comparato, *Aspectos Jurídicos da Macro-Empresa*, 1970; and Alfredo Lamy Filho and José Luiz Bulhões Pedreira, *A Lei das S/A*, 3th ed., 1997.

in a concentrated market environment and has to be rethought in the face of the new reality of the nation's market. In accordance with the author, the concept of *sale of control*, which is a key element of the rule, triggering a mandatory public bid for the non-controlling shares, is not always clear in a situation of ownership dispersion.¹¹

The exactly same worry was stressed by the Securities and Exchange Commission of Brazil's (CVM's) highly commented decision in a case involving the Italian companies Telco and Olimpia, and the Brazilian company Tim. Telco acquired the control of Olimpia, which had indirect and minority control of Tim. By the majority of votes, the CVM's commissioners decided that Article 254-A did not require, in that case, a public bid by Telco (the acquisition of Tim's control) for the non-controlling Tim's shares, mainly because there was no proper *sale of control*. Of the five commissioners, however, one defended that Article 254-A is only applicable to sales of *majority* control, two defended that it must be applied to *any* sale of control, and two did not opine about the matter.

The controversy shows how intricate the difference between a legislation used to concentration and the reality of dispersion can be. And how necessary a well-defined regulation to accommodate that new reality is.

In the CVM chairwoman's own words "*the complexity of this case, the difficulty to characterize the existence or not of control, illustrates well the type of challenge that awaits us*".¹²

Second, the so called *Novo Mercado reform*, which among other modification, intends to explicitly consider the possibility of offerings and control acquisition in companies without defined controlling share-

holder. The Novo Mercado governing documents will oblige the companies adherents to accept new rules concerning acquisition of control and adoption of anti-takeover defenses that differentiate situations where there is defined control and where there is not.¹³

And third, showing exactly how well-acquitted the Brazilian regulators are about the dispersion ownership scenario, in December 2009, the CVM issued the first ever regulation about proxy solicitation in the country: the Instrução CVM n. 481/ 2009.

The new rule, enacted under the CVM regulatory power is the definitive recognition that the Brazilian legal structure can no longer avoid the market tendency of ownership pulverization.

1.2 Instrução CVM n. 481/2009: regulatory anticipation to a changing scenario

Article 126, § 2º of the Brazilian Corporation Law (Federal Law n. 6.404/1976) gives express authority to the CVM on regulating proxy solicitations.

That authority, however, had never been used until the end of 2009, more than thirty years later. Consequently, the Brazilian market has never had a specific regulation of proxy solicitation.

Since the corporate market in Brazil kept its historical patterns of ownership concentration, without any exception until recent years, the lack of a regulation on the subject has not had any important impact so far.

The new trend of ownership dispersion discussed above, however, pushed the CVM to enact the first ever rule on proxy

11. Eduardo Secchi Munhoz, *Corporate control transactions in Brazil: the case of companies without a controlling shareholder*, forthcoming.

12. CVM RJ2009/1956, 7.15.2009. Free translation.

13. The reform, which has been discussed since 2008, is in its fine tuning and final voting stages. It is expected to be approved by BOVESPA and the Novo Mercado's companies by the second half of 2010.

solicitation in Brazil. The proposal was issued for public comments in April 2009 and the final rule was announced in December of the same year.¹⁴

As it is explained in the proposal, the importance of Instrução CVM n. 481/2009 rises *"as long as companies composed exclusively by voting shares, and in most cases without a majority controller, emerge in Brazil"*.¹⁵

In this sense, the declared goal of the new rule is *"to create a simple framework able to lower the cost of voting and to facilitate the shareholder participation on the corporation's business oversight"*.¹⁶

The Instrução CVM n. 481/2009 binds only the corporations that are or should be registered before the CVM. In other words, the vast majority of Brazilian companies, which have no intention of having their securities publicly traded, are not subject to the new proxy solicitation regulation.

It covers, therefore, exactly the environment where the tendency toward pulverization of control and ownership is concrete. It serves also as a path to an eventual amendment to the Brazilian Corporation Law regulating proxy solicitation for Brazilian closely-held corporations.¹⁷

14. Besides proxy solicitation, the new CVM rule also regulates disclosure regarding the shareholders' meetings (procedures, documents and information that have to be presented to shareholders, forms and schedules to be filled in, in accordance with each proposal to be voted upon etc.).

15. *Edital de Audiência Pública* n. 02/2009, p. 1. Free translation.

16. *Edital de Audiência Pública* n. 02/2009, p. 1. Free translation.

17. It is another example of what is being called as *regulatory dualism*. The unique reality is the Novo Mercado pushed for a modern regulation on proxy solicitation, even though more than 99% of the Brazilian companies have not and will probably never will have any significant level of ownership dispersion. Regulatory dualism analyzing the Novo Mercado experience is discussed in: Ronald J. Gilson, Henry Hansmann and Mariana Pargendler, *Regulatory dualism as a development strategy: cor-*

1.3 Article 28 of Instrução CVM n. 481/2009 and the shareholders' right to indicate directors

Article 28 of the new CVM rule expressly requires the inclusion in the company's proxy solicitation material of nominees to the board of directors indicated by minority shareholders owning at least 0.5% of the totality of the company's shares.¹⁸

There was no precedent or direct legal basis for the new requirement other than the principles that all shareholders may indicate nominees to the board of directors, and that a corporate decision through proxy material has to be as close as possible to a shareholder meeting.

The provision seems to have been very well accepted by the market, having had no significant objection raised against it so far. By the same token, however, there has also been no extensive public discussion about the matter.

This apparent indifference regarding Article 28 may be explained by the mere inexperience of Brazilian companies with dispersed control, shareholders' activism, and proxy fights. It means that a more aware reflection about the rule will probably be made in the next few years, when the effects and possible limitations of Article 28 that had not been anticipated during the public discussion will be practically felt.

Such a sensitive provision will hardly be free of criticism when in full operation, especially, if the tendency toward control pulverization is confirmed in Brazil.

A very good reason to believe that some future discussion about Article 28 is indeed inevitable, can be drawn from a quick look at the extensiveness of the public discussion about the exact same subject brought about by the 2009 SEC Propo-

porate reform in Brazil, the U.S., and the EU, available at SSRN: <http://ssrn.com/abstract=1541226>.

18. Article 28 also regulates the right to indicate members to the company's audit committee.

sal on Facilitating Shareholder Director Nomination.

Confronting Article 28 of Instrução CVM n. 481/2009 with the SEC's proposal and all the discussion surrounding it may thus be useful in anticipating potential weaknesses (or spotting efficient regulatory achievements) of the Brazilian provision, borrowing empirical experience about proxy solicitation and bringing it to a reality that has not yet been concretely introduced to the matter.

1.4 *The SEC's proposed rule on facilitating shareholder director nomination: a comparative approach*

In June 2009, the SEC issued for public comments a new proposal on facilitating shareholder nomination through proxy solicitation (Releases ns. 33-9046, 34-60089, IC-28765, File n. S7-10-09, 74 FR 29024). The period for comments was reopened in December of the same year.

A flow of comments was received from every sector of the society, and the proposal is being largely discussed by interested groups. It is uncertain when and whether it will be enacted, since the political struggle for its approval grows each day.

Included in the package of reforms on the financial sector regulation, and with analogous provision being attempted on federal bills,¹⁹ the proposal is facing resistance from several business groups, worried about the potential effects of enhancing shareholder access to the board of directors.

The main political goal of the proposal is indeed to help strengthen the over-

sight of companies' boards, in reaction to the confidence crisis generated during the recent financial struggle.²⁰

As it is stated in the proposal's release, *"the Commission has determined to revisit whether and how the federal proxy rules may be impeding the ability of shareholders to hold boards accountable through the exercise of their fundamental right to nominate and elect members to company boards of directors"*.²¹

Immediately, the SEC *"focused on removing burdens that the federal proxy process currently places on the ability of shareholders to exercise the basic rights to nominate and elect directors"* and promised to *"improve the proxy process so that it functions, as nearly as possible, as a replacement for an in-person meeting of shareholders"*.²²

Based on public comments received in the solicitation of public input, the SEC concluded that shareholders currently face significant obstacles to efficiently exercise their right to indicate and vote for a board of directors. And, in accordance to which, suggest those same inputs: *"including shareholder nominees for director in company proxy materials would be the most direct and effective method of facilitating shareholders' rights in connection with the nomination and election of directors"*.²³

The proposal, therefore, is *"intended to remove impediments to shareholders' ability to participate meaningfully in the nomination and election of directors, to promote the exercise of shareholders' rights to nominate and elect directors, to*

19. See: "Proxy plan roils talks on finance rules", *The Wall Street Journal*, 3.17.2010, p. A2. The proposal is reflected on the financial reform bill in discussion by the U.S. Congress. The SEC proposal will likely be reserved until a conclusion is reached by Congress on the topic and regarding general reform on the financial sector. That conclusion is hoped to furnish SEC with more legitimacy to face the sure to be made allegations of its lack of regulatory power to enact the rule.

20. "This crisis has led many to raise serious concerns about the accountability and responsiveness of some companies and boards of directors to the interests of shareholders, and has resulted in a loss of investor confidence." SEC Release n. 33-9046, p. 7. See also Andrea Beltratti and René M. Stulz, *Why did some banks perform better during the credit crisis? A cross-country study of the impact of governance and regulation*, available at <http://ssrn.com/abstract=1433502>.

21. SEC Release n. 33-9046, p. 7.

22. SEC Release n. 33-9046, pp. 13-14.

23. SEC Release n. 33-9046, p. 31.

open up communication between a company and its shareholders, and to provide shareholders with better information to make an informed voting decision by requiring disclosure about the nominating shareholder or group, as well as nominees for director submitted by a nominating shareholder or group".²⁴

It is proposed to be implemented through new rules (especially Rule 14a-11) and amendments to current rules, schedules and forms, especially Rule 14a-8(i)(8).

The new Rule 14a-11 would require companies to include in their proxy materials nominees for director indicated by a shareholder or group of shareholders achieving minimum thresholds of participation and long term commitment to the company, with no intent to change control, and along with a high level of related disclosure about both the indication and the nominee.²⁵

Rule 14a-8(i)(8), normally referred to as the "election exclusion", would be amended in order to *"enable shareholders to submit proposal that would amend, or that request an amendment to, a company's governing documents"*²⁶ regarding nomination procedures or disclosures related to shareholder nominations, provided the proposal does not conflict with proposed Rule 14a-11. As proposed, revised Rule 14a-8(i)(8) would not restrict the types of

amendments that a shareholder could propose to a company's governing documents regarding nomination procedures or disclosures related to shareholder nominations, although any such proposals that conflict with proposed Rule 14a-11 or state law could be excluded".²⁷

The amendment would end the uncertainty related to the interpretation of the current provision on Rule 14a-8(i)(8), which today, in the SEC's view, permits the exclusion by the company, from its proxy material, of a shareholder proposal that would establish a procedure that may result in contested elections.²⁸

Other rules and amendments were also proposed, to complement and reflect the provisions on the new Rule 14a-11 and on the new text of Rule 14a-8(i)(8). Among those, the new rules 14a-18, 14a-19, 14n-1, and the amendments to the Schedule 14A, and form 8-k.²⁹

It is a proposal, in conclusion, that adds one additional step to the SEC's continuous process of adapting the proxy regulation to the dynamic corporate reality. It is summed up with, and benefits from the discussions raised by, the 2003 and 2007 proposals on the same subject, as well as the recent new rules and amendments on proxy internet availability of proxy material and on proxy disclosure and solicitation enhancements.³⁰

24. SEC Release n. 33-9046, p. 202. In short, the anticipated benefits of the proposal would be "(1) a reduction in the cost to shareholder of soliciting votes in support of a nominated candidate for election to the board of directors; (2) improved disclosure of shareholder nominated director candidates; (3) potential improved board performance; and (4) enhanced ability for shareholders and companies to adopt their preferred shareholder nomination procedure". SEC Release n. 33-9046, p. 183.

25. SEC Release n. 33-9046, especially pp. 31-32, 43, 52, 53, 62, 147, 151, 177.

26. By company's governing documents the release means the company's charter, articles of incorporation, certificate of incorporation, and/or bylaws, as applicable, in accordance with state law.

27. SEC Release n. 33-9046, p. 158-159.

28. See SEC Election of Directors Adopting Release; SEC Release n. 33-9046, p. 23-24; and *American Federation of State, County and Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006), case that limited to a certain degree the SEC's interpretation of Rule 14a-8(i)(8). See also comments on the American Federation case at John C. Coffee Jr., Joel Seligman and Hillary A. Sale, *Securities Regulation: Cases and Materials*, 10th ed., p. 92.

29. SEC Release n. 33-9046, pp. 127, 135, 138, 142, 143, 170, 210-250.

30. See www.sec.gov/spotlight/proxymatters.shtml for the recent new rules and amendments; and SEC Release n. 33-9046, pp. 15, 19, 23, 33, 34, 37,

It is also, in consequence, a proposal preceded by an in-depth and extensive public reflection, covering a vast range of related issues. Exploring the records and the outcome of this process to analyze the recently released Brazilian provision on the same matter is an extraordinary chance for useful comparative legal examination.

That comparison is precisely the subject of this paper.

In the following items, the fundamental differences between the Brazilian and the U.S. systems will be introduced, and the key elements of each country's approach to the regulation of shareholder director nomination will be examined in detail.

2. Analysis

2.1 Brazil and U.S.: fundamental differences regarding proxy solicitation

In general terms, most of the conclusions obtained from the discussions about the SEC proposal on facilitating shareholder director nomination can be applied for purposes of optimizing the CVM rule on the same subject.

However, it is necessary to keep in mind some relevant differences between both corporate realities that can affect the accuracy of the suggested comparison.

First, even if limited to the Novo Mercado, the corporate control in Brazil is much more concentrated than in the U.S. The U.S. market is essentially a dispersed market, with all its culture and legislation having been built on the dispersed assumption. The opposite happened in Brazil.³¹

for brief comments on the 2003 and 2007 proposals.

31. For an introduction to the voting system in the U.S. see Robert Charles Clark, *Corporate Law*, pp. 357-400; James D. Cox and Thomas Lee Hazen, *Corporations*, 2nd ed., pp. 336-381; and John C. Coffee Jr., Joel Seligman and Hillary A. Sale, *Securities Regulation: Cases and Materials*, 10th ed., op.

The rule in the U.S. is the use of proxy rather than in-person vote casting. And normally only through proxy it is possible to achieve certain required quorums, making possible essential corporation decision taking.

As a result, all corporate and legal cultures in the U.S. have the dispersed scenario and the proxy mechanism as the default.³² In Brazil, dealing with the necessity of giving voice to a diffuse base of shareholders is not only a new regulatory challenge, but also a shock to the corporate culture. Thinking about regulating proxy solicitation in Brazil requires taking into consideration that controllers are used to controlling alone, that legislation was designed to concentrate control, and that minority shareholders have no experience in making themselves heard in boardrooms.

Another collateral effect of a dispersed ownership market is the improved role of management in controlling the company. In the U.S., management is an active player both in the internal and external aspects of the company's decisions. The

cit., pp. 1.210-1.255. For more specific analysis see, for example, Frank Easterbrook and Daniel R. Fischel, "Voting in corporate law", in *Journal of Law and Economics*, vol. 36, n. 2, p. 395; Frank Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law*, pp. 63-89; and John Pound, "Proxy contests and the efficiency of shareholder oversight", in Roberta Romano, *Foundations of Corporate Law*, pp. 197-206. For a background on the SEC statutes and on the formation of the U.S. federal securities regulation, see Louis Loss, Joel Seligman and Troy Paredes, *Fundamentals of Securities Regulation*, 5th ed., pp. 1-21. And for a glance at the voting system on European jurisdiction, see, for example, Maurice Cozian et al., *Droit des Sociétés*, 18th ed., pp. 312-325, for France; Francesco Galgano, *Diritto Commerciale - Le Società*, 16th ed., 281-285, for Italy; Antônio Menezes Cordeiro, *Manual de Direito das Sociedades*, vols. 1 e 2, pp. 609-610, for Portugal; and Herbert Wiedemann, *Gesellschaftsrecht I - Grundlagen*, 1980.

32. For an economic and political analysis of the U.S. structure of corporate ownership and its consequences, see Mark J. Roe, *Strong Managers Weak Owners - The Political Roots of American Corporate Finance*, Princeton University Press, Princeton, 1994.

company is normally the management. In Brazil, the company is the controlling shareholder. And the management often is not more than a controller's *alter ego*.

In Brazil, the tendency toward dispersion will also demand reflection on the management role and on related legislation. Together with the examination of the proxy solicitation process, attention has also to be deferred to the rules governing management responsibility.³³ For the first time, management will achieve such a level of independency, and, for better and for worse, there will not be a distinct controlling shareholder to both choose and closely oversee management.

In terms of enforcement, Brazil and the U.S. are also very different. In short, enforcement in Brazil is not as clear a threat against misconduct as it is in the U.S. Some level of slowness, low quality, and corruption in the judicial enforcement has to be added to the Brazilian equation. Fraud and liability in the U.S. securities markets, even though sometimes controversial, conceptually complex, and abusively explored, are infinitely ahead of the enforcement efforts in Brazil.

Mitigating the effects of the relatively unreliable enforcement structure in Brazil, especially in cases of complex corporate litigation, is the fact that all companies listed in the Novo Mercado (and shareholders) have to expressly consent to submit all litigation involving the company and its shareholders to a highly specialized arbitral body maintained by BOVESPA (*Câmara de Arbitragem do Mercado – CAM*).³⁴

33. For a complete overview of the current Brazilian framework on management liability, see Marcelo Vieira von Adamek, *Responsabilidade Civil dos Administradores de S/A e as Ações Correlatas*, 2009. For a view on the U.S. system of management duties and liabilities see, for example, James D. Cox and Thomas Lee Hazen, *Corporations*, op. cit., pp. 183-220.

34. Even though there is no doubt that the companies and management are bound by the Novo Mer-

Costs of proxy procedures in the U.S. are normally incurred by the proponent. It means that, with some exceptions, management proxy material is paid from corporate funds, and opponent or individual proxy material is paid by the shareholder. There had been no rule about this in Brazil until the release of Instrução CVM n. 481/2009. And there is no significant practice on proxy solicitation so far. The new CVM rule, however, establishes as default that the costs incurred with proxy solicitation by shareholders must be reimbursed by the company, subject to certain minimum requirements, especially participation representativeness and level of approval of the proposals.

Shifting the costs burden can provoke very important outcomes. How the regulatory option concerning the proxy solicitation expenses will impact the Brazilian corporate market is a matter to be closely observed.

In Brazil there is a similar mechanism to the U.S. plurality vote. However, the much more concentrated market has made the *voto múltiplo*³⁵ mechanism nothing more than a pure minority right to representation on the board. The legislation itself recognizes the predominance of the concentration culture, assuring the majority of the board to shareholders or group of shareholders with more than 50% of the voting shares.³⁶ The tendency of dispersion will put under probation the efficacy and

cado's requisite for listing, it is questionable whether the shareholders can be automatically bound by the arbitrage clause on the company's bylaws simply by acquiring a share. The arbitrage may be much more efficient, but also may represent higher costs for shareholders. See Taissa Macafferri Licatti, "Novo Mercado: influência e aspectos relacionados à inserção da cláusula compromissória arbitral nos estatutos sociais", in Haroldo Malheiros Duclerc Verçosa (org.), *Aspectos da Arbitragem Institucional – 12 Anos da Lei 9.307/1996*, p. 233-279.

35. Article 141 of the Brazilian Corporation Law.

36. Article 141, § 7º, of the Brazilian Corporation Law.

the limits of the related Brazilian provisions.

Concerning internal laws conflicts, Brazil has as an advantage over the U.S. by the fact that the corporation law is under the centralized responsibility of the Federal Government. There is no significant corporation or securities legislation at the States' level. It makes the regulation easier and clearer.

Finally, the SEC proposal applies to most of the U.S. mutual funds (investment companies).³⁷ The CVM's new rule does not touch on mutual funds matters.

These are the general differences between both countries in this particular respect. The following item examines this, focusing on the main elements of the proxy solicitation legal framework.

2.2 The shareholders' right to indicate nominees to the board of director

The right to indicate directors, and to submit proposals to be deliberated by the shareholders' meeting, seems to be unanimously recognized in both Brazilian and U.S. jurisdictions.

In the U.S., state law implies the rights to indicate directors and submit proposals, as a right derived from the shareholders' right to vote, monitor, and participate.³⁸ Federal securities law expressly regulates, and limits, the shareholders' right to indicate directors and to submit pro-

posals.³⁹ And case law determines both the existence and the utility of the right to indicate directors and submit proposals.⁴⁰

In Brazil, the right to indicate directors and to submit proposals is little more than a practically accepted principle. Assuring the right of all shareholders to propose whatever they think may be positive to the company not only is coherent with the set of shareholders essential rights, but also is recommended in any human project proposing common advancement.

Nevertheless, despite common sense, the right to indicate directors became expressed only with the enactment of the Ins-

39. Especially Section 14 of the 1934 Act and related Rules.

40. *Durkin v. National Bank of Olyphant*, 772 F.2d 55, 59 (3d Cir. 1985): "We rest our holding as well on the common sense notion that the unadorned right to cast a ballot in a contest for office, a vehicle for participatory decision-making and the exercise of choice, is meaningless without the right to participate in selecting the contestants. As the nominating process circumscribes the range of the choice to be made, it is a fundamental and outcome-determinative step in the election of officeholders. To allow for voting while maintaining a closed candidate selection process thus renders the former an empty exercise. This is as true in the corporate suffrage context as it is in civic elections, where federal law recognizes that access to the candidate selection process is a component of constitutionally-mandated voting rights. See *United States v. Classic*, 313 U.S. 299, 316-317, 61 S.Ct. 1031, 1038, 85 L.Ed. 1368 (1941) (article I, section 2 right to choose congressional representatives includes the right to participate in primary elections); *Smith v. Allwright*, 321 U.S. 649, 661-662, 64 S.Ct. 757, 763-64, 88 L.Ed. 987 (1944) (15th amendment prohibition of race-based abridgement of voting rights applies to primary as well as general elections). Banks do not exist for the purpose of creating an aristocracy of directors and officers who can continue in office indefinitely, immune from the wishes of the shareholder-owners of the corporation. And there is no more justification for precluding shareholders from nominating candidates for their board of directors than there would be for public officials to deny citizens the right to vote because of their race, poverty or sex. Cf. U.S. Const. amends. XV, XXIV, and XIX."; and *Hubbard v. Hollywood Park Realty Enterprises, Inc.*, 1991 Del. Ch. LEXIS 9 (Del. Ch. Jan. 14, 1991).

37. See SEC Release n. 33-9046, p. 32.

38. About the structures concerning the vote and the right to vote in modern corporations, see, for example, Tullio Ascarelli, "Sui poteri della maggioranza nella società per azioni ed alcuni loro limiti", in *Rivista di Diritto Commerciale*, p. 169; Francesco Galgano, *La Forza del Numero e la Legge della Ragione. Storia del Principio di Maggioranza*; Georges Ripert, *Aspects Juridiques du Capitalisme Moderne*, 2th ed., p. 96; Roberto Sacchi, "L'intervento e il voto nell'assemblea della s.p.a. - Profili procedurali", in *Il Diritto Attuale*, n. 9, 1990; and Henry Hansmann, *The Ownership of Enterprise*, pp. 39-43.

trução CVM n. 481/2009 (which applies only to listed companies). The same rule implies the right to submit general proposals to the shareholders' meeting but is not crystal clear in that respect and does not say anything about including shareholders' proposals within the management proxy material.⁴¹

The Brazilian Corporation Law does not regulate director nomination or shareholders' proposals. Articles 130, § 1º, a, 124, § 5º, II, 123, c, and 125, imply the right to submit proposals for deliberation, but are not clear about the matter, and probably refer only to in-person proposals. Although it is also common sense that a proposal can be included within the deliberations if approved by the shareholders present at the meeting, there is no provision in the Brazilian Corporation Law directly corroborating it. On the contrary: Articles 124, and 159, § 1º, establish as a default that only matters previously included on the meeting agenda, or related subjects, can be voted on. Articles 161, § 3º, and 164 are exceptions specified by the law, which confirm the rule. And in all cases, the documents related to the matters to be voted have to be previously made available to the shareholders (Articles 133, and 135, § 3º).

Naturally, all the obligations concerning disclosure of documents and previous knowledge of the matters to be voted on during the meetings are unquestionably useful corporate governance requirements. However, the lack of a specific regulation on shareholders' proposals leaves room for biased interpretations of those provisions, opening a dangerous loophole in the Brazilian Corporation legislation.

Fortunately, thanks to the new CVM's ruling, at least the process of director nomination is already clearer. Its specific requirements will be dealt with, and compared to those of the SEC proposal, in the next item.

2.3 Requirements

Both the SEC proposal and the CVM rule have similar principles and goals sustaining them, concerning the shareholder's right to indicate directors. However, the SEC proposal is considerably more specific and detailed. The Brazilian provision is limited to one section, while the SEC thought about, discussed, and built a couple of rules on it and several amendments to the U.S. securities regulation. Since the reality in the Brazilian Market in fact does not justify a longer and more expensive regulation on the subject, learning from the current U.S. experience may prove to be a very convenient way to evaluate the Instrução CVM n. 481/2009 and eventually optimize its application.

The present item and the following, therefore, will analyze and compare both countries' main requirements and elements of the shareholder director nomination procedure, using the more specific U.S. ones as a guide to the examination.

Beginning with the requirements, the objective of this section, the SEC proposal basically requires that the shareholder proposing a nominee has a minimum ownership level and certain holding period of their shares before and after the nomination; that the correct procedure and deadlines are met; that the shareholder's intention is not to pursue the control; that there is disclosure of related information from both the shareholder and the company; that the nominee meet all its own requirements; and that the limited number of nominees be respected.

The similarities or disparities with the Brazilian rule will be treated on the following sub-items.

a) Minimum Ownership Level

Paragraph (b)(1)(i) to (iii) of the proposed Rule 14a-11 disposes that, in order to be eligible to indicate a nominee, "[t]he

41. Instrução CVM n. 481/2009, Articles 28 and 32.

shareholder individually, or the shareholder group in the aggregate, must beneficially own 1% to 5% *"of the registrant's securities that are entitled to be voted in the election of directors"*, depending on the nature of the issuer, in accordance with the definitions on Rule 12b-2.

Large accelerated filers must own at least 1% of the issuer's securities entitled to be voted. Accelerated filers must own at least 3%. And non-accelerated filers must own at least 5%.⁴²

In Brazil, the minimum participation required is 0.5% of the total number of shares issued by the company, whether with voting capacity or not, whether in circulation or not. There is no differentiation by size or type of issuer.⁴³

The differentiation would not have been strange for the Brazilian regulation, since the CVM had already considered the nature of the issuer to apply different rules regarding registration and disclosure in the Instrução CVM n. 480/2009, and the Instrução CVM n. 165/1991 requires different minimum levels of ownership for different sizes of companies in order to require the utilization of plurality vote.

The 0.5% threshold is mentioned in Article 126, § 3º, of the Brazilian Corporation Law as the minimum ownership level to legitimize a shareholder to request the shareholder's list for purposes of proxy so-

licitation. Since it is the only clue the Brazilian Corporation Law gives about the subject, adopting that threshold was the easiest solution for the CVM to avoid further complications regarding the search for the ideal level of representativeness and, even more so, concerning the justification in terms of regulatory power to establish a certain level.

It is true that a requirement of a 0.5% participation for every company is simpler and provides huge access to minority shareholders. It is hard to know, however, whether that is the correct number for the entire market, especially when comparing to the U.S., which requires higher levels of ownership in a much more dispersed market.

Both countries provide that the threshold may be achieved either by an individual shareholder or by a group of shareholders. The SEC proposed provision 14a-11(b)(1) is specific: *"the shareholder individually, or the shareholder group in the aggregate"*. Thus it is Article 28 of the CVM rule:⁴⁴ *"nominees indicated by shareholders representing, at the minimum, 0.5% (...)"*.

In the U.S. case, communications needed to form the shareholders group, in connection with Rule 14a-11, are proposed to be exempt from the definition of proxy solicitation (Rule 14a-2(b)(2)).

In accordance with Article 22, III, of the CVM rule those communications will be considered proxy solicitation if addressed to more than 10 shareholders. That is, at least, the only interpretation made possible from the rule's text. It is not clear, however, whether the rule was designed to regulate that situation. Possibly it was not. And the definition whether certain communications needed in order to aggregate the minimum 0.5% of shares will be considered proxy solicitation or not, triggering

42. For the researches supporting the thresholds chosen and related justifications, see SEC Release n. 33-9046, pp. 46, 57, and 151. For the differences regarding the 2003 proposal, especially the decision to not have a triggering event, see SEC Release n. 33-9046, p. 33.

43. The percentile adopted was much discussed during the period of the rule's public comments. Most of the commentators agreed with 0.5%, but others, including the U.S. proxy advisory Glass Lewis suggested increasing the minimum level of ownership. It was mentioned, for example, the Instrução CVM n. 358/2002 which consider 5% as a threshold for purposes of ownership disclosure (equivalent to the Exchange Act §§ 13(d) and 13(g)). See *Relatório de Análise - Audiência Pública* n. 02/2009.

44. Even though Article 126, § 3º, of the Brazilian Corporation Law seems to be restricted to an individual shareholder.

the obligation to be extended to all shareholders, will be left to future administrative interpretations or amendments.

b) *Duration of Ownership*

Rule 14a-11(b)(2), as proposed, requires that “[t]he shareholder or each member of the shareholder group must have held the securities that are used for purposes of determining the applicable ownership threshold (...) continuously for at least one year as of the date it provides notice to the registrant [regarding the indication] on Schedule 14N and intend to continue to hold those securities through the date of the subject election of directors”.

The requirement expressly reserves the prerogative of indicating directors to long-term shareholders, since they are “more likely to have interests that are better aligned with other shareholders and are less likely to use the rule solely for short-term gain”.⁴⁵

The CVM rules does not require any holding period. It seems to be a weakness in the Brazilian rule, since it unnecessarily gives room to abusive minority shareholders practices. The sum of the low ownership requirement with no holding period asked may lead to undesired campaigns captained by opportunistic shareholders.

And the holding period requirement is not an uncommon requirement for the Brazilian Corporation law. Its Article 141, § 6º, requires a minimum of three uninterrupted months of ownership before the shareholders meeting by a shareholder willing to participate in a separate election for the board of directors, granted to minority shareholders by § 4º of the same provision. The same requisite could have been transplanted to the CVM rule without additional costs or risks of exceeding regulatory power.

45. SEC Release n. 33-9046, p. 33, p. 50.

c) *Purpose of Ownership*

In the U.S. case, the nomination procedures regulated by the proposed Rule 14a-11 are available only to shareholders that have not acquired or held the securities “for the purpose of or with the effect of changing control of the company or to gain more than a limited number of seats on the board”.⁴⁶

The provision aims to limit the right in Rule 14a-11 exclusively to minority shareholders and to avoid its misuse in proxy contests for control. The provision intends also to avoid that the company – therefore all the shareholders – pay for the costs of one shareholder or group of shareholders pursuing control.⁴⁷

No similar provision exists in the CVM rule. It means that any shareholder may use the unique proxy solicitation process to achieve or affect the company’s control or the majority on the board, benefiting from the right to include nominees in the management proxy material and from the reimbursement rights.

d) *Nominee’s Requirements*

Both the SEC and the CVM rules determine that the nominee must meet the requirement imposed by general corporation laws, SRO’s regulations, and the company’s governing documents. They not impose any particular requirement. The SEC rules expressly and the CVM rules by omission.

The recurrent requirements of independence, common in the U.S. and in Brazil, especially under the Novo Mercado regulation, are probably the most important standards to be observed in either case.

Naturally, the nominee indicated by minority shareholders will occupy one of the spots reserved or required to be filled

46. SEC Release n. 33-9046, p. 52.

47. See SEC Release n. 33-9046, p. 75. For contested elections other rules apply.

by an independent director. In other words, the election of a director through the proxy process will not imply that the controlling shareholder will have to lose one of his "non-independent" spots.

Accordingly, *"a nominating shareholder will not be deemed an 'affiliate' of the company (...) solely as result of nominating a director or soliciting for the election of such a director nominee or against a company nominee pursuant to Rule 14a-11"*.⁴⁸

e) Maximum Number of Nominees

The nomination through the process of Rule 14a-11 is a right of all shareholders not willing to take or change control. This right, however, comprises the indication of nominees to fill only one or a limited number of spots on the board of directors.

In accordance to the paragraph (d) of the proposed rule, *"[t]he registrant will not be required to include in its proxy statement and form of proxy more than one shareholder nominee or the number of nominees that represents 25 percent of the registrant's board of directors, whichever is greater"*.

Since the right is for all, but the spots are limited, the rule addresses situations where more than one shareholder or group would be eligible to indicate nominees, establishing that *"the registrant shall include in the proxy statement and form of proxy the nominee or nominees of the first nominating shareholder or nominating shareholder group from which the registrant receives timely notice"*. Where the first nominating shareholder or group *"does not nominate the maximum number of directors required to be included by the registrant, the nominee or nominees of the next nominating shareholder or nominating shareholder group from which the registrant receives timely notice (...) would be*

included in the registrant's proxy materials, up to and including the total number required to be included by the registrant" (14a-11(d)(3)).⁴⁹

And in case the company has a director indicated through the 14a-11 procedures already serving on the board and his term extends past the date of the new election, shareholders will have the right to indicate only a number of directors that, summed to the one already serving, will not surpass the limit determined by the rule.

Diversely, the CVM rule does not impose any limit on the number of indication through the Article 28 proxy procedures. Any shareholder or group of shareholders eligible can include his or their nominees and all indicated nominees will be included on the company's proxy material.

By not providing anything in that respect, it is possible to conclude that the rule also permits more than one indication by shareholder or group, or as many indications as spots on the board to be filled.

The Brazilian Corporation Law provision that warrants separated elections to minority groups for limited spots on the board of directors or audit committee, such as Article 141, § 4º, and Article 161, § 4º, cannot be used as limits to the permissive right to indicate nominees as now regulated by Instrução CVM n. 481/2009. The way that the Article 28 of the CVM rule was written clearly distinguishes the right to indicate from the right to elect separately, and poses no numerical limit to the indications.

In one sense the CVM rule, as it can be read currently, has great advantages over the U.S. proposed rule: it unquestionably provides full access of shareholders to the nomination and full similarity to a shareholder meeting.

However, it seems to be an advantage resulting more from superficiality of the

48. SEC Release n. 33-9046, p. 33, p. 70.

49. See also SEC Release n. 33-9046, pp. 74-80, and 192.

rule than from actual regulatory planning. Although it is understandable that the rule does not go further into details regarding the limits of the indications, since the Brazilian market is still discovering what proxy solicitation means, the incompleteness of the provision may reveal itself dangerous and very costly to the companies in case the utilization of proxy in Brazil marches faster than the regulatory framework is expecting it to.

f) *General disclosure*

Brazil and the U.S. require a high level of disclosure from the nominating shareholders during the process of indicating directors through proxy solicitation.

The proposed provisions in the SEC Rules, especially 14a-11, 14a-18, 14a-19, and 14n-1, will normally require from shareholders the following information:⁵⁰

- The name and address of the nominating shareholder or each member of the nominating shareholder group;
- Information regarding the amount and percentage of securities beneficially owned and entitled to vote at the meeting;
- A written statement from the "record" holder of the shares beneficially owned by the nominating shareholder or each member of the nominating shareholder group (usually a broker or bank) verifying that, as of the date of the shareholder notice on Schedule 14N, the shareholder continuously held the securities for at least one year;
- A written statement of the nominating shareholder's or group's intent to continue to own the requisite shares through the shareholder meeting at which directors are elected. Additionally, the nominating shareholder or group would provide a written statement regarding the nominating shareholder's or group's intent with res-

pect to continued ownership after the election;

- A certification that to the best of the nominating shareholder's or group's knowledge and belief, the securities are not held for the purpose of, or with the effect of, changing the control of the issuer or gaining more than a limited number of seats on the board of directors;
- A representation that the nominating shareholder or group is eligible to submit a nominee under Rule 14a-11;
- A representation that, to the knowledge of the nominating shareholder or group, the candidate's nomination or initial service on the board, if elected, would not violate controlling state law, federal law, or applicable listing standards (other than a standard relating to independence);
- A representation that, to the knowledge of the nominating shareholder or group, the nominee meets the objective criteria for independence from the company that are set forth in applicable rules of a national securities exchange or national securities association or, in the case of a registered investment company or business development company, that the nominee to the board is not an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act;
- A representation that neither the nominee nor the nominating shareholder (or any member of the nominating shareholder group, if applicable) has an agreement with the company regarding the nomination of the nominee;
- A statement from the nominee that the nominee consents to be named in the company's proxy statement and to serve on the board if elected, for inclusion in the company's proxy statement;
- A statement that the nominating shareholder or each member of the nominating shareholder group intends to continue to own the requisite amount of securities through the date of the meeting;

⁵⁰ See the proposed rules and amendments, and SEC Release n. 33-9046, pp. 81-87, and 185.

- Disclosure about the nominee complying with the requirements of Item 4(b), Item 5(b), and Items 7(a), (b) and (c) and, for investment companies, Item 22(b) of Exchange Act Schedule 14A, for inclusion in the company's proxy statement;

- Disclosure about the nominating shareholder or members of a nominating shareholder group consistent with the disclosure currently required pursuant to Item 4(b) and Item 5(b) of Schedule 14A in a contested election;

- Disclosure about whether the nominating shareholder or member of a nominating shareholder group has been involved in any legal proceeding during the past five years, as specified in Item 401(f) of Regulation S-K;

- Any direct or indirect material interest in any contract or agreement between the nominating shareholder or group or the nominee and the company or any affiliate of the company (including any employment agreement, collective bargaining agreement, or consulting agreement);

- Any material pending or threatened litigation in which the nominating shareholder or group or nominee is a party or a material participant and that involves the company, any of its officers or directors, or any affiliate of the company;

- Any other material relationship between the nominating shareholder or group or the nominee and the company or any affiliate of the company not otherwise disclosed;

- Disclosure of any website address on which the nominating shareholder or group may publish soliciting materials;

- If desired to be included in the company's proxy statement, any statement in support of the shareholder nominee or nominees, which may not exceed 500 words.

That information has to be furnished by a notice on the proposed new Exchange Act Schedule 14N, to be sent to the company and filed with the SEC.

Within 10 days of the announcement of the election's final result, the nominating shareholders or group of shareholders are required also to file an amendment to Schedule 14N disclosing "*the nominating shareholder's or group's intention to continue ownership of their shares*", providing "*information as to whether the outcome of the election may have altered the intent of the shareholder and what further plans with regard to the company the nominating shareholder may have*".⁵¹

The high level of disclosure required by the proposed rule is expressly a way to increase the information available both for shareholders in the decision process and for the company to check eligibility of the nominating shareholder or group of shareholders.

Besides, the disclosure also intends to avoid illegal practices during the proxy procedures, such as the organization of a fake independent group of shareholders, in reality acting as a surrogate of the company, with the only purpose of blocking actual minority shareholders from indicating nominees.⁵²

With similar goals, but relatively more superficial, Article 28, § 2º, of the CVM rule requires the following information from the shareholders.⁵³

- Object of the solicitation;
- Name and address;
- Amount and percentage of shares owned by each nominating shareholder;
- Shares on loan
- Each nominating shareholder exposition on the company's shares underlining derivatives;

51. SEC Release n. 33-9046, p. 89.

52. See SEC Release n. 33-9046, p. 66.

53. Although the text of the provision is not clearly applicable to the nominating shareholders, since it refers originally to the general disclosure requirements in any case of proxy solicitation, it is very likely, and indeed reasonable, that it is the right interpretation. The provision, nevertheless, could be more accurate.

- Any material relationship between the nominating shareholder or group and the company or related parts during the previous three years;

- Any special interest on the approval of the proxy solicitation subject.

That information has to be provided by the shareholders to the company on the same notice requiring the nomination.

And, in accordance with Article 26 of the rule, all material related to the proxy solicitation has to be available on the internet.

The more generic terms of the Brazilian rule and the lack of requirement of representations regarding the nominating shareholders' intentions, once more reflect the simplicity of the national market and reveal a sensitive regulatory incompleteness. The provisions regarding disclosure are not as specific as the U.S. ones, and in the Brazilian case, the nominating shareholders have much less exposition in the proxy solicitation. It creates an incentive to misuse the proxy procedures and makes harder eventual necessary enforcement actions.

That fact has even worse effects in the Brazilian reality, as the country's judicial control is known to be weak. Even though administrative oversight is efficient and private arbitrages are increasingly being used in Brazil, virtually all securities litigation still end being affected by the judiciary system. The Brazilian Corporation Law, in its turn, offers only principles and general provisions about shareholder responsibility, lacking a more specific framework for liability resulting from the use of proxy solicitation. And even CVM regulation does not have sufficiently detailed provisions applicable to the subject.

Specific liability rules for the use of proxies, as they exist in the U.S.,⁵⁴ would

certainly provide a helpful dose of certainty and trust to the solicitation procedures in Brazil, especially considering that it will be the first time that the national market is facing this new way of deliberating.

A final important difference between each country's rules on disclosures is the opportunity that the SEC rule expressly assures the nominating shareholders to include a text of support to their nominees in the proxy material. Although of limited extension, the text seems not only to be reasonable, but also may be useful as a device to neutralize any management/controller scheme to obfuscate the minority shareholders' nominations.⁵⁵

2.4 Procedures

In accordance to the SEC proposed provisions, a date has to be established by the company to receive the shareholders' nomination notice. That date can be determined in any of the company's governing documents or policies. In case such provision is not in place, the nominating shareholders have to send their notice "*no later than 120 calendar days before the date that the company mailed its proxy materials for the prior year's annual meeting*". If the company decides to anticipate the meeting, then it has to disclose the new date by which the shareholders must submit the notice in a Form 8-K within four business days after the new meeting date is determined.

provisions, John C. Coffee Jr., Joel Seligman and Hillary A. Sale, *Securities Regulation: Cases and Materials*, op. cit., pp. 1227-1255.

55. The CVM rule does not say anything about a text of support to be included by the nominating shareholder. Some parts of the text of the Public Comments Report for the rule (*Relatório de Análise – Audiência Pública n. 02/2009*) however present indications that the nomination is deemed to be something more than the mere name of a candidate. The CVM was express, when answering one of the comments received, affirming that there is no limitation on the size of the publications promoted by the shareholder and for them to be reimbursed by the company in accordance with Article 32 of the rule.

54. Especially Rule 14a-9 and its proposed paragraph (c). See also, regarding the proxy fraud

Once the notice is timeously submitted by the shareholders on the new Schedule 14N, the company will proceed to the regularity examination of the nomination. If there is no event permitting the exclusion of the nomination, the company will notify the nominating shareholders no later than 30 days before the filing of the definitive proxy materials, as a proof of adequate receipt and as a confirmation of the inclusion of the nominees in the materials (Rule 14a-11(f)(2)).

Where the company finds any irregularity on the nomination, it can exclude the proposal from the proxy materials (Rule 14a-11(f)(1)). The only reasons that legitimate exclusion are the following:⁵⁶

- Proposed Rule 14a-11 is not applicable to the company;
- The nominating shareholder or group has not complied with the requirements of Rule 14a-11;
- The nominee does not meet the requirements of Rule 14a-11;
- Any representation required to be included in the notice to the company is false or misleading in any material respect; or
- The company has received more nominees than it is required to include by proposed Rule 14a-11 and the nominating shareholder or group is not entitled to have its nominee included under the criteria proposed in Rule 14a-11(d)(3).

A nomination cannot be excluded, therefore, on a subjective basis by the management or simply because it is not relevant to the company in some respect.

Based on the objective reasons above, if the company decides to exclude the nomination from the proxy materials, it has to notify the nominating shareholders in writing with the explanation for the exclusion within 14 calendar days of the receipt of the shareholders' notice (14a-11(f)(3) and (4)).

The nominating shareholders or group will then have 14 calendar days to respond to the company's notice and correct any eligibility or procedural deficiencies (14a-11(f)(5)). Neither the composition of the nominating shareholder group nor the shareholder nominee may be changed as means to correct a deficiency identified in the company's notice, unless for the purposes of keeping the number of nominees under the limit of nominees required to be included in the proxy materials (14a-11(f)(6)).

If, after receiving the shareholder's response or the response period has expired, the company makes the decision to exclude the nomination, it will have to provide a notice with the basis of its decision and related information, including a counsel's opinion, to the SEC, with a copy to the shareholders, no later than 80 calendar days before filing the definitive proxy materials (14a-11(f)(7)-(10)).

The nominating shareholder or group may submit a response to the company's notice to the SEC, with copy to the company, within 14 calendar days from the receipt of the notice (14a-11(f)(11)).

An informal statement by the SEC staff can then be provided (14a-11(f)(12)).

In either case, the company shall provide the nominating shareholder or group, no later than 30 calendar days before the filing of the definitive proxy material, with notice of whether it will include or exclude the nominees, subject to the liability consequences of an irregular exclusion (14a-11(f)(13) and (14)).⁵⁷

Once it has been decided to include the shareholders nomination in the proxy material, management has to assure that these nominees will be presented in an impartial manner in accordance to Rule 14a-4. Option to vote for, against, or withhold authority must be available for each nomi-

57. For a graphic representation of the Rule 14a-11 deadlines, see SEC Release n. 33-9046, p. 107.

nee individually, including the management ones, but not for any group of nominees.⁵⁸

The nominating shareholders are permitted to solicit support outside the proxy statement; so are all efforts to form a group of shareholders to indicate a nominee under Rule 14a-11. Both the support solicitation and the effort to form a group will be exempt from the proxy rules. To qualify for the exemption, the related communications will have to comply with certain proposed requirements, or rely on any already existing proxy rules exemption.⁵⁹

Communications regarding the solicitation of support to a nominee must comply with the following requirements:

- The soliciting party does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a shareholder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization (Rule 14a-2(b)(8)(i));
- Each written communication includes:

The identity of the nominating shareholder or group and a description of his or her direct or indirect interests, by security holdings or otherwise;

A prominent legend in clear, plain language advising shareholders that a shareholder nominee is or will be included in the company's proxy statement and to read the company's proxy statement when it becomes available because it includes important information. The legend also must ex-

plain to shareholders that they can find the proxy statement, other soliciting material and any other relevant documents, at no charge, on the Commission's website;

Any soliciting material published, sent or given to shareholders in accordance with this paragraph must be filed by the nominating shareholder or group with the Commission, under the company's Exchange Act file number, no later than the date the material is first published, sent or given to shareholders. Three copies of the material would at the same time be filed with, or mailed for filing to, each national securities exchange upon which any class of securities of the company is listed and registered. The soliciting material would be required to include a cover page in the form set forth in Schedule 14A, with the appropriate box on the cover page marked (14a-2(b)(8)(iii)).

Communications regarding the formation of a group must comply with the following requirements:

- Each written communication includes no more than:

A statement of the shareholder's intent to form a nominating shareholder group in order to nominate a director under the proposed rule;

Identification of, and a brief statement regarding, the potential nominee or nominees or, where no nominee or nominees have been identified, the characteristics of the nominee or nominees that the shareholder intends to nominate, if any;

The percentage of securities that the shareholder beneficially owns or the aggregate percentage owned by any group to which the shareholder belongs; and

The means by which shareholders may contact the soliciting party;

- Any written soliciting material published, sent or given to shareholders in accordance with the terms of this provision is filed with the Commission by the nominating shareholder, under the company's Exchange Act file number (or in the case

58. SEC Release n. 33-9046, p. 108: "In our view, this option would not be appropriate where the company's form of proxy includes shareholder nominees, as grouping the company's nominees may make it easier to vote for all of the company's nominees than to vote for the shareholder nominees in addition to some of the company nominees".

59. SEC Release n. 33-9046, p. 99, and pp. 113-118.

of a registered investment company, under the company's Investment Company Act file number), no later than the date the material is first published, sent or given to shareholders. The soliciting material would be required to include a cover page in the form set forth in Schedule 14A, with the appropriate box on the cover page marked (Rule 14a-2(b)(7)(ii)).

The procedures in Brazil are significantly simpler. Article 27 of the Instrução CVM n. 481/2009 requires that the company publicly discloses its intention to solicit proxy no later than 10 business days before the proxy materials are released.

Article 28 determines that the shareholders or group of shareholders interested in indicating nominees to the board of directors shall send a notice in writing to the company within five business days from the release of the company's communication refereed above.

The impartiality is not expressly assured by the CVM rule. It only can be inferred from the general principles and liability provisions that management and controlling shareholders cannot highlight their nominees in detriment of the minority shareholders' nominees or present the shareholders nominations in any biased manner. And indirectly from Article 31, § 2º of the rule, this is also applicable to electronic proxies.

More specific provision in that respect would be useful to avoid common mechanisms used by management to weaken shareholders' proposals.

The Brazilian rule also does not regulate the procedures to reject a shareholder nomination. It is likely that a known ineligibility of a nominee, for example, would authorize the company to exclude the related indication from the proxy material. However, the lack of a procedure to inform shareholders and give them a chance to correct any formal imperfections on the nomination may make the proxy system unstable and provides opportunities for

abusive conduct on the part of management.

Similarly, it is not clear whether the Brazilian rule permits management to indicate a group of nominees while the shareholders are indicating nominees individually. That uncertainty may also increase incentives for abusive practices.

Finally, the CVM rule provides no exception or exemption from the definition of proxy solicitation for communications related to the nomination, both for forming a group of shareholders or soliciting support for an indication.

All communications will be examined in light of the definition provided by Article 22 of the Instrução CVM n. 481/2009. That provision defines as proxy solicitation any solicitation for authority using public means and addressed to more than five shareholders, when promoted by management or controlling shareholders, or to more than 10 shareholders, when promoted by any other person.

Communications used merely to ask for support do not seem to meet the definition; neither do communications explicitly proposing the formation of a group to indicate nominees.

The key element is unquestionably the request for authority, especially considering the absence of express exemptions.

In this sense, it is arguable that a public communication asking for the formation of a group through the creation of a shareholder agreement may be considered proxy solicitation, since this kind of contract, highly common in Brazil, normally provides mutual concession of authority to the assignees to vote in certain matters.

Perhaps issues familiar to the Brazilian market, such as the one referred to above, could have been specifically approached by the CVM rule in order to avoid predictable controversies in the application of Instrução CVM n. 481/2009.

2.5 Costs

As already discussed in item 2.1, the default in the U.S. is the cost being incurred by the proponent of the proxy solicitation, while in Brazil the CVM rule shifted the burden to the company as default.

The main proposition of the new SEC proposal is the transfer of expenses related to indication of nominees to the board of directors, from the shareholders to the company facilitating the nominations, when the nominating shareholders are not seeking effective control.⁶⁰

Despite the strong opposition the SEC proposal is facing, having the company bearing the costs for director nomination may already spontaneously be found in certain companies seeking improve their management oversight and corporate governance reputation by reducing the burden over shareholders interested in challenging directors' elections.

It is the case of the well-commented case of HealthSouth, which taking advantage of a recent Delaware law allowing such bylaws,⁶¹ changed its own at the end of 2009 in order to provide reimbursement for successful shareholder contests for the board.⁶²

The HealthSouth case was one of the less than 100 cases of board challenges in the U.S. last year, a number that seems not very representative considering the universality of U.S. companies and the level of dispersion of ownership.⁶³ The SEC rules facilitating nominations and the company's

reimbursement provision will likely change that number, if approved.

Having the governing documents providing reimbursement in the case of shareholder nominations is not, however, a reason to waive the company's obligations under proposed SEC rules. Since the bylaws reimbursement provisions may vary a lot among companies, the SEC deny the possibility of waiving the proposed proxy rules.

In Brazil, Article 32 of Instrução CVM n. 481/2009, the only costs-related provision in the rule, determines that, in the case where the company does not utilize a full electronic proxy system, it has to reimburse shareholders the expenses incurred by the solicitation.

There is no subject limitation for the reimbursement. However, the nature of the expenses and the amount of reimbursement are limited. And only shareholders owning 0.5% or more of the total number of shares issued by the company can be reimbursed.

The expenses the company is obliged to reimburse are restricted to the costs of up to three public releases in the newspaper normally used by the company to publish its own releases, and the costs of printing and sending proxy materials to the shareholders.⁶⁴

An integral reimbursement will be due by the company to the proposing shareholder if his proposal is approved or at least one of his nominees is elected.

Where the proposal is not approved and/or any nominee is elected, the company will reimburse a minimum of 50% of the expenses.⁶⁵

64. The original proposal also included reimbursement of attorney fees. The majority of the comments presented arguments against it. It was cut in the final rule. See *Relatório de Análise – Audiência Pública* n. 02/2009.

65. The original proposal was 70% of minimum reimbursement. It was reduced to 50% after

60. See SEC Release n. 33-9046, p. 99, and pp. 16, 31 and 75.

61. New § 113 of the Delaware Corporation Law, effective August 1st, 2009, authorizing the inclusion of reimbursement rights and conditions in the bylaws.

62. See *The Wall Street Journal*, October 26, 2009, pp. B1 and B5.

63. See *The Wall Street Journal*, October 26, 2009, pp. B1 and B5, and databases on proxy voting on www.riskmetrics.com.

In both cases, the reimbursement will be due within 10 business days from the receipt of notice from the shareholder to the company accompanied by adequate expenses proofs.

The provision is naturally not applicable when the shareholders' nominations are simply included in the management proxy material.

Nevertheless, the possibility of full or at least 50% reimbursement, added to a low ownership percentage requirement, no limitation of concurrent nominations or proxy fights, no differentiated rules for board contests, matter unrestricted reimbursement rules, no established procedures for rejecting proposals, and no specific liability, may provide the wrong incentives for minority shareholders in Brazil.

It is very difficult to predict how the provisions of the new CVM rule will be used by the shareholders and how the dispersion tendency will develop. But it is realistic to expect a large misuse of the rule in the case where the diffused ownership becomes a reality in the Brazilian capital market.

For instance, the incentive to carry out irresponsible or even litigant proxy contests is great, since most or all of the costs will be reimbursed by the company. And even the inclusion of a nominee within the management proxy material may be underutilized, since conducting a campaign for one's nominees in one's own proxy materials can be much more efficient and equally cheap.

It is true that Article 32 limits the reimbursement to the companies that do not have a full electronic proxy system.

public comments on the subject. The *ABRASCA*, Brazilian association of listed companies, for example, suggested that no reimbursement at all should be due or, alternatively, the shareholder and company should share the expenses equally. Naturally, the companies may establish higher levels of reimbursement independently. See *Relatório de Análise – Audiência Pública* n. 02/2009.

The solution, evidently, will be a complete adaption of the Brazilian companies to electronic platforms. That adaption is not quick and easy, however. Its timing, versus the evolution of the market patterns, will determine the efficiency or weakness of the CVM rule.

Until the complete migration to full electronic systems, the general rules and principles of the Brazilian Corporation law and CVM rules concerning abusive practices of minority shareholders may not be enough to avoid opportunistic misuse of the Instrução CVM n. 481/2009.⁶⁶

2.6 Access as default?

The opt-in, opt-out dilemma

The SEC proposal establishes the right to include nominees in the company's proxy material as a non-renounceable and irrevocable right. Opponents to the proposal, however, raised two alternatives: keeping the no-access as the default and leaving to shareholders the decision to include it in the company's election procedures; or determining the access as default, but permitting the shareholders to opt out from this default.

The subject was extensively analyzed in a paper sent by Professors Lucian Bebchuk and Scott Hirst as a public comment to the proposal on facilitating shareholder director nomination.⁶⁷

66. The CVM's goal is, expressly, "create incentives for the use of the internet as a mean to propagate information related to the shareholders meeting and to collect proxies" (see *Relatório de Análise – Audiência Pública* n. 02/2009, free translation).

67. Lucian A. Bebchuk and Scott Hirst, "Private ordering and the proxy access debate", in *The Business Lawyer*, vol. 65, n. 2, pp. 329–360, available at <http://papers.ssrn.com/abstract=1513408> and at www.sec.gov. Advocating for more flexibility on the nomination procedures see also Joseph A. Grundfest, *Measurement Issues in the Proxy Debate*, available at www.sec.gov; the comments made by the firm Cleary Gottlieb Steen & Hamilton LLP, on August 17, 2009, to the proposal, available at

In their paper, the authors identified “strong reasons against retaining no-access as the default”. They concluded that “[t] here is substantial empirical evidence indicating that director insulation from removal is associated with lower firm value and worse performance” and that “when opting out from a default arrangement serving shareholder interests, a switch is more likely to occur when it is favored by the board than when disfavored by the board”. Their conclusions demonstrate, in short, that shareholders will face substantial impediments on trying to reverse the default and that this precise “asymmetry in the reversibility” is the strongest argument against keeping no-access as the default.⁶⁸

Concerning the second possibility, the authors concluded that they “support allowing shareholders to opt out of a federal proxy access regime, provided that the opt-out process includes necessary safeguards”, namely a requirement of “majority approval by shareholders in a vote where the benefits to shareholders of proxy access are adequately disclosed” and the assurance that shareholders would “be able to reverse past opt-out decisions by a majority vote at any time”.⁶⁹

The SEC, however, has so far maintained the position that the right to include nominees in the company’s proxy material cannot be renounced or revoked. That position simply reflects the main drive of the proposal: to make the proxy process as similar to the shareholder meeting as possible.⁷⁰ Indicating a nominee in an election to the board of directors is considered an

essential shareholder right and, as such, cannot be eliminated by an individual or collective decision.

Although the Instrução CVM n. 481/2009 and the Brazilian Corporation Law are not clear in that respect, the text of the CVM rule does not give any suggestion that the right to include nominees in the company’s proxy material could be renounced or revoked. The access is the default and the only possibility.

It means specifically that the Brazilian companies’ bylaws cannot be modified to exclude the right to indicate nominees or to raise the minimum level of ownership required to make a shareholder eligible to exercise that right. A modification to lower the requirement or to extend the right to all shareholders, however, is perfectly acceptable.

2.7 Pros and cons of facilitating shareholder director nomination

The options currently available in the U.S. to shareholders dissatisfied with a company’s management are typically the following: sell their shares (“Wall Street Walk”); show up personally at the shareholders meeting to present their proposals; conduct a proxy contest; submit a proxy proposal; or carry out a “withhold vote” or “vote no” campaign.⁷¹

Selling the shares is an extreme measure that does not take into consideration long-term commitments or expectation, or even liquidity issues. It is naturally a less-than-optimal solution as, even if it helps correct the problem, the seller will not profit from his attitude.

A proxy contest is normally too costly to be borne by most of the shareholders. Since the U.S. rule determines that the proponent incurs expenses in the proxy solicitation, only large shareholders can consider that measure.

www.sec.gov; and the letter sent to the SEC on January 19, 2010, by the law firms Cravath, Swaine & More LLP, Davis Polk & Wardwell LLP, Latham & Watkins LLP, Simpson Thacher & Barlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wachtell, Lipton, Rosen & Katz, available at www.sec.gov.

68. Lucian A. Bebchuk and Scott Hirst, “Private ordering and the proxy access”, debate in *The Business Lawyer*, op. cit., abstract.

69. Idem, abstract.

70. SEC Release n. 33-9046, pp. 13-14.

71. See SEC Release n. 33-9046, pp. 15-16.

Shareholders proposals, in accordance to Rule 14a-8, may be included in the company's proxy material, avoiding most of the costs that would otherwise be incurred by the proponent shareholder. However, the procedure is not available for proposals related to director elections (14a-8(i)(8)). For that reason, the alternative *"has been criticized as an ineffective tool for exercising ownership rights"*.⁷²

Without vote and vote no campaigns are also relatively ineffective. They can also be costly, the adoption of plurality vote may weaken the effect of against votes or authority withholdings (or require a much larger campaign adhesion), and shareholders cannot solicit proxy authority through these campaigns.

In this scenario, the SEC believes that enacting its proposal will create an alternative that overcomes all the explained difficulties a shareholder currently faces when trying to exercise his unquestionable rights to indicate a nominee to the board of directors and oversee the management activities.

As already discussed, the core of the new proposal is shifting the cost of the nomination from the shareholders to the company, which will have to include its indications in its proxy material, without any conflict with Rule 14a-8(i)(8).

Facilitating the shareholder director nominations, the SEC expects to bring a series of benefits to the market, among them, the following:⁷³

- The new provisions are a very direct and effective method of assuring the shareholders their right to indicate directors and to participate in the administration oversight, by reducing their indication related costs;

- The new provisions will also improve disclosure of shareholder nominated director candidates;

- The presence of the shareholder-nominated directors *"would make boards more accountable to the shareholders who own the company and (...) this accountability would improve corporate governance and make companies more responsive to shareholder concerns"*;

- The shareholders' nominations will increase the competition for the board seats, enhancing the shareholder inputs in the administration, the accountability of current directors, and the directors' focus on their roles before the company;

- Increasing the directors' accountability and the shareholders' participation will also enhance the U.S. market competitiveness;

- The competition for a board seat tends to lead to the nomination of better candidates for the board of directors;

- The new provisions will provide a more appropriate procedure than the regular proxy solicitation for shareholders willing to indicate only a small number of directors and not seeking to affect control;

- All the nominees will be included on only one proxy card, clearly distinguished, which will promote clear disclosure, helping the shareholders' decision making;

- Shareholders will have more contact with the board election procedures and likely have closer knowledge about the management, enhancing their capacities to make investment decisions;

- The provisions *"should improve and streamline information flow between investors and the company"*;

- The existence of the new procedures will enhance the ability of *"shareholders and companies to adopt their preferred shareholder nomination procedures"*.

On the other hand, possible disadvantages of the proposed rules are:⁷⁴

- Shareholder-nominated directors may be too focused on their nominating

72. SEC Release n. 33-9046, p. 17.

73. SEC Release n. 33-9046, pp. 10-12, 31, 183-189, and 201-202.

74. SEC Release n. 33-9046, pp. 12-13, 23, 31, 189-198.

group, deviating the administration from the overall interest, impeding the proper functioning of the board and causing inefficiencies;

- The possibility of having a contested election may deter qualified candidates from serving as members of the board;

- A greater shareholder access to the election procedures "*could turn every election of directors into a contest, which would be costly and disruptive to companies*";

- The procedures proposed by the new rules will raise the complexity of the director elections and the costs incurred by the company.

Unquestionably, the same benefits are also expected in the Brazilian context by the enactment of the Instrução CVM n. 481/2009.⁷⁵

The potential disadvantages, the damaging capacity of which are, in fact, doubtful in the U.S., are easily contestable in the Brazilian case.

The Brazilian Corporation Law already assures minority representativeness on the administration⁷⁶ and already have provisions making illegal abusive biased conduct on the part of minority nominated directors. Facilitating shareholders nomination will not increase the risk or denature the principles on which the Brazilian Corporation Law is based.

Regarding the possibility of qualified candidates being deterred from serving as members of the board because of contested elections, besides the unpredictability of the assertion, it seems enough to argue that the lack of an adequate channel by which shareholders could indicate their nominees has been excluding good candidates for the board of directors since the beginning of Brazilian corporate history.

75. In this sense, see the *Edital de Audiência Pública* n. 02/2009, p. 1.

76. Brazilian Corporation Law Articles 141 and 161.

A greater shareholder access to the election procedures may, in fact, turn every election of directors in a contest, which may be costly and disruptive to companies. Nevertheless, the contrast between shareholders' and management/controller's opinions are natural to the corporation structures. And the costs related to the purely democratic shock of new ideas cannot be traded with the usurpation of a legitimate shareholder right.

Finally, it is true that the new procedures will raise the complexity of the director elections and the costs incurred by the company. However, especially in the Brazilian case, it was the way, for the first time, to concretize an abstract right shareholders have had since the enactment of the Brazilian Corporation Law in 1976. There has been no actual increase of costs, since there was no due proxy process before the new CVM rule.⁷⁷

3. Conclusions

3.1 What lessons should Brazil learn from the U.S. public reflections on the subject?

As discussed in items 2.1 through 2.7, the U.S. and Brazil have many differences concerning their respective markets. Those structural differences in each market completely explain and, in part, justify each market's regulation concerning proxy regulation.

The absence of a proxy culture in Brazil explains why the nation's first rule on proxy solicitation was enacted only in

77. For further analysis on the pros and cons, see also David F. Larcker, Gaizka Ormazabal and Daniel J. Taylor, *The Regulation of Corporate Governance*, available at www.sec.gov, and the debates of the Harvard Law School Proxy Access Round Table held on October 7, 2009, available at <http://ssrn.com/abstract=1539027>. Another interesting document favoring the proposal is the support letter sent to the SEC by 80 preeminent U.S. professors from different areas on August 17, 2009.

2009 and why it is such a simple rule. Indeed, Brazil had no great experience as background to consider the rules and no great costs were justified on the seminal rule.

Nevertheless, even for an initial rule, some things could have been better explored and more detailed, in order to avoid potential regulatory impasses, which were predictable considering the expected increase in the ownership dispersion level of the Brazilian market, in particular of the Novo Mercado.

The larger U.S. experience and the convenience of a concomitant public discussion on facilitating shareholder director nomination helped in analyzing the new Brazilian rule and stressing some of its weaknesses.

Basically, it was demonstrated that without significant increase of costs, the rule could have been more specific and could have gone a little further on the regulation of shareholder nomination through the company's proxy material.

That is the case, for example, of the lack of clear procedures to exclude nominations or to include general shareholder proposals in the company's proxy material. It is also the case of the lack of any holding requirement to nominating shareholders or of any statement of purpose, which could be very helpful in the shareholders' decision-making process. It is, finally, the case of the lack of any provision assuring nominating shareholders a way to require support of their candidates, such as a limited text to be included in the company's proxy material or on the website.

Seen as one item, the rule may be also criticized for potentially giving incentive for opportunistic and speculative behaviors. Adding up the low ownership requirement, no requirement for long-term commitment to the company or purposes statement, no limit of number of nominations, no differentiated rules for proxy fights or board contest, the possibility of reimbursement, and the lack of specific liability provisions,

the rule provides for very low costs to investors simply interested in pressuring the company or merely trying their luck on a board election.

That negative incentive exists even in the case where the company has a fully electronic proxy system and therefore no reimbursement is required in accordance with Article 32 of the Instrução CVM n. 481/2009. The remaining elements are enough to stimulate such an investor to include his nomination on the company's website also at zero cost and risk.

In conclusion, the Instrução CVM n. 481/2009 is definitively a great initiative that was put into motion thanks to a wise vision of the Brazilian regulator. However, the same accuracy on reading and anticipating the Brazilian market reality could already have lead to the creation of a rule somewhat more detailed and therefore more prepared to fully embrace that welcomed evolution on the national capital market.

3.2 Avoiding piggybacking: what lessons should Brazil not learn from the U.S. experience

Having spoken about the CVM rule's weaknesses, it is important also to highlight its particular strengths.

Two great qualities of the Instrução CVM n. 481/2009 are its straightforwardness and its trust in good market functioning. The rule, although in some points excessive, is simplistic and, believing in a relatively fair interaction between the market players, regulates nothing more than the exact core of the subject.

Rather than mere regulatory naivety, that characteristic in fact shows a legislative framework still not inoculated with the fears of minority misconducts and abusive litigation.

In this sense, the almost paranoid, although justifiable, concern of the U.S. with investor and litigator abuses makes that

country's corporate and security regulations much more complex. Consequently the rules become less and less clear because they have to cover not only the core of the regulated subject but also all the defensive measures of shareholders' rights against malversation.

It is true that the "purity" of the CVM rule is in part the result of a simpler market, with less fear of abuse solely because of a shorter history of corporate interaction, and consequently fewer business barricades against regulatory reforms expanding the shareholder rights.⁷⁸

However, the fact that the rule's qualities may be considered a natural outcome of the context rather than a intentionally-engineered regulatory effort does not mean that this gift cannot be maintained.

And this maintenance is exactly where the U.S. influence has to stop flowing to the Brazilian regulatory machine. Evidently not all U.S. legislative devices can be transposed to the Brazilian legal framework. In this particular case, U.S. provisions make rules more complex solely because of the necessity of avoiding abusive litigation and an exaggerated concern about improper shareholder activism is not useful for the Brazilian reality.

The non-limitation on the number of nominees that shareholders can indicate is a good example of the Brazilian rule's character. Taken together with other elements of the rule, it may create the wrong incentives for opportunist investors, as argued above, but on its own is a proof of trust in the corporation democracy.

Indeed, that provision makes the Brazilian system of shareholder director nomination through proxy closer to an in-person meeting than the U.S. system. And this ap-

proximation is precisely the goal of the U.S.-proposed rule.

The boundaries faced by nominating shareholders are only those set by general rules on liability and the shareholders' elementary duties (Article 115 of the Brazilian Corporation Law, for example).

It was not negligence that the present item and the previous one showed apparent contradictory assertions concerning the disadvantages and qualities of the Instrução CVM n. 481/2009. The ideas presented are not contradictory though. They are superimposed in order to identify which elements are mutually exclusive.

The idea is that fixing the weaknesses of the CVM rule does not imply the giving up of its strengths.

On the contrary, the challenge facing the Brazilian regulator is precisely to keep the rule's objectivity without providing unnecessary opportunities to misuse it. It is possible. And this paper tries to spotlight a few initial steps on this important pathway.

2010.

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