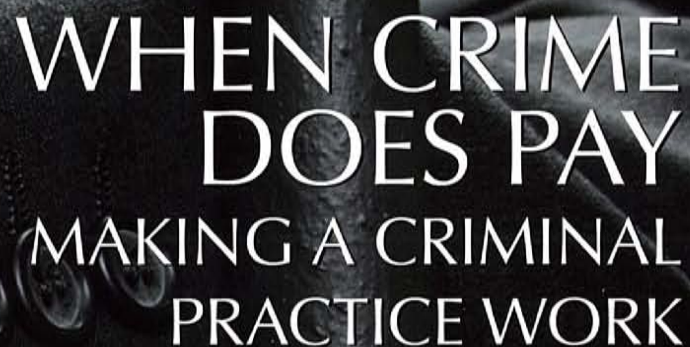
Volume 8 • Issue 8

LATINLAWYER MAGAZINE

THE BUSINESS LAW MAGAZINE FOR LATIN AMERICA



WHEN CRIME DOES PAY

MAKING A CRIMINAL PRACTICE WORK

Mexico law firms ramp up competition • Strong corporate governance procedures • NAFTA at 15 • Antitrust in Argentina

STANDARD BEARERS

With regulatory oversight sharpening across the region, David Thorley talks to in-house and private practice lawyers across the region about the challenges of developing and maintaining good governance

When Chile's securities regulator issued fines last year to eight individuals linked to the failed merger of retailers D&S and Falabella for the illegal use of inside information, it found it was punishing a group with some very close inter-relations.

D&S director Hans Eben and external press adviser Ana Maria Laguna, and Falabella shareholder Maria Luisa Solari, were all fined for passing on confidential information to family and business associates who then bought shares in D&S. Those people were Solari's boyfriend Marcel Zarour, Laguna's husband Peter Studer, Vicente Aresti, a colleague of Eben's in another company, his brother Eugene Aresti, and another business associate, Alejandro Ureta.

> The region's companies face challenges in ensuring their corporate governance structures do not leave them in breach of the rules

Although such high-profile cases of malpractice are quite rare in Latin America, the family-dominated executive structure is not, and with an ever-tightening regulatory framework, the region's companies face stiff challenges in ensuring that their corporate governance structures do not leave them in breach of the rules.

The family model of ownership prevails to the extent that a 2007 study in Brazil found 103 of the country's 200 largest companies to be family controlled. This brings its own difficulties for those businesses seeking to participate in the international capital markets. Last month's IFC-World Bank report on corporate governance in Latin American companies characterised the difficulties: "Investors – both shareholders and creditors – may look with distrust on family-controlled companies, because of the risk that the controlling family may abuse the rights of other shareholders. So investors likely will scrutinise such companies with care before taking the plunge and investing."

The challenge lawyers face, then, is to help those companies formulate corporate governance structures which allow those familial systems of ownership to be accommodated within regulations designed with an independent shareholding structure in mind.

Paulo Cezar Aragão, of Brazilian firm Barbosa Müssnich & Aragão, says one problem is that although Brazil's securities regulator, the

CVM, makes recommendations on corporate governance, the concept itself is inadequately defined: "Everything and the kitchen sink seems to fit into the concept."

In reforming its own corporate governance, Peruvian mining company Buenaventura found that, in the absence of clear guidelines on where to start and how to progress, it had first to take a moral decision about the cultural direction it wanted to take: all shareholders – family members or not – were required to make the good of the company their focus, not that of the family.

CEO Roque Benavides put the matter in terms with which family stakeholders could readily identify: "I don't know cases of families in Latin America that had become more united because of money, but I do know of many cases where families have destroyed companies because of money. The lesson to be learned here is that company value is what unites shareholders, irrespective of whether these are family members or institutional shareholders."

The will to reform is present in many of the region's businesses, but Diego Parise of Argentine firm Mitrani, Caballero, Rosso Alba, Francia, Ojam & Ruiz Moreno explains some of the inherent difficulties in redesigning these systems: "Recent reforms in corporate governance standards in Latin America have been largely inspired by the US model. However, unlike in the US – where control of most public companies is in the public float – listed corporations in Latin America have a shareholder or group of shareholders with effective voting control. Consequently, the US-based corporate governance standards often fail to address problems that are inherent in a controlling shareholder system and, in some cases, even collide with established legal institutions and traditions.

"A blind import of solutions from other jurisdictions, very often with diverse corporate ownership structures, will not enhance investor protection or foster the development of local capital markets," he adds.

Regional trends

Some companies clearly have a head start. Brazilian cosmetics group Natura, for example, has a dedicated corporate governance specialist, Moacir Salzstein, as part of its legal team. The company has been, says Salzstein, "developing its own corporate governance for the last 12 years," adding that it spends approximately 0.5 per cent of its net sales on corporate governance work.

But most businesses have not yet reached the level of sophistication in corporate governance that Natura's early start has allowed it. And the resources it commits to it, along with the company's expansion beyond its home country's borders, give Salzstein a good sense of how corporate governance practices differ across the region. In general, Brazil, he says, "may be considered a regional leader in corporate governance followed by countries such as Colombia, Chile, Mexico and Peru".

Nubia Zapata Garcia, a member of the in-house legal team at Colombian electricity group ISA, agrees with his assessment. ISA has operations in Colombia, Brazil, Peru, Bolivia and Central America, and Zapata says: "Brazil is where the ISA Group has found the most advanced governance practices. In Peru companies are fully aware of the governance issue, and some companies are really advanced on this matter, but in our opinion, they still haven't incorporated it into the core of their entrepreneurial culture."

"In Colombia," she says, "the subject is a priority for both the companies and the regulators. However, Colombia is still behind Brazil in terms of commitment and development on this matter."

In the tide of regulatory tightening that has followed the financial crisis, governments across the region have been introducing measures to strengthen corporate governance in the companies that list on their exchanges. Most recently, Chile passed a new law introducing stricter regulations on the shareholding structure of companies, as well as on disclosure of financial information. And this summer, both Colombia and Costa Rica introduced reforms, with Colombia bringing its companies' financial reporting practices in line with international standards, and Costa Rica demanding that its companies publish stricter codes of corporate conduct, take greater care to ensure the independence of their directors, and take extra measures to guard against conflicts of interest.

In general, sophistication in corporate governance systems seems to develop alongside the growth of a country's capital markets, with Brazil's widely accepted leadership in the field seen as a reflection of its markets' growth. In 2001, the São Paulo stock exchange, Bovespa, created the Novo Mercado, in which only companies with the strongest corporate governance frameworks are allowed to participate. And the sophistication of its businesses in developing good governance has led the country's securities regulator, the CVM, this year to simplify the procedures for making securities offerings to qualified investors. The move brought Brazil's securities regulations into line with corresponding rules in the US, by exempting restricted offerings of some securities to qualified investors from registration with the CVM.

But the converse of this formula is that countries with less well-developed capital markets suffer in

Cristian Mitrani

Paulo Cezar Aragão

Sergio Michelsen

Carlos Raul Yepes

Alexis Rovzar

Diego Parise

corporate governance terms. "In undeveloped capital markets such as Argentina's," says Cristian Mitrani, also of Mitrani Caballero, "corporations have historically displayed minimum standards of corporate governance. The listing requirements of Argentina's most important self-regulatory market (the Buenos Aires stock exchange) have long remained substantially unchanged in terms of corporate governance."

Another factor, he adds, is that: "Equity issues, value traded and market capitalisation in Argentina's capital markets have always been negligible, and consequently the incentives to advance further in the field of corporate governance have not been very strong." The country's markets, he says, have "more basic and pressing problems: authorities should start showing commitment to the rule of law and taking concrete action to overcome the low credibility of political institutions".

In fact, the country's government has won itself few friends in the business community, which views its nationalisation of Argentina's pension funds at the end of last year as a move to centralise power, which has done its credibility no favours. As a result, the government has significant shareholding stakes in some of its largest private companies.

In a recent article for LATINLAWYER, Pastoriza Eviner Cangueiro Ruiz & Buljevich partner Esteban Buljevich characterised the situation, saying: "Healthy limits to interventionism are easy to define but difficult to achieve. For example, the government appointing company directors could still be considered a reasonable measure so long as the appointee directors do not act in the government's interests, but rather fulfil their duties like any other director.

"The government could eventually have a conflict of interests between its roles as guardian, tax collector and regulator of the private sector, and its duties as a shareholder of all these companies," he argued.

In an ideal world, believes Alexis Rovzar of White & Case LLP's New York office, a culture of corporate governance could develop with incentives that go beyond the regulatory: "Government banks and development banks, and eventually commercial banks, could offer reduced rates and longer terms to companies that offer good corporate governance. Rating agencies could make it one of their criteria, tax authorities could offer incentives, even large suppliers could maybe play a role."

Clearly, most of the region's countries fall somewhere between these two poles. Most lawyers LATINLAWYER spoke to cite the shareholding structure of their country's businesses as the main obstacle to improved corporate governance. Sergio Michelsen, a partner with Colombia's Brigard & Urrutia Abogados, says: "The largest and most important companies in the region are either family firms or government-controlled companies. The very dynamics of these types of business mean that the founding family or government do not wish to limit their control over the company, meaning there is a predisposition against the adoption of good governance measures, unless there is a compelling reason to adopt them, such as adopting financing for corporate expansion."

Even in Brazil, says Paulo Cezar Aragão, still "the biggest challenge is to overcome long-entrenched practices that, in some cases, may have generated asymmetrical advantages for certain shareholders or members of the management".

The main incentive for companies to overcome these difficulties seems to be the added attraction for investors in a company with a strong set of corporate governance rules. As José Maria Eyzaguirre of Chilean firm Claro y Cía puts it: "The goal is going from just complying with the law and ethics rule to really minimising the risks, gaining the trust of the market and improving competitiveness."

So for the region's companies – or those wishing to maintain a lead in best governance practices – the challenge is not so much to keep up with developing regulatory trends, as to compete with other businesses in attracting the attention of investors and winning their confidence. From the perspective of the general counsel, no one wants to be the one explaining to management that an indistinct focus on governance and structures was what frightened off a key investor.

Colombian cement company Argos found that, like Buenaventura in Peru, it had to take ethical decisions about what it includes in its corporate governance programme. "For example," says general counsel Carlos Raul Yepes, "we had to decide if corporate social responsibility is part of corporate governance or not."

The company decided that it is, and set about developing a wide-ranging set of governance rules, which Yepes says is constantly under review. Those rules, he explains, are designed to endure in the long term, and include "permanent communication channels between the top management and the entire company," "campaigns about values and codes of conduct," and "a committee to monitor good practice at the company."

Argos is now entering the second phase of its corporate governance reform, which he explains will "establish policies aimed at assuring the sustainability of our business, and an internal control system that ensures the quality of the information we report, and that we are always in compliance with reporting processes".

Help from outside?

Both Yepes and Moacir Salzstein at Natura say their in-house legal teams have designed all improvements in corporate governance at their companies, but others see a role for external firms in the area. ISA's Nubia Zapata Garcia says: "External firms are always important since they always know the state-of-the-art trends in corporate governance." But nonetheless, she says that ISA does not hire external firms to help in the area.

From the other side of the fence, Sergio Michelsen echoes Zapata, saying: "The main role for external firms in connection with their clients' corporate governance programmes is to spread best practice, and to allow individual clients to benefit from the common experience of other companies in the market."

In terms of hard advice, says Eyzaguirre, this translates into being able to offer companies "clear rules on dos and don'ts, and a fresh view on close-call independent matters, especially to companies where the majority of the board is appointed by a controlling shareholder."

To this list, Diego Parise adds a firm's know-how in designing a single corporate governance programme for clients with multiple stock listing, which encompasses the different requirements of the various jurisdictions involved. In some cases of dual listing, says Eyzaguirre, "there is a trend in the market to get delisted from the US and European stock exchanges just for the cost of compliance".

But Alexis Rovzar doesn't accept that cost is the driving factor, saying: "Some Mexican companies in the last two or three years are deregistering in the US, and for these companies, cost is an excuse. The truth is in most cases that they weren't attracting the investors."

"In my experience," he adds, "once you adopt these procedures, the benefits to the organisation and its stakeholders outweigh the costs."

Perhaps this is where the government reforms have the greatest role to play: in establishing regulatory frameworks which are suitably grounded in international models to enable Latin America's companies to compete on international markets without the need for a comprehensive overhaul of their corporate governance.

One problem that arises is the relative pace of reforms required in Latin America, as compared to the growth of US corporate governance regulation. While Eyzaguirre says, "in Chile, looking at the trends in the US and Europe has become common in recent decades," he admits that "in Latin America the structural changes have taken place over a shorter time period, and this makes change more difficult."

But to Michelsen, though, this is not the problem's core: "The main obstacles for a widespread adoption of corporate governance measures are the limited depth of the capital markets, and the types of company that dominate the local markets.

"The need to move on all fronts at once in connection with corporate governance matters would not be an issue if such underlying problems did not exist," he concludes. This may seem a tall order for some of the region's governments, but "root and branch reform" seems to be the clarion call of lawyers in those countries.

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