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THE BRAZILIAN ATTEMPT ON SELF-REGULATORY TAKEOVER AND CORPORATE REORGANIZATIONS LEGISLATION — THE BRAZILIAN TAKEOVER PANEL (CAF) [1]

A EXPERIÊNCIA BRASILEIRA EM LEGISLAÇÃO AUTORREGULADORA DE AQUISIÇÕES E REORGANIZAÇÕES SOCIETÁRIAS — O COMITÊ DE AQUISIÇÕES E FUSÕES (CAF)

Thomas Ayres

Abstract: This article discusses takeover and corporate reorganization control in Brazil and the purpose behind the creation of the Brazilian Takeover Panel (CAF). The article aims to analyze the effectiveness of the Takeover Panel in the United Kingdom and its inspiration to the Brazilian model. Additionally, the article examines the benefits of regulatory dualism, as evidenced by the *Novo Mercado*. The article evaluates the mandatory bid rule proposed by the CAF, the prohibition of statutory poison pills and support by the Brazilian Securities and Exchange Commission (CVM). The article presents studies and theories on how the CAF can engage participants, serve as a self-regulatory entity and provide equitable conditions in corporate transactions.

Keywords: Takeover. Brazilian Takeover Panel. Mandatory bid rule. Equitable conditions.

Resumo: Este artigo discute o controle sobre aquisições e reorganizações societárias no Brasil e o objetivo por trás da criação do

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1 Artigo recebido em 18.05.2015 e aceito em 06.12.2015.

Comitê de Aquisições e Fusões (CAF). O artigo visa analisar a eficácia do *Takeover Panel* no Reino Unido e sua inspiração para o modelo brasileiro. Além disso, o artigo examina os benefícios do dualismo regulatório, como demonstrado pelo *Novo Mercado*. O artigo avalia a regra da oferta obrigatória proposta pelo CAF, a proibição das *poison pills* e o apoio dado pela Comissão de Valores Mobiliários (CVM). O artigo apresenta estudos e teorias sobre como a CAF pode atrair participantes, servir como uma entidade de autorregulação e fornecer condições equitativas em operações societárias.

Palavras-chave: Aquisição. Comitê de Aquisições e Fusões. Oferta obrigatória. Condições equitativas.

Sumário: 1. Introduction. 2. Inspiration — The U.K. Takeover panel. 3. Background of the CAF — the Mandatory Bid Rule. 4. The purpose of the Brazilian Takeover Panel. 5. Main points of debate: i. Enforcement powers and concurrence with the CVM. ii. Required public offering. iii. Prohibition of Poison Pills. 6. Conclusion.

1. Introduction

Brazil has been often regarded as an attractive, emerging and promising economy. Yet, as is the case with many developing nations, most of foreign investors gaze Brazil as a nation that is still crawling to obtain sound levels of corporate governance and protection of investments. Advances have been made during this century and this paper aims to analyze how self-regulation attempts can improve shareholder treatment in Brazil without jeopardizing the charm of the securities market for business and financial transactions.

It is in this sense that most of minority shareholders find themselves, nowadays, still struggling with potential lack of proper information, such as in Eike Batista's OGX downfall, the largest bankruptcy procedure in Latin America, or where the government controls and directly influences the business of a company, as seen in the cur-

rent scandal involving Petrobras and the payment of high contractual commissions that would fund government propaganda. In both cases, minority shareholders have been pursuing in court their rights that were violated due to arbitrary and undutiful conduct by the controlling shareholder.

In light of recent events, much has been discussed regarding what levels of minority shareholder protection are indeed acceptable and within reach of all participants in the market, including the regulatory bodies. The *Novo Mercado* proved to be a substantially positive experience by displaying the willingness of Brazil's securities market to adopt more transparent corporate governance practices as well equitable practices.

The *Novo Mercado* was established in late 2000, under the expectation that the securities market in Brazil would benefit from regulatory dualism. The expectation was that voluntary adoption of the *Novo Mercado*'s thresholds of corporate governance and transparency would walk together with the regulations set forth under Law 6,404 of 1976 (Corporations Law) and the rules from the Brazilian Securities and Exchange Commission. It was inspired on the German Stock Exchange's (Deutsche Börse AG) more regulated segment, the *Neuer Markt*. The German experiment intended to be a shares market for technology and high-growth companies and was more heavily regulated than the normal segment. The *Novo Mercado* made no attempt to narrow which sectors of the industry should adhere to it, but followed the idea of more sophisticated and enhanced regulation in terms of corporate governance.

One of the outcomes of the *Novo Mercado* was a gradual increase in profitability by companies that adopted the highest levels of corporate governance. The IGC — Special Corporate Governance Stock Index — was formulated by the Sao Paulo Stock Exchange and designed to measure the return of a portfolio composed of shares of companies that are listed at the *Novo Mercado* level or classified as Level 1 or Level 2. Regulatory dualism has surely improved the stock

market in Brazil by incorporating a dynamic element that is key to its usefulness with a refined tactic to execution[2]. The *Novo Mercado* went all the way in educating the Brazilian market. At the "Novo Mercado" level, companies must have: only voting shares ("one share, one vote"), a minimum of 25% of free float of shares in the market minimum, a non-staggered board of directors and U.S. GAAP or IFRS prepared accounting[3]. The whole *Novo Mercado* exertion provided a new variety to a market ruled by banks, extractors of raw materials and state-owned companies by enriching companies with sophisticated corporate governance terms[4]. The successful IPO of the cosmetics company Natura in 2004 was a milestone of the *Novo Mercado*'s victory.

The creation of the Brazilian Takeover Panel followed the success in the set-up of the British Takeover Panel and finds support in the current understanding of the Brazilian Securities and Exchange Commission (CVM). It follows the premises that the environment of corporate ownership has to provide grounds for fair and equitable trade of shares, regardless of how disperse or concentrated ownership of shares is.

This paper will aim to analyze the concept of the self-regulatory takeover procedure in Brazil with the formation of the CAF and its inspiration in the U.K. Takeover Panel. The main aspect of the Panel will be looked into: the mandatory bid rule as a result of purchase of a significant stake in a company. The issues of cooperation with

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2 *See generally* GILSON, Ronald J.; HANSMANN, Henry; PARGENDLER, Mariana. Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States and the European Union. 63, *Stanford Law Review* 475, 2011.

3 BLACK, Bernard S.; CARVALHO, Antonio Gledson de; SAMPAIO, Joelson Oliveira. The Evolution of Corporate Governance in Brazil. April 3, 2014. *Northwestern Law & Econ Research Paper*, No. 12-22, p. 6. Available at: http://ssrn.com/abstract=2181039. Accessed on: April 15, 2015.

4 *New wave for the Novo Mercado*. Available at: www.economist.com/node/5563405. Accessed on: April 15, 2015.

the CVM and enforcement capacities of the Panel will also be examined in detail. Additionally, this paper will briefly analyze how the Code moves away from the Delaware-inspired defensive mechanisms against hostile takeover — i.e. poison pills — and thus, is more "shareholder" favored than "director" favored. The concluding remarks will ponder on the potential success of the Brazilian Takeover Panel.

2. Inspiration — The U.K. Takeover Panel

The U.K. Takeover Panel was introduced in the year of 1968 with the goal of protecting shareholders of companies receiving a takeover offer. The fundamental purpose of the City Code of Takeovers is, ultimately, placing shareholders on a privileged position over managers. The overriding approach of the British Takeover Panel is that shareholders own the company and should be free to decide its future[5]. The Takeover Code is principle-based and focuses on providing sufficient disclosure of information to shareholders without interfering in the business strategy, financial outcome or merits of the proposed deal[6].

Based on the principle of voluntariness and independence, the Panel is a self-funding body, but with the caveat that the Code applies to all companies headquartered in the United Kingdom. One of the principles of the Code is that the board of a company who receives an offer for acquisition has to act in the best interests of the company and not deny access of information to the holders of equity. Hence, perhaps the most leading variance of the British regulation on takeovers, as opposed to the U.S. court-made approach under Dela-

5 *General Guide to the UK Takeover Regime*. February, 2014. Available at: www.skadden.com/newsletters/UK_Takeover_Regime.pdf. Accessed on: April 16, 2015.

6 PATRONE, Michael R. *Sour Chocolate*: The U.K. Takeover Panel's Improper Reaction to Kraft's Acquisition of Cadbury. 2011. p. 66. Available at: http://ssrn.com/abstract=1800468. Accessed on: April 17, 2015.

ware law, has to do with defensive mechanisms. Boards in Britain cannot take any frustrating action when the offer is on the table[7]. In addition, the tradition has been one of unfriendliness against devices intended to back off potential bidders.

What is relevant to note is that the Takeover Panel inflicts a strong reputational fear to companies that are expected to abide by its rules. Informality is evident in the Panel's *modus operandi* and its enforcement abilities, which will be later discussed, have been questioned at a court of law in rare situations. Since 2006, the Panel has had the ability to seek court enforcement of its rulings entered by the Hearing Committee and the Appellant Board. The reputational loss of breaching the U.K. Takeover Code is huge, as well as requesting judicial review of the Panel's decisions.

3. Background of the CAF — the Mandatory Bid Rule

The Brazilian Takeover Panel was inspired in the successful example of the U.K.'s Takeover Panel. Brazilian regulation was remolded significantly over time and much concern arose when the tag along clause was reinserted into the Corporations Law by means of an amendment enacted by the Brazilian Congress in 2001 through Law 10,303. While the amended law allowed the issuance of preferential (non-voting) shares — a point the *Novo Mercado* rules would come to reject — it reintroduced the mandatory bid rule through tag along. Article 254-A was introduced to the Corporations Law, providing that in the event of change of control the acquirer should offer to buy the shares of remaining shareholders for a price of at least 80% of the value paid for the shares. Parsimoniously, the purpose was to protect minority shareholders from the appropriation of the valued aggrega-

7 KASTIEL, Kobi. *To-may-to To-mah-to*: 10 Surprises for a US Bidder on a UK Takeover. April 4, 2014. Available at: http://corpgov.law.harvard.edu/2014/04/04/to-may-to-to-mah-to-10-surprises-for-a-us-bidder-on-a-uk-takeover/. Accessed on: April 18, 2015.

ted by private benefits of control gained by the acquiring shareholder. However, the 20% deficiency in the payable price sparked a sense of incomplete legal assurance for minority investors.

As to exit rights, it may be considered that the current law does not address the situation when the price offered is not attractive, in which case such protection loses all its purpose. Because it is impossible to grant identical treatment to shareholders with shares of different classes, the equality principle cannot be fully observed. However, it is argued that by relaxing the equal price requirement legislators found a way to fine-tune the balance between minority protections and to allow changes of control[8].

While the big firms such as Petrobras and Vale foregone adoption to the *Novo Mercado* due to their settled position in the market, mid-market firms saw the *Novo Mercado* as a good opportunity to leverage, in a way, in terms of public rating — transparency and level of accredited information. Academics bear that the goal of the *Novo Mercado* was to address the problems in the investor protection regime by means of a privately created law[9] that would serve as a dual and additional regulation.

Perhaps because BMF&Bovespa avoided upsetting its biggest clients — the giant firms — the *Novo Mercado* was not imposed, but rather could be voluntarily adopted. While the *Novo Mercado's* principles demand respect to the mandatory bid rule and the issuance of voting shares only, its outright determination was to improve general corporate governance aspects in publicly listed companies. The Takeover Panel in Brazil was produced with the purpose of further granting minority shareholders more equitable conditions in mergers and squeeze-out transactions.

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8 TESTA, Pedro. *The Mandatory Bid Rule in the European Community and in Brazil*: a Critical View. August, 2006. p. 35. Available at: http://ssrn.com/abstract=943089. Accessed on: April 21, 2015.

9 GILSON, Ronald J.; HANSMANN, Henry; PARGENDLER, Mariana. Op. cit. p. 486.

The suggestion of turning to the British model is a result of the fact that, in terms of structure, Brazilian M&A practices derive in concept from the U.S. and European techniques for the acquisition of private companies. There is very little difference between a share purchase agreement enforceable under Brazil, U.S. or U.K. law. There are, however, some differences as far as how you implement transactions from a corporate perspective. For example, it is very rare that cross-border transactions into Brazil are not channeled through a local vehicle.

4. The purpose of the Brazilian Takeover Panel

Takeover regulation's main role is to set the rules of how to respond to a change in control and give individuals exit mechanisms. The probability of opt-out will depend on the rules governing the corporation and if the group that such rules empower, such as controlling or minority shareholders, welcomes the change[10].

The CAF was established and began operations in August 2013. It has a judgment panel composed of eleven members who serve a two-year term of appointment. Its *raison d'être* is to reinforce the Brazilian capitals market since the introduction of the *Novo Mercado*. The Panel is governed by a Self-Regulatory Code (Code).

It was a product of brainstorming by many jurists and law commentators and carried support of the most relevant institutions in the Brazilian capital market, such as the Association of Financial and Capital Markets Entities (ANBIMA) and the Brazilian Corporate Go-

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10 ENRIQUES, Luca; GILSON, Ronald J.; PACCES, Alessio M. *The Case for an Unbiased Takeover Law (with an Application to the European Union)*. June, 2014. ECGI — Law Working Paper No. 212; *Harvard Business Law Review*, v. 4, Issue 1, p. 85-127, 2014; ECGI — Law Working Paper No. 212; Columbia Law and Economics Working Paper No. 450; Stanford Law and Economics Online Working Paper No. 444, p. 88, Available at: http://ssrn.com/abstract=2258926. Accessed on: April 22, 2015.

vernance Institute (IBGC), as well as the Sao Paulo Stock Exchange (BM&FBOVESPA). Since day one, when these players took the task of coming up with this innovative merger and acquisitions control body, the CAF's contribution was that it added value to the existing legal framework enforced by the Brazilian Securities and Exchange Commission (CVM). As it shall be noted, the Brazilian Association of Publicly-Held Corporations (ABRASCA) decided to stay out due to its disagreement on the mandatory bid rule required per the Code.

The Brazilian model is a voluntary self-regulatory organization with its own code and, as it will be analyzed in further detail herein, with a dual regulatory purpose — thus, not created to clash with the CVM rules and enforcement provisions. Members of the CAF allege that it is starting to be more widely known, to demonstrate its usefulness to the market and to gain credibility and consolidate itself as a tool to mitigate shareholders' uncertainties.

The CAF — as its role model, the U.K. Takeover Panel — finds support in the OECD Principles of corporate governance. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class[11]. The OECD is largely concerned with the threat of abusive self-dealing in the transactional context. Those concerns are embodied in its Principles, which protect shareholders from not being able to fight for their rights. As author Bob Tricker points out, the principle of equitable treatment of shareholders demands that the corporate governance framework affords equal protections and remedies to majority and minority shareholders[12].

Additionally, although not a direct and specific goal of CAF, to guarantee the rights of minority shareholders is an essential require-

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11 *OECD Principles of Corporate Governance*. 2004. Available at: http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf. Accessed on: April 30, 2015.

12 TRICKER, Bob. *Corporate Governance*: Principles, Policies, and Practices. Second Edition. Oxford: Oxford University Press, 2012. p. 133.

ment for the achievement of a level-playing field in corporate restructuring and takeover bids. Therefore, if the primary purpose of the CAF is to ensure such conditions, is of great interest to the minority shareholders of listed companies in Brazil that the CAF has success.

As it shall be analyzed in more detail herein, contrariwise, Professor David Kershaw, of the London School of Economics, suggests that controlling ownership structures halt significant increase in the activity levels of hostile takeovers, which might slow down the Brazilian Panel's take off[13]. Even so, the *Oi/Brasil Telecom* merger case study will intend to demonstrate how the CAF could have provided a fairer handling to minority shareholders in the merger, had it existed and governed the transaction at the time.

5. Main points of debate

i. Enforcement powers and concurrence with the CVM

Because of its private classification as a mechanism of dualistic regulation, the CAF does not have power to adopt its own decisions or penalties for failure to comply with the rules stated in CAF's Self-Regulation Code. It can only give warnings, censure or removal of the "CAF stamp". This means that it works on the basis of reputational prosecutions. Therefore, it is pivotal that the CAF works jointly and cooperatively with the CVM for the due enforcement of actions against players that misbehave.

In fact, the main objective behind the creation of the Brazilian Takeover Panel, which was to implement a more equitable scenario for shifts of control in Brazil, did not aim to confront with CVM and

13 KERSHAW, David. *Corporate Law and Self-Regulation*. March 25, 2015. LSE Legal Studies Working Paper No. 5/2015, p. 20. Available at: http://ssrn.com/abstract=2574201. Accessed on: April 27, 2015.

its enforcement powers granted by federal law. Part of the background preceding the CAF, indeed, finds support in CVM's current understanding regarding managers' duties in negotiating mergers, acquisitions.

It is untainted from review of the CAF's Self-Regulation Code that the independent body is intended to work cooperatively with the Brazilian laws, as its participants choose to be bound by it. Likewise, introductory language in the code sets forth precisely that it should not be considered as a substitute of the applicable legislation nor a substitute of the Brazilian Securities Commission and its own and exclusive enforcement muscles.

Desire to engage the CAF in aiding the CVM observing compliance with market regulation exists. This is why progressive movements on part of the Commission have been seen as to vest the CAF with relevance and authority. Initially, CVM' s non-binding opinion (*Parecer de Orientação*) — Guiding Opinion No. 35 — that reiterates the duty officers of a company have of negotiating an equitable trade of shares and providing an equitable distribution of the transaction premium suggests that the idea behind the CAF is certainly encouraged.

In this regard, Marcelo Barbosa opined that Guiding Opinion No. 35 was a step in the right direction. Barbosa opines, though, that CVM has only issued a recommendation. In order to guarantee the balanced treatment of the various interests at stake, the market still depends on measures that are effectively binding on the parties[14].

It is stated that Guiding Opinion No. 35 is a safe harbor in connection to transactions involving related companies and that transactions that do not follow those guidelines will be subject to closer scrutiny by the CVM. This is where the CAF and its proposed goal may come into play.

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14 Opinion by BARBOSA, Marcelo. Available at: http://www.transparenciaegovernanca.com.br/TG/index.php?option=com_content&view=article&id=120%3Amarcelo-barbosa-&catid=55%3Aopiniao-dos-especialistas&Itemid=230&lang=br. Accessed on: April 30, 2015.

More significantly, in complement to Guiding Opinion no. 35, the CVM joined the CAF in executing a Cooperation Agreement in January 2013. President Leonardo Pereira agreed with the CAF that the corporate reorganization transactions with related parties that are subject to the CAF's Self-Regulatory Code enjoy presumption of regularity.

In publicly stating its support to the CAF, the CVM, the highest body in terms of securities regulation in Brazil, put pressure on market players for adhesion to sounder and more equitable measures when conducting a corporate reorganization. The premium of control new acquirers get has to be balanced out with a voluntary public offering.

It seems clear that the CAF has the same proposition as the United Kingdom's Takeover Panel and this is the motive that led the CVM to grant public support to it: take an unbiased action to defend its rules that depart from the principle of equitable treatment of shareholders. CVM gave "regulatory encouragement" to apply the CAF's rules by assigning a presumed legality to certain transactions submitted to the CAF and, then, waiving, in principle, these deals from further review and scrutiny[15].

In the U.K., should a member breach the Code, it may be publicly criticized or cold-shouldered (which means the removal of authorization for regulators to act on behalf of the person). In result, the player can no longer act in the takeover market in the U.K. Should the Panel conclude that a transaction is faulty, advisers may be exposed to civil liability to clients who suffered loss in relation to the bid concerned. In addition to the cold-shouldering and endorsement of the Panel's decisions by the Financial Services Authority, the Takeover Panel has not needed to seek judicial enforcement of its decisions up

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15 *Supervision and Enforcement in Corporate Governance*. OECD Publishing. Available at: http://dx.doi.org/10.1787/9789264203334-en. Accessed on: April 27, 2015.

to this date[16]. In other words, the Takeover Panel in the United Kingdom has enough power to enforce rulings against its participants. Now, it is imperative to compare the British, indeed, "role model" to the structuralized mechanism in the CAF's Code.

As the Brazilian specialized media rightfully indicates, the British Panel has "raised the bar" and posited a challenge for the CAF to conquer. Allied to strong backup from market participants, the CAF's purpose should be one of pertaining the reputational gain from adhering to it. If the CAF succeeds, as the *Novo Mercado* did, in offering high status to its participants, most of its decisions will prevail. However, as Kershaw, on a Self-Regulation study, disclaimed, attempts to generate space for this regulatory solution — the CAF — have created difficulties in traversing the territorial authority of the existing Brazilian regulator, the CVM[17].

The attitude is direct and fundamentally centered in the point that the CAF lacks. The Code in Brazil makes no attempt to set any enforcement mechanism worth of note. Kershaw's suggestion is truly appropriate: a major compliance result as well the creation of a culture of self-regulatory compliance may occur if key (and coordinating) market players can be given a financial stake in the rules and their enforcement. This means that self-regulatory enforcement purposes will survive if the most relevant players in the market, such as banks, profit from compliance.

ii. Required public offering

Potentially, the main attribute behind the CAF is one of its fundamental principles setting forth the requirement of mandatory ten-

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16 ARMOUR, John. *Enforcement Strategies in UK Corporate Governance*: a Roadmap and Empirical Assessment. April, 2008. ECGI — Law Working Paper No. 106/2008. p. 28. Available at: http://ssrn.com/abstract=1133542. Accessed on: May 2, 2015.

17 KERSHAW, David. Op. cit. p. 17.

der offers by purchasers of stock who acquire between 20 to 30% of a company's corporate capital in a single transaction[18]. The BM&FBovespa recently attempted to include a similar provision in the regulation of *Novo Mercado*, one of its listing segments, but ended up withdrawing its proposal after facing strong resistance from the listed members.

The rationale is, theoretically, straightforward. With the achievement of a determinate stake at a company, it is deemed that the buyer has established a position of holding material ownership interest in the company[19]. The issuance of non-voting shares in the Brazilian capitals market is still widespread. This leads to control being concentrated in the hands of few controlling blocks that will be able to vote in the general shareholders' meetings. The trend is, however, towards less dual-class shares over the time, as *Novo Mercado* standards strive to solidify the "one vote, one share concept". The structuring of a legal framework obliging the mandatory bid with the accomplishment of the Material Ownership Interest is seen by the CAF as an enhancement to the provisions in the Corporations Law.

What is more, the fairness sought by the enhanced tag along trigger under the CAF rules resides in the value to be paid by the shares. The CAF Code sets forth that price must at least be the highest purchase price the acquirer paid in the market for voting shares of the

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18 Article 65 of the Self-Regulatory Code on Mergers and Acquisitions. A shareholder or Shareholders Group that directly or indirectly reaches a Material Ownership Interest in shares of an Adherent Company, in a single or a series of transactions, shall be required (i) promptly to release a notice of material fact, as prescribed by CVM Ruling 358 dated January 3, 2002, and (ii) to carry out a Material Ownership Tender Offer for all other shares, and securities convertible into shares issued by the Adherent Company. Available at: http://cafbrasil.org.br/eng/. Accessed on: April 14, 2015.

19 The Self-Regulating Code defines Material Ownership Interest as: ownership interest in shares carrying voting rights issued by the Adherent Company and representing no less than a percentage stated in the bylaws of the relevant Adherent Company observing the minimum of twenty percent (20%) and maximum of thirty percent (30%) of the voting capital stock. Available at: http://cafbrasil.org.br/eng/. Accessed on: April 14, 2015.

adherent company in the twelve (12) months period prior to the date of the tender offer[20].

This specific point sparked discontent from ABRASCA, because it says that there is a strong reluctance on the part of publicly-held corporations to accept that the price take into account the best market value in twelve months of the shares to be sold[21]. ABRASCA voiced its objection during the drafting period of the Code and was able to squeeze in a provision in which the CAF may lessen the requirement and analyze case-by-case circumstances. In spite of that, ABRASCA opted not to adhere, which may explain why the CAF is yet to make a major breakthrough in the Brazilian capital markets. The view is that the CAF's provision is far-fetched because it does not take into account market volatility, arbitrage and the benefits a new stockholder could bring to a company suffering from critical cash flow issues[22]. It means that, for many bulky entities subject to a controlling shareholder, the CAF rule prevents the receipt of the private benefits of control premium.

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20 Article 65, Paragraph 1.The Material Ownership Tender Offer announcement must be published no later than forty-five (45) days after the date the shareholder hits the relevant Material Ownership Interest threshold (the tender offer trigger). The Tender Offer price must at least equal the following: (i) for voting shares, and securities convertible into voting shares of the Offeree Company, the highest buy price the acquirer paid in the market for voting shares of the Adherent Company in the twelve (12) months period preceding the date of the tender offer trigger, with adjustments to account for corporate actions such as distributions of dividends and interest on shareholders' equity, bonus issues, stock splits and reverse splits, but not any corporate restructuring transactions herein defined as Corporate Restructuring Transactions; and (ii) for non-voting or restricted-voting preferred shares and securities convertible into non-voting or restricted-voting preferred shares, eighty percent (80%) of the price per share offered for voting shares. Available at: http://cafbrasil.org.br/eng/. Accessed on: April 16, 2015.

21 STUBER, Walter; STUBER, Adriana Maria Gödel. *Brazil*: The Adoption Of The Mergers And Acquisitions Committee In Brazil. 2012. Available at: http://www.mondaq.com/x/184328/debt+capital+markets/The+Adoption+Of+the+Mergers+And+Acquisitions+Committee+In+Brazil. Accessed on: May 3, 2015.

22 YOKOI, Yuki. *Selo da paz?* Available at: www.capitalaberto.com.br/pageflip/108/Ed%20108/assets/basic-html/page23.html. Accessed on: May 3, 2015.

This point englobes critical concern from the creators of the CAF because it represents a significant deadlock in agreeing to one on the Panel's main principles, which is equitable treatment of all shareholders. It is fundamental that this discontent is overcome with the agreement of a formula and language that brings together all participants and relevant associations in the Brazilian securities scenario. While the *Novo Mercado* deep-rooted a new set of more stylish corporate governance standards, it did not alter the financials of transactions. The *Novo Mercado* granted a "quality stamp"[23] to companies that adhered to it and required the mandatory bid rule, but for the same conditions of the price paid in the purchase and only in the case of control.

Case Study Oi/Brasil Telecom: When Oi — one of Brazil's largest telecommunications company — decided to acquire Brasil Telecom in April 2008, it envisioned merging the two companies into one only listed company (Oi S.A.). For this type of transaction, CVM's Guiding Opinion No. 35 recommends that the transaction is approved by majority of the non-controlling shareholders or that a special independent committee is installed. Oi opted for the latter.

There was market consensus that the merger had sufficient synergy to be regarded as positive for both companies, as procedures would simplify and increase the geographic reach as well as costumers' base. Minority shareholders opposed, however, to the creation of the independent committee, set up to determine how the stock and assets exchange process in the merger would be, because it was prejudicial to the minority group, especially for the short amount of time the committee allowed for the evaluation of the presented exchange ratios.

The justification and objective points did not converge: the basis of exchange was the market value of the shares. Arguably, inves-

23 CARVALHO, Antonio Gledson de. *Corporate Governance in Brasil from a Retrospective Point of View* (Governança Corporativa no Brasil em Perspectiva). August 1, 2001. p. 27. Available at: http://ssrn.com/abstract=1147801. Accessed on: May 3, 2015.

tors in the matured telecommunications market in Brazil, a segment controlled by very few players, expected an aggressive dividends policy, which in Brasil Telecom's case was modest. In 2010, the pay-out-ratio of dividends over the company's profits was of twenty five (25%) — the minimum accepted by law, but the company had one of the lowest debts in the sector. This, it was argued, reduced the dividend yield of the company compared to competitors[24].

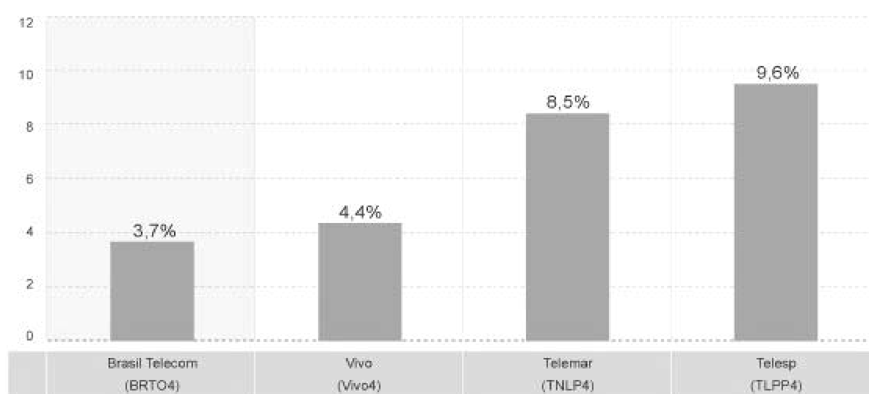

Figure 1[25]

**Retorno de dividendos* = dividend yield

It is argued that had the CAF existed — and the company ob-

24 ROCHA, André. *A operação da Oi foi justa com os minoritários da Brasil Telecom?* September 13, 2011. Available at: www.valor.com.br/valor-investe/o-estrategista/1005574/operacao-da-oi-foi-justa-com-os-minoritarios-da-brasil-telecom. Accessed on: May 1, 2015.

25 Available at: www.valor.com.br/valor-investe/o-estrategista/1005574/operacao-da-oi-foi-justa-com-os-minoritarios-da-brasil-telecom. Accessed on: May 2, 2015. Reproducing a graph from *Economatica.*

served the Code — good part of the discontent and controversy might have been surpassed by means of public and market pressure on the situation. Minority shareholders understood that self-dealing was happening since the members selected to comprise the independent committee were not really independent — as they were part of the board of directors of the company. The CAF also requires the board of directors to precisely explain its decisions and methodology in the appraisal of assets in corporate reorganizations.

iii. Prohibition of Poison Pills

To challenge the actions of a corporation's board of directors or officers — and, thus, prevent the so called "agency problem", poison pills mechanisms aim to prevent actions that may harm the interests of the company that is subject to threats of a hostile acquisition. The poison pills will mean that principles of business judgement rule are a defense shield, especially for managers who are also equity holders at corporations. Defense methods cause officers to be out of the comfort zone and apply the best and fairest possible administration skills in the interest of everyone in a company.

As ownership structures have been changing, one may think that potential buyers might be able to acquire control more easily in the market. However, antitakeover mechanisms are inserted in the public companies' bylaws. In Brazil, the predominant takeover defense is a provision in the company's charter that allows current shareholders to sell their shares to an acquirer who attains a critical limit of target's shares. In this sense it resembles the mandatory tender offer required by law but is triggered by a lower threshold of shares' acquisition[26].

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26 GORGA, Érica. *Changing the Paradigm of Stock Ownership*: From Concentrated Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries. April, 2008. 3rd Annual Conference on Empirical Legal Studies Papers. p. 47. Available at:

The adoption of poison pills has been historically discussed in cases presented before the Delaware Supreme Court and consequently, impacted the formulation of contractual law — i.e. bylaws — of open-capital companies in Brazil. *Smith v. Van Gorkom* set the precedent that to determine whether a business judgment reached by a board of directors was an informed one, there has to be determination if the directors were grossly negligent. In sequence, *Moran v. Household*, indicated the need to assessing the validity of the statutory poison pills to the business judgment rule. Since *Moran*, the use of poison pills in form of shareholders' rights plan has extensively become an attractive mechanism, together with the idea of staggered boards, for American companies to defend themselves from threats of hostile takeovers[27].

On the other hand, however, the Brazilian model took inspiration in the Takeover Panel due to the fact that the reality of control dispersion in the country has progressed exponentially.

Much light has been shed on the CAF's prohibition to the adoption of poison pills in the bylaws of companies that adhere to the Panel. The final result is that investors' money flow to the company and under the "director primacy" principle, small investors tolerate the system of dependency on directors' discretion for corporate decisions[28]. Under the efficient rent protection explanation indicated by Bebchuk, antitakeover arrangements reduce the value of the shares of public investors[29].

The author adds that board veto provisions remove the disci-

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http://ssrn.com/abstract=1121037. Accessed on: April 20, 2015.

27 See generally BRATTON, William W. *Corporate Finance*. New York: Foundation Press, 2008.

28 STOUT, Lynn A. Bad and Not-so-Bad Arguments for Shareholder Primacy. *Cornell Law Faculty Publications*. Paper 448, p. 1205, 1206, 2002. Available at: http://scholarship.law.cornell.edu/facpub/448. Accessed on: May 4, 2015.

29 BEBCHUK, Lucian A. Why Firms Adopt Antitakeover Arrangements. *University of Pennsylvania Law Review*, v. 152, p. 713-753, 2003; *Harvard Law and Economics Discussion Paper No. 420*, p. 3, 2003. Available at: http://ssrn.com/abstract=404200. Accessed on: May 2, 2015.

plinary force that the threat of a takeover can have on managers, as without fear, they might not look to reduce the costs and increase profit margins for the shareholders[30].

Stout poses arguments for director primacy based on shareholders' long-run interests, such as the fact, pointed out by Bratton, from a financial perspective, that the most profitable companies are the ones who borrow the least — which creates the hypothesis that managers of the best-performing firms tend to forego maximization of shareholder value[31].

Companies that adhered to the *Novo Mercado* vetoed a provision that aimed to prevent new corporations opting for a *Novo Mercado* listing from adopting overly restrictive mandatory bid requirements in their bylaws — and thus representing antitakeover defense shields. This is in consonance to Brazil's loose definition of what disperse control is. Companies that have disperse control may either have a major block holder controlling the company, or equity holders with less than 50% but that hold a number of voting shares that gives them *de facto* control in general assemblies.

The reluctance of the CAF to accept poison pills is seen in the body's mandatory bid rule. The measure aims to end with poison pills by forbidding companies of inserting statutory obligation of a tender offer in case a certain relevant stake (defined at the bylaws). The result intended is that by not allowing a trigger lower than 20% for the tender offer, companies and managers are not isolated from takeovers.

6. Conclusion

This is the usual maturation process of a new reference focu-

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30 BEBCHUK, Lucian A. Op. cit. p. 713-753.

31 BRATTON, William W. Op. cit. p. 235.

sed on raising the bar of corporate governance standards. CAF may represents a qualitative leap when it comes to the Brazilian stock market, with a significant increase in investors' confidence and a clear differential over other emerging markets. The investors' role, encouraging companies to adhere to or consult with CAF, will be essential for its consolidation. For that, the CAF will benefit from taking note of suggestions from all sides in the financial market in order to adjust its Code.

Participants in the private practice sector understand that because the entities that form the CAF are institutions whose agenda includes the protection of minority shareholders' rights in listed companies. This in itself indicates that the discussion of rules of the CAF and the nomination of the members of the Committee itself will take into account the positioning of these institutions.

Having the CVM land its official support to the existence and activity of the Brazilian Takeover attempt is remarkably important vis-à-vis the intended increase in shareholding fairness. The level of regulatory dualism in a country where the state had failed to frame proper corporate jurisprudence, such as Brazil, is credible. The mandatory bid rule is a keystone norm for the Panel since it gives minority holders the certainty of an exit option in several forms of control modification.

Mergers and acquisitions activity in Brazil, as well as corporate reorganizations, remain vivid. But in order to efficaciously replicate the British architected Panel and success, relying on Professor David Kershaw's theory might be helpful: alternative norms and relaxation of the rule integrity on the mandatory bid price might have speeded up the listing of companies to the CAF[32]. Where financial players, such as investment bankers and private equity, see a decrease in the premium arising out of transactions, their support for the system

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32 *See generally* KERSHAW, David. Op. cit.

might not happen. This may, ultimately, turn the whole effort somehow innocuous.

Because of the numerous interests in the securities market, the CAF's step towards fairer treatment for minority shareholders is useable. It is essential that the body continues to obtain support from the CVM and pledges to have actual enforcement power. The CAF could add value to its own existence from revisiting its mandatory bid rule in order to gain backing from the publicly-held companies. In a market with large ownership concentration, in spite of the existence of emerging companies and business that abide to the *Novo Mercado*, it is difficult to fence off financial interests surrounding change of control transactions. If the CAF is able to integrate, to the maximum extent, the interests from groups of minority shareholders, investors and controllers, it may represent, in the long-term, another valuable addition to regulatory dualism in Brazil and inspire other emerging markets.