REMARKS ON SHAREHOLDERS ACTIVISM IN LATIN AMERICA

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Shareholders Activism is relatively new in the Latin American corporate scenario. Minority Shareholders protection is consistently shy if compared with more matured markets of the Anglo Saxon world or Europe.

In the small economies of the hemisphere, companies have been largely dominated by family groups that have diversified into a vast variety of economic sectors. On the other hand, in the smaller Latin American economies, stock markets are not very active and have become basically debt issuance venues, rather than markets to offer shares of listed companies. Hence, in those smaller economies, corporate governance was not at the forefront of issues in the corporate world and minority protection was very limited, sometimes inexistent, unless contemplated in shareholders agreements or company statutes. However, with the opening of economies, the incursion of foreign strategic and institutional investors and some degree of legal reform, there are signs of shareholders activism equivalent in some of the larger economies and in particular in those, with a more consolidated stock exchange.

Over the past decades institutional investors such as pension funds and insurance companies, employee organizations or unions have increased their presence in companies in Latin America and further, become more active and interested in governance issues, performance and results.

As in other jurisdictions around the world, there has been a shy growth in shareholders activism inspired by US investors and bolstered by the globalisation of the financial markets in general.

Nevertheless, in the jurisdictions analysed for purposes of this paper, there is no evidence of specific legal reform or amendments to formally regulate shareholders activism, given the civil law tradition that prevails in the Latin American legal market.

As markets matured and open, the larger economies in Latin America has seen signs of increased, albeit still shy, shareholders activism. Privately managed pension funds in Latin America are expanding their investment profile into equity securities. Given their focus on long-term investing, these institutions can serve as valuable allies in an activist campaign.

Some of the flourishing shareholder claims challenging M&A transactions can be seen in cases such as the lawsuit filed by an ex-minority shareholder of Latam Airlines, the lawsuit filed by a minority shareholder of CorpBanca, the Enersis/Endesa case, the Grupo Oi SA/Portugal Telecom case, the dispute initiated by minority shareholders of Grupo Éxito in Colombia and the claim issued by minority shareholders of Avianca Airlines.

The legal grounds on which minority shareholders base these kinds of claims in jurisdictions such as Brazil, Chile and Colombia can be categorised as: (i) breach of fiduciary duties by directors and officers; (ii) oversight and information rights that the shareholders have; (iii) appraisal rights when certain transactions take place; and (iv) abuse of voting rights by the majority shareholder.

As indicated supra, minority shareholders across Latin America have a variety of legal mechanisms that they can use to protect their rights. Although there is still a long way to go to consolidate minority shareholder rights in Latin America, courts are now more aware of the existence and implementation of such rights and are starting to become more sophisticated in resolving these cases. As a result of this activism, minority shareholders are exerting pressure on company management and this helps companies and their directors to become more diligent and careful in the performance of their duties.

For instance, in Mexico, one of Latin America´s largest economies and most active stock exchanges, recent legal amendments have established stronger and more effective minority rights. The following are the most relevant in non-public companies:

- At least 22% of the capital stock is required in order to appoint a member of the board of directors (or an examiner) when the company has three or more shareholders.
- 33% of those present at a shareholders' meeting have the right to request a postponement of the resolution of an issue for three days without it being necessary to formally call a new meeting.
- 33% of the capital stock can object to a resolution before a court, provided such shareholders voted against the resolution or did not attend the meeting. The claim to object to a resolution must be filed within the following 15 days after the closure of the meeting, establishing which provision of the law or bye-laws was violated.
- 33% of the capital stock can request the board of directors to call a shareholders' meeting if no meeting has been held for two consecutive years or if in the meeting, the issues on the agenda of the annual meeting were not discussed.

In public companies, under the Securities Market Law (Ley del Mercado de Valores):

- Shareholders with voting rights that individually or jointly represent 10% of the capital stock can appoint a member of the board of directors and/or an examiner.
- Shareholders with voting rights that individually or jointly represent 10% of the capital stock can request the examiner or president of the board of directors, at any time, to call a shareholders' meeting regarding issues related to their voting rights and can request the postponement of a resolution on a meeting's issue with respect to which they feel uninformed.

- Shareholders with voting rights that individually or jointly represent 20% of the capital stock can object to a resolution related to their voting rights taken in a general meeting.

In jurisdictions such as Brazil, Colombia and Chile, dissenting shareholders have the right to withdraw from the company and be paid for their shares (either by the company or remaining shareholders) if the general shareholder assembly decides to merge, transform or spin-off.

In addition to the previous protections, in Colombia and Brazil shareholders have the right to sue other shareholders who have abused their voting rights to obtain a personal benefit, which goes against the interests of the company or causes damage to the minority shareholders or to the company.

Another force that unfortunately has prompted shareholders activism in Latin America is the level of corruption in some jurisdictions. As a result of the numerous investigations on corrupt practices and the losses experienced by shareholders in the value of their shares due to the mismanagement of companies, the level of shareholder activism in countries such as Brazil, Mexico and Argentina, is increasing and is forcing companies to establish stricter corporate governance and internal control policies.

Most of the shareholders activism cases in Latin America focus on corporate governance, designation and compensation of directors, performance, financial results and anticorruption practices.

In line with the above, Perú published the 17th Investment Confidence Index in 2017 which gathers the perspective of executives of companies of diverse economic sectors. Said study identified as one of the main findings that the shareholders activism is growing and that the companies shall recognize the need of an inclusive growth strategy. According to said study:

- 13% consider that activism will become a relevant subject in the agendas of the board of directors
- 68% consider that activism will remain passive, whereas 26% consider that it will grow
- 21% consider that the increase in shareholders activism will become a sensitive topic in M&A transactions

According to prominent Mexican attorney Daniel del Rio, some practical steps that a company can take to minimise the risk of being targeted by an activist shareholder include the following:

- Including clauses in the bye-laws to prevent hostile takeovers.

Including prohibitions in the corporate bye-laws stating that a shareholder cannot own more than 49% of the capital stock.

- Improving vulnerable areas of the company which the activist shareholder may attack.

- Gaining a better understanding of the shareholders by working with consultants and advisors to ensure a good understanding of investor policy.

SOME EXAMPLES OF SHAREHOLDERS ACTIVISM IN LATIN AMERICA

I. BRF/PREVI case in Brazil

One of the most sounded activism cases concerns BRF SA, the Brazilian super diversified food giant, when it reported a record annual loss for 2017.

Previ, Brazil's biggest pension fund, sent a letter in within 48 hours, demanding BRF Chairman Abilio Diniz convene a shareholder meeting to remove the entire board, including himself. After a two-month fight, Previ succeeded: Investors voted in five new directors and replaced Mr. Diniz with a new independent Chairman.

That success is just the latest example of how the pension fund, which counts more than 200,000 current and former employees of Banco do Brasil as participants, is using its 180 billion reais ($50 billion) in assets under management as ammunition in a minority-shareholder rights war.

> *"As part of its new activism, Previ will stop participating in groups with controlling interests in a company, which limit the pension fund's ability to exit investments whenever it wants. It's seeking out companies that prioritize transparency, good governance and respect for minority shareholders' rights. (…) As part of the strategy shift, Previ participated in the initial public equity offering of Petrobras's fuel unit in December, buying 10% of the roughly 5 billion reais raised. It was the second-biggest investor, partly because the company agreed to be listed on Brazil's "New Market," which demands a stricter set of governance rules, including a minimum free-float to help boost liquidity."* reported one of Brazil´s top business publications.

Interesting enough, Latin Finance reported a few months before the Previ case was made public that Brazil's securities regulator, the CVM, expressed cautious optimism on the rise of Latin American shareholder activism: "The existence of shareholder activism is a natural

process and may bring very positive results," … "When the different players involved are duly conscious of their roles, dialogues are extremely productive, technical, and contribute effectively to the capital markets' evolution."

II. Unión Andina de Cementos S.A.A. ("UNACEM")

In 1967 UNACEM engaged Sindicato de Inversiones y Administración S.A. (SIA) -company affiliated to the controlling sharholders to manage the company. The agreement had particular provisions, such as, (i) automatic and indefinite renewal and (ii) a consideration in favor of SIA equivalent to 10% of UNACEM´s profits.

In 2017, minority institutional shareholders requested an international consultancy company to review the agrrement with SIA on the basis that the consideration agreed upon affected their interest and reduces their expected earnings

In 2018, the consultant issued its report, indicating that the contract was not consistent with market conditions and that the benefits this contract brought to UNACEM were not evident.

As a result thereof, the company integrated a committee to analyse a proposal to modify the agreement with SIA or terminate the agreement. The proposal was expected by the end of 2018. Nevertheless, the report was not issued as UNACEM decided to merge with SIA and two other companies.

III. Corporación Lindley S.A. ("Lindley")

In 2015, Arca Continental -a Mexican company- acquired 53.16% of Lindley, a Peruvian company controlled by the Lindley family. As the company was not listed in the stock Exchange, the acquisition was based on a private SPA, with the following basic terms and conditions (a) Arca Continental (i) payment of the purchase price for the shares $760 million and an additional consideration of $150 million for a non competition covenant and (ii) additional acquisition of 2.03% of preferred shares owned by Lindley. On the other hand (b) the Lindley family, as seller undertook to (i) purchase 64,5 million shares of Arca Continental and (ii) acquire non strategic assets owned by Lindley for $137 million (lthe "Transaction").

Several minority institutional shareholders reacted against The Transacción on the basis that minority protection provisions were infringed and they were not included in the negotiations and the Transaction violated transparency principles as seller never disclosed as relevant matter the negotiations, as required by the regulator of securities.

As a result of the manifestations of disconfort in 2015, Arca Continental made an offer to the institutional shareholders to acquire their shares. The minority shareholders rejected the offer arguing it was unfair and not at fair market value. Neverthless, Arca Continental managed to acquire around 20% of the preferred stock of the minority shareholders.

The institutional shareholders started a campaign against The Transaction and in 2016 the securities regulator imposed a fine on Lindley for not disclosing the Transaction as a relevant matter given the change of control and for not using fair market value for the acquisition of the additional package of shares.

IV. Enersis

A controlling group of shareholders of Enersis – an energy group in Chile – that were also the managers of the company, made a special deal to sell their shares in Enersis to Endesa España at a better price than the shares of other shareholders, and with special personal benefits. Once the situation was known, some of the minority shareholders objected to the transaction. As a consequence, the Securities Superintendence sanctioned such managers with fines on the grounds of acting in conflict of interest and for breaching their director duties. Although the transaction still went ahead, the conditions by which the controlling shareholders would be favoured were eliminated.

V. Capital Airports Holding Company v CAH Colombia SA (Ruling No. 800-020 of 2014).

The majority shareholder of CAH Colombia (CAH) filed a claim against the company for a decision taken by the shareholders' assembly, without its participation, that led to an abusive dilution of its capital participation. Azzaro Internacional SA, a minority shareholder of CAH, taking advantage of the absence of the majority shareholder, approved an issuance of shares, not subject to pre-emptive rights and at face value. In this case, the SS found that the capitalisation was abusive, as it was directed, mainly, to reduce CAH shareholding in the company, in an apparent attempt to prevent CAH from selling its majority block to a third party