SHAREHOLDER LITIGATION IN BRAZIL: THE OVERLOOKED ROLE OF RESCISSION LAWSUITS

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SHAREHOLDER LITIGATION IN BRAZIL: THE OVERLOOKED ROLE OF RESCISSION LAWSUITS

André Elias Schwartz[*]

Abstract

Brazilian corporate law enforcement is widely held as ineffective. This perception stems from the stated dearth of derivative suits in the country, even though little is known about how shareholder litigation plays out in practice. Against this backdrop, comparative studies on the subject argue that, in jurisdictions where derivative suits are rare, shareholders often resort to lawsuits aiming to invalidate general meeting resolutions to address grievances. Considering this scenario, this article presents a close examination of shareholder litigation in Brazil by surveying precedents from the Court of Appeals of São Paulo between 2015 and 2020. It reveals that, following the experience of several other civil law jurisdictions, the rescission suit is the main judicial remedy sought by shareholders in the country. It also shows that, more often than not, rescission suits are judged in favor of plaintiffs, even though they still leave gaps in investor protection. By shedding light on this reality, this article unveils the dominance of rescission suits in judicial corporate disputes in Brazil and offers further support to the OECD's existing recommendations to strengthen the country's legal framework for derivative suits.

INTRODUCTION

There is a widespread perception that the Brazilian system of private enforcement of shareholder rights is ineffective.[1] Among the main diagnoses in this regard is that the country has very few judicial cases of derivative litigation,[2] as noted by a recent OECD report offering

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[1] *See* Guilherme Setoguti J. Pereira, *Arbitragem, Confidencialidade e Desenvolvimento do Direito Societário e do Mercado de Capitais: O Brasil Fez a Escolha Certa?* [Arbitration, Confidentiality and the Development of Corporate Law and the Capital Market: Did Brazil Make the Right Choice?], *in* 3 DIREITO SOCIETÁRIO, MERCADO DE CAPITAIS, ARBITRAGEM E OUTROS TEMAS: HOMENAGEM A NELSON EIZIRIK 309, 313–315 (Rodrigo Rocha Monteiro de Castro et al. eds., 2021).

[2] As per "derivative litigation," this article refers to lawsuits initiated by shareholders on behalf of the company against corporate fiduciaries – directors, officers and controlling shareholders. *See* Part I. On the dearth of derivative litigation

recommendations to strengthen Brazil's framework for investor protection.[3] Despite ongoing debates for reforms based on the OECD report, there is a lack of empirical studies investigating how shareholder litigation has been playing out in practice in Brazil.

Although the dearth of derivative litigation in Brazil strikes many commentators as startling,[4] this article suggests that this situation is not quite as bad as one might believe. Brazil is not the only country where derivative lawsuits turn out to be an unpopular mechanism for the enforcement of shareholder rights. In the face of severe disincentives for derivative litigation, investors in Brazil seem to rely on an alternative mechanism to create at least some deterrence against wrongdoing by managers and controlling shareholders. Through comparative studies on the subject covering several Continental European jurisdictions, Professor Martin Gelter[5] shows that, in civil law jurisdictions, shareholder litigation typically relies on lawsuits seeking to invalidate decisions taken in the shareholder meeting—rescission lawsuits—which

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in Brazil, *see*, e.g., Paulo Cezar Aragão, *A CVM em Juízo: Limites e Possibilidades* [The CVM Before the Courts: Limits and Possibilities], 34 DIREITO REVISTA DE DIREITO BANCÁRIO E DO MERCADO DE CAPITAIS 38, 40 (2006) (noting that in the more than thirty years of authority of the 1940 Corporations Law, only one liability lawsuit against officers or directors has been brought); Paulo Cezar Aragão, *Aspectos Processuais da Legislação Societária* [Procedural Aspects of Corporate Legislation], *in* 3 PROCESSO SOCIETÁRIO 636 (Flávio Luiz Yarshell & Guilherme Setoguti J. Pereira eds., 2018) (noting that in almost forty years of authority of the 1940 Corporations Law, the Brazilian judiciary has examined very few liability suits); Viviane Muller Prado & Vinicius Correa Buranelli, *Relatório da Pesquisa de Jurisprudência sobre Direito Societário e Mercado de Capitais no Tribunal de Justiça de São Paulo* [Report on a Survey of Jurisprudence on Corporate Law and Capital Markets in the Court of Appeals of São Paulo], 9 CADERNO DIREITO GV 36 (2006) (noting that liability lawsuits against directors, officers or controlling shareholders were not frequent in the sample); Viviane Muller Prado, *Não Custa Nada Mentir: Desafios para o Ressarcimento de Investidores* ["It Costs Nothing to Lie": Challenges for Investor Compensation], ACADEMIA (Jan. 21, 2022, 11:03), https://www.academia.edu/28762978/N%C3%83O_CUSTA_NADA_MENTIR_desafios_para_o_ressarcimento_de_investidores (noting that the survey of precedents from state and federal courts from the South and Southeast regions of Brazil did not reveal a single liability lawsuit with a decision on the merits).

[3] ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT [OECD], PRIVATE ENFORCEMENT OF SHAREHOLDER RIGHTS: A COMPARISON OF SELECTED JURISDICTIONS AND POLICY ALTERNATIVES FOR BRAZIL (2020), http://www.oecd.org/corporate/shareholder-rights-brazil.htm.

[4] *Supra* note 2.

[5] Martin Gelter is Professor of Law at Fordham University School of Law and Research Member of the European Corporate Governance Institute.

act as an alternative given the existing barriers to the filing and success of derivative suits.[6]

The goal of this study is to examine whether this finding also applies to the Brazilian context. It reveals that shareholder litigation in Brazil follows the pattern identified in other civil law countries, with a prevalence of rescission suits. It also finds that, while plaintiff shareholders have not obtained compensation in a single derivative suit during the period examined, they have succeeded in more than half of the rescission suits surveyed. This article notes, however, that the rescission suit still leaves gaps in shareholder protection in Brazil. In bringing this reality to light, this study reinforces the relevance and urgency of a legal reform that improves Brazil's framework for the private enforcement of shareholder rights.

The exposition is organized as follows. Part I offers a brief overview of Gelter's taxonomy of shareholder litigation mechanisms, informed by considerations on the incentives that lead a certain type of lawsuit to prevail. Part II outlines the shareholder lawsuits prescribed by Brazilian corporate law and the institutional incentives to bring them in light of the theoretical framework presented by Gelter. Part III analyzes reality in Brazil by surveying liability and rescission suits from January 2015 to December 2020 decided by the country's most active Court of Appeals on corporate law, the Court of Appeals of São Paulo. Part IV assesses the OECD recommendations to strengthen Brazil's framework for the private enforcement of shareholder rights in light of the factual scenario revealed in Part III. Part V concludes.

I. THE "ANNA KARENINA PRINCIPLE" AND THE "PATH OF LEAST RESISTANCE" IN SHAREHOLDER LITIGATION

In a study published in 2018, Gelter proposed a taxonomy of shareholder lawsuits across jurisdictions based on the type of harm they address.[7] The author identifies four types of harm, two of which are

[6] Martin Gelter, *Mapping Types of Shareholder Lawsuits Across Jurisdictions*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 459, 459 (Sean Griffith et al. eds., 2018) ("In the civil law world, derivative litigation and close equivalents exist, but often another form of shareholder litigation takes a more prominent role, namely litigation regarding the validity of shareholder resolutions.").

[7] *Id.* at 461–70.

relevant to this analysis.[8] The first type of harm is the one inflicted *upon the corporation*, which affects shareholders reflectively due to a loss in value of their shares. This type of harm results from careless business decisions or transactions benefiting either the fiduciary or controlling shareholders.[9]

The second type is *direct harm to shareholders* without any corresponding loss to the corporation, as when controlling shareholders dilute the minority's ownership stake.[10] According to Gelter, this typically happens when new shares are issued (for example, to a majority shareholder at a low price), when shares are repurchased and in the course of a merger where shareholders received inadequate compensation.[11]

From these categories, Gelter contrasts two types of shareholder lawsuits: those addressing *harm to the corporation* and those addressing *harm to shareholders*. The author observes that seeking redress for harm

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[8] In addition to the two types of harms mentioned herein, Gelter points out a third type, which is present when shareholders are "formally treated equally, but a particular conduct, or the absence of such conduct, has a more significant impact on some shareholders than on others, resulting in particular harm to the former." *Id.* at 461. According to the author, that is the case, e.g., of situations in which majority shareholders withhold profits, remove minority shareholders from management positions or enter into shareholder agreements that lock "minority shareholders into a position where they can expect neither profits nor capital gains . . . in order to coerce them to sell at a low price." *Id.* at 461. Gelter explains that this happens mostly in closely held firms, whose shares are normally an illiquid investment. The remedy envisioned against this type of harm is typically dissolution. For an in-depth analysis of the enforcement of the *partial dissolution lawsuit* in business companies in Brazil, *see* Gebran, *infra* note 29. Moreover, Gelter mentions a fourth type of harm: "shareholders in publicly traded firms may be harmed by false and misleading information being publicized by the company." Gelter, *supra* note 6, at 461. Considering that this type of harm typically falls within the purview of securities law, the author excludes it from his shareholder lawsuits taxonomy.

[9] Gelter, *supra* note 6, at 460. Such practices are associated with the agency problems between (i) shareholders and managers and (ii) controlling and noncontrolling shareholders, respectively. *See* John Armour et al., *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 29–30 (John Armour et al. eds., 3rd ed. 2017) [hereinafter ANATOMY OF CORPORATE LAW].

[10] In Delaware, dilution claims are now considered solely derivative, not direct. This understanding limits the ability of minority shareholders to bring such claims in the wake of a consummated merger since, following an acquisition of all shares, they lose their standing to pursue derivative claims. *See* Brookfield Asset Mgmt., Inc. v. Rosson, 261 A.3d 1251 (Del. 2021).

[11] Gelter, *supra* note 6, at 460.

to the corporation is usually a task assigned to its officers. Many jurisdictions, however, authorize shareholders to pursue a claim on behalf of the company should officers not do so, therefore permitting *derivative lawsuits*.[12] On the second group of lawsuits, Gelter notes that shareholders who suffer direct harm are often authorized to claim compensation on their own behalf through a *direct lawsuit*.

Regarding mechanisms seeking redress for harm to shareholders as a class, the author highlights the North American direct class action, which allows a single shareholder to claim for compensation on its own behalf and on behalf of other same class shareholders. Also, Gelter points to the existence of a functional equivalent to the direct class action in civil law jurisdictions: the *rescission lawsuit*, which seeks to rescind or nullify decisions taken in the shareholder meeting.[13]

In a 2012 article, Gelter argues that shareholders will seek the "Path of Least Resistance" in litigation.[14] That is, if a legal system imposes barriers to pursuing a certain type of legal remedy, disgruntled shareholders will resort to other enforcement mechanisms.[15] To support this idea, the author formulates the "Anna Karenina Principle"[16] for shareholder litigation, namely, the preconditions for a particular type of lawsuit to become a frequently used enforcement mechanism for investor protection.[17] Those can be put into three categories.

First, shareholders must face favorable standing requirements and have the opportunity to sue potential wrongdoers. As described by the author, several civil law jurisdictions require shareholders (or groups of shareholders) to hold a qualified percentage of the company's shares or a specified amount of capital to bring a derivative suit. These

[12] *Id.* at 461–462.

[13] *Id.* at 463. On the technical level, there is typically a distinction between resolutions that are subject to rescission and those that are null and void. However, the Brazilian corporate law treats these situations indistinctly, since it allows for the filing of the rescission suit to challenge all kinds of defects related to the general meeting. *See* Part II.B.

[14] Martin Gelter, *Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?* 37 BROOK. J. INT'L L. 843, 844–46 (2012).

[15] *Id.* at 845.

[16] This refers to Leo Tolstoy's classic novel, where families share a number of core characteristics that must all be present to ensure a happy family life. Analogically, Gelter argues that jurisdictions must present a certain factor selection to provide an adequate incentive to shareholder litigation.

[17] *Id.* at 856–80.

jurisdictions also tend to restrict derivative suits in scope by not allowing the inclusion of controlling shareholders as defendants.[18]

Second, litigations costs and risks must be favorable to the plaintiff shareholder both at the *ex ante* and *ex post* stages.[19] At the *ex ante* stage, upfront court fees, in particular if they are measured as percentages of the amount in dispute, and the requirement to provide a deposit to cover litigation costs may deter litigation. At the *ex post* stage, applying the "loser pays" principle—that is, requiring the losing party to pay for not only its own expenses, but also the winner's—also hinders lawsuits. The same deterrent effect is obtained by authorizing any premium resulting from a successful derivative suit to be shared among shareholders in a way that litigation risks fall on the plaintiff, but any bonuses are shared with class members.[20] To have an incentive to sue, the potential benefit from successful litigation must outweighs its costs.[21]

Third, plaintiff shareholders must have access to all information necessary to establish a colorable claim. Information asymmetry represents a significant barrier to derivative litigation due to the general difficulty for minority shareholders to prove the violation of fiduciary duties, given that they usually do not have access to the corporate records that might substantiate the suit.[22] Overcoming such a barrier depends on the existence of procedural rules of efficient allocation of the burden of proof or pre-trial discovery.

According to Gelter, only the United States and Japan seem to "get it right" with respect to all necessary criteria to make derivative litigation successful.[23] The absence of any of the preconditions outlined in the "Anna Karenina Principle" in a derivative litigation model reduces its attractiveness for potential plaintiffs, who will most likely resort to other

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[18] Gelter, *supra* note 6, at 471–73.

[19] *Id*. at 473–74.

[20] This represents a notorious freeriding problem in derivative litigation. *See* OECD, *supra* note 3, at 24 ("At first glance, shareholders' incentive to sue looks weak. Plaintiffs only benefit from such a suit in proportion to their shares in the company, while the remaining benefits accrue to others. Nevertheless, they typically have to invest time and bear the cost.").

[21] It is important that jurisdictions strike a balance between adequate incentives and legal mechanisms for shareholders to seek redress while avoiding excessive litigation. *Id.* at 24 ("An effective litigation mechanism therefore needs to walk a tight line between over- and under- litigation. An ideal system will permit meritorious suits to go forward and shut down abusive ones at an early stage.").

[22] *Id.* at 8; Gelter, *supra* note 6, at 474–475; Buschinelli & Breschiani, *infra* note 46, at 256.

[23] Gelter, *supra* note 14, at 845.

mechanisms. In civil law jurisdictions, the "Path of Least Resistance" for shareholder litigation tends to be the rescission lawsuit.[24]

There are several reasons for that. In most civil law jurisdictions, rescission suits have liberal standing rules and do not require a minimum ownership threshold. Moreover, the allocation of cost and risk is favorable for plaintiff shareholders. The amount in dispute, which determines the amount of court fees the plaintiff has to advance, is normally limited and foreseeable.[25] Finally, suits of this type are generally easier to bring because they clear away the issue of access to information, as they are often based on allegations of non-compliance with procedural aspects rather than violations of fiduciary duties.[26]

II. THE INSTITUTIONAL FRAMEWORK FOR SHAREHOLDER LITIGATION IN BRAZIL[27]

To test the applicability of the shareholder litigation pattern mentioned by Gelter to Brazil, it is first useful to explore the shareholder lawsuits prescribed by the Brazilian Corporate Law (*Lei das Sociedades por Ações* – LSA)[28] and the institutional incentives to bring them, in light of the theoretical framework presented by the author.

The LSA subjects officers and controlling shareholders to a stringent set of duties and responsibilities (LSA articles 116, 117, 153 through 158, and 245). To enforce those corporate reins, the LSA prescribes lawsuits which can be properly categorized under Gelter's

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[24] Gelter, *supra* note 6, at 466.

[25] In many Continental European countries, the amount in dispute is limited to the lower of 10% of the corporation's nominal capital or EUR 500,000. *See* Gelter, *supra* note 14, at 887.

[26] Gelter, *supra* note 6, at 478.

[27] *See* OECD, STRENGTHENING THE ENFORCEMENT OF SHAREHOLDERS' RIGHTS (2019), http://conteudo.cvm.gov.br/export/sites/cvm/menu/acesso_informacao /serieshistoricas/estudos/anexos/interim_report_strengthening_the_enforcement_of_s hareholders_rights.pdf; *see also* OECD, *supra* note 3.

[28] LAW NO. 6,404 OF DECEMBER 15, 1976 [LSA] [BRAZILIAN CORPORATE LAW] (Braz.), https://conteudo.cvm.gov.br/export/sites/cvm/subportal_ingles/menu /investors/anexos/Law-6.404-ing.pdf. This official translated version does not include the changes in the LSA introduced by the recent Law No. 14,195, *infra* note 104.

taxonomy into two types: those seeking to address (i) *harm to the corporation* and (ii) *harm to shareholders*.[29]

A. Lawsuits Addressing Harm to the Corporation

In Brazil, lawsuits addressing harm to the corporation are termed corporate suits (*ações sociais*), which can be divided into (a) *direct corporate suits* and (b) *derivative suits*, depending on whether the company is represented by its officers or shareholders.

When an officer or director causes losses to the corporation's property by acting within the scope of its authority with fault or wrongful intent or by breaching the law or the corporate charter's provisions (LSA article 158), the corporation is entitled to bring an action for civil liability pursuant to LSA article 159.[30] It is a precondition

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[29] This study focuses on the lawsuits prescribed by LSA which fall under the taxonomy presented by Gelter, i.e., lawsuits addressing harm to the corporation or to shareholders, with no intention of covering all the legal mechanism available for investor protection under the Brazilian corporate system. *See* Gelter, *supra* note 6, at 444. It is noteworthy that there is an important discussion about the rise of the *partial dissolution lawsuit* as a protection mechanism available to shareholders of business companies in Brazil. For an in-depth analysis of the enforcement of such mechanism, *see* João Gebran, A Efetivação da Dissolução Parcial de Sociedade Anônima [The Enforcement of the Partial Dissolution of the Business Company] (2021) (Masters Dissertation, Fundação Getulio Vargas Law School at São Paulo).

[30] LSA, art. 159 ("Article 159. By a resolution passed in a general meeting, the corporation may bring an action for civil liability against any officer for the losses caused to the corporation's property.

Paragraph 1. The resolution may be passed at an annual general meeting and, if included in the agenda or arising directly out of any matter included therein, at an extraordinary general meeting.

Paragraph 2. The officer or officers against whom the legal action is to be filed shall be disqualified and replaced at the same general meeting.

Paragraph 3. Any shareholder may bring the action if proceedings are not instituted within three months from the date of the resolution of the general meeting.

Paragraph 4. Should the general meeting decide not to institute proceedings, they may be instituted by shareholders representing at least five per cent of the capital.

Paragraph 5. Any damages recovered by proceedings instituted by a shareholder shall be transferred to the corporation, but the corporation shall reimburse him for all expenses incurred, including monetary adjustment and interest on his expenditure, up to the limit of such damages.

Paragraph 6. A judge may excuse the officer from liability, when convinced that he acted in good faith and in the interests of the corporation.

Paragraph 7. The action permitted under this article shall not preclude any action available to any shareholder or third party directly harmed by the acts of the officer.").

for the filing of this action to first submit it for shareholder approval. Such a resolution can be passed at the annual general meeting without a specific agenda item or at an extraordinary meeting if it is an express item on the agenda or directly derives from any discussion (LSA article 159, paragraph 1).[31]

If the majority of the shareholders attending the general meeting favors the lawsuit (resolution to sue), the officer or director to be sued is automatically removed from office, and the management of the company must file the liability suit (LSA article 159, main section) represented by its officers (LSA article 144). Should the corporation remain unresponsive and take no action within three months from the date of the resolution, any shareholder can file a lawsuit acting as nominal plaintiff for the company and seek redress on its behalf (LSA article 159, paragraph 3). Alternatively, if the general meeting refuses to initiate legal proceedings, any shareholder or group of shareholders representing at least 5% of the capital stock of the company[32] may bring a derivative suit, also as nominal plaintiff for the corporation, and seek redress in its favor (LSA article 159, paragraph 4).

As an incentive for derivative litigation against officers and directors, the LSA requires the corporation to reimburse plaintiff

[31] *Id.* para 1. On the rules for calling the general meeting, *see* OECD, *supra* note 3, at 112–13 ("The board of directors or the officers, subject to the bylaws, have the authority to call a general shareholders meeting (LSA article 123). The general meeting can also be called (i) by the audit committee ('Conselho Fiscal') if the competent administrative bodies delay doing so or in case of serious or urgent matters; (ii) by any shareholder in accordance with the law or the bylaws whenever the officers delay the call for more than 60 days; (iii) by shareholders representing at least five per cent of the capital if the managers do not comply within eight days with their justifiable request that a meeting be called, stating the matters to be discussed; or (iv) by shareholders representing at least five per cent of the voting capital or five per cent of nonvoting shareholders whenever the officers do not comply within eight days with the request that a meeting be called to appoint a statutory audit committee. There is no specific provision in Brazilian law regarding ownership requirements to include items on the agenda.").

[32] All the threshold percentages mentioned in LSA are further reduced for publicly traded companies depending on the amount of capital stock stated in the company's charter. Pursuant to LSA article 291, the capital markets regulator has the authority to reduce the thresholds for publicly traded companies, based on the capital stock stated in the corporate charter, and it effectively did so on 22 June 2020 through CVM Rule 627. The percentage is now 5% for the first BRL 100,000,000, 4% for the bracket from BRL 100,000,000 to BRL 1,000,000,000, 3% for the bracket from BRL 1,000,000,000 to BRL 5,000,000,000, 2% for the bracket from BRL 5,000,000,000 to BRL 10,000,000,000, and 1% for all capital above BRL 10,000,000,000.

shareholders for litigation expenses in case of a favorable outcome, up to the limit of the damages recovered (LSA article 159, paragraph 5). However, the disincentives to go down this path turn out to be staggering. A first difficulty concerns meeting the ownership threshold of 5% necessary both to convene an extraordinary meeting in case there is no upcoming annual event and to pursue the demand if the majority of the shareholders have rejected it.[33]

A second issue concerns the expenditure of time. Investors must wait for the general meeting to adopt a resolution on the initiation of legal proceedings against the accused manager and, in case of a resolution to sue, they must wait an additional three-month period while officers are expected to act.[34] These steps are not only time consuming, but require the investment of money: to file a derivative suit, shareholders must pay for attorney fees and anticipate court costs, which represent 1% of the value of the material damage in dispute, observing the approximate minimum value of USD 28.88 and maximum of USD 17,328.22.[35] Considering that Brazilian civil procedure operates by the "loser pays" principle,[36] shareholders also bear the risk of having to reimburse the defendant's litigation costs and attorney's fees if the suit fails, besides not being reimbursed by the corporation. In return for all this, plaintiffs only benefit from derivative suits indirectly and

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[33] On the minimum shareholder ownership requirement to convene an extraordinary meeting, *see* OECD, *supra* note 3, at 112-13.

[34] The requirement that plaintiffs bring a case to the shareholder meeting before filing a derivative suit introduces considerable delays into the process of holding officers and directors liable. *See* OECD, *supra* note 3, at 7 ("Some countries require the shareholder meeting to be involved in the decision to allow the initiation of a lawsuit on behalf of the company (only Brazil and Spain among the nine surveyed countries) while other jurisdictions make it optional (Germany and Italy). While the goal of such a rule is understandable, it might introduce considerable delays into the process.").

[35] Or EUR 25,25 and EUR 15,155.01, respectively. This calculation was based on the 2022 São Paulo State Fiscal Units (*Unidades Fiscais do Estado de São Paulo* - UFESPs). The Brazilian Central Bank's official conversion rate from 16/01/2022 was used for the conversion of BRL 159,85 and BRL 95.910,00. *Conversor de Moedas*, BANCO CENTRAL DO BRASIL, https://www.bcb.gov.br/conversao.

[36] Brazilian Civil Procedure Code (*Código de Processo Civil* – CPC) articles 82 and 85. *See* Fredie Didier Jr. & Teresa Arruda Alvim (eds.), CPC BRASILEIRO TRADUZIDO PARA A LÍNGUA INGLESA [Brazilian CPC Translated into English], 55–56 (2017).

proportionally to their shares in the company, as the results of a favorable award accrued to the corporation.[37]

To make matters worse, the Brazilian system imposes procedural barriers to obtaining redress from officers and directors which are particular to the country.[38] The LSA exempts managers from liability upon shareholder approval of the management's accounts and financial statements, except in cases of fraud, error, wrongful intent or simulation (LSA article 134, paragraph 3).[39] This exonerating effect is known as *quitus*.[40] In a situation where the wrongdoing is discovered after the approval of the management's accounts, shareholders must first rescind the *quitus* by annulling the resolution that exempted officers and directors from liability. Only after this, will the general meeting be able to decide on whether the company should pursue a claim for liability of any of the members of the management.[41]

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[37] *See* OECD, *supra* note 3, at 7–8 ("The financial risk of having to pay court fees and other litigation expenses in case of losing the dispute is likely the most relevant disincentive for a minority shareholder to initiate a derivative action. This disincentive is exacerbated by the fact that the shareholder would only benefit from the remedy in proportion to his or her stake in the shares of the company.").

[38] For an analysis of the effects of the resolution approving the managers' accounts in other civil law jurisdictions, *see* OECD *supra* note 27, at 11.

[39] LSA, art. 134, para. 3 ("The approval, without reservations, of the financial statements and accounts shall exempt the officers and members of the statutory audit committee from liability except as regards error, bad faith, fraud or misrepresentations (article 286)").

[40] *See* OECD, *supra* note 3, at 9 ("The exoneration covers even management conduct that was not explicitly referred to in the financial statements and in other documents presented to the shareholders meeting."). For an in-depth analysis of *quitus*, *see* Marcelo Von Adamek, RESPONSABILIDADE CIVIL DOS ADMINISTRADORES DE S/A E AS AÇÕES CORRELATAS [Civil Liability of Business Companies' Managers and Related Lawsuits] 248–257 (2009). It is noteworthy that many civil law jurisdictions authorize resolutions to discharge directors from liability, but their effects are somewhat weaker than the Brazilian *quitus*. *See* Eugenia Unanyants-Jackson, *Directors Liability Discharge Proposals: The Implications for Shareholders,* MANIFEST INFORMATION SERVICES, LTD. (June 2008), https://www.cerhahempel.com/fileadmin/docs/publications/Birkner/Directors_Liabilities_-June_2008.pdf. The legal requirement for the rescission of the *quitus* was not identified as a relevant barrier to the filing of liability suits nor as an incentive to bringing rescission suits in Gelter's studies on Continental European jurisdictions. *Supra* notes 6 and 14.

[41] It is undisputed that shareholders must first rescind the *quitus* before filing the liability suit against officers. *See* Superior Court of Justice, REsp 1.515.710-RJ, Third Chamber, Rapporteur Justice Marco Aurélio Bellizze, decided on May 12, 2015

As a consequence, even before filing the liability suit against officers and directors, shareholders must deal with the inconvenience of annulling the approval of the management's accounts.[42] This requirement intensifies the disincentives related to the investment of time and money, as well as the risk of failure for the plaintiff. Moreover, the rescission suit must be filed within two years from the date of resolution (LSA article 286), while the liability suit must be filed within three years from the date of publication of the minutes of the general meeting that approved the balance sheet for the fiscal year in which the violation occurred (LSA article 287, II). Such a difference in the statute of limitations of the rescission and liability suits may be interpreted as a decrease in the statute of limitation applicable to the latter in case of harm to the corporation caused by officers or directors.[43]

In turn, when a controlling shareholder causes losses to the corporation's property by performing acts that constitute an abuse of power,[44] minority shareholders may seek redress on behalf of the corporation under LSA article 246.[45] There is a consensus among

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("In view of the approval of the unqualified accounts for 2006 and 2007, which, by express legal provision, exonerates the officers and directors from any liability, the action for this purpose [liability suit] must necessarily be preceded by an action to annul the resolution of the meeting, with a demonstration of defect in consent." [translated]).

[42] In a dated study on shareholder litigation before the Milan Tribunal, Luca Enriques has revealed that lawsuits seeking to rescind the approval of the management's accounts are also common in Italy, although the author describes them as a mostly symbolic form of litigation. *See* Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan*, 3 EUR. BUS. ORG. L. REV. 765, 785 (2002) ("Since the annual accounts of closely held corporations in Italy are seldom impeccable, it is not uncommon that minority challenge their approval in court. This is a clear example of how minority shareholder litigation in Italy can be 'ostensible'. In fact, these suits commonly bear no relation at all to the grievance that the shareholders bringing them have against majority shareholders or directors.").

[43] *See* OECD, *supra* note 3, at 114.

[44] LSA articles 115 and 116 set out the duties of the controlling shareholder and exemplify the actions that may be regarded as an abuse of controlling power. LSA arts. 115 and 116.

[45] *Id.* at art. 246 ("A controlling corporation shall be obliged to compensate any damage it may cause to a controlled corporation by any acts infringing the provisions of articles 116 and 117.

Paragraph 1. Proceedings for compensation may be brought by:

(a) shareholders representing five per cent or more of the capital;

scholars that, unlike a liability suit against officers and directors, shareholders are not required to submit the decision to file the action from LSA article 246 for shareholder approval.[46] However, it is important to note the existence of a decision from the Brazilian Superior Court of Justice (*Superior Tribunal de Justiça* – STJ), when analyzing the matter incidentally, conditioned the filing of this type of suit on prior resolution by the general meeting.[47]

As article 246 refers to the possibility of filing a liability suit only against the controlling corporation, commentators have been equally inclusive of controlling shareholders as defendants in this proceeding.[48]

(b) any shareholder, provided he guarantees payment of the legal costs in the event of the action being dismissed.

Paragraph 2. If the controlling corporation is held responsible, in addition to paying compensation and costs, it shall pay an indemnity in respect of lawyers' fees of twenty per cent of the compensation awarded and a further premium of five per cent to the plaintiff.”).

[46] Scholars assume that there would be an automatic conflict of interest between the controlling shareholder and the company in these cases. *See* Gabriel Saad Kik Buschinelli & Rafael Helou Bresciani, *Aspectos Processuais da Ação de Responsabilidade do Controlador Movida por Acionista Titular de Menos de 5% do Capital Social (art. 246, § 1º, "b", da Lei 6.4.04/76)* [Procedural Aspects of the Controlling Shareholder's Liability Action brought by a Shareholder that Holds Less than 5% of the Capital Stock (LSA art. 246, para. 1, item b)], *in* 2 PROCESSO SOCIETÁRIO 262 (Flávio Luiz Yarshell & Guilherme Setoguti J. Pereira, eds., 2015) (“The understanding that a shareholder resolution would be necessary, however, does not take into account the fact that the system for holding the controller accountable under article 246 of Law 6,404/76 is different and specific in relation to that outlined for the manager under article 159, which is why the action against the controller can be brought directly by the minority shareholder without requiring prior shareholder resolution.” [translated]).

[47] *See* Superior Court of Justice, REsp 798.264-SP, Third Chamber, Rapporteur Justice Carlos Alberto Menezes, decided on Feb. 6, 2007 (“What must be examined here is whether this action from [L.S.A.] articles 245 and 246 is subordinate to the provisions of article 159, main section, that is, whether prior authorization by the general meeting is necessary. With all due respect to the thesis espoused by the precedent, I have that it is.” [translated]).

[48] *See* Buschinelli & Bresciani, *supra* note 46, at 249; *see also* Julian Fonseca Peña Chediak, *Reflexões Sobre a Efetividade do Regime de Responsabilização do Acionista Controlador* [Reflections on the Effectiveness of the Controlling Shareholder Liability System], *in* LEI DAS S.A. EM SEUS 40 ANOS 217-21 (Alberto Venâncio Filho et al., eds., 2017); *see also* Guilherme Setoguti J. Pereira, ENFORCEMENT E TUTELA INDENIZATÓRIA NO DIREITO SOCIETÁRIO E NO MERCADO DE CAPITAIS [Enforcement and Indemnification in Corporate Law and Capital Markets] 75–80 (Quartier Latin, 2018).

Nevertheless, Brazilian precedents on the matter are still inconsistent, as the STJ has conflicting decisions recognizing the minority shareholders' right to sue controlling shareholders on behalf of the company both under LSA articles 159 and 246.[49]

As in the derivative actions against officers and directors, shareholders who decide to file a liability suit under LSA article 246 will be required to bear all the costs associated with proceedings, including attorney fees and court costs, and will only be entitled to a reimbursement in case of a favorable ruling—but according to LSA Article 246, paragraph 2, the reimbursement will cover only court fees.[50] As an *ex ante* disincentive particular to litigation against controlling shareholders, the LSA requires minority shareholders who do not represent at least 5% of the corporation's capital to post security for legal costs (including court fees and attorney fees) in case of an adverse ruling (LSA, article 246, paragraph 1, item b), which are calculated based on the amount in dispute.[51]

On the other hand, the LSA has established innovative *ex post* incentives for derivative litigation against controlling shareholders.[5252]

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[49] *See* Superior Court of Justice, REsp 1.214.497-RJ, Fourth Chamber, Rapporteur Justice João Otávio de Noronha, decided on Sep. 23, 2014 (noting that controlling shareholders can be included as defendants in derivative suits under the analogous application of LSA article 159, paragraphs 3 and 4); *see also* Superior Court of Justice, REsp 798.264-SP, Third Chamber, Rapporteur Justice Carlos Alberto Menezes, decided on Feb. 6, 2007 (noting that controlling shareholders can be included as defendants in derivative suits under LSA article 246). The importance of defining the legal grounds for the derivative action against controlling shareholders relies on the differences of incentives regarding the derivative suits from LSA articles 159 and 246, as analyzed in Part II.

[50] *Supra* note 46.

[51] *See* Superior Court of Justice, AgRg nos EDcl no Ag 989.637-MG, Third Chamber, Rapporteur Justice Ricardo Villas Bôas Cueva, decided on May 17, 2016 ("The value of the security pursuant to LSA, art. 246, para. 1, item b, must be calculated based on the on the amount in dispute." [translated]).

[52] Brazilian law strongly differs from the other jurisdictions in this regard. S*ee* OECD, *supra* note 3, at 39 ("Brazilian law strongly differs from the other jurisdictions in that the winning lawyer is, instead of reimbursement, granted a fee payable by the losing party. This fee is set by the judge and typically corresponds to between 10% and 20% of the award. However, in the derivative action against controlling shareholders the fee is always 20%, without any discretion for the judge."). Nonetheless, this provision does not create enough incentive to mitigate the burdens imposed to shareholders who are interested in filing the derivative lawsuit from LSA article 246, as shown in Part III.

In case the plaintiff shareholder succeeds, besides being reimbursed for legal expenses, he or she is entitled to receive a payment (a premium) from the controlling shareholder corresponding to 5% of the compensation awarded. More remarkably, the plaintiff's lawyer is entitled to fees corresponding to 20% of the compensation awarded (LSA, article 246, paragraph 2). Even though a literal interpretation of the rule indicates that these percentages should apply to the total amount of the awarded compensation, the STJ has already ruled that the premium and the attorney's fees from LSA article 246, paragraph 2, should be calculated in proportion to the plaintiff shareholder's stake in the company.[53] This precedent jeopardizes any special incentive to bring litigation against controlling shareholders in Brazil.[54]

B. Lawsuits Addressing Harm to Shareholders

Regarding lawsuits addressing harm to shareholders, investors are allowed to bring a direct shareholder lawsuit under LSA article 159, paragraph 7 when directly harmed.[55] Although the LSA prescribes this action as a remedy for harm caused by the acts of the management, its analog application against controlling shareholders is undisputed in Brazil.[56]

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[53] *See* Superior Court of Justice, REsp 1.220.272-RJ, Fourth Chamber, Rapporteur Justice Luis Felipe Salomão, decided on Dec. 14, 2010 (noting that the indirect economic benefit to which the plaintiff shareholder is entitled in a derivative suit under LSA article 246 is proportional to his or her stake in the shares of the company).

[54] *See* OECD, *supra* note 3, at 121 ("Contrary to what LSA article 246, paragraph 2º establishes, the STJ has already ruled that the 5% bonus and the 20% attorney fees should be calculated not on the total amount of the award but rather on the plaintiff shareholder's ownership percentage multiplied by the amount of the award. If this rationale prevails over the express wording of the rule it would deal a heavy blow to the existing incentive for shareholders to defend the interests of the company.").

[55] The Brazilian system does not provide for the possibility of redress for damages caused to shareholders *indirectly*. *See* Ana Carolina Weber, Dano ao acionista: Contribuições à Teoria de Responsabilidade Societária [Shareholder Damage: Inputs to The Corporate Liability Theory], (2020) (Ph.D. thesis, University of São Paulo Law School).

[56] *See* Superior Court of Justice, REsp 1.214.497-RJ, Fourth Chamber, Rapporteur Justice João Otávio de Noronha, decided on Sep. 23, 2014 ("First of all, it should be pointed out that there is no controversy regarding the possibility of filing a liability lawsuit against the controlling shareholder, whether a natural or legal person, despite the fact that the Brazilian Corporate Law is silent on the matter. With the

Both the direct shareholder suit (LSA article 159, paragraph 7) and derivative suits (LSA articles 159, paragraphs 3 and 4, and 246) strongly rely on the plaintiff's access to information to succeed, once shareholders' prospect of bringing a plausible claim depends on their ability to prove the elements of breach of fiduciary duty. As a general rule from the Brazilian Civil Procedure Code (*Código de Processo Civil* – CPC),[57] the plaintiff has the burden to prove all the facts that give rise to his or her rights, while the defendant has the burden to prove the existence of facts that prevent, extinguish or modify the plaintiff's rights (article 373). However, such allocation of the burden of proof is known to be inefficient in many cases of shareholder litigation, given that, due to difficulties in accessing the corporation's internal documents, minority shareholders will usually have little or no information to form the basis for evidence of wrongdoing.[58]

The Brazilian system provides for procedural mechanisms aiming to mitigate such an information asymmetry. First, one may initiate a preliminary procedure for an early production of evidence (CPC article 381). This is a way of reducing risks when the party is not completely convinced that it will have all the evidence at its disposal to start the discussion on the merits. Second, plaintiffs may petition for a disclosure of documents, both under the civil procedure (CPC articles 396 through 404) and corporate (LSA article 105) legislations.[59] The lawsuit for the inspection of books and records of the corporation under LSA article 105 has an autonomous and satisfactory nature of the shareholders' right to supervise the acts of the management (LSA article 109, III). Such a petition can be filed by shareholders who represent at least 5% of the

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support of authoritative doctrine and through an extensive interpretation of LSA article 159, it is understood that civil liability suits against officers, explicitly addressed in the legal text, can also be extended to the controlling shareholder." [translated]).

[57] *See* Didier Jr. & Alvim, *supra* note 36.

[58] *Supra* note 22.

[59] CPC articles 396 through 404 do not regulate any specific procedure for seeking the disclosure of documents. This gap has generated a controversy in Brazil regarding the appropriate procedure for framing the right to produce evidence when there is no further substantive law providing for it. *See* Vinicius Silva Lemos, *A Exibição de Documento como um Procedimento Especial Autônomo: A Análise do Equívoco do REsp 1774987 e do Acerto do REsp 1803251 pelo STJ* [The Disclosure of Document as a Special Autonomous Procedure: the Analysis of the Misconception the of REsp 1774987 and the Correct of the REsp 1803251 by the STJ], 325 REVISTA DE PROCESSO 147 (2022). Nonetheless, it is undisputed that shareholders can file a specific lawsuit to enforce their right to inspect corporate books and records as expressly provided for by LSA article 105.

company's capital, provided that (a) acts contrary to the law or to the charter occur or (b) there are grounds to suspect that serious irregularities have been committed by the corporation.

Third, the Brazilian law allows for the dynamization of the burden of the proof (CPC, article 373, paragraph 1). In exceptional cases where it is (a) impossible or excessively difficult to attend the standard allocation of burden of proof or (b) much easier for the opposing party to obtain certain evidence, the judge may assign the burden of proof differently, provided this is done in a reasoned decision. In theory, dynamization of the burden of the proof should apply to derivative suits, given the usual information gap between the plaintiff shareholder and the defendant officer, director or controlling shareholder.

The difficulty with the production of evidence is traditionally held as one of the main reasons for the lack of Brazilian corporate law enforcement.[60] However, this perception disregards the changes in civil procedure brought by the Civil Procedure Code of 2015 (CPC/15), which has instituted both the early production of evidence and the dynamization of the burden of the proof.[61] The analysis of the application of such mechanisms in shareholder litigation since the CPC/15 went into effect reveals that it is still not possible to state with certainty and based on empirical data that Brazil's current civil procedure regime does not allow for effective evidence production in derivative litigation.[62]

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[60] *See* Érica Gorga, *Is U.S. Law Enforcement Stronger than That of a Developing Country? The Case of Securities Fraud by Brazilian Corporations and Lessons for the Private and Public Enforcement Debate*, 54 COLUM. J. TRANSNAT'L L. 603, 657 (2016) ("Another shortcoming is that Brazilian civil procedure also fails to provide shareholders legal mechanisms to access corporate information because of its lack of discovery proceedings."); *see also* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law"*, 63 EMORY L.J. 1383, 1486 (2014) ("Lacking litigation discovery, private parties in Brazil have restricted means of verifying company disclosures.").

[61] The former Brazilian Civil Procedure Code of 1973 provided for an early production of evidence. *See* CÓDIGO DE PROCESSO CIVIL [C.P.C.] [CIVIL CODE OF PROCEDURE], art. 846, sec. VI (Braz.). However, the scope of the action was more limited than its current provision and its filing was conditioned to the demonstration of urgency and risk of perishing or of impossibility of producing the evidence in due time.

[62] *See* Guilherme Setoguti J. Pereira & André Elias Schwartz, *Produção da Prova em Ações Derivadas: Uma Dificuldade que Persiste?* [Production of Evidence

Finally, Brazilian law also provides for lawsuits seeking to invalidate shareholder resolutions—rescission suits—which similarly to the North American class action, presents class effect.[63] There are three types of defects which may give rise to disputes over shareholder resolutions. First, one might claim that a formal requirement provided for by the law, corporate charter, or shareholders' agreement was disregarded. Among procedural defects, one can allege that the call for the meeting was not properly publicized (LSA articles 124 and 289), it did not observe the minimum advance notice required (e.g., LSA article 124, paragraph 1), the documentation necessary to support the meeting (e.g., LSA article 133) was not made available, the meeting was held in an incorrect venue (LSA article 124, paragraph 2), a shareholder was not allowed to enter the meeting, a shareholder's right to speak was not observed, the agenda was not respected or the installation and deliberation quorums were wrongly calculated.[64] Second, one might challenge the content of a resolution, arguing that it breached the law or the charter. Third, one might contest the exercise of vote by a given shareholder, on the grounds that the resolution was passed due to the vote of an investor whose interests were in conflict with those of the company.[65]

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in Derivative Lawsuits: A Persisting Difficulty?], *in* EMPRESA, LIBERDADE E CIDADANIA - LIBER AMICORUM MODESTO CARVALHOSA (Fernando Kuyven ed.) (forthcoming 2022).

[63] *See* Guilherme Setoguti J. Pereira, IMPUGNAÇÃO DE DELIBERAÇÕES DE ASSEMBLEIA DAS S/A [Challenging Shareholder Resolutions in Business Companies] 265–66 (Quartier Latin, 2013) ("Any decision that rules on the validity of a resolution - including one that dismisses the claim for annulment - will produce the same effects in the sphere of all shareholders, whether or not they were part of the lawsuit." [translated]); *see also* Modesto Carvalhosa, 4 COMENTÁRIOS À LEI DE SOCIEDADES ANÔNIMAS: ARTS. 243 A 300 [Commentaries on The Corporate Law: Arts. 234 to 300], 517–18 (Saraiva., 5th ed. 2011) ("The lawsuit, in this case, constitutes a true class action, due to its own associative nature, both to the company and to the interest communion from each category of preferred shareholders, debenture holders and beneficiaries." [translated]).

[64] *See* Ivo Bari Ferreira, INVALIDADE DE DELIBERAÇÕES ASSEMBLEARES À LUZ DA DOUTRINA E DOS TRIBUNAIS: REGIMES DE INVALIDADE APLICÁVEIS ÀS DELIBERAÇÕES DE ACIONISTAS [Invalidity of Shareholder Resolutions in Light of The Doctrine and The Courts: Invalidity Regimes Applicable to Shareholder Resolutions], 46 (Dialética, 2021).

[65] On the different doctrines of conflict of interest in the general meeting prevailing in Brazil, *see infra* note 113.

Despite the scholarly understanding that, under the Brazilian civil system of nullity and annullability of legal business, these scenarios should entail different outcomes in terms of scope of invalidity and statute of limitations,[66] the LSA article 286 treats the different grounds on which a rescission suit may be brought indistinctly.[67] That is, regardless of its object, the rescission suit can be brought within two years after a resolution is passed and result in its entire annulment.

In the absence of an express rule addressing standing requirements, scholars recognize that any shareholders—with the exception of those who voted in favor of the challenged resolution—[68] as well as third parties that may be directly affected by it,[69] are allowed to bring a rescission suit. The formal defendant in this type of suit is the corporation, even though it is usually *de facto* directed against the corporation's controlling shareholders.[70]

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[66] *See* Erasmo Valladão Azevedo e Novaes França, INVALIDADE DAS DELIBERAÇÕES DE ASSEMBLEIA DAS S/A E OUTROS ESCRITOS SOBRE O TEMA DA INVALIDADE DAS DELIBERAÇÕES SOCIAIS [Invalidity of Shareholder Resolutions in Business Companies and Other Writings on The Subject of The Invalidity of Shareholder Resolutions], 97–98 (Malheiros, 2nd ed. 2017).

[67] LSA, art. 286 ("Proceedings to annul resolutions made at a general or special meeting of shareholders which has been called or opened otherwise than in accordance with the law or charter, or which has been the subject of error, bad faith, fraud or misrepresentation, shall not be commenced after a period of two years has elapsed from the date of the resolution.").

[68] This understanding is based on the *nemo venire contra factum proprium* doctrine. *See* Eduardo Talamini, *Legitimidade e Interesse nas Ações de Impugnação de Deliberações Societárias* [Standing to Sue and Interest in Rescission Lawsuits], 313 REVISTA DE PROCESSO 245, 249–50 (2021).

[69] E.g., a third-party holding collateral over shares in case of a resolution for a change of the rights assigned to such a class of shares; or a creditor in case of a resolution that represents fraud against creditors. *Id*. at 253–54.

[70] *See* Gelter, *supra* note 6, at 465 ("While in concentrated ownership systems corporations are *de facto* controlled by a shareholder or a shareholder coalition, rescission lawsuits that are formally brought against the corporation *de facto* constitute a way for minority shareholders to put the brakes on the majority's actions."). Corporate ownership in Brazil has historically been concentrated in the hands of controlling shareholders, although studies suggest that the country's publicly traded corporations have experienced a modest rise in ownership dispersion after the creation of *Novo Mercado*, the segment with the highest standards of corporate governance practices in Brazilian stock exchange. *See* Érica Gorga, *Berle e Means e e Evolução da Propriedade e do Controle Acionários no Mercado de Capitais Brasileiro* [Berle and Means and the Evolution of Shareholder Ownership and Control in the Brazilian Capital Market], *in* ESTUDOS AVANÇADOS DE DIREITO EMPRESARIAL: CONTRATOS,

The Brazilian jurisprudence establishes that court costs for the rescission suit must be calculated by estimate, according to the economic reality of the claim.[71] Thus, the costs for filing rescission suits are not necessarily lower nor more predictable than those of liability suits. However, rescission suits are much simpler than liability suits in terms of access to information. While the latter requires proof of breach of fiduciary duties, the former might be sustained upon evidence of procedural defect of the challenged resolution.

In addition to the above-mentioned incentives, which are to some extent aligned with those present in other civil law jurisdictions, Brazil's framework reveals a singularity that makes rescission suits especially attractive in the country. The LSA assigns broad power to shareholders by establishing a relatively extensive array of corporate decisions which must be approved by the general meeting (LSA article 122).[72] As a result, shareholders can use rescission suits as a means to address various issues that would otherwise be litigated through derivative actions, although these suits are subject to the serious limitation of not

DIREITO SOCIETÁRIO E BANCÁRIO 182 (Érica Gorga & Juliana Krueger Pela, 2013); *see also* Érica Gorga, *Changing the Paradigm of Stock Ownership from Concentrated towards Dispersed Ownership: Evidence from Brazil and Consequences for Emerging Countries*, 29 NW. J. INT'L L. & BUS. 439 (2009).

[71] *See*, e.g., Court of Appeals of São Paulo, Interlocutory Appeal 2104151-85.2020.8.26.0000, First Reserved Chamber for Business Law, Rapporteur Pereira Calças, decided on Nov. 25, 2020; Court of Appeals of São Paulo, Appeal 0040273-27.2014.8.26.0100, First Reserved Chamber for Business Law, Rapporteur Alexandre Lazzarini, decided on Nov. 9, 2017; Court of Appeals of São Paulo, Appeal 0197368-96.2009.8.26.0100, Second Reserved Chamber for Business Law, Rapporteur Campos Mello, decided on Oct. 26, 2016.

[72] *See* Mariana Pargendler, *How Universal Is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil*, 58 COLUM. J. TRANSNAT'L L. 1, 30–31 (2019) ("There is well-established variation among different jurisdictions in this area, with European jurisdictions generally conferring far greater rights on shareholders than board-centric U.S. law. The difference here is one of degree, with Brazilian corporate law being even more shareholder-centric than these already shareholder-friendly jurisdictions . . . The LSA is unusual not only in determining what shareholders *may* decide, but also what they *must* decide. As in other legal systems, Brazilian law requires shareholders to approve certain key corporate decisions. While Brazil follows other jurisdictions in imposing a shareholder vote with respect to charter amendments, mergers, and dissolution, it goes beyond international practice by also demanding shareholder approval of bankruptcy filings, as well as bond issuances by close corporations.").

covering most related-party transactions, as it will be explored in Part IV.

It is noteworthy that rescission suits in Brazil do not automatically suspend the effects of the challenged resolution. The plaintiff shareholder may request a preliminary injunction for this purpose, which shall only be granted upon verification of (i) the probability that the claim is meritorious (*fumus boni iuris*) and (ii) the risk of loss or injury to the useful outcome of the lawsuit (*periculum in mora*), pursuant to CPC article 300. Therefore, shareholders could hardly hinder the company's conduct by suspending an important business decision without having a solid case. This means that shareholders in Brazil do not face incentives to bring rescission suits as a means to blackmail the company into lucrative settlement agreements, as it has once been an issue in Germany.[73]

In light of all these considerations, one may argue that Brazil fails to meet several requirements for an effective framework for liability actions, including derivative suits. Thus, considering the experience of other civil law countries, the Brazilian "Path of Least Resistance" for the private enforcement of shareholder rights seems to be the rescission suit. This hypothesis must be tested with empirical data, as it will be done in the next section.

III. LIABILITY AND RESCISSION SUITS BEFORE THE COURT OF APPEALS OF SÃO PAULO (2015-2020)

Corporate disputes in Brazil tend to be solved through administrative or, more recently, arbitral proceedings.[74] Nevertheless, to examine the applicability of the shareholder litigation pattern identified in other civil law jurisdictions to the country, this article focuses on disputes brought to the Judiciary, covering precedents from the

[73] *See* Gelter, *supra* note 14, at 885; *see also* Gelter, *supra* note 6, at 476–77.

[74] *See* OECD, *supra* note 3, at 111 ("According to Rodrigues, that comparison suggested that investors and companies prefer to initiate an administrative proceeding rather than file a liability suit, possibly because the latter is more costly, ineffective and slow."); *see also* Ronald J. Gilson et al., *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union*, 63 STAN. L. REV. 475, 492–93 (2013) ("In Brazil, the Novo Mercado and Level 2 attempt to avoid the enforcement difficulties associated with an ineffective judiciary through the provision of mandatory and institutionalized arbitration for internal affairs disputes.").

Reserved Chambers for Business Law of the Court of Appeals of São Paulo[75] (*Câmaras Reservadas de Direito Empresarial do Tribunal de Justiça de São Paulo*) between January 2015 and December 2020. I have chosen the Court of Appeals of São Paulo (*Tribunal de Justiça de São Paulo* – TJSP) given that most Brazilian corporations are registered in São Paulo and the state has the highest number of disputes regarding business corporations in Brazil.[76] The choice for the Reserved Chambers for Business Law is justified due to their specialization in corporate disputes.[77] Finally, I have surveyed cases decided between 2015 and 2020 since this time frame fairly represents current reality.

For a compilation of precedents, I have used the Chambers' precedents repository. I have considered over 123 decisions which contain selected terms. To ensure relevance between the decisions found and the research scope, I have selected decisions which dealt with the invalidation of shareholder resolutions or the compensation for material damages on business companies through an individual analysis of ruling summaries.

There were 18 lawsuits seeking compensation and 47 seeking invalidation of shareholder resolutions in the period.[78] The main finding of this article is that the number of lawsuits seeking the rescission of shareholder resolutions greatly surpasses the number of those seeking

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[75] The Court of Appeals of São Paulo, as the superior instance of the Judiciary of the state, is the appealing instance to the sentences given by a judge of first instance in the state districts. The Reserved Chambers for Business Law are panels from the Court which are dedicated to business matters. For an overview of dispute resolution in Brazil, including the structure of the country's judiciary, *see* Rogério Carmona Bianco et al., *Litigation and Enforcement in Brazil: Overview*, THOMSOM REUTERS (Apr. 1, 2022), https://uk.practicallaw.thomsonreuters.com/9-502-2479?transitionType=Default&contextData=(sc.Default)&firstPage=true.

[76] Instituto Brasileiro de Geografia e Estatística (IBGE), *Demografia das Empresas e Estatísticas de Empreendedorismo 2017*, 33 ESTUDOS & PESQUISAS INFORMAÇÃO ECONÔMICA 39 (2019).

[77] Bianco et al., *supra* note 75.

[78] Out of 18 lawsuits with a request for compensation, 10 had only this request, while eight also had a request for rescission of shareholder resolution, collection, or declaration. Out of 47 lawsuits with a request for rescission of shareholder resolution, 39 had only this request, while seven also had a request for compensation, partial dissolution of the company, duty to perform or declaration. I have analyzed 31 lawsuits whose object was neither rescission of shareholder resolution nor redress for material damage (e.g., duty to perform lawsuit, accountability lawsuit, inhibitory lawsuit etc.). In this group, dissolution lawsuits were the most evident. For an in-depth analysis of the enforcement of the partial dissolution lawsuit in business corporations in Brazil, *see* Gebran, *supra* note 29.

compensation for damages. That is, on the context herein analyzed, the rescission suit is the most common mechanism for the private enforcement of shareholders rights in Brazil. This finding seems to confirm that shareholder litigation in Brazil follows the same pattern identified in other civil law countries.

A. Liability Lawsuits

The number of lawsuits addressing damages in business corporations brought before the TJSP between 2015 and 2020 confirms the prevailing theory among national commentators: the Brazilian judiciary has examined liability lawsuits on very few occasions. In a context where the Brazilian judiciary is almost never provoked to decide claims for damages,[79] decisions on the merits are even rarer: the TJSP has analyzed the merits of only five out of 18 lawsuits seeking redress for harm to the corporation or shareholders.[80] Out of the six lawsuits extinguished with no decision on the merits, four of them were due to a lack of jurisdiction from state judge given the presence of an arbitration clause in the company's charter[81] and two of them were due to the plaintiff's lack of standing to sue.[82] There were claims seeking to impose

[79] The settlement rate of civil disputes in Brazil is relatively low and therefore can be ignored without significantly impacting the result of this empirical survey. *See* Yun-chien Chang & Daniel M. Klerman, *Settlement Around the World: Settlement Rates in the Largest Economies*, USC Legal Stud. Research Paper No. 21-8 33 (Feb. 25, 2021) ("selection effects may be sufficiently small that, for many purposes, they can be ignored when studying litigation in civil law countries.").

[80] I have considered that the TJSP did not examine the merits of the lawsuit when the Court's decision (i) merely addressed procedural matters, e.g., the determination of legal fees, the joinder of parties, etc. or (ii) raised an incidental issue, e.g., the lack of annulment of the shareholder resolution that approved the act for which the defendant is requested to be held liable.

[81] *See* Court of Appeals of São Paulo, Appeal 1016781-21.2016.8.26.0002, Second Reserved Chamber for Business Law, Rapporteur Ricardo Negrão, decided on Aug. 11, 2020; Court of Appeals of São Paulo, Appeal 1097358-17.2015.8.26.0100, First Reserved Chamber for Business Law, Rapporteur Cesar Ciampolini, decided on Jun. 20, 2018; Court of Appeals of São Paulo, Appeal 1003528-36.2016.8.26.0011, First Reserved Chamber for Business Law, Rapporteur Francisco Loureiro, decided on Mar. 1, 2018; Court of Appeals of São Paulo, Interlocutory Appeal 2255037-72.2015.8.26.0000, First Reserved Chamber for Business Law, Rapporteur Maia da Cunha, decided on Feb. 24, 2016.

[82] In those last two demands, shareholders claimed redress for damages due to (i) the outbreak of the Operation Car Wash and (ii) acts of mismanagement. The Court has decided that the alleged harm would have been inflicted upon the corporation,

liability on four different types of parties, as described in the table below:

TABLE 1 – Corporation, officer, controlling corporation, and controlling shareholder occurrence as defendants on liability lawsuits considering business companies

Defendant	**Listed corporations**	**Closed corporations**	**Total**
Corporation	8	5	*13*
Officer or director	2	6	*8*
Controlling corporation	3	4	*7*
Individual controlling shareholder	1	4	*5*
Total	*14*	*19*	*33*

Source: author's elaboration

Of the cases examined, the corporation is the party that has appeared most often as a defendant in liability suits.[83] Out of the 13 claims that included the corporation as defendant, five of them addressed false and misleading information being publicized by the company,[84] while eight addressed abuses of controlling power or

which means that redress should be sought trough a corporate lawsuit instead of direct shareholder lawsuit. *See* Court of Appeals of São Paulo, Appeal 1052131-96.2018.8.26.0100, First Reserved Chamber for Business Law, Rapporteur Hamid Bdine, decided on Mar. 6, 2019; Court of Appeals of São Paulo, Appeal 3003790-53.2013.8.26.0270, Second Reserved Chamber for Business Law, Rapporteur Fabio Tabosa, decided on Sep. 30, 2019.

[83] This reinforces an already identified feature of corporate litigation in Brazil, *see* Prado & Buranelli, *supra* note 2, at 36 ("In corporate law, … corporations themselves, not their controllers and officers, appear as respondents." [translated]).

[84] Gelter has excluded the types of harm which fall within the purview of securities law from his shareholder litigation taxonomy. Gelter, *supra* note 8. Indeed, it makes sense to treat harms related to a breach of securities law as being ontologically different from those related to a breach of corporate law, since these systems are founded in different axioms. On one hand, scholars traditionally conceive corporate law as aiming to provide business enterprises with core defining elements of the corporate form. *See* John Armour, *What Is Corporate Law?*, *in* ANATOMY OF CORPORATE LAW 1 ("It follows that a principal function of corporate law is to provide

management mistake. In seven lawsuits, there was no express mention of the legal grounds that would justify holding the corporation liable. In the remaining cases, the plaintiff has pleaded for the recognition of the company's joint and several liability, either under Brazilian Civil Code general rules or without even referring to any legal grounds that would authorize said joint and several liability. In most cases, shareholders have claimed compensation for damages against the corporation itself instead of seeking redress from officers or controlling shareholders. This finding shows that claims for damages in practice are disconnected from theory, as there is no legal provision authorizing the inclusion of the corporation as a defendant in liability suits and because this possibility remains highly controversial in Brazil.[85]

Out of the five lawsuits in which TJSP has decided on the merits of liability lawsuit—including three cases of publicly listed companies—only one of them had a favorable result for the plaintiff shareholder. This is the lawsuit which sustained the condemnation of

business enterprises with a legal form that possesses these five core attributes."). It is noteworthy, however, that recent studies have unveiled the erosion of the corporate attributes in jurisdictions with weak institutional environment, considering the Brazilian experience. *See* Pargendler, *supra* note 72, at 56–57 ("However, the recent Brazilian experience gives pause to the inevitability of the business corporation's core traits. Through a series of judicial decisions and statutes, Brazilian law has significantly weakened the canonical corporate elements. The strong version of the corporate form, which is generally assumed to be universal, is no longer available under Brazilian law."). On the other hand, the securities law aims to allow corporations to raise external capital in the face of agency problems. *See* Luca Enriques et al., *Corporate Law and Securities Markets*, *in* ANATOMY OF CORPORATE LAW 243 ("From a more functional perspective, this body of rules, commonly referred to as 'securities law' or 'securities regulation,' supports corporations in their efforts to raise external capital in the face of the familiar agency problems. The broad thrust of securities law is concerned with affiliation strategies— the entry and exit of investors to and from the body of shareholders— primarily by increasing the quantity, quality, and reliability of corporate disclosures. Securities laws also provide enforcement mechanisms capable of bypassing the collective action problems faced by dispersed investors. To the extent that these measures increase investors' expected returns, firms that issue securities to the public ('issuers') should enjoy a lower cost of capital."). However, situations of publication of false and misleading information by the company are in the borderline of these systems in Brazil, as shareholders can seek redress for damages caused by such a conduct both under the corporate law and securities regulation. This is why this survey includes these five actions: even though they refer to a violation of the securities regulation, they are based on LSA article 159, paragraph 7.

[85] For a compilation of the Brazilian debate on this topic, *see* Pereira, *supra* note 48, at 87–92.

Mossi & Ghisolf International S.A. and Mossi & Ghisolf Global Participações Ltda., controlling shareholders of M&G Poliéster S.A., on the grounds that they had caused direct harm to the plaintiff shareholders, minority investors in M&G Poliéster S.A. The defendants created a new corporation, M&G Polímeros S.A., to explore a similar activity and merged it to the controlled corporation afterwards, which entailed an increase in the capital of M&G Poliéster S.A. and the dilution of the plaintiffs' stake of the company from 11.55% to 2.9%, without granting minority shareholders a chance to take part in the company's expansion.[86]

The other lawsuits were dismissed under the argument that the plaintiffs had not proven the existence of civil liability requirements, specifically an unlawful act and the existence of a causal link. Regarding the discussion of each one of these cases, there was a lawsuit against Paranapanema S.A. addressing dividend collection and compensation for overdue payment.[87] The Court dismissed the action on the grounds that (i) there was no unlawful act, as the postponement of the dividend payment had been approved by unanimous resolution from an extraordinary meeting, and (ii) there was no proof of causation between later dividend payment and the alleged damage.

In another lawsuit,[88] minority shareholder Pound S.A. claimed damages for the alleged mismanagement of Ferrovia Paraná S.A. by its officers and directors and by its controlling shareholder, América Latina Logística do Brasil S.A., resulting from resolutions which would have presented a conflict of interest with Ferrovia Paraná S.A., leading it to bankruptcy. The Court dismissed the request due to the lack of proof of

[86] Court of Appeals of São Paulo, Appeal 0250192-35.2009.8.26.0002, First Reserved Chamber for Business Law, Rapporteur Francisco Loureiro, decided on Feb. 7, 2018.

[87] Court of Appeals of São Paulo, Appeal 1002982-64.20178.26.0554, First Reserved Chamber for Business Law, Rapporteur Azuma Nishi, decided on Aug. 21, 2019.

[88] Court of Appeals of São Paulo, Appeal 0006710-91.2004.8.26.0100, First Reserved Chamber for Business Law, Rapporteur Francisco Loureiro, decided on Mar. 4, 2020.

causation between the losses of the plaintiff and the respondents' allegedly willful behavior.

In a lawsuit which also had a compensation claim,[89] the plaintiff shareholders requested (i) the rescission of a general meeting resolution which approved the management's accounts and (ii) the liability of officers and controlling shareholders. The Court (i) ordered the case to be retried at the first instance,[90] since the plaintiff shareholders were not given the chance to produce necessary evidence, and (ii) confirmed the dismissal of the claims against the controlling shareholders due to the lack of proof of the illegality of their votes in the challenged resolution.

Finally, in another lawsuit which also had a compensation claim,[91] an individual plaintiff pleaded for the (i) rescission of the shareholder resolution which approved the demutualization of BM&F, one of Brazil's former stock and futures exchange,[92] and (ii) condemnation of BM&F and BM&FBOVESPA S.A. to pay compensation for the allegedly illegal distribution of BM&F's assets. The Court dismissed the claim due to lack of proof of the alleged irregularities.

B. Rescission Lawsuits

Among the 47 rescission suits found, the five most challenged types of resolutions concerned the (i) approval of management's accounts and financial statements, (ii) election and discharge of officers and directors, (iii) capital increase, (iv) corporate transaction[93] and (v)

[89] Court of Appeals of São Paulo, Appeal 1110009-13.20178.26.0100, First Reserved Chamber for Business Law, Rapporteur Cesar Ciampolini, decided on Oct. 28, 2020.

[90] On the structure of the Brazilian judiciary, *see* Bianco et al., *supra* note 75.

[91] Court of Appeals of São Paulo, Appeal 0197368-96.2009.8.26.0100, Second Reserved Chamber for Business Law, Rapporteur Campos Mello, decided on Oct. 17, 2016.

[92] BM&F was dissolved through distribution of 99% of its converted titles on BM&FBOVESPA S/A shares.

[93] Out of the seven disputed corporate transactions, four of them refer to company incorporation; one, to the conversion of a limited liability company into a business company; one, to BM&F demutualization, *Id.*; and one, to demerger.

use of profits. The table below presents the occurrence of each type of challenged resolution:[94]

TABLE 2 – Types of challenged shareholder resolutions on business companies

Type of challenged resolution	**Listed corporations**	**Closed corporations**	**Total**
Approval of management's accounts and financial statements	0	12	*12*
Election and discharge of officers and directors	0	11	*11*
Capital increase	0	7	*7*
Corporate transaction	2	5	*7*
Use of profits	0	5	*5*
Charter amendment	0	4	*4*
Sale of assets	2	0	*2*
Restriction on the exercise of shareholder rights	0	2	*2*
Reimbursement of shares to heirs	0	1	*1*
Purchase of treasury stock	0	1	*1*
Total	*4*	*48*	*52*

Source: author's elaboration

The most frequently challenged type of resolution was the approval of management's accounts and financial statements. This can be explained considering that the rescission of the *quitus* is a necessary step to hold officers and directors liable in Brazil, as described in Part II. However, even if one disregards the demands aiming to annul the

[94] On five lawsuits, more than one type of resolution has been challenged. Moreover, the challenged resolutions for "charter amendment" specifically concerned the (i) conversion of shares; (ii) inclusion of an arbitral clause in the corporate charter; (iii) creation of a statutory reserve and (iv) change of voting quorums.

approval of management's accounts and financial statements, there are still more rescission suits than claims for damages.[95] This seems to rule out the hypothesis that rescission suits are frequent in Brazil simply as a means to the subsequent filing of liability suits. Conversely, the sample suggests that rescission suits are used as an alternative path for the protection of shareholders rights in the country.

The 47 compiled lawsuits in which the TJSP has examined the validity of shareholder resolutions represent the outcome of 45 first instance proceedings, given that the Court was provoked to act twice in two lawsuits.[96] First, to review a preliminary injunction granted to suspend the effects of a shareholder resolution and then to rule on an appeal. In this vein, it was noticed that 13 demands brought before the TJSP addressed injunctive relief, and 34 were about final decision on the merits.

Regarding the results of the analyzed rescission suits, injunctive relief to suspend the effects of a resolution was granted on approximately 40% of cases. In turn, on full cognition basis, the Court rendered an award in favor of the plaintiff shareholder on more than half of the occasions in which it has decided on the merits of the annulment request. This shows that, subject to its limitations, the rescission suit has ended up favoring minority shareholders more often than not.

IV. REFORM OPTIONS FOR STRENGTHENING THE PRIVATE ENFORCEMENT OF SHAREHOLDER RIGHTS IN BRAZIL

A. Rescission Lawsuits

This article has revealed that investors in Brazil have been reliant on rescission suits to seek judicial recourse. Notwithstanding the relative success they have been obtaining, this mechanism still leaves serious gaps in their protection. The main evidence in this regard is the fact that rescission suits cannot be used to curb abuses arising from business

[95] I have not identified how many lawsuits seeking to rescind the approval of management's accounts and financial statements were actually followed by liability lawsuits against officers or directors. There is an opportunity for further research on the correlation of these lawsuits in Brazil.

[96] *See* Bianco et al., *supra* note 75.

decisions that are not submitted to the general meeting, which is the case of most related-party transactions (RPTs) in Brazil.[97]

Related-party transactions are known to be one of the main sources of misappropriation of corporation value.[98] Even so, Brazil traditionally stands out for lacking control mechanisms to prevent abuses arising from such transactions.[99] Until a 2021 legal reform, the LSA did not require any RPTs to be submitted for the approval of either shareholders or the board of directors.[100] Thus, unless the transaction concerned a matter falling under the general meeting exclusive authority (LSA article 122), officers and controlling shareholders could engage in RPTs virtually without restriction.[101]

Aiming to foster the country's business environment, Brazilian legislators enacted Law No. 14,195 (originally Provisional Measure No.

[97] This article refers to "related-party transactions" as "transactions in which related parties such as directors and controlling shareholders deal with the corporation – traditional self-dealing and managerial compensation – and transactions in which related parties may appropriate value belonging to the corporation – the taking of corporate opportunities and trading in the company's shares." *See* Enriques et al., *Related-Party Transactions*, *in* ANATOMY OF CORPORATE LAW 145.

[98] *See* Dan W. Puchniak & Umakanth Varottil, *Related Party Transactions in Commonwealth Asia: Complicating the Comparative Paradigm*, 17 BERKELEY BUS. L.J. 1, 4 (2020) ("The World Bank views the RPT Index as a critically important corporate governance metric and policy promotion tool as it 'focuses on one of the most serious breaches of good corporate governance around the world: the related-party transaction.'").

[99] *See* Enriques et al., *supra* note 97, at 167 ("Brazilian law is probably even more lax in policing related-party transactions involving either controlling shareholders or managers: trusteeship and decisions strategies are used only sparingly, while enforcement problems hamper the efficacy of disclosure mandates and duty of loyalty standards.").

[100] *See* Alexandre Di Miceli da Silveira et al., *Related Party Transactions: Legal Strategies and Associations with Corporate Governance and Firm Value in Brazil* 13 (2008), https://ssrn.com/abstract=1307738 ("The strategy of approval of related-party transactions by the Board of Directors or by the shareholders meeting is not used by national legislation and self-regulation. Corporate law does not require that transactions between the company and its officers, members of the Board of Directors, or controlling shareholders to be subject to resolution in neither the Board of Directors nor the shareholders meeting." [translated]).

[101] The LSA prohibits officers from borrowing money or property from the corporation or using its property, services or taking advantage of its standing for his or her own benefit or for the benefit of a corporation in which he or she has an interest or of a third party, without the prior approval of the general meeting or the board. LSA, art. 154, para. 2, item b.

1,040/2021)[102] on August 26, 2021.[103] Among other provisions,[104] this law amended the LSA to expand the authority of publicly traded companies' general meeting to deliberate on "the disposal or contribution of assets to another company, in case the transaction amount is higher than 50% of the company's total assets indicated in the latest balance sheet approved" (LSA article 122, X).[105]

The new requirement for shareholder approval of significant RPTs means Brazil is stepping towards the right direction. The implementation of this *ex ante* strategy represents a normative response aiming to ensure the fairness of such transactions and places the Brazilian corporate law closer to international practice.[106] Although less common than board approval,[107] the requirement for shareholder approval of significant RPTs seems particularly fitting for Brazil's corporate system for three reasons. First, such requirement is aligned with the shareholder-centric approach that characterizes the LSA.[108] Second, a solution that relies on prior shareholder approval rather than on the judicial review of transactions[109] seems more promising to the

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[102] Provisional measures are rules with legal force issued by the President in situations of relevance and urgency. Despite producing immediate legal effects, such measures need later approval by the National Congress to be definitively converted into an ordinary law.

[103] LAW NO 14,195, OF AUGUST 26, 2021 (Braz.), popularly referred to as *Business Environment Law*.

[104] For a summary of the changes provided for in Law No. 14,195, *see Law No. 14,195/21: Changes to Corporate Legislation*, MONTGOMERY & ASSOCIADOS (Mar. 3, 2022, 10:02 AM), https://montgomery.adv.br/en/law-no-14195-21-changes-to-corporate-legislation/.

[105] For a comprehensive analysis of the newly added item X of LSA article 122, *see* Gustavo Machado Gonzalez, *As Novas Competências da Assembleia Geral (1): Transações com Partes Relacionadas (Comentários ao Inciso X do Artigo 122 da Lei Das Sociedades por Ações)* [The New Competencies of the General Meeting (1): Related-Party Transactions (Comments on Item X of Article 122 of the Brazilian Corporate Law)], 1 REVISTA DE DIREITO SOCIETÁRIO E M&A (2022).

[106] For a panorama of the legal framework for related-party transactions across jurisdictions, *see* OECD, *OECD Corporate Governance Factbook 2021* (2021), https://www.oecd.org/corporate/corporate-governance-factbook.htm.

[107] *Id.* at 80 ("Although less commonly required than board approval, three-fifths of jurisdictions require shareholder approval under certain conditions.").

[108] *See* Pargendler, *supra* note 72.

[109] This is the case, e.g., of Delaware's regulation of RPTs. While commendable, the Delaware model is not replicable in Brazil –at least not in the next few years– considering its high reliance on an effective enforcement of shareholder rights to curb

Brazilian case, considering that the country's judicial enforcement of shareholders rights is still ineffective, as this study has shown.[110] Third, allowing minority shareholders to have a say in relevant RPTs considers the concentrated ownership structure of Brazil's capital market, in which the conflict of interests between controlling and non-controlling shareholders is especially sensitive.[111]

However, the LSA still provides for insufficient control mechanisms of related-party transactions. The vast majority of RPTs can still be concluded in Brazil without ever being submitted for shareholder approval, given that the LSA article 122, X sets an exceptionally high threshold for that to be required.[112] And even if a RPT is submitted to the general meeting, the LSA remains unclear as to whether the self-interested controlling shareholder is allowed to vote the resolution to approve it or a "majority of the minority" shareholders is needed to pass

wrongdoings. For a panorama of Delaware's mechanisms to control RPTs, *see* Jonathan Rosenberg & Alexandra Lewis-Reisen, *Controlling-Shareholder Related-Party Transactions Under Delaware Law*, HARV. L. SCH. (Mar. 1, 2022, 6:26 PM), https://corpgov.law.harvard.edu/2017/08/30/controlling-shareholder-related-party-transactions-under-delaware-law.

[110] Specifically on the judicial review of RPTs in Brazil, *see* Pargendler, *supra* note 72, at 43 ("But policing related-party transactions is an exceedingly difficult task that Brazilian courts do not seem to perform well.").

[111] On the characteristics of the Brazilian ownership system, *supra* note 72. On the parallel between concentrated ownership structures and the rise of agency problems between controlling and non-controlling shareholders, *see* Armour et al., *supra* note 9, at 46 ("In most jurisdictions around the world, the ownership of shares in publicly traded firms is concentrated in the hands of relatively few shareholders —whether families or institutional investors. With such ownership patterns, owners face relatively low coordination costs as between themselves, and are able to rely on governance strategies to control managers —although of course the control of controlling shareholders themselves becomes more problematic."); *see also* Luca Enriques et al., *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, *in* ANATOMY OF CORPORATE LAW 105 ("Anecdotal evidence concords with the existing (albeit dated) empirical evidence to suggest that the minority–majority agency problem remains severe in these jurisdictions [including Brazil], despite legal efforts to mitigate it through increased mandatory disclosure, appointment rights for minority shareholders in Italy and Brazil, and pressure to add independent directors arising from listing standards or codes of best practice.").

[112] Such a high threshold deviates from international practice. *See* OECD, *supra* note 3, at 80–81 ("Such requirements often apply only to large transactions (for example, for transactions involving at least 10% of total assets), while in some jurisdictions, the threshold is much lower (for example, 1% of a company's market capitalization in Sweden).").

the resolution. This brings up an old debate among scholars, but which is still one of the main points of contention regarding the Brazilian corporate law: whether (i) a shareholder who has a special interest in a resolution is automatically prevented from voting it under the assumption that his or her interests are in conflict with those of the company (*formal* conflict of interest doctrine), or (ii) the conflict of interest takes place only if the resolution actually results in a private benefit for the interested shareholder to the detriment of the company's interests, which could only be assessed after the exercise of the voting right (*substantial* conflict of interest doctrine). This controversy centers on the interpretation of LSA article 115, paragraph 1, and remains unsettled considering the Brazilian Securities and Exchange Commission's (*Comissão de Valores Mobiliários* – CVM) ambiguous understanding of the matter.[113] Such legal uncertainty imposes the risk that controlling shareholders might be allowed to vote on resolutions for the approval of RPTs, which would ultimately leave minority investors unprotected.[114]

Therefore, rescission suits suffer from severe limitations from an investor protection standpoint, as demonstrated by their inability to remediate abuses arising from most RPTs. It follows that an effective enforcement of shareholder rights in Brazil depends on the improvement of the country's legal framework for liability actions, including derivative suits.

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[113] In defense of the *formal* conflict of interest doctrine, *see* Modesto Carvalhosa, 2 COMENTÁRIOS À LEI DE SOCIEDADES ANÔNIMAS: ARTIGOS 75 A 137 [Commentaries on The Corporate Law: Articles 75 through 137] 465 (4th ed., 2008) ("There is a legal prohibition for the shareholder who has a formal conflict of interest with the company to vote in any way, even if it is in the company's interest." [translated]). On the *substantial* conflict of interest doctrine, *see* Luiz Gastão Paes de Barros Leães, *Conflito de Interesses* [Conflict of Interest], *in* ESTUDOS E PARECERES SOBRE SOCIEDADES ANÔNIMAS 25 (1936) ("it is necessary to investigate the merit of the incompatibility between the exercise of the vote and the matter submitted to the deliberation of the general meeting, from where it must be considered on a case by case basis, for the purpose of its annulment" [translated]). For an analysis of the evolution of the CVM interpretation of LSA article 115, *see* Calixto Salomão Filho, O NOVO DIREITO SOCIETÁRIO: EFICÁCIA E SUSTENTABILIDADE [The New Corporate Law: Effectiveness and Sustainability] 201-209 (5th ed., 2019).

[114] *See* Enriques et al., *supra* note 111, at 84 ("Nevertheless, requirement of approval by a majority of the outstanding shares is no protection for minority investors if the controlling shareholder enjoys such a majority.").

B. Liability Lawsuits

This article supports the OECD report on the private enforcement of shareholder rights in Brazil[115] with empirical data. It shows that liability actions in the country, including derivative suits, are falling short without almost ever having an examination of the merits. It also shows that, despite the difficulties in succeeding with these demands, upset shareholders still bring claims for damages, which indicates an urge to obtain monetary relief which is currently not being addressed in Brazil. These findings highlight the relevance and urgency of strengthening the country's corporate law enforcement.

The debate over legal reforms aiming to address the underenforcement of shareholder rights in Brazil is plagued by fears of providing excessive incentives for derivative suits, which could ultimately entail a surge in non-meritorious litigation. Even though this is a reasonable concern,[116] the Brazilian experience with rescission suits shows that, despite all the flexibility of this remedy, shareholders have resorted to it on less than 50 occasions in a period of five years. Therefore, this study has revealed no evidence of frivolous litigation that could significantly impact the operation of Brazilian companies. Notwithstanding that the differences between the rescission and liability suits prevent a clear parallel from being drawn, these findings suggest that, even if the LSA was to offer serious incentives to derivative litigation, this would most likely not lead to a flood of non-meritorious claims in Brazil. Or, at least, this study demonstrates that the shortcoming of derivative litigation in Brazil is of greater concern than the risk of non-meritorious lawsuits.

In this vein, the OECD report has made three main recommendations to improve Brazil's derivative litigation model. First, it has suggested the extinction of the *quitus* to eliminate the intricate problem of annulling the approval of the management's accounts to file a liability claim against officers and directors.[117] Second, it has proposed the creation of pre-trial procedure to serve both (i) to evaluate whether the claim is non-meritorious and (ii) as a cut-off point after which the corporation must bear litigation costs even if the lawsuit is ultimately

[115] *See* OECD, *supra* note 3.

[116] *See* OECD, *supra* note 21.

[117] *See* OECD, *supra* note 3, at 8–9.

unsuccessful.[118] Third, it has advised that shareholders be given express authorization to settle derivative suits on behalf of the corporation upon general meeting approval, provided that shareholders owning the same amount of shares necessary to file a derivative suit have blocking rights.[119]

The findings of this study prove the relevance of these three recommendations. First, derivative litigation is almost non-existent in Brazil. To make it a viable option for shareholders, a Brazilian law reform should focus on meeting the criteria of the Anna Karenina Principle. As seen in Part I, this includes allocating the risks and costs of litigation in favor of the plaintiff shareholder, which the OECD considers to be the main measure to foster derivative litigation.[120]

Second, the merits of derivative suits are hardly ever examined in Brazil. The fact that considerable liability claims are denied on a preliminary basis is largely justified considering that shareholders often choose the wrong venue to seek redress for damages (e.g., by filing a direct suit to claim for damages caused to the corporation).[121] Disregarding cases of legal malpractice, this reality might be explained in light of the disincentives to bring a derivative suit, especially the (i) standing to sue and (ii) condition that the action must first be submitted to the general meeting in case it includes officers or directors as defendants. While both these requirements were designed to prevent non-meritorious suits, they have made derivative litigation extremely difficult in Brazil. Thus, a Brazilian law reform should establish mechanisms to deter non-meritorious derivative suits without creating excessive difficulties to the filing of those which are meritorious.

Third, most liability suits with a decision on the merits have failed to provide redress to shareholders due to the lack of proof of the defendant's liability. This finding draws attention to an issue that has proved to be of utmost relevancy to the success of derivative litigation,

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[118] *Id.* at 9–13.

[119] *Id.* at 13–14.

[120] *Id.* at 7–8 ("The financial risk of having to pay court fees and other litigation expenses in case of losing the dispute is likely the most relevant disincentive for a minority shareholder to initiate a derivative action.").

[121] *See* Court of Appeals of São Paulo, Appeal 1052131-96.2018.8.26.0100, First Reserved Chamber for Business Law, Rapporteur Hamid Bdine, decided on Mar. 6, 2019; Court of Appeals of São Paulo, Appeal 3003790-53.2013.8.26.0270, Second Reserved Chamber for Business Law, Rapporteur Fabio Tabosa, decided on Sep. 30, 2019.

although little explored in the OECD report: the access of plaintiff shareholders to effective evidence production mechanisms. On this topic, the OECD report asserts that the mechanisms of evidence production under the Brazilian civil procedure system are limited and ineffective, but it does not refer to any recent studies that support this conclusion.[122]

As seen in Part II, the Brazilian Civil Procedure Code of 2015 has instituted new evidence production mechanisms that can facilitate the elimination of information asymmetry, especially the dynamization of the burden of proof (article 373, paragraph 1) and the early production of evidence (article 381). However, given the shortage of derivative suits filed under the CPC/15, it is still not possible to assess whether such mechanisms are actually being applied in derivative litigation. Thus, it remains unclear whether the stated difficulty with the production of evidence in Brazil stems from normative limitations, as the OECD report suggests, or from practical issues. Regarding the latter, it is possible that the parties and the judiciary are not yet applying the solutions to the problem of evidence production already presented by the CPC/15. Therefore, the need for a reform of the Brazilian procedural rules of evidence production is yet to be ascertained.[123]

Finally, this study has not identified the lack of rescission of the *quitus* as a major reason for the failure of derivative actions against officers and directors. This does not mean the *quitus* is not a significant hurdle to derivative litigation in Brazil. Rather, the analysis of the Brazilian framework in Part II suggests that it is. Such a requirement certainly has discouraged shareholders from pursuing liability claims and perhaps part of the rescission suits identified in Part III.B have not unfolded into derivative suits because they have failed to annul the approval of management's accounts and financial statements. Yet, it is still unclear to what extent the *quitus* has been impacting derivative litigation in Brazil.

[122] OECD, *supra* note 3, at 124 ("Like most other civil law jurisdictions, Brazil does not have broad production of evidence mechanisms such as the US-style discovery. The Company Law prescribes which documents the shareholders have the right to access and the CPC provides for procedural tools for obtaining documents. However, these mechanisms are not effective and case law is somehow uncertain about the interpretation of those provisions and about which documents the shareholders can access, especially with regard to listed companies.").

[123] *See* Pereira & Schwartz, *supra* note 62.

Based on the above considerations, I propose that the private enforcement of shareholder rights in Brazil must be improved by eliminating the excessive barriers to the filing of derivative suits and the examination of their merits. These can be achieved through the (i) creation of a pre-trial procedure to change the allocation of risks and costs of litigation[124] and (ii) extinction of the *quitus*, both according to the OECD's recommendations. In addition to having incentives to file derivative suits, minority shareholders must also be given a real chance of success in these demands. This might require improving the plaintiff's ability to prove his or her claim, if further research on the topic concludes that the current mechanisms of evidence production in derivative litigation in Brazil are ineffective. Lastly, a legal reform should be considered to regulate settlements in derivative suits as suggested by the OECD, as this would help to prevent the expenditure of time and money associated with litigation.

CONCLUSION

This article has revealed that, given existing hurdles to derivative litigation, shareholders in Brazil have been resorting to an alternative litigation mechanism: the rescission lawsuit. This study has found that, between 2015 and 2020, the Court of Appeals of São Paulo examined 47 rescission suits in contrast to 18 liability claims. Such a prevalence of rescission suits suggests that shareholder litigation in Brazil follows the same pattern identified in other civil law jurisdictions. Moreover, while no derivative suit was upheld by the Court during the analyzed period, more than half of the rescission suits were judged in favor of the

[124] I acknowledge that the creation of pre-trial procedure represents a challenge to Brazilian legislators, since it would impact other diplomas besides the LSA. The redesign of the financial incentives for derivative litigation might require, e.g., rethinking the application of the CPC's "loser pays" principle, which would ultimately entail a system-wide reform – unless a microsystem is created. Thus, I believe the debate on the strengthening of the private enforcement of shareholder rights in Brazil should focus on how a pre-trial procedure might be introduced in the country without representing an ill-advised *legal transplant*. On the definition and impact of *legal transplants* and *legal implants* in the "international corporate law" (ICL), *see* Mariana Pargendler, *The Rise of International Corporate Law*, 98 WASH. U. L. REV. 1765, 1774–77 (2021). On the key issues in designing a pre-trial procedure for derivative litigation in "loser pays" jurisdictions, *see* Martin Gelter, *Preliminary Procedures in Shareholder Derivative Litigation: A Beneficial Legal Transplant?* 19 ECFR 3 (2022).

plaintiff, which indicates that the latter are relatively successful from the shareholder's perspective.

However, rescission suits are not a panacea for shareholder protection in Brazil. The main evidence in this regard is the fact that they cannot be used to curb abuses arising from business decisions that are not submitted for shareholder approval, which is the case of most related-party transactions in the country. It follows that Brazilian legislators must strengthen the country's legal framework for private enforcement of shareholder rights both by providing incentives for the filing of derivative actions and increasing their chance of success. A law reform with this purpose should consider creating a pre-trial procedure for derivative suits, extinguishing the *quitus* and regulating settlements in this type of suit, all according to the OECD's recommendations. It should also consider improving shareholders' access to information if the current mechanisms for evidence production in Brazil are proved ineffective.