

December 22, 2023

Brazilian Corporations: Governance, Novo Mercado, and Regulatory Challenges

Corporate governance frameworks differ in corporations and companies with a controlling shareholder, as each model is subject to peculiar ownership structures and corporate conflicts.

Several recent cases analyzed by Amec, including Zamp's, show it is necessary to expand the debate on regulations tailored for companies with a dispersed ownership structure. This topic will be addressed in this publication.

Fábio Coelho

CEO

fabio.coelho@amecbrasil.org.br

One defining aspect of capital markets in Latin America, particularly in Brazil[1], is the prevalence of companies with established controlling shareholders or control blocks. This unique characteristic was even accounted for during the formulation of Brazil's Corporate Law (Lei das SA) in 1976, and little has changed since then.

In Brazil, a small share of public companies fit the corporation model. These entities possess a dispersed ownership structure and lack a clear controlling shareholder. By refining this definition to exclude companies where reference shareholders act as controlling ones, the count of true corporations in Brazil dwindles to fewer than a dozen[2].

Consequently, shareholders typically hold significantly larger stakes in Brazilian corporations than in developed markets, where investors' stakes rarely exceed 5% of a company's equity. In Brazil, a shareholder holding 50% of a company's shares may still be deemed a non-controlling shareholder in theory. This indicates that neither local regulations, jurisprudence, or self-regulation mechanisms are fully equipped to manage corporate conflicts in companies with dispersed ownership structures.

Corporate governance guidelines avoid favoring one ownership structure over another, recognizing that each comes with unique challenges. However, the issue lies in legal loopholes that pave the way for misinterpretations of regulations. The absence of a corporate governance framework aligned with dispersed ownership structures and the lack of precise ownership definitions in legislation creates an environment of regulatory uncertainty. The grey areas in regulation make effective oversight by market agents difficult in such circumstances.

This uncertainty has been evident in numerous cases recently analyzed by Amec, such as IRB, Linx & Stone, and Vale. It also sets the stage for further discussions in recent privatization processes, suggesting the need for new parameters to gauge the interplay between shareholders and governance bodies within these companies. As a guiding principle, a reference shareholder who acts like a controlling one should be treated accordingly, bound by the associated rights and responsibilities. This ongoing debate will be addressed in this publication.

[1] <https://amecbrasil.org.br/wp-content/uploads/2020/03/Amec-Corporations-Brasileiras.pdf> e <https://amecbrasil.org.br/wp-content/uploads/2021/03/Opinio-AMEC-Voto-Contrario-no-Brasil-v02.pdf>

[2] Special Report: "Corporations Brasileiras: Aspectos de Governança e Dilemas de Crescimento". Amec. Available [here](#).

Amec Opinion

December 22, 2023



THE ZAMP CASE

Zamp operates within the restaurant industry and is listed in B3's Novo Mercado, which demands the highest corporate governance standards in the country. The company is known for running the Burger King brand in Brazil. Originally established in 2011 under the name BK Brasil, it expanded its operations by acquiring franchises of the hamburger chain in the country. In 2017, the company went public, joining Novo Mercado.

Like many businesses in this sector, Zamp encountered challenges during the Covid-19 pandemic. The impact of reduced revenues and heavy cost structures significantly affected its operations. The company rebranded as Zamp in 2022 and has had its corporate structure significantly changed in the last 3 years. Particularly noteworthy are the adjustments implemented in the last six months, driven by dilemmas over their growth strategies and repeated takeover attempts.

Technically categorized as a corporation under the definition outlined in the Lei das SA, the company lacks a controlling shareholder. Among its main shareholders,^[3] there are Restaurant Brands International (holder of the master franchise agreement and operating as Burger King do Brasil) with a 9.4% stake, Mubadala Capital with a 39.6% stake, FitPart with a 16.8% stake, and Mar Asset with a 3.8% stake.

Mubadala, a private equity firm owned by Abu Dhabi's sovereign fund, has long signaled its interest in acquiring the company. As of 2022, Mubadala had acquired a 5% ownership stake and publicly declared its intention to conduct a takeover bid ("Oferta Pública de Aquisição" or OPA, in Portuguese) to secure a controlling stake in Zamp (50% of shares plus one). However, this bid was rejected by other shareholders and subsequently retracted.

Since then, Mubadala has significantly increased its holdings and currently possesses nearly 40% of the company's capital, indicating a clear ambition to gain control. This shareholder called for an Extraordinary General Meeting (EGM) to discuss the company's voluntary departure from the Novo Mercado^[4], citing the B3 segment bylaws that dismiss the need for a takeover bid (OPA). Other shareholders promptly reacted to the proposal to downlist the company to an inferior listing segment. MAR Asset then submitted a request to amend the company's bylaws during the EGM, aiming to introduce a poison pill and clauses restricting voting rights.

[3] Sources: company data and information published on a Material Fact published on Dec. 18, 2023.

4) In a letter sent to the company on Nov. 20, 2023, Mubadala notes that "the company's listing on B3's Novo Mercado currently blocks some funding alternatives to expand its activities, posing hurdles that overcome eventual benefits that might come from listing in a premium segment. "It also argues that the voluntary departure might contribute to accelerating growth and the execution of Zamp's long-term growth strategies, expanding the options available, including (i) the possibility of fundraising through preferred shares (ii) merging with local and foreign companies that have synergies with Zamp's businesses and that are not listed in Novo Mercado at the moment; (iii) potential migration of its listing to foreign markets."

Amec Opinion

December 22, 2023



THE IMPLICATIONS OF LEAVING NOVO MERCADO FOR SHAREHOLDERS

Amec has previously addressed voluntary departures from prime listing segments on multiple occasions. Discussions have been held in 2012[5], 2015[6], and 2017[7], among others. At times, the argument has centered on the notion that "leaving a premium listing segment is easy and carries no repercussions"[8]. Novo Mercado's current bylaws (RNM) rule that a departure entails a takeover bid (OPA) to cancel the company's registration. However, the possibility of waiving this requirement exists as an exception (pending shareholder approval in a general assembly).

We have no intention to reopen discussions on shareholder voting in circumstances in which there is a conflict of interest[9]. However, in companies with clearly established controlling shareholders, allowing only shareholders holding outstanding shares to deliberate on contentious matters during an assembly evidently mitigates the influence of the controlling shareholder in controversial situations. This approach is internationally adopted to protect and safeguard collective interests and is frequently mentioned by the OECD[10].

In a corporation, neither Novo Mercado's bylaws nor any other regulations prevent reference shareholders from voting under any circumstances. In the aforementioned case, when a shareholder proposing downlisting publicly expresses the intent to take control of the company, there should be criteria for deliberating the topic in a shareholder meeting. Novo Mercado remains a crucial governance benchmark for the country, demanding consistent and effective implementation. The insights gleaned from operations like Zamp's EGM highlight the need to address specific gaps.

PERSPECTIVES ON CORPORATE GOVERNANCE AND SHAREHOLDER CONTROL

The definition of a controlling shareholder as outlined in the Brazilian Corporate Law should have been updated long ago.

[5] Note to the Market: Unified OPAs. Apr. 4, 2012.

[6] Carta Presi 06/2015. Jul. 27, 2015.

[7] Amec Opinion: It is Time to Decide.

[8] It is worth quoting an excerpt of Amec Opinion: It is Time to Decide. "Why pay a 'premium' for a company listed in Novo Mercado if it can cancel its commitment to its clauses and leave Novo Mercado anytime it wants?"

[9] This is a controversial and recurring topic for jurisprudence. Amec has spoken about it on several occasions, providing economic arguments for supporting the approach of formal conflicts. See full article at: <https://valor.globo.com/financas/coluna/voto-em-conflito-e-a-presuncao-da-boa-fe.ghtml>.

[10] See Corporate Governance Factbook 2023. OECD. Available at: https://www.oecd-ilibrary.org/finance-andinvestment/oecd-corporate-governance-factbook-2023_6d912314-en

Amec Opinion



December 22, 2023

Article 116 of the law presents criteria for a controlling shareholder, encompassing a combination of: i) majority voting power; ii) the ability to elect the majority of company managers, iii) the use of power to direct the company's activities and internal structure.

The only way for a shareholder to permanently hold the majority of votes is by possessing 50% of shares plus one. There have been multiple attempts over time to introduce an updated definition on this matter, such as Novo Mercado's bylaws, which define control as "the effective power wielded by shareholders to guide the company's social activities and internal operations, whether directly or indirectly, de facto or de jure, regardless of the shares held."^[11]

Some interpretations define a controller as the shareholder who managed to elect the company's managers for three years in a row. Albeit relevant, those views have always been counterargued by the Brazilian Corporate Law.

The emergence of reference shareholders has brought forth several challenges unaddressed by the existing law. Consequently, various initiatives have surfaced aiming to protect shareholders when a reference shareholder effectively controls a company by electing most managers or influencing business strategies. Among these initiatives are poison pills, voting limitations, and efforts to introduce the concept of "OPA 30" in Brazil.

The 55th issue of the newsletter Amec Viewpoint discussed such topics^[12]. Poison pills were first introduced in the American, British, and European markets due to the presence of companies lacking a clearly defined controlling shareholder. In England, when a shareholder acquires over 30% of a company's shares, they are obligated to extend an offer to all other shareholders, purchasing at the same price as their last purchase.

This limitation on a shareholder's stake is designed to prevent or minimize the potential for de facto ownership with a relatively low holding. It serves as a protective measure for minority shareholders, ensuring that if a shareholder (or a group of shareholders) genuinely seeks to gain control of the company, they must acquire the entire equity.

The 30% threshold was established in England by the Takeover Panel, a self-regulatory body. In 2006, it became part of British corporate law and later was incorporated into the corporate law of the European Economic Community through a specific directive. In Brazil, the Comitê de Aquisições e Fusões (CAF) attempted, albeit unsuccessfully, to propose a similar concept. The rejection of this proposal led to the termination of the initiative in 2021.

[11] See Novo Mercado's bylaws, Article 37, §1°.

[12] Available at: <https://mail.amecbrasil.org.br/vl/-56dcc4fe347465c4910bb9a08244b4ccaf4c786e9me0e2SC0e>

Amec Opinion



December 22, 2023

Poison pills have been employed in many different ways in Brazil, resulting in multiple interpretations of the instrument and subsequent conflicts. Over time, there were a few attempts to establish regulations standardizing the use of poison pills. The stock exchange B3 drafted at least two proposals outlining fundamental rules for defense mechanisms applicable to companies listed in the Novo Mercado segment.

The initial attempt took place in 2008 with the introduction of "OPA 30," which aimed to set the 30% threshold as a trigger for poison pills. However, companies opposed the measure, resulting in its subsequent rejection. The subject resurfaced during the 2017 bylaws update but faced rejection once more.

Therefore, the need to create a new definition for a controlling shareholder, the introduction of "OPA 30" (or another threshold considered more suitable by the market), or even creating an OPA for the original acquisition of control should be addressed in order to improve corporations' regulation.

We emphasize once again that dispersed ownership structures remain rare. In many cases, we observe the presence of reference shareholders still holding significant stakes in these companies. In true corporations, specifically, company managers gain more power as ownership becomes more dispersed. Hence, there's a need to devise measures that restore equilibrium, bridge regulatory gaps, and effectively regulate such ownership structures.

It is worth noting that shareholder engagement becomes even more relevant in corporations in order to deliberate about strategic and relevant topics for business development. In this context, reducing free float thresholds to international levels may further compromise the low investor turnover in assemblies even more. It also highlights the importance of fostering a stewardship culture, which the Brazilian market still needs to enhance.

The Brazilian Securities and Exchange Commission (CVM) has recently proposed a public hearing to update takeover bid (OPA) regulations. This presents an opportunity to update rules across different listing segments on B3. Amec is aware of such unique characteristics and will contribute to ensuring the improvement of Brazilian regulations on corporations.

Check out other Amec content and follow our social media:

