Corporate Governance Rules in Argentina

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Corporate Governance Rules in Argentina - Introduction

The concept of "Corporate Governance" as such, came about in Argentina in 2000 (just before the massive devaluation of the Argentine peso and crisis of its stock market) with the enactment of decree No 677/2001 (the "Transparency Decree"). Before, the concept of "Corporate Governance" had not been envisaged in Argentine legislation.

The idea of the Transparency Decree was to strengthen the argentine stock market (and boost confidence in such market) by setting forth certain rules (corporate governance rules) that would provide more security to investors.

Such Transparency Decree provided for a "Transparency Regime in the Public Offering of Securities". The purpose of this Transparency Decree was to adjust the current local legislation to the main international rules on corporate governance for the improvement of the protection of investors. Unfortunately, despite the Transparency Decree, Argentine faced a large devaluation of its currency and the Argentine stock market crashed in December 2001.

The Transparency Decree, as explained, applies only for public companies. In connection with privately held companies, the change took place two years thereafter, in 2003. In 2003 a new administration of the Public Registry of Commerce of the City of Buenos Aires[1] ("PRC") was appointed. The new administration of the PRC provided for some drastic changes in the PRC and therefore certain corporate governance rules were implemented.

These rules refereed to:

(i) fiduciary duties and guaranties to be provided by directors of argentine companies;
(ii) rules on capital increases protecting minority shareholders;
(iii) rules on "irrevocable capital contributions" a widespread practice of using such account in the financial statements of argentine companies to address problems in the net worth of companies without the need of increasing the capital stock;
(iv) rules on the extension of the corporate purpose of companies;
(v) rules on the mandatory capitalization of certain items of the financial statements.

This whole new set of rules was slowly implemented. In 2005, all these new PRC rules were unified in one single piece of regulation of the PRC.

[1] In Argentina, we have a decentralized system, so each province has its own Public Registry of Commerce; however, the PRC of the City of Buenos Aires is, by far, the one with the largest amount of companies registered.

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In this paper, we will firstly explain the impact of the Transparency Decree for public companies; and then we will analyze the rules of the PRC applicable to closed companies.

(1) Transparency Decree for public offering companies in Argentina

The most remarkable improvement introduced by the Transparency Decree related to it finally addressing the corporate rules applicable to public companies. In the past, Argentine public companies had the same corporate rules as privately held companies. Neither the Argentine Corporate Law ("ACL") nor the Securities Law (law 17,811) provided for special corporate rules for public companies.

Some of the new provisions of the Transparency Decree are the following:

(i) It defines certain concepts that were not defined before in the context of the public offering such as: (a) Securities (including any type of tradable security); (b) controlled, and controlling group; (c) concerted behavior; and (d) privileged information.

(ii) It provides for a specific corporate regime for public companies, with specific duties as (a) reporting; (b) confidentiality; (c) fiduciary; and (d) information duties for directors and managers of public companies.

(iii) The Transparency Decree provides for an audit committee composed by non-executive independents directors.

(iv) The Transparency Decree regulates and defines the concept of "insider" and "insider trading", together with setting forth sanctions for insider trading;

(v) The Transparency Decree also punishes the manipulation of the market that could either alter the free trading of securities or that could lead to error by the investors.

In the following paragraphs we shall describe the main rules implemented by the Transparency Decree.

A) Audit committee

This audit committee (the "Audit Committee") is a board committee that should be composed by three or more non-executive independent directors (we explain and discuss non-executive independent directors later on n this paper). Its members must be independent in relation with the company and, with the controlling entity.

The Audit Committee is conceived as a sub-organ within the board of directors. Its main duties are linked with the extern and intern audit, and the information that has to be given to the market.

The main functions of the Audit Committee are:

(i) Supervise the operation of the administrative and accountancy system.
(ii) Express its opinion about the board of directors' proposal for the appointment of external auditors.
(iii) Provide the securities market information about operations that can lead to a conflict of interests among the corporate members or the controlling shareholders.
(iv) Call for meetings in which managers, members of the controlling party and external auditors must participate in.
(v) Request professional advice.

B) Non-executive independent directors

A member of the board of directors is not considered "independent", when he or she falls under any of the following conditions:

(i) if he or she is an employee of the company or has been and employee for the last three months;

(ii) if he or she is an employee of a shareholder that has a "significant interest" in the company. A "significant interest" exist when:

(a) the shareholder owns at least a thirty-five percent (35%) of the issued shares, or;
(b) the shareholder own less than thirty-five percent of the issued shares, only if he can appoint one or more directors, or;
(c) the shareholder is part of an agreement with other shareholder in respect to the management of the public company or controlling party.

(iii) if he or she has a professional relationship or belongs to a company or association that has a professional relationship with the company;

(iv) if he or she receives a remuneration from the company aside from the one that corresponds to his duties as a director;

(v) if he or she receives a remuneration from a shareholder that has a significant share interest or influence in the public company, or from the company in which the shareholder has a share interest or significant influence in;

(vi) if he or she owns a significant share interest in the public company;

(vii) if he or she owns a significant share interest in the company that has a significant influence in the public company;

(viii) if he or she provides goods or services to the public company or to a shareholders that has a significant share interest or influence in the public company for amounts considerably higher than the remuneration for his duties in the board of directors;

(ix) if he or she is the (a) spouse or (b) fourth degree blood relative or (c) second degree non-blood relative, of a person that would not be independent if that person was a director.

C) External auditor

The general shareholders' meeting, along with the approbation of the accountant states, shall appoint public accountants to fulfil external auditing duties. Only registered independent certified public accountants can be appointed as external auditors.[2]

The board of directors can also make a proposal for the appointment of external auditors. Such proposal must be approved by the Audit Committee.

The National Securities Commission ("NSC") can also request the appointment of an external auditor in case the rights of minority shareholders may be affected[3] (for example because of a capital increase or reduction). Such appointment must be requested by shareholders representing at least five percent (5%) of the corporate capital.

External auditors are in charge of accountant reports. These reports compose a pillar in the protection of investors and the transparency of markets[4]

D) The role of the board of directors

The Transparency Decree expressly establishes the board of directors must have a relevant participation in planning financial strategies and must be aware of the position of the company in the market.

International studies have showed the effectiveness of the board of directors in fulfilling its duties allows seeing its transparency and the level of professionalism of its members.

The Transparency Decree extends the directors duties, including information, disclosing and confidentiality duties.

E) Confidentiality duties

[2] External auditors must be independent not only in relation with the company, but also in relation with the controller parties. Also they must present an affidavit informing the sanctions they have received whether they were penal or administrative sanctions.
[3] In accordance with section 14 of the Transparency Decree.
[4] MARÍA CELIA MARSILI, in *Mercado de Capitales. Régimen de las emisoras.* UADE University, Ed. Rubinzal-Culzoni, page 99.

Controlling shareholders, members of the Surveillance Committee, directors, managers, shareholders, or any other corporate member that becomes aware or possesses non-public information which can alter the negotiation of securities must hold strict confidence.

Insiders cannot negotiate until this information becomes public.

F) Loyalty duties

The Transparency Decree provides that managers and controlling parties must put the shareholders' common interests above of other interests. They must set preventive mechanisms aimed to protect corporate interests and reduce conflicts of interest among insiders. The Transparency Decree expressly sets negotiation procedures must guarantee the "*protective principles of the investors, equity, efficiency and transparence*"[5].

The loyalty duty was already regulated in the ACL[6]. In a wide interpretation, this loyalty duty prohibits insider trading. This specific regulation is provided in order to make corporate members respect the trust of investors and preserve the market's transparency.

G) Prohibition of insider trading

The Transparency Decree provides specific regulation on insider trading, inexistent till the moment of its enactment. It defines reserved information as any kind of non-public information refereed to one or several securities, or to one or several securities issuers. Such information, if it is publicly informed, can cause damage on conditions, price and negotiation of securities.

The Transparency Decree expressly prohibits using reserved information in own benefit or in benefit of others, to obtain advantages of any kind in the market, whether this information is refereed to (i) the purchase or selling of tradable securities, or (ii) operations related to public offering.

Moreover, when companies attempt to acquire the control and a *significant participation*[7] of a public company subject to the regime of public offering, this company must execute a mandatory public offer following the procedures provided by the NSC.

(2) Corporate Governance for privately held companies

At the end of 2003 a new management was appointed at the PRC. With such new appointment, major changes were introduced. During 2004 the PCR issued a total of 28 resolutions.

[5] Section 11 of the Transparency Decree.
[6] Section 59 of the ACL.
[7] In accordance with section 23 of the Transparency Decree.

Resolution No. 7 of 2005 (the "PRC Resolution") introduced an extensive modification on corporate governance rules for privately held companies in Argentina. This PRC Resolution is a unification of several resolutions implemented during 2004.

The following are the most important changes established for closed companies by the PRC Resolution:

(i) Guaranties to be provided by directors and managers of argentine companies.
(ii) Rules on capital increases protecting minority shareholders.
(iii) Rules on "irrevocable capital contributions" that are normally used to address problems in the net worth without the need of increasing the capital stock.
(iv) The corporate purpose must be clearly determined.
(v) Capitalization of certain items of financial statements that in the past need not to be capitalized.

In the following paragraphs we shall describe the main characteristics of the provisions listed above, implemented by the PRC Resolution.

A) Guaranties provided by directors and managers of argentine companies.

This rule aims at protecting the interests of shareholders that can be affected by the acts of directors and managers of argentine companies.

Therefore directors and managers are subject of a guarantees regime. The ACL remarks the importance of this regime that, before PRC Resolution came into force, was distorted by guarantees of unsuitable amounts.

Directors of corporations and managers of limited liability companies must provide a guarantee through either of the following elements:

(i) bonds;
(ii) public securities;
(iii) amounts of money in national currency or foreign exchange deposited in financial entities to the order of the company;
(iv) bank guarantees or bonds;
(v) guarantee insurances; or
(vi) liability insurances in favour of the company.

Consequently, managers and directors cannot constitute a guarantee through direct incomes of founds in the corporate cash.

The amount of the guarantee for managers and directors is AR$10,000 (ten thousand argentine pesos), with the exception of managers of limited liability companies whose activities are of a low magnitude and its capital is inferior to AR$12,000[8]. In these cases the PRC shall set guarantees for a lower amount, but not less to AR$2,000.

[8] This exception was introduced by the resolution 21/2004 that modified resolution 20/2004. The amount of $12.000 was established by the 1st section by Decree No. 1937 of the year 1991.

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B) Rules on capital increases for the protection of minority shareholders

The PRC Resolution prohibits reductions of the capital to zero with a subsequent increase.

The PRC Resolution prevents this type of reduction because it would provoke (a) that majority shareholders, as they had a major participation shall have the economic power to restore their former position or even improve it, while (b) minority shareholders in most cases will not be able to restore their participation in the company.

Minority shareholders shall not have enough liquidity to attend a new capital increase, in some cases they would be forced to renounce their preferential subscription rights, and their participation in the company shall be disintegrated or in some cases annulled.

Majority jurisprudence also objects the reduction of the capital to zero, specifically because it is not a procedure approved by the ACL to overcome a state of dissolution of the company.

C) Rules on irrevocable capital contributions

Irrevocable capital contributions for subsequent subscriptions of shares will be part of the net worth since the date of its aceptation by the board of directors and the aceptation by the management.

The capitalization of the irrevocable capital contributions must be included as an special matter in the agenda of the shareholder's meeting, which must approved it.

The capitalization of irrevocable capital contributions is a limitation to the contributor itself and to the majority shareholders as well. As these contributions compose the corporate net worth, they cannot be withdrawn whenever the contributor requires, which is a usual practice in relation to revocable contributions.

The maintenance of irrevocable capital contributions in the net worth acts as a voluntary reserve that protects third parties and beneficiates minority shareholders.

The written agreement for the capitalization of irrevocable capital contributions must include among others requirements (i) the term during which the contributors obliges itself to maintain the contribution, and (ii) the acceptance that the restitution will be conditioned by the opposition of creditors regime.

D) Clear determination of the corporate purpose

The PRC Resolution provides that the corporate purpose must be determined, clear and precise. It must contain the description of specific activities that will be executed by the company.

This implies a limitation to managers and directors as they cannot execute acts that exceed the corporate purpose. This limitation is imposed as a protection for shareholders that do not have administrative positions.

Prior to the enactment of the PRC Resolution, managers could protect themselves under a vague definition of the corporate purpose, when they have executed acts unfavourable for the shareholders.

Under the provisions of the ACL, managers cannot execute acts that are strange to the corporate purpose, alleging they are complementary with it. The PRC Resolution expressly sets these kind of activities must be clearly specified in the corporate purpose.

The ACL already included the obligation of a clear determination of the corporate purpose. The ACL also provides that managers and legal representatives are responsible for the acts that are "*notoriously strange to the corporate purpose*".[9]

E) Mandatory capitalization of certain items of the financial statements

The PRC Resolution sets the mandatory capitalization of balance results, utilities and reserves. Before the PCR Resolution enactment was not mandatory to capitalize these elements.

This regulation is aimed to protect minority shareholders with the capitalization of balance results before the capitalization of other elements, such as capitalization of credits or capitalization of contributions.

F) Common regulations for both public offering companies and closed companies

Shareholders' meetings

Shareholders may take decisions in ordinary or extraordinary meetings. Through those meetings shareholders have the exclusive right of treatment and voting certain matters. In each kind of meeting they reserve the treatment of the following matters:

In ordinary shareholders' meetings:

(i) corporate annual accounts;

(ii) appointment, remuneration, removal and responsibility of directors, and members of the Surveillance Committee, and;

(iii) increases, up to five times, of the corporate capital.

In extraordinary shareholders' meetings shareholders must consider the matters that are not reserved to ordinary shareholders' meetings, and specially:

[9] Section 58 of the ACL.

(i) increases less than five times of the corporate capital;

(ii) corporate capital reduction and refund;

(iii) redemption, refund and amortisation of shares;

(iv) merger, transformation and dissolution of the company; appointment, removal, and remuneration of liquidators, consideration of accounts, and matters related to the performance of the corporate liquidation subject of a definitive approval resolution;

(v) issuance of debentures and its conversion to shares, and;

(vi) issuance of bonds.

In both kinds of meetings shareholders can vote by proxy[10], but they may not be represented by directors, syndics, members of the Surveillance Committee, managers or other employees of the company.

Directors, syndics, managers and members of the Surveillance Committee must attend in every shareholders meeting, but they cannot vote in decisions of approval of their acts or decisions in respect with their responsibility and removal.

Protection of minority shareholders

Shareholders in possession of at least a five percent (5%) of the corporate capital can request the board of directors to call a general meeting. For such meeting, shareholders can propose the treatment of specific matters in the agenda, and can also request the circulation of statement by dissident shareholders.

The ACL provides for protective minority shareholders measures allowing the appointment of one third of the board of directors by the accumulation of votes.

The corporate by-laws cannot invalidate the right of accumulation of votes. The ACL also provides for the impossibility of the partial renew of the board of directors if by providing this measure, shareholders cannot execute the right of accumulation of votes.

Corporate administration inside the board of directors

The board of directors shall act with the diligence of a good business man.

The board of directors can appoint an executive committee, composed by directors, to manage the day-to-day business of the company, only if the corporate by-laws allows it. If an executive committee is created, the board of directors must provide for its faculties, and shall supervise all of its actions.

[10] To vote by proxy shareholders need to grant a power of attorney through (a) public instrument, or (b) private instrument with sing certificated by bank, notary public or in a judicial manner; except the by-laws provides otherwise.

The board of directors can also appoint general or special managers, they may be directors or not. These managers are responsible for failing to comply with their assigned duties, but this does not excludes the directors' liability for the managers' acts.

Surveillance on the board of directors

There is a distinction in this point whether the company counts or not with a supervisory body.

(a) If the company counts with a supervisory body shareholders that represent at least the two percent (2%) of the share capital can make an information request to the supervisory body. Thereafter, the supervisory body must comply with the request if it considers it reasonable, and ask for the required information to the board of directors.

(b) If the company has no supervisory body, shareholders have free access to the corporate accountant books and can make a direct information request to the board of directors.

Remuneration of managers

Generally, the by-laws sets the remuneration of directors and the Surveillance Committee, but the shareholders' meeting can establish such remunerations.

The remuneration of directors and members of the Surveillance Committee can not exceed the twenty-five percent (25%) of the company's earnings. This percentage is limited to five percent (5%) if dividends are not distributed among the shareholders, and has increased proportionally to the percentage distributed.

The vote of majority shareholders

The ACL provides for a special right for shareholders holding a special class of shares.

Shareholders in possession of a special class of shares can appoint directors, if the by-laws provides for such measure. Directors appointed by shareholders holding a special class of shares, can only be removed by the majority of those shareholders.

Removal of directors

Despite the mentioned above, directors can be removed, whether they hold a special class of shares or not, by the following causes:

(i) If they are unable to fulfil their duties.

(ii) If they are responsible of bankruptcy. In these terms they can be appointed as managers only after five (5) years of the rehabilitation.

(iii) If they are responsible of fraudulent bankruptcy. In these terms they can only be appointed as managers after ten (10) years of rehabilitation.

(iv) If they are responsible of criminal convictions, such as theft or the issue of bad checks. In these terms they can be appointed as directors only after ten (10) years of fulfilling their sentence.

Directors and shareholders liability

Shareholders and third parties can always execute individual legal actions against directors.

Directors are responsible before the company, shareholders and third parties, for:

(i) failing in fulfilling their duties, for breaking the law, the by-laws, or by any other damage caused by a wilful misconduct, abuse of their faculties and gross negligence;

(ii) not reporting relevant information that can alter or have an substantial impact in the corporate share price;

(iii)using privileged information for their benefit of benefit of third parties, and;

(iv)allow or worsen the insolvency of the company. They can be criminally liable for fraud and certain wilful acts.

Directors can be jointly responsible for:

(i) they wilfully not declare their employees salaries to the social security system;

(ii) they do not comply with foreign exchange obligations, and;

(iii)tax evasion.

Directors are exempt from responsibility of a bad decision taken by the board of directors that may cause damage to the company, if they leave a written constancy of their dissidence. They must also inform their opposition to the syndic before the responsibility is reported to the board of directors, the syndic, the enforcement authority, or the legal action is executed.

Directors also are exempt from responsibility when their administration is approved by the shareholders at a general meeting, unless shareholders that represent at least the five percent (5%) of the corporate capital oppose the resolution of the shareholder's general meeting.

Piercing of the corporate veil

Companies are a separate entity of the members that compose the company, and therefore the company is responsible for its acts and omission.

However, shareholders or directors that execute strange acts to the corporate purpose, and that have used the corporate veil to break the law, damage the public policy, the good faith or rights of third parties, shall be directly responsible for their acts.

Therefore the mentioned above, shareholders and directors shall be directly responsible if they have abused of the corporate structure. This is commonly named as the *piercing of the corporate viel*[11].

The Present of Corporate Governance Rules in Argentina

As in most of the Latin-American countries, the achievement of an important increase in the transparency levels and the self-commitment of companies have been a principal aspect in connection with the development of corporate governance rules in Argentina.

This was accomplished, in principle, through effective laws and regulations. Notably, the majority of the developments came from the legislation -for public companies trough the Transparency Decree and subsequent regulations of the NSC and the different exchanges of Argentina and for closed companies' trough the rules of the PRC

Final considerations

The corporate governance rules have made a remarkable impact on business worldwide, after big economic scandals and companies' failures such as *Enron* and *Worldcom* among others.

These practices are clearly necessary in a globalized and changing world. They are not strange to developing economies, especially to Argentina where the economic crisis has had its remarkable consequences.

Good corporate governance practices may adequate to each type of companies, therefore it is needed the commitment of insiders in the analysis of which would be the more suitable strategies for each company and how carry them out.

Protect not only the interests of investor but also of those that have a reasonable interest in the company is essential.

The adoption of these corporate governance measures is essential in a country that was severely affected in its economy in the last years. After the 2001 crisis the implementation of measures that favor the transparency of the market is required.

[11]The doctrine used these terms in a generalized way, as an example *The juridical person and the piercing of the corporate viel*, of Guillermo Julio Borda, Ed. Argentina, 2001.

The implementation of these practices not only must be considered as positive for the development of public companies but also domestic companies, privately held, which are the majority in our economy.

Additionally, corporate governance practices must be considered central in the development of the financial system, the capital market and the strengthening and growth of the economy.