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Modernizing corporate law in Latin America: Lessons from Ecuador

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In the past decades, several countries in Latin America, including Argentina, Colombia, Mexico and Uruguay, have implemented significant corporate law reforms. In the meantime, the regulatory framework for companies in Ecuador has remained virtually intact since 1964. This situation, however, has dramatically changed in 2020.

In one of the most ambitious corporate law reforms observed in Latin America in the past decades, Ecuador has recently modernized its corporate law. The reforms implemented in Ecuador are aligned with the policy recommendations suggested in an article submitted by the Ibero-American Institute for Law and Finance to the Ecuadorian Parliament, and adopt elements from several jurisdictions including Australia, Colombia, Spain, the United Kingdom, and the United States. In our view, since many corporate law jurisdictions in Latin America suffer from similar problems (eg high costs associated with the process of setting up a company, excessive mandatory rules for private companies, and lack of adequate mechanisms to prevent opportunistic behavior of controllers vis-à-vis minority shareholders), the reforms recently adopted in Ecuador can serve as a valuable guidance for other Latin American countries interested in modernizing their corporate laws.

First, Ecuador has adopted the simplified corporation ('SAS') approved by the Organization of American States, which is mainly inspired by the Colombian SAS. The primary features of this innovative form of business organization include: (i) the abolition of the minimum legal capital traditionally required to set up a private company in Ecuador; (ii) the abolition of certain formalities and intermediaries required for the formation of companies in the country; (iii) the possibility of setting up a company by a single shareholder; and (vi) greater flexibility of the shareholders to design the internal rules governing the corporation. Recent data collected from the Ecuadorian Superintendence of Companies are already showing the success of the SAS in Ecuador.

Second, the recent corporate law reforms implemented in Ecuador significantly increases the level of protection of minority shareholders. This is achieved through several mechanisms including: (i) the adoption of a derivative action (unavailable for minority shareholders until this reform); (ii) the existence of a majority of the minority ('MOM') approval for certain transactions; and (iii) the empowerment of minority shareholders in the appointment of independent directors, even requiring—if adopted by the constitution—two levels of approval (majority of the shareholders and majority of the minority) as some of us have suggested for Latin American companies, and more generally for companies with controlling shareholders, especially in emerging economies.

Third, the regulatory framework for directors' duties has also been improved significantly. On the one hand, corporate directors are subject to a more stringent duty of loyalty. On the other hand, corporate directors will enjoy the protection of the business judgment rule (BJR). Therefore, courts will not second-guess business decisions made by corporate directors. The Ecuadorian BJR includes elements from the BJR existing in various jurisdictions around the world. Firstly, it is a codified BJR, as it occurs in Australia, Germany and Spain. Secondly, the requirements of the BJR are very similar to those existing in Spain. Finally, the Ecuadorian BJR has been designed as a presumption in favor of corporate directors. Namely, unless the plaintiff shows that the directors incurred a conflict of interests, acted in an oppressive manner, or violated the law, the judgment made by corporate directors will be respected by courts. Therefore, this latter aspect of the Ecuadorian BJR seems to resemble the BJR adopted by Delaware courts, and the 'abstention doctrine' supported by some authors.

Fourth, in addition to the increasing power of minority shareholders and the improvement of the regulatory framework of directors' duties, the corporate law reforms implemented in Ecuador have also led to the enactment of a Corporate Governance Code (CGC). This is the first Corporate Governance Code adopted in Ecuador and, following the model existing in other countries, it adopts a 'comply or explain' approach. Among other aspects, the Ecuadorian Corporate Governance Code improves, clarifies and modernizes many aspects related to the remuneration of corporate directors, the appointment and removal of independent directors, the composition of the board, the governance of family-owned firms, related party transactions, and disclosure of financial and non-financial information. It also promotes various good practices for compliance and the decision-making process in the boardroom.

Fifth, the recent corporate law reforms provide a more attractive exit for companies by introducing a quick dissolution process. Moreover, the reforms embrace the use of new technologies in several ways. On the one hand, the new legislation allows the use of electronic devices for shareholders' meetings. On the other hand, companies will be permitted to keep their accounting records digitally. Finally, the new corporate law framework facilitates the use of blockchain for various purposes, including the tokenization of shares.

This corporate law reform represents a turning point in the history of corporate law in Ecuador, and probably in Latin America. Nonetheless, regulators and policymakers should be aware that corporate law in Ecuador still faces many challenges, including the improvement of the judicial system. In the absence of an adequate enforcement infrastructure, any good law on the books can become useless in practice. Still, we believe that, despite these institutional challenges, as well as other legal reforms needed to modernize the regulatory framework for companies and financial markets in Ecuador, the recent corporate law reform will create several benefits for the local and regional economy, and it can also serve as a valuable guidance for other Latin American countries seeking to modernize their corporate laws.

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