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RECENT REFORMS IN MEXICAN RULES ON CORPORATE GOVERNANCE AND SHAREHOLDER RIGHTS

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A year ago, the corporate governance system in Mexico for publicly traded companies was basically voluntary. There was a voluntary code with which a number of companies complied. Companies that were listed on the Bolsa\(^1\) had to disclose the extent to which they were in compliance with that voluntary code of best corporate practices. The situation has changed since then with the amendment of the Mexican Securities Act.\(^2\)

In the past year our legal environment has changed. Last year many of the corporate governance issues were codified in a standard, so that Mexican listed companies could voluntarily choose to perform under the code or not to do so. It was a only a rule of level of disclosure. The market valuation of a company's equity depended on its level of compliance with the code.

Last June Mexico had a major review of our financial law and Mexican financial laws were amended to comply with certain international principles. In particular, the Mexican Securities Act was amended in order to recognize the need for the following: 1) regulation of corporate governance; 2) full, fair and prompt disclosure; 3) minority rights, and 4) transparency of stock transactions.

One question I would raise for my U.S. colleagues is whether this is consistent with the legislative history of the 1933 and 1934 federal securities acts of the United States, or whether Mexican law, as we will see, is consistent with Rule 10B5\(^3\) in the United States and the 1934 act.

CHANGES IN MEXICAN CORPORATE GOVERNANCE

What has happened to regulation of corporate governance in Mexico? The Mexican Securities Act now acknowledges and requires the following:

First, the Act requires the presence of independent directors and a Mexican issuer. The law does not define “independent”; nevertheless, the law provides certain guidelines in order to be able to determine who is a related director or whether a director does not qualify as independent. The boards must be composed of between five and twenty members. This is true because before, in publicly traded companies,

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1. The Bolsa Mexicana de Valores (BMV) or Bolsa is the Mexican Stock Exchange. It is a private institution, legally incorporated as a limited company with variable capital that operates under a concession from the Ministry of Finance and Public Credit and is governed by the Securities Market Act. Its shareholders consist exclusively of authorized brokerage firms, each of which owns a single share. See, http://www.bmv.com.mx/bmving/generalinfo.html

2. The Mexican Securities Act is also known as the Ley de la Comisión Nacional Bancaria y de Valores (Law of the National Banking and Securities Commission). The text is available at: http://www.cdhhcu.gob.mx/leyinfo/46/.

3. 10B-5 is a provision in U.S. federal securities law that prohibits fraudulent and misleading activities in securities transactions.
either we had very large boards or we had boards that were closely held, usually with related persons that were equity holders and board members and the issuer.

Second, at least 25 percent of the board must be independent. There must also be an alternate director for each director appointed, and companies must comply with the same ratio of independents.

Here come the important matters. Before the law was amended, which matters were referred to the board of directors were basically determined by the shareholders. The regulations that are still in force only required certain major corporate events to be approved by the board, such as divestitures of subsidiaries, or how the equity of the subsidiary would be voted in the shareholders meeting of a subsidiary, as well as the exercise of the withdrawal rights in a subsidiary. Today, due to corporate governance, the board has a special duty to assure the disclosure of extraordinary corporate transactions of the issuer. Extraordinary corporate transactions are those that are executed between management and non-independent directors, i.e., those directors who have an equity stake in the corporation. Other considerations include major corporate positions and divestitures of the company and guarantees to be issued or accepted by the company and other major reorganization of corporate assets.

This is the first time that the Mexican Securities Act has imposed upon the Mexican issuer a duty of care and accountability. It will be a question for the Mexican practitioners in the corporate area, as well as the securities lawyers and trial lawyers in Mexico, to discuss how the Securities Act, Commercial Code, and commercial litigation should interact. This is the framework. These are the rules of the game in connection with duty of care and accountability.

Going further in corporate governance, after the board of directors we have a new corporate governance principle in the law that was already in the Code, and I refer to the auditing committee. The auditing committee is now mandatory. The auditing committee must be composed of a majority of independent directors and must be chaired by an independent director. The functions of the auditing committee will be set forth in the bylaws. Nevertheless, it will be one of the mandatory functions or responsibilities of the auditing committee to be able to learn and give an opinion in connection with related party transactions. The resolutions of the auditing committee will have to be presented to the board of directors and then to the annual shareholders meeting of the company. Additionally, we need to file an annual report that has an extensive management discussion and analysis (MD & A) of the issuer, including board compensation. Full disclosure and transparency have to do with short selling and trading.

The other major change in Mexico is insider trading. Before the law was amended, there were many loopholes for insider trading in Mexico. For example, if the insider did not make any profit, one could not enforce the action. There were no remedies. There was another loophole as to whether insider trading requested a benefit for the insider. Today, Mexico has learned from the U.S. S.E.C. and from the federal cases in the United States. Now we have criminal offenses that apply not only in 10B-5 situations but also when an insider makes an illegal disclosure. An illegal disclosure of a material fact constitutes a criminal offense in Mexico. In my opinion, this is beyond 10B-5, because 10B-5 requires that somebody, even in a conspiracy charge, make a trade. In Mexico, one can still be liable for insider
trading—even if one does not make a trade—just for the disclosure of material information that was not disclosed by the issuer.

Another major change in Mexico is the fact that now companies can have, in the bylaws and subject to the approval of the CNBV, poison pills approved by the government. With these poison pills, companies can avoid unfriendly takeovers in Mexico.

MINORITY RIGHTS

The matter of minority rights in Mexico involves contractual principles set forth in Mexican corporate laws, such as bylaws and shareholders agreements. Based on these principles, Mexico wants to enhance minority rights. In the Mexican Securities Act we have made certain revisions of the rights that apply to corporations. Such changes are the following:

For a listed company, 10 percent of equity holders can appoint a director. Further, an inspector can be appointed with a 10-percent vote. A 10 percent equity holder may call a shareholders meeting, provided that the shareholder complies with the procedure set forth in the Mexican corporate law: the process goes through the inspector or the board members. What is important is that a call for a shareholders meeting can be requested.

Another important factor is that enforcement of an action to impose liability against directors—that is, an action for accountability—is now based on a 15 percent ownership. Holders of 15 percent can bring directive actions against the board. Information and deferral of corporate decisions requires 10 percent. Other claims to enjoin actions of the shareholders require 20 percent. This is an improvement. In certain cases, we have moved from a 33 percent requirement to a requirement of 10 percent.

The next step is to complete the legal framework. We have disclosure, criminal sanctions for insider trading, an increase in minority rights. Perhaps the next step would be to improve Mexican law in order to be able to enforce registration rights that you have under stockholder agreements.