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

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Corporate governance literature usually refers to enforcement superiority to explain the premium that foreign firms enjoy when cross-listing in U.S. stock exchanges. This Article casts doubt on this hypothesis by analyzing two comparative case studies of private

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and public enforcement actions taken against securities fraud in the United States and in an emerging market during the 2008 financial crisis.

Two leading non-financial Brazilian corporations cross-listed in the United States—Sadia S.A. and Aracruz Celulose S.A.—suffered billion-dollar losses when the Brazilian real unexpectedly plummeted in relation to the dollar. Despite previous disclosure that they engaged in pure hedging activity to manage risk, their great losses were considered to be the result of highly speculative trading in currency derivatives. Consequently, U.S. lawyers filed securities class action complaints in New York and Florida on behalf of American Depositary Receipt holders. Both corporations sued their Chief Financial Officers in derivative suits in São Paulo and Rio de Janeiro. The Securities and Exchange Commission of Brazil (Comissão de Valores Mobiliários) started administrative proceedings against the companies and their officers, board members, and auditors; yet the U.S. Securities and Exchange Commission did not take any action.

Because the alleged wrongdoing was the same in the U.S. and Brazilian actions, the parallel U.S. and Brazilian enforcement developments provide the opportunity for concrete qualitative assessments of the corporate governance issues, legal consequences, and different outcomes in these two jurisdictions. The case studies show that U.S. enforcement was superior in terms of private shareholder financial recovery but inferior when it came to public discipline and out-of-pocket liability costs for corporate actors. This Article advances normative conclusions for improving private and public enforcement and the comparative corporate governance debate.

Transactions in . . . derivatives have resulted in massive losses that fueled currency market panics and helped transmit the financial crisis to emerging markets.[1]

INTRODUCTION

Theoretical hypotheses in the academic literature and empirical data support a general belief among academics, policy makers, and market players that U.S. enforcement of capital markets regulation is one of the strongest in the world.[2] According to a number of indices and measures, the United States earns one of the highest scores in enforcement of investor rights.[3] This enforcement is considered particularly robust because it relies on a complex set of private and public mechanisms.[4] The United States has an active private enforcement system unparalleled by any other market in the

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1. *See* Randall Dodd, *Playing with Fire*, FIN. & DEV., June 2009, at 40, https://www.imf.org/external/pubs/ft/fandd/2009/06/pdf/dodd.pdf.

2. John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 242, 244 (2007) ("[I]ntensity of enforcement may be the factor that best distinguishes the United States from other international market centers. . . . A leading difference between civil and common law systems and also between the United States and the rest of the world over much of the last century has been enforcement intensity."); *see infra* note 3 (providing supporting empirical evidence).

3. Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 461 (2008) (finding that common law countries outperform civil law countries in an index of shareholder protection against self-dealing transactions in seventy-two countries, which implicitly suggests U.S. superiority, since the United States is the most important representative of the common law tradition besides the United Kingdom); Rafael La Porta et al., *What Works in Securities Laws*, 61 J. FIN. 1, 15–16 (2006) (finding that the United States ties with Australia for the highest score (0.9) in their public enforcement index); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1142–43 (1998) (assessing the quality of enforcement of legal rules protecting corporate shareholders and creditors in forty-nine countries, and showing the United States is only systematically outperformed by a few countries such as Canada, New Zealand, the Netherlands, Switzerland, and notably the Scandinavian ones). *See generally* Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997) (analyzing how such quality of enforcement affects the strength of capital markets).

4. The literature usually classifies enforcement as public or private. *See* Coffee, *supra* note 2, at 266–67 (explaining that "private enforcement" refers to the enforcement of corporate and securities statutes and laws by private party plaintiffs). A civil action commenced against an officer of a corporation by the Securities and Exchange Commission is an example of public enforcement. *See* La Porta et al., *What Works in Securities Laws?*, *supra* note 3, at 2–3.

world.[5] Similarly, the Securities and Exchange Commission (SEC) has one of the highest resource-based expenditures in capital markets public enforcement[6] and features the largest monetary sanctions.[7] Together, these private and public enforcement actions constitute vigorous overall enforcement.

This is not to say that U.S. securities enforcement is flawless. It has indeed been the target of severe criticism as to its effectiveness, costs, rent-seeking incentives, and deterrent power.[8] Yet the literature has generally taken for granted that U.S. enforcement is stronger than that of most countries.[9] This assumption is evident in the legal bonding hypothesis of foreign cross-listed companies, which posits that the premium in the value of their shares[10] reflects the stronger U.S. regulatory system.[11]

5. Coffee, *supra* note 2, at 245 (arguing that the U.S. system of private enforcement "has no true functional analogue anywhere else in the world").

6. *See* Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207, 214–15 tbl.2 (2009).

7. For instance, the SEC has recently announced a probably unbeatable record of US$ 3.4 billion in monetary sanctions applied against wrongdoers. Press Release, SEC, SEC Announces Enforcement Results for FY 2013 (Dec. 17, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540503617.

8. *See, e.g.*, Donald C. Langevoort, *On Leaving Corporate Executives "Naked, Homeless and Without Wheels": Corporate Fraud, Equitable Remedies, and the Debate over Entity Versus Individual Liability*, 42 WAKE FOREST L. REV. 627, 650–52 (2007); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 499–500 (1991). *See generally* Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055 (2006); John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534 (2006); DEBORAH HENSLER ET AL., RAND INSTITUTE FOR CIVIL JUSTICE, CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAINS (2000), http://www.rand.org/pubs/monograph_reports/MR969/index.html.

9. *See, e.g.*, Coffee, *supra* note 2, at 240 ("Thus, to explain the valuation premium that is associated with a U.S. listing and conspicuously absent from a London listing, one is compelled to assign at least considerable weight to the variable of enforcement.").

10. Craig Doidge, G. Andrew Karolyi & René M. Stulz, *Has New York Become Less Competitive than London in Global Markets? Evaluating Foreign Listing Choices over Time*, 91 J. FIN. ECON 253, 253 (2009) ("[W]e find that there is a significant premium for U.S. exchange listings every year, that the premium has not fallen significantly in recent years, and that it persists when allowing for time-invariant unobservable firm characteristics. In contrast, no premium exists for listings on London's Main Market in any year."). *See generally* Craig Doidge, G. Andrew Karolyi & René M. Stulz, *Why Are Foreign Firms Listed in the U.S. Worth More?*, 71 J. FIN. ECON. 205 (2004) (finding that foreign firms cross-listed in the United States had Tobin's q ratios 16.5% higher than those of non-cross-listed firms from the same country at the end of 1997).

11. *See* Coffee, *supra* note 2, at 229 ("[H]igher enforcement intensity gives the U.S.

Despite this theory, however, the empirical literature on enforcement of securities regulation is still insufficient to provide evidence for the standard assumption of U.S. superiority. On the one hand, most enforcement studies have been restricted to an exclusive assessment of public and private enforcement in the United States.[12] This domestic approach, although fruitful, is not enough to establish that U.S. enforcement is stronger than that of any other jurisdiction. In the same vein, international studies that focus exclusively on an enforcement analysis in foreign jurisdictions suffer from the same one-sided shortcoming.[13] They cannot *in abstracto* establish that foreign enforcement in foreign jurisdictions is weaker than that of the United States. Further relying on the independent results of the domestic and international literature does not prove or disprove the enforcement-superiority hypothesis either, because it is difficult to establish which jurisdiction has stronger enforcement based on

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economy a lower cost of capital and higher securities valuations. This higher intensity attracts some foreign listings."). *But see* G. Andrew Karolyi, *Corporate Governance, Agency Problems and International Cross-Listings: A Defense of the Bonding Hypothesis*, 13 EMERGING MKTS. REV. 516, 524 (2012) ("[A] proper verdict about the bonding hypothesis, especially of its purer 'legal' form, has not yet been fully rendered. I think a more complete understanding of the enforcement mechanisms around the world, their financial needs as inputs and the full scope of legal outcomes is still needed.").

12. *See generally* Stavros Gadinis, *The SEC and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 BUS. L. 679 (2012); Coffee, *supra* note 2; A. Gande & D. P. Miller, *Why Do U.S. Securities Laws Matter to Non-U.S. Firms? Evidence from Private Class-Action Lawsuits* (Apr. 2012), http://ssrn.com/abstract=1939059 (working paper); Beiting Cheng et al., *Securities Litigation Risk for Foreign Companies Listed in the U.S.* (June 2012), http://ssrn.com/abstract=2163864 (working paper); James D. Cox & Randall S. Thomas, *Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Law* (Duke L. Scholarship Repository, Working Paper No. 41, 2010), http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2952&context=faculty_scholarship; Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301 (2008); James D. Cox & Randall S. Thomas, *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 NOTRE DAME L. REV. 893 (2004); James D. Cox & Randall S. Thomas, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737 (2003).

13. *See generally* THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH (Dan W. Puchniak, Harald Baum & Michael Ewing-Chow eds., 2012) (analyzing private enforcement through derivative actions in a number of jurisdictions in Asia); Chunxin Jia, Shujun Ding, Yuanshun Li & Zhenyu Wu, *Fraud, Enforcement Action, and the Role of Corporate Governance: Evidence from China*, 90 J. BUS. ETHICS 561 (2009); Guido Ferrarini & Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case*, *in* AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE U.S. 159 (John Armour & Joseph A. McCahery eds., 2006).

comparisons of different facts and cases, at different times and in different jurisdictions, and under diverse systems of enforcement.[14]

On the other hand, the majority of the available comparative enforcement studies rely on quantitative data and indices of public and private enforcement, without engaging in a deeper qualitative analysis.[15] These studies suffer from oversimplification as well as methodological and conceptual problems. For instance, some studies rely on answers given by the best judgment of lawyers as to the legal consequences of a hypothetical case of corporate wrongdoing.[16] While lawyers' evaluations of hypothetical cases advance our knowledge on the enforcement problem, the methodological shortcoming is clear: often clients, regulators, or judges—rather than lawyers—decide what will happen in a real legal case. Further, real enforcement outcomes are not entirely predictable even if one applies the doctrines and case law particular to a given legal problem.[17] Lawyers' assessments may be biased by their own practices, such as whether their clients are more likely to be controlling shareholders, managers, or minority shareholders.

Other studies rely on disputable proxies to measure enforcement. For example, one could ask whether resource expenses related to staff and regulatory budgets are the proper variable for measuring public enforcement intensity.[18] Similarly, studies that exclusively

14. *See, e.g.*, Brief for the Republic of France as Amicus Curiae in Support of Respondents at 1–2, Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010) (No. 09-1191) (asserting that nations police securities fraud by means of incompatible regulatory schemes, and that France has made a considered choice to rely on public actions (*l'action publique*) rather than private class actions).

15. *See generally* Djankov et al., *supra* note 3; Jackson & Roe, *supra* note 6; Mathias M. Siems, *Private Enforcement of Directors' Duties: Derivative Actions as a Global Phenomenon*, *in* COLLECTIVE ACTIONS: ENHANCING ACCESS TO JUSTICE AND RECONCILING MULTILAYER INTERESTS? 93 (Stefan Wrbka, Steven Van Uytsel & Mathias Siems eds., 2012).

16. Djankov et al., *supra* note 3, at 432–33 (basing their analysis on a hypothetical example of a self-dealing transaction); La Porta et al., *What Works in Securities Laws?*, *supra* note 3, at 5 (basing their analysis in an abstract assessment of "the regulation of the promoter's problem" and subsequently relying on the answers of lawyers about the possible legal enforcement consequences to both of these problems in forty-nine jurisdictions).

17. Djankov et al., *supra* note 3, at 433 (stating that the lawyers "provided the text of laws, statutes, judicial precedent, and regulatory opinions used to answer our questionnaire").

18. *See* Jackson & Roe, *supra* note 6, at 210–11 (acknowledging a number of shortcomings in their methodology). In the same vein, La Porta et al., *Law and Finance*, *supra* note 3, at 1140, rely on five proxies for the quality of enforcement: efficiency of the judicial system, rule of law, corruption, risk of expropriation by the government, and likelihood of contract repudiation by the government. The authors also rely on the quality of

analyze the use of derivative suits *or* class actions in international jurisdictions[19] may miss the fact that these two types of suits can substitute for each other if a jurisdiction provides legal infrastructure for only one of the two. In other words, the observation that class actions have not been filed in connection with a particular corporate wrongdoing does not necessarily mean a total absence of private enforcement in a particular jurisdiction. Private enforcement can also rely on derivative suits filed in jurisdictions that do not provide for class action mechanisms.[20] In a specific case, this type of substitution between the two private litigation avenues—derivative vs. class actions—is better revealed through a qualitative comparative analysis.

Yet, even after careful research, one will hardly find studies that pursue this kind of qualitative analysis of real enforcement cases along several dimensions of inquiry. One rare and particularly interesting study was conducted by Armour et al.[21] The authors compare the private enforcement approaches for corporate law in the United States and the United Kingdom. While the study shows an indisputably larger number of enforcement actions in the United States compared to the United Kingdom, it concludes that most U.S. actions are dismissed and hardly ever result in out-of-pocket liability.[22] In other

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a country's accounting standards.

La Porta et al., *What Works in Securities Laws?*, *supra* note 3, at 9, 11–13, use a "public enforcement index" calculated by the arithmetic means of the "(1) supervisor characteristics index; (2) rule-making power index; (3) investigative powers index; [and] (4) orders index." *Id.* They use a disclosure index composed by the arithmetic mean of the following variables: (1) prospectus; (2) compensation; (3) shareholders; (4) inside ownership; (5) irregular contracts; and (6) transactions; and a liability standard index that is the mean of the following variables: (1) liability standard for the issuer and its directors; (2) liability standard for distributors; and (3) liability standard for accountants in order to measure private enforcement. *Id*. at 5–7. One could question the adequacy of all these indices as proxies for measuring enforcement intensity.

19. *See generally* THE DERIVATIVE ACTION IN ASIA, *supra* note 13; THE LAW OF CLASS ACTIONS IN EUROPE (Jürgen G. Bakhaus, Alberto Cassone & Giovanni B. Ramello eds., 2012).

20. This is exactly what happened in the case studies of securities fraud discussed in this Article. *See infra* Part III for detailed factual description; *see also* John Armour et al., *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 J. EMPIRICAL LEGAL STUD. 687, 721 (2009) ("Differences in general rules governing class actions, contingency fees, and who pays the winner's legal expenses, in tandem with rules specific to corporate law that govern the availability of derivative actions and direct claims by shareholders, may do much to explain the large differences in levels of private enforcement.").

21. Armour et al., *supra* note 20, at 721.

22. *Id*. at 710, 722.

words, their deterrent effect is questionable. Based on this research, one can hardly conclude that the U.S. enforcement approach is stronger than that of the United Kingdom.[23]

Therefore, the literature has failed to empirically establish that U.S. enforcement is in fact as superior as theory claims. This Article further investigates this hypothesis by adopting a novel methodological approach. It builds on two case studies of real securities fraud that happened concomitantly in U.S. and Brazilian markets during the 2008 financial crisis.

During the crisis, as the Brazilian real (R$) unexpectedly plummeted in relation to the U.S. dollar (US$), two leading Brazilian corporations—Sadia S.A. and Aracruz Celulose S.A.—incurred billion-dollar losses in the currency derivative markets, precipitating severe financial turmoil.[24] Both of these non-financial companies had previously disclosed that they had adopted conservative financial policies. They reported in their financial statements that they relied on hedging instruments[25] to manage risk exposure to exchange-rate fluctuations, therefore protecting the revenues of core international business operations.[26] Yet their actual losses far surpassed those expected from pure hedging activity. Instead, the unforeseen losses were found to be the outcome of the companies' highly speculative operations in the currency derivatives futures markets.

As a consequence, several lawsuits were filed both in the United States and in Brazil. U.S. lawyers initiated federal class actions in New York and Florida on behalf of American Depositary Receipt (ADR) holders, arguing that the companies were heavily speculating in currency rates in disregard of any prudent hedging. According to the plaintiffs, the wild bets in the derivatives markets contradicted the companies' policies, public statements, and disclosure materials; the speculative trading was largely a strategic effort to supplement profits; and the companies and their executives were gambling away shareholder money in highly volatile currency investments.[27] In shareholder meetings, Brazilian shareholders voted

23. In fact, the authors conclude that "private enforcement of corporate law in the United States is not as robust as is often assumed." *Id*. at 722.

24. Many other companies from emerging markets suffered losses with currency exchange derivatives. *See infra* note 109. In this study I examine only the two most egregious and widely discussed Brazilian cases, although many other Brazilian companies also incurred considerable losses. *See infra* note 110.

25. *See infra* notes 111–13.

26. *See infra* notes 106–07 and accompanying text.

27. Amended Class Action Complaint for Violation of the Federal Securities Law at 1–2, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v.

for the corporations to file derivative suits against their former Chief Financial Officers (CFOs) in São Paulo and Rio de Janeiro. Interestingly, I did not find any evidence of actions taken by the U.S. securities market regulator, the SEC, against either of the companies. In contrast, *Comissão de Valores Mobiliários* (CVM), the Brazilian Securities and Exchange Commission, started administrative proceedings against both corporations and their managers, board members, and independent auditors.

As the settlement hearings for the Sadia and Aracruz cases have been completed in the United States,[28] and the legal actions in Brazil have also concluded, this Article conducts the first comprehensive comparative study of both cases. Because the alleged factual wrongdoing was generally the same in both the United States and Brazil, affecting in the same way international and national securities holders of the two Brazilian corporations, the scenario offers concrete comparative case studies of the corporate governance issues, legal developments, and case results in two different jurisdictions. To conduct this analysis, this Article adopts the methodology of multiple case studies, focusing on both the Sadia and the Aracruz cases in order to draw a number of jurisdictional comparisons.

This approach has several advantages. First, because both cases involve shareholders in a developed common-law jurisdiction alongside those in an emerging market that has been classified as a French civil law jurisdiction with relatively weaker investor legal protections,[29] this exercise allows a cross-country assessment of differences in substantive law; enforcement, regulatory, and administrative approaches; as well as the role of public regulators and private players as gatekeepers in these contrasting jurisdictions. Second, at the academic level, I can assess a number of theoretical propositions in the comparative corporate governance literature regarding corporate, securities, and investor protection laws, and, in particular, public and private enforcement in developed and emerging markets.[30] Third, as the analysis encompasses two case studies, it also allows intra-case comparisons of where and how the two differ. Fourth, it is

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Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. Oct. 5, 2009) (No. 08-23317-CIV) [hereinafter Aracruz Amended Class Action Complaint].

28. The hearing of the Aracruz settlement took place on July 17, 2013. The Sadia case had already received the order authorizing distribution of the net settlement fund on February 26, 2013.

29. La Porta et al., *Law and Finance*, *supra* note 3, at 1130–34 (classifying Brazil as a French civil law jurisdiction, which, according to their work, scores the lowest in investor legal protection).

30. *See infra* Part I.

unusual for the same alleged illicit behavior in the capital markets to give rise to concomitant legal actions in two jurisdictions. In this vein, this is the first time that two Brazilian corporations have been sued both in Brazil and in the United States for the same kind of corporate wrongdoing. Moreover, U.S. enforcement actions against foreign cross-listed firms are considered rare.[31] Therefore, the two cases provide additional evidence regarding current theories of U.S. public and private enforcement against U.S. cross-listed firms.[32] In sum, this approach attempts to fill a literature gap by assessing the "intensity" of the enforcement actions so as to determine whether U.S. enforcement is indeed stronger in practice, as theory suggests.

To engage in this analysis, I collected information, documents, and materials from a variety of sources. I gathered national and international media articles from newspapers and magazines and collected all electronic files of the U.S. securities class actions against Sadia and Aracruz available on *Bloomberg Law*.[33] I also gathered documents concerning the administrative proceedings against Sadia and Aracruz available on the CVM website, as well as documents from the Brazilian Judiciary in São Paulo, Rio de Janeiro, and the upper courts regarding the derivative suits filed.[34] Because the Brazilian lawsuits in both São Paulo and Rio de Janeiro are largely unavailable electronically from either the public court websites or any private database, I made numerous visits to examine the files of the lawsuits in São Paulo's public notaries (*cartórios*) and petitioned Rio de Janeiro's courthouse to retrieve the Aracruz lawsuits from its archives.[35] Because the Aracruz suit was held in "secrecy of justice"

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31. Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?*, 75 J. FIN. ECON. 319, 335, 342–43, 346–49 (2005). *See generally* Natalya Shnitser, *A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 YALE L.J. 1638 (2010).

32. *See infra* Part I.

33. The *Bloomberg Law* database is nurtured by the PACER database. PACER stands for Public Access to Court Electronic Records and is "an electronic public access service that allows users to obtain case and docket information from federal appellate, district, and bankruptcy courts, and the PACER Case Locator. PACER is provided by the Federal Judiciary in keeping with its commitment to providing public access to court information via a centralized service." PACER, http://www.pacer.gov (last visited Apr. 10, 2016). Whenever *Bloomberg Law* did not present a particular document, I tried to get it from PACER.

34. These are the locations of residence of the former defendant CFOs of Sadia and Aracruz, respectively.

35. Considering the two cases, the only documents available electronically are related to decisions of the *Superior Tribunal de Justiça* in the Sadia case. The *Superior Tribunal de Justiça* is Brazil's highest court of appeals for corporate matters. *See infra* note 37.

(*segredo de justiça*), that is, withheld from the public, in Rio de Janeiro,[36] I was not able to access it.

In spite of the two cases arising from the same alleged facts, I show that they generated very different legal developments in the United States and in Brazil, including different legal actions initiated by different private players and different charges against distinct wrongdoers, all leading to diverse outcomes. My comparative analysis of the judicial and administrative lawsuits in both jurisdictions reveals a number of findings in formal and material dimensions involving publicity and availability of information, corporate and securities law and enforcement, civil procedure issues, case outcomes, corporate monitoring by private and public players, and gatekeeper behavior.

Regarding the disclosure and publicity of judicial documents in both the Sadia and Aracruz cases, I note that the U.S. judicial system provides more availability and easier electronic access to legal documents than Brazil's.

In the arena of corporate and securities law, the U.S. class actions filed against the companies and several of their managers focused on federal securities regulation violations, namely Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, Rule 10b-5 claims, and the fraud on the market doctrine.[37] In turn, the Sadia and Aracruz lawsuits filed in Brazil are functionally equivalent to U.S. derivative suits, not to class actions. They were filed by the Brazilian companies and focused on corporate law violations, targeting only the companies' CFOs and seeking personal liability for fiduciary duty violations.[38] Accordingly, these different lawsuits were built on distinct legal arguments, resulting in very different outcomes.

The Sadia U.S. suit settled for US$ 27 million and the Aracruz U.S. suit for US$ 37.5 million.[39] Most of the cash recoveries went to U.S. investors.[40] In contrast, in the Sadia Brazilian suit, the *Superior Tribunal de Justiça* (STJ), Brazil's highest court for corporate law,[41] confirmed the judicial decision dismissing the action against the CFO based on the formal argument that a shareholders

36. I discuss the problem of "secrecy of justice" *infra* Part III.C.1.

37. *See infra* note 143 and accompanying text.

38. *See infra* notes 244–48, 268–72 and accompanying text.

39. *See infra* notes 177–80, 202–04 and accompanying text.

40. *See infra* notes 351–53 and accompanying text.

41. Brazil has two upper courts. In general, the Brazilian *Supremo Tribunal Federal* is the highest appeals court for constitutional matters and the STJ is the highest appeals court for matters of private law.

meeting had earlier approved, without reservation, the corporate accounts incorporating the company's financial losses. In the Aracruz Brazilian suit, the R$ 1.5 million settlement (equivalent to US$ 710,900)[42] was paid to the company, constituting a negligible fraction of its losses. Aracruz shareholders were not entitled to any financial indemnification, because the financial award of a Brazilian derivative suit, as with its U.S. counterpart, belonged to the company and not to its shareholders.[43] Consequently, the financial outcome for shareholders, who in theory suffered equivalent investment losses, turned out in practice to contrast greatly in the two jurisdictions.

While the U.S. investors were directly indemnified in both the Sadia and Aracruz cases, Brazilian investors did not recover anything in either case.[44] This disparity in results was largely driven by the lack of effective private litigation mechanisms in Brazil. Class actions would be the most suitable mechanism for protecting Brazilian investors' interests in these cases. Nonetheless, only derivative suits were pursued.

While class actions do exist in Brazilian law, they suffer from a number of shortcomings.[45] First, there are problems of initiation. In the United States, once private attorneys are entitled to a contingent fee of the settlement, they are better incentivized to initiate private lawsuits and thus act as gatekeepers. Brazilian private attorneys are mostly forbidden to work on a contingent basis and do not have the same policing incentives; therefore, they do not play the same

42. For the exchange conversion, I used the exchange rate of US$ 1 = R$ 2.11 provided by the Brazilian Central Bank for the day of the settlement on March 3, 2012. *Taxas de Câmbio*, BANCO CENTRAL DO BRASIL, http://www4.bcb.gov.br/pec/taxas/port/ptaxnpesq.asp?id=txcotacao (last visited Feb. 29, 2016).

43. *See infra* notes 217–20 and accompanying text.

44. *See infra* notes 351–53 and accompanying text.

45. Indeed, this is a problem not only faced in Brazil but also in most European jurisdictions. *See* Samuel Issacharoff & Geoffrey P. Miller, *Will Aggregate Litigation Come to Europe?*, 62 VAND. L. REV. 179, 191–208 (2009) (discussing European problems with organizational standing, litigation funding, and opt-in systems); *id.* at 209 ("From the American vantage point, we look at the European experiments with a concern that law without the institutional framework for its enforcement is necessarily lacking."); Richard A. Nagareda, *Aggregate Litigation Across the Atlantic and the Future of American Exceptionalism*, 62 VAND. L. REV. 1, 6 (2009) ("European receptiveness to new procedures for aggregate litigation, in one form or another, stops markedly short of full-fledged embrace for U.S.-style class actions, much less related features of litigation finance."); Paolo Giudici, *Representative Litigation in Italian Capital Markets: Italian Derivative Suits and (if Ever) Securities Class Actions*, 6 EUR. COMP. FIN. L. REV. 246, 263–64 (2009) ("[T]he civil procedure system must be radically reviewed in order to generate a true, effective level of private enforcement in Italy.").

gatekeeping role. Second, Brazilian class actions suffer from technical flaws in civil procedure, especially with respect to fact investigation and settlement abilities. In these aspects, U.S. class action suits rely on higher levels of availability of information as well as expert analysis in order to assess facts and evaluate potential damages. I conjecture that, in addition to the incentive structure, the systematic application of valuation methods in U.S. legal disputes partially explains the higher value of settlements and financial recovery reached in U.S. securities class actions.

At the public enforcement level, the lack of SEC action in both the Sadia and Aracruz cases contrasts with the hypotheses and findings of the literature about the stronger role of public enforcement in market development in the United States.[46] My analysis corroborates scholarly hypotheses about the more significant role played by private enforcement in the United States as compared to public enforcement in relation to U.S.-listed foreign firms.[47]

In contrast to the lack of public response in the United States, in Brazil both the Sadia and Aracruz cases resulted in public enforcement actions, though produced different results. The CVM convicted and imposed fines on some of Sadia's managers for violating the duty of care. It also imposed on Sadia's former CFO an abstention from the exercise of any managerial position in a publicly held company for three years. Nonetheless, the CVM settled the case with Aracruz board members and officers.[48] Here, I note once more that financial recoveries went to the CVM itself or to a universal fund, not back to investors.[49] The CVM further settled the two cases with the company's independent auditors.[50]

Therefore, on balance, U.S. securities law achieved better protection of securities investment for U.S. investors by means of private, but not public enforcement. The public actions by the Brazilian securities regulator resulted in (abstention and pecuniary) punishment of corporate wrongdoers and hence produced a stronger deterrent effect. In sum, the comparative findings of the Sadia and Aracruz case studies cast doubt on a number of hypotheses raised by

46. *See infra* notes 61–63 and accompanying text.

47. *See infra* notes 54–57 and accompanying text.

48. *See infra* Part IV.B.

49. Although not developed in this Article, SEC settlements can result in shareholder financial indemnification, as discussed generally in Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331 (2015). Instead, the financial resources gathered from Brazilian CVM settlements are directed to funds controlled by regulators and are not distributed to damaged shareholders.

50. *See infra* notes 370, 381 and accompanying text.

the extant comparative corporate governance literature, in particular the assumption of U.S. enforcement superiority relative to that of other countries.

This Article is organized as follows: Part I sets forth the theoretical framework, discussing the underlying academic literature related to the case studies and putting forward the hypotheses that the study addresses. Part II describes the Sadia and Aracruz controversies, discussing the factual background and alleged wrongdoing of officers and directors at both corporations. Part III analyzes private enforcement legal actions in both the United States and Brazil against Sadia, Aracruz, and their officers and directors, comparing the legal suits filed as well as their outcomes. Part IV discusses actions of public enforcement, which were taken only in Brazil against board members, officers, and independent auditors. Part V analyzes the theoretical and practical consequences of the case studies, suggesting areas in which private and public enforcement could be improved in the United States and in Brazil. Finally, I conclude.

One last caveat: I acknowledge the limits of my analysis inherent in the nature of the chosen methodology. Case studies can suffer from selection bias affecting the generalization of conclusions to a broader population of cases. In this vein, the Sadia and Aracruz outcomes could reflect the biases of lawyers, judges, courts, and administrative regulators that may not be replicated in other cases. However, the qualitative analysis of the case studies conducted in this Article raises a number of important questions and hypotheses about systemic private and public enforcement in both developed and emerging markets that can guide future quantitative and qualitative analyses.

I. Review of the Relevant Literature

Corporate-law and economics scholarship has recently explored how varying levels of "intensity" in the enforcement of corporate and securities laws impact the development of capital markets.[51] In particular, this literature has explored which variables in enforcement practices best promote strong capital markets.

Scholars distinguish between public and private enforcement.[52] The latter refers to the enforcement of corporate and securi-

51. *See, e.g.*, Coffee, *supra* note 2, at 232; Jackson & Roe, *supra* note 6, at 207. *See generally* La Porta et al., *What Works in Securities Laws?*, *supra* note 3; Siems, *supra* note 15; Armour et al., *supra* note 20.

52. *See supra* note 4 and accompanying text.

ties laws by private party plaintiffs, including shareholders and lawyers litigating derivative suits or class actions. On the other hand, public enforcement refers to actions commenced by public regulators such as the SEC and the Brazilian CVM against corporations, controlling shareholders, managers, or gatekeepers.[53]

Some studies have proposed that private enforcement is more important than public enforcement. Coffee argues that the unique U.S. system of private enforcement, based on an entrepreneurial plaintiffs' bar incentivized by contingent fees, provides greater annual aggregate sanctions than do public enforcers.[54] La Porta et al. analyze securities laws regulating the public issuance of new equity in forty-nine countries.[55] They focus on mandatory disclosure, liability standards, and public enforcement, creating indices to assess these factors. They find that both the disclosure requirements and liability standards associated with a lower burden of proof on investors seeking damages from the omission of material information in a prospectus are positively correlated with larger stock markets.[56] In contrast, public enforcement, which they quantify in an index of formal regulatory powers, is not statistically significant in their regressions.[57]

On the other hand, Armour et al. suggest that private enforcement is less central to strong securities markets than the previous literature assumes.[58] Based on an empirical survey of corporate lawsuits, they discuss the absence of private enforcement against directors of publicly held companies in the United Kingdom. They argue that even in the United States, private enforcement results in only minor out-of-pocket liability for directors.[59]

Other critics, such as Jackson and Roe, argue that private lawsuits distort incentives, do not penalize the relevant actors, and are many times less efficacious than public enforcement.[60] They meas-

53. JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 2 (2006) ("[T]he gatekeeper is an agent who acts as a reputational intermediary to assure investors as to the quality of the 'signal' sent by the corporate issuer."). Examples of gatekeepers include auditors, accountants, investment bankers, securities analysts, and attorneys.

54. Coffee, *supra* note 2, at 245.

55. *See generally* La Porta et al., *What Works in Securities Laws?*, *supra* note 3.

56. *See generally id.*

57. *See generally id.*; Djankov et al., *supra* note 3 (positing the key role of private contracting and enforcement for financial development and deemphasizing the role of public enforcers).

58. Armour et al., *supra* note 20, at 687.

59. *Id.* at 722 (citing only three instances of liability in an eight-year period).

60. Jackson & Roe, *supra* note 6, at 208.

ure public enforcement by the regulatory budgets and staffing levels of securities regulators, finding that resources spent on public enforcement positively correlate with more robust capital markets. According to this resource-based perspective, public enforcement significantly outperforms La Porta et al.'s measures for liability rules, while the results still show disclosure rules as a relevant private enforcement factor. Jackson and Roe therefore do not disregard the importance of private enforcement but caution that public enforcement is just as important.[61] In the same vein, Bratton and Wachter defend a shift in emphasis from private to public enforcement on the grounds that the former is more expensive than the latter. They recommend substantially enlarging the scope of public enforcement actions.[62] Consistent with this rationale, Rose goes as far as to propose a ban on "expensive" mechanisms of private enforcement and instead convene all security fraud enforcement actions under a single public regulator.[63]

The issue so far remains controversial. The most recent evidence from a study conducted by Choi and Pritchard concludes that private enforcement assures at least as much deterrent value as—"if not more" than—public enforcement.[64] The authors then question the hypothesis that SEC investigations are superior to private ones.[65]

A related body of literature important to this Article focuses on capital markets enforcement actions against cross-listed foreign firms. Scholars have identified a premium associated with the cross-

61. *Id.* at 237.

62. William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 70 (2010) ("We show that public enforcement offers the shareholders more value than private enforcement. Private resources are tied to a low-deterrence, enterprise-liability framework. Public enforcement, even now, yields the shareholders comparable damage returns per dollar invested in enforcement. It can be deployed more flexibly, and it can be refocused against individual wrongdoers to enhance deterrence.").

63. Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2203 (2010) ("[P]rivate enforcement introduces a host of costs that could be avoided if lawmakers relied instead on a well-incentivized public enforcer.").

64. *See generally* Stephen J. Choi & Adam C. Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison* (Mich. Law & Econ. Research Paper Series, Working Paper No. 12-022, 2014), http://ssrn.com/abstract=2109739.

65. *Id*. at 24 ("Our results suggest that private plaintiffs' attorneys, if anything, provide greater deterrence against more serious securities law violations compared with the SEC. From a policy perspective, our findings offer little support to commentators who call for a shift from private actions to greater public enforcement.").

listing of foreign companies in the U.S. market.[66] This premium is usually attributed to self-bonding, that is, managers deliberately submitting to a stricter regulatory regime—that of the United States.[67] In this view, foreign cross-listed firms choose to comply with more comprehensive U.S. financial disclosure requirements and to subject themselves to the public enforcement authority of the SEC and the private enforcement system of U.S. litigation. Doing so allegedly diminishes the ability of controlling shareholders and managers to extract private benefits, a premise reflected in the increase in share prices upon cross-listing.[68]

And yet, a contradiction appears to exist in that U.S. public enforcement rarely targets foreign issuers. Siegel examines data from the SEC's enforcement record against U.S.-listed foreign issuers and concludes that it rarely enforced securities laws against cross-listed foreign firms between 1934 and 2002.[69] He focuses on Mexican firms that allegedly bonded themselves through listed ADRs and shows that such bonding did not preclude expropriation of billions of dollars in company assets by insiders during the Mexican crisis of 1994. He also reports that none of those companies or insiders was charged or punished by the SEC (aside from delisting).[70] Shnitser extensively analyzes available data on enforcement actions by the SEC against foreign issuers cross-listed on U.S. exchanges between 2000 and 2008. She similarly concludes that significantly fewer public enforcement actions were taken against foreign firms when com-

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66. *See generally* Doidge, Karolyi & Stulz, *Why Are Foreign Firms Listed in the U.S. Worth More?*, *supra* note 10; Doidge, Karolyi & Stulz, *Has New York Become Less Competitive than London in Global Markets? Evaluating Foreign Listing Choices Over Time*, *supra* note 10.

67. *See* John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 644 (1999); Doidge, Karolyi & Stulz, *Why Are Foreign Firms Listed in the U.S. Worth More?*, *supra* note 10, at 209–10. *See generally* Karolyi, *supra* note 11 (reviewing the literature's support and arguments against the bonding hypothesis).

68. *See* Coffee, *supra* note 67, at 644; Doidge, Karolyi & Stulz, *Why Are Foreign Firms Listed in the U.S. Worth More?*, *supra* note 10, at 235. *See generally* Karolyi, *supra* note 11 (reviewing the literature's support and arguments against the bonding hypothesis); Craig Doidge et al., *Private Benefits of Control, Ownership, and the Cross-Listing Decision*, 64 J. FIN. 425 (2009) (analyzing how the level of private benefits of control, measured by ownership control rights, influences the cross-listing decision and finding that higher levels of control, and therefore higher private benefits, are associated with less cross-listing).

69. *See* Siegel, *supra* note 31, at 321, 335, 342–43.

70. *Id*. at 321, 335. The author also mentions that they were not prosecuted by private actions.

pared to the actions pursued against domestic firms.[71] Therefore, actual public enforcement of securities laws brings into question the legal bonding hypothesis.[72]

U.S. private enforcement against foreign issuers also suffers from a number of shortcomings.[73] A recent study by Cheng et al. finds that U.S.-listed foreign companies face securities class action lawsuits at half of the rate of U.S. domestic firms with similar levels of ex-ante litigation risk. This lower litigation exposure is explained by the higher transaction costs incurred in pursuing litigation against foreign firms.[74] Once a foreign firm's main business operations, decisions, and board, managerial, and shareholders meetings take place in a foreign jurisdiction where their managers likely reside, the costs of legal procedures, such as service of process, evidence gathering, and production, increase.

Nonetheless, other available evidence disputes Cheng et al.'s findings. Gande and Miller find that from 1996 to 2008 the percentage of foreign firms sued in U.S. class actions was close to that of U.S. firms—11.79% versus 13.80%, respectively.[75] This means that one in every eight foreign firms trading in the United States was sued at least once during the investigated time frame, a frequency that has steadily increased over time from 6% to 14% of the total U.S. private-enforcement activity.[76] Firms from thirty-six countries were targeted. In addition to the pecuniary indemnification paid by these foreign firms—US$ 9 billion in settlements—they also faced substantially larger monetary penalties due to market discounts to their stock value—overall a US$ 73 billion loss. Corporate insiders also

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71. Shnitser, *supra* note 31, at 1693.

72. *See generally* Karolyi, *supra* note 11 (pointing out flaws of the legal bonding hypothesis, while still defending it, and reviewing the new literature on reputational bonding).

73. *See* Siegel, *supra* note 31, at 343–49.

74. *See generally* Cheng et al., *supra* note 12 (examining claims for violations of Section 10b-5 and Section 11 of the Securities Act against foreign companies for all foreign firms from 1996 to 2010, using the Institutional Shareholder Services and Securities Class Action Clearinghouse database). However, one important caveat is that the trend reverses for material restatements. The authors report that foreign firms with a material restatement are 2.18 times more likely to be sued than U.S. firms that engage in equivalent restatements. *Id.* at 4. Along the same lines, another study shows that the rate of restatements for U.S.-listed foreign firms is lower than the rate for U.S. domestic firms. *See generally* Suraj Srinivasan, Aida Sijamic Wahid & Gwen Yu, *Admitting Mistakes: Home Country Effect on the Reliability of Restatement Reporting*, 90 ACCT. REV. 1201 (2015).

75. Gande & Miller, *supra* note 12, at 9.

76. *Id.* The number for U.S. domestic firms is one in every seven firms being sued. *Id.* at 8.

bore significant costs in losses associated with their shareholdings.[77] These findings suggest that, for cross-listed firms, private enforcement is more frequent and economically impactful than is public enforcement in the United States.

Indeed, the issue of enforcement against foreign issuers has recently become of particular and controversial concern to policy makers. On June 24, 2010, in *Morrison v. National Australia Bank Ltd.*, the U.S. Supreme Court limited the extraterritorial reach of U.S. securities laws over foreign firms.[78] *Morrison* essentially prevents foreign investors who have acquired securities of foreign issuers on a foreign exchange (f-cubed claims) from bringing legal action in the United States.[79] Congress promptly responded to the *Morrison* decision with the Dodd-Frank Act provision that affords extraterritorial jurisdiction to district courts in fraud actions brought by the SEC and the Department of Justice.[80] Therefore, Congress has tried to remediate the weakening effect of the Supreme Court decision on private enforcement by allowing more room for public enforcement. Yet, the evidence discussed above suggests that public enforcement may be more forgiving than private enforcement in practice, so it is unclear whether this potential substitution of private by public enforcement will successfully produce more effective enforcement against foreign firms.

If empirical evidence supports the view that foreign firms are rarely investigated by U.S. public enforcers and also face limited litigation by U.S. private agents, then we can expect less liability, punishment, and deterrent effect for foreign firms compared to their U.S.

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77. *Id*. at 4–5.

78. Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010).

79. *See generally* Érica Gorga, *The Impact of the Financial Crisis on Nonfinancial Firms: The Case of Brazilian Corporations and Proposals for Fixing Transnational Securities Litigation*, 16 THEORETICAL INQUIRIES L. 131 (2015) (providing detailed analysis and critique of the impact of *Morrison* on transnational litigation involving foreign firms); Amir Licht, Christopher Poliquin, Jordan I. Siegel & Xi Li, *What Makes the Bonding Stick? A Natural Experiment Involving the U.S. Supreme Court and Cross-Listed Firms* (Harvard Business School Strategy Unit, Working Paper No. 11-072, 2013) (finding no negative stock price reaction for U.S.-listed foreign firms in connection with the *Morrison* decision).

80. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P(b)(2), 124 Stat. 1376 (2010) (codified as amended at 15 U.S.C. § 78aa(b)) (granting jurisdiction if the fraud involving conduct within the United States constitutes "significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors" or if the fraud has a substantial effect within the United States). *See generally* U.S. SEC, STUDY ON THE CROSS-BORDER SCOPE OF THE PRIVATE RIGHT OF ACTION UNDER SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934 (2012).

domestic counterparts. How, then, can the literature attribute the premium commanded by foreign firms cross-listed in the United States to stronger enforcement against corporate wrongdoings?

To explain this paradox, one proponent of the bonding hypothesis argues that, even if the United States does police foreign issuers more weakly than its domestic issuers, that weaker policing may still constitute a tougher regime than foreign issuers face at home, which would justify the cross-listing bonding premium.[81] Finance scholars, too, have relied on the assumption of U.S. enforcement superiority to test their models related to cross-listing.[82] The problem is that so far the bonding hypothesis has not been qualitatively evaluated in a concrete setting in which U.S. enforcement actions can be directly compared to those of the cross-listed firm's home country for the same kind of alleged wrongdoing. This Article pursues such an evaluation by means of the Sadia and Aracruz case studies.

A brief review of prior case studies shows how the methodology adopted in this Article differs from previous work. Milhaupt and Pistor conduct case studies of relevant firm-level crises around the world, using a methodology they call "institutional autopsies."[83] They have studied the Enron case in the United States, the Mannesmann case in Germany, the SK case in Korea, the China Aviation Oil case in China, and the Yukos case in Russia. While this methodology arguably reveals the inner logic, weaknesses, and prospects for reform in the jurisdictions analyzed,[84] the focus on one distinctive crisis in each country prevents a comparison of how these different jurisdictions respond to the same type of episodic crisis. For example, as the Enron facts differed from those in the Mannesmann case,

81. Coffee, *supra* note 2, at 289 ("Thus, it may be true that U.S. enforcers allocate disproportionately fewer resources to cases involving foreign defendants, but, even if this effort is modest by U.S. standards, it may still far exceed the limited attention that securities fraud receives abroad."). The author provides a few examples of private enforcement actions against foreign firms. *Id.*

82. Doidge et al., *Private Benefits of Control, Ownership, and the Cross-Listing Decision*, *supra* note 68, at 426 ("In framing our private benefits hypothesis, it is important to note that we do not argue that foreign firms listed in the United States are subject to the same monitoring or scrutiny that is applied to U.S. firms. Rather, what is important for our hypothesis is that foreign firms listed in the United States face more constraints and potential enforcement actions than similar home-country firms that are not listed in the United States.").

83. CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD 45–46 (2008).

84. *Id.* at 9, 46.

differences in enforcement between the United States and Germany could be significantly driven by the different underlying facts of each case. Cross-comparability of enforcement developments and outcomes are therefore restricted.

Ferrarini and Giudici provide a case study of the corporate governance issues and enforcement actions involving the Parmalat case.[85] They examine the criminal proceedings and civil actions developed in Italy and argue that any failures should not be attributed to Italian auditing or liability rules but to enforcement problems.[86] The authors review court decisions regarding audit liability, concluding that Italian private enforcement in this area is very weak.[87] They further point out flaws in the Italian court system and civil procedure, especially the lack of efficient discovery rules and its toll on class actions.[88] Although the authors report that investors have brought civil actions related to Parmalat in the United States,[89] they do not compare the developments and results of these actions to those in Italy.

Siegel has focused on the analysis of wrongdoing engaged by Mexican firms listed in the United States. He very briefly discusses the lack of U.S. public and private enforcement against these firms, which he claims makes the case against the legal bonding hypothesis of the U.S. market.[90] Siegel, nonetheless, fails to establish that Mexican public or private enforcement against the same perpetrating companies was any better than those in the United States. For this reason, we cannot establish whether U.S. enforcement was overall weaker than Mexican enforcement, or whether Mexican enforcement was also severely flawed.[91] Therefore, none of the existing case studies on securities market regulation fully assess the U.S. enforce-

85. *See generally* Ferrarini & Giudici, *supra* note 13.

86. *Id.* at 180, 184.

87. *Id.* at 184–86.

88. *Id.* at 194, 201.

89. *Id.* at 170–71, 206.

90. Siegel, *supra* note 31, at 335.

91. Overall, one cannot determine from Siegel's presented data if the legal mechanisms and results of Mexican public and/or private enforcement were ultimately more effective than in the United States. Siegel provides only very brief summaries of the kind of public "accusations" these insiders suffered in Mexico. *Id.* at 325, 333. It remains unclear whether the accusations were based on criminal, tax, or securities law, or even whether the accused ended up being punished by the alleged illegal practices. In at least five of his eleven reported cases, the accused was suing the government to recover damages suffered, was acquitted, or had her charges dismissed. *Id.* at 336–42. It is also unclear what the legal results were for the minority shareholders who lost value and took action against the companies (according to his table 3). *Id.* at 336–39.

ment superiority hypothesis that is the topic of this Article.

Through the analysis of the Sadia and Aracruz case studies, this Article explores the following questions discussed by recent scholarship: a) whether the wrongdoings of U.S.-listed foreign issuers Sadia and Aracruz were the target of public and private enforcement in the United States and in Brazil; b) which type of enforcement was more intense, U.S. private or public coercion mechanisms or, alternatively, Brazilian private or public actions; and c) whether the U.S. enforcement superiority hypothesis holds for the cases of these foreign cross-listed firms; or, in other words, whether these firms were subjected to stronger enforcement actions in the United States than in their home-country of Brazil.

Before exploring these questions, I begin the next Part with a factual background of the Sadia and Aracruz cases.

II. "HEDGING" WITH DERIVATIVES: THE SADIA AND ARACRUZ CASES

Sadia S.A. (Sadia) and Aracruz Celulose S.A. (Aracruz) were two major Brazilian industrial exporting companies.

Sadia was founded in 1944 and headquartered in Concórdia, Santa Catarina.[92] Sadia was a major Brazilian food and beverages company whose principal activities included production, distribution, exporting, and marketing of refrigerated and frozen food products.[93] It was Brazil's main exporter of meat-based products. The company sold its products through retail shops and food service chains throughout Latin America, the Middle East, Asia, and Europe.[94] Sadia's stocks traded on the BM&FBovespa, the São Paulo Stock Exchange. In April 2001, Sadia joined the Level 1 listing segment,[95] trading its common shares under the symbol "SDIA3" and its non-voting preferred shares[96] under "SDIA4 BZ." At the same time, Sa-

92. *Company Overview of Sadia S.A.*, BLOOMBERG BUS., http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=880980 (last visited Mar. 6, 2016).

93. *Id.*

94. *See* Kenneth Rapoza, *CFO Who Laid Low Brazil's Sadia: Blame It on Lehman*, DOW JONES NEWSWIRES (Apr. 17, 2009) ("Sadia is Brazil's sixth-largest exporter. As a brand, it is the equivalent of a Purdue Farms Inc. As an investment, Sadia's New York-traded shares have collapsed 72% since Sept. 25 [2008], making it one of Brazil's biggest victims of the financial crisis.").

95. Level 1 is a special listing segment from the BM&FBovespa that requires compliance with enhanced disclosure requirements.

96. *See* Sadia S.A., *Estatuto Social Consolidado na Assembléia Geral Extradordinária Realizada em 23.11.2007*, art. 12 (2007), http://sadia.infoinvest.com.br/modulos/doc.asp?

dia listed Level II ADRs[97] on the New York Stock Exchange (NYSE) trading under the symbol "SDA." The sponsored ADRs represented that Sadia's non-voting preferred shares in June 2008 constituted 26.7% of the total number of these shares and 19.06% of Sadia's total capital.[98] Sadia also listed its non-voting preferred shares in November 2004 on the Spanish Market for Latin-American Stocks in Euros (LATIBEX) under the symbol "XSDI SM" on the Madrid Stock Exchange.

Aracruz was founded in 1967 and headquartered in Aracruz, Espírito Santo, Brazil.[99] It was a major forest products manufacturer

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arquivo=01884070.WAN&doc=ian020.doc&language=ptb (explaining Sadia's non-voting preferred shares afforded investors priority in the proportional payment of the non-cumulative minimum dividend of twenty-eight percent of the net profits of the exercise and also qualified them for the tag along provision of Law 6.404/76, Article 254-A, which means they would receive eighty percent of the premium of the control value paid to ordinary voting shares); *see also* Érica Gorga, *Culture and Corporate Law Reform: A Case Study of Brazil*, 27 U. PA. J. INT'L ECON. L. 803, 842–44 (2006) (discussing the rights of non-voting preferred shares in Brazil).

97. There are three levels of ADRs: Levels I, II, and III. Level II and Level III ADRs are sponsored ADR programs. To register their securities, Sadia and Aracruz had to file forms F-6 and 20-F with the SEC along with other ongoing disclosures. These companies became subject to the same reporting requirements imposed by the SEC and the trading exchanges as U.S. corporations listed on the same exchanges. The primary difference between Level II and Level III ADRs is that Level III ADRs allow issuance of new shares of the foreign corporation, enabling it to raise capital, while Level II ADRs do not. As a consequence, Level III ADRs are the highest form of sponsored ADRs and subject to greater disclosure requirements. They are traded on exchanges and generate the most interest from investors. Companies that issue Level III ADRs must file an offering prospectus on Form F-1. J.P. MORGAN, DEPOSITARY RECEIPTS REFERENCE GUIDE (2005), http://eshow.moneyshow.com/Files/JPMOR/eMS_P2_Brochure_1.pdf. Sadia was one of the companies that, despite pursuing an ADR Level II cross-listing in the United States, decided not to migrate to the highest corporate governance listing level of BM&FBovespa, *Novo Mercado*, probably in order to avoid the required compliance with the one-share-one-vote rule. *See* 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, 486–87 (2009).

98. Sadia S.A., Informações Trimestrais (June 30, 2008), http://siteempresas.bovespa.com.br/dxw/FrDXW.asp?moeda=L&tipo=4&data=30/06/2008&razao=SADIA%20SA&site=C&pregao=SADIA%20S/A&ccvm=18848. After the turmoil, by the end of 2008, Sadia reported that the ADRs represented 26.2% of its preferred capital. Sadia S.A., Mensagem da Administração (2008), http://sadia.infoinvest.com.br/modulos/doc.asp?arquivo=01884080.WFL&doc=dfp220.doc&language=ptb (letter to shareholders). Calculations based on figures provided in CVM. ITR-30.06.2008 (on file with author).

99. *Company Overview of Aracruz Celulose S.A.*, BLOOMBERG BUS., http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=384824 (last visited Mar. 6, 2016).

and wood pulp producer.[100] Its main product was bleached eucalyptus pulp, a high-grade hardwood pulp sold to paper products manufacturers. It operated a wholly owned subsidiary, Aracruz Celulose (U.S.A.) Inc., in Aventura, Florida. Aracruz was the first Brazilian company to launch a Level III ADR program[101] on the NYSE. Aracruz securities began trading on the NYSE in 1992 under the symbol "ARA."[102] At the end of 2007, the sponsored ADRs referenced Aracruz's non-voting preferred shares (class B), representing 64.90% of the total number of these shares and 33.89% of Aracruz's total capital.[103] In 2002, Aracruz joined BM&FBovespa on its Level 1 listing segment. It traded common voting stocks under the symbol "ARCZ3" and non-voting stocks classes A and B under "ARCZ5" and "ARCZ6," respectively.[104]

Both Sadia and Aracruz were naturally exposed to exchange-rate risks because of their regular trading activities in North America, Europe, and Asia. To cope with this risk, they usually engaged in hedging to guard against fluctuations in currency exchange rates. Virtually all Aracruz's revenues were tied to the U.S. dollar—it exported nearly 100% of its production—while 15% of its debt and 75% of its production costs were incurred in Brazilian reais. Similarly, Sadia exported approximately 1,000 different products to more than 100 countries.[105] For this reason, currency exchange hedging was an essential strategy for both companies in assuring future revenue and managing cash flows.[106]

Foreign exchange risk hedging was supposed to lock in future

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100. *Id.*

101. *See* J.P. MORGAN, *supra* note 97 (explaining the distinctions between levels).

102. *Citi Appointed Successor Depositary for Aracruz Celulose S.A. NYSE Listed ADR Program*, BUS. WIRE (July 25, 2007), http://www.businesswire.com/news/home/20070725005674/en/Citi-Appointed-Successor-Depositary-Aracruz-Celulose-S.A.

103. Aracruz Celulose S.A., Annual Report (Form 20-F) 72 (Mar. 31, 2008), http://www.sec.gov/Archives/edgar/data/883952/000118003108000015/f080331a.htm. I rely on 2007 data, because I have not found information available for the number of preferred class B shares referenced in ADRs in 2008 in the disclosure filed with the SEC or with the CVM.

104. Aracruz, Financial Statements 29 (2003), http://people.stern.nyu.edu/adamodar/pdfiles/acf2E/aracruzannual.pdf. The issuance of non-voting shares also explains why Aracruz did not migrate to *Novo Mercado*, despite having already cross-listed at the most demanding ADR level on the NYSE. *See generally* Gorga, *supra* note 97.

105. Consolidated Amended Complaint at 6, *In re* Sadia S.A. Sec. Litig., 643 F. Supp. 2d 521 (S.D.N.Y. 2009) (No. 1:08-cv-09528) [hereinafter Sadia Consolidated Amended Complaint].

106. *See* Aracruz Amended Class Action Complaint, *supra* note 27, at 9.

revenue values by managing the oscillations of the Brazilian real relative to the U.S. dollar. By definition, a hedge is designed to defend a company from risk exposure and help reduce the risk on an existing investment. It is not intended to yield additional profits. A hedge is analogous to an insurance policy in that it protects against financial losses. In a standard hedge operation, losses incurred on currency derivatives contracts would be offset by gains in sales contracts, and vice versa, stabilizing the company's expected margin.[107] Investors in a company with large export revenues generally expect a stable cash flow protected by a well-designed hedging policy.

Between 2004 and mid-2008, the Brazilian real steadily appreciated in value in relation to the U.S. dollar. Expecting that the trend would persist, many companies began to engage in derivative trading with the so called Sell Target Forward (STF) contracts offered by financial institutions.[108] Instead of pursuing hedging, companies developed a speculative strategy, expecting to enjoy easy financial gains with the uptrend of the real. However, as a consequence of the crisis, the value of the U.S. dollar unexpectedly increased against the Brazilian real.[109] After the rapid price decrease of the real, many companies then suffered considerable financial

107. *See* STEPHEN A. ROSS, RANDOLPH W. WESTERFIELD & JEFFREY JAFFE, CORPORATE FINANCE 772 (10th ed. 2013) ("[D]erivatives are tools for changing the firm's risk exposure."). Increasing risk exposure simply means speculating in the hope of achieving a higher return with the movement of some economic variables. In contrast, decreasing the risk exposure is defined as hedging. *Id.* ("Hedging offsets the firm's risk, such as the risk in a project, by one or more transactions in the financial markets.").

108. *See* Antonio Delfim Netto, *Hedge tóxico* [*Toxic Hedge*], VALOR ECONÔMICO (Oct. 14, 2008) (discussing the huge asymmetry of the burden of the contracts in detriment to the exporting companies); Carlos Caminada & Adriana Brasileiro, *Aracruz Faces $2.13 Billion Deadline over Derivatives,* BLOOMBERG BUS. (Dec. 10, 2008), http://www.bloomberg.com/news/articles/2008-12-11/aracruz-faces-213-billion-deadline-over-brazil-derivatives (stating that the banks that sold the derivatives included Citigroup Inc., Merrill Lynch & Co., Barclays Plc, Banco UBS Pactual SA, Deutsche Bank AG, and others).

109. *See* João Ricardo Ribeiro Coutinho, Hsia Hua Sheng & Mayra Ivanoff Lora, *The Use of Fx Derivatives and the Cost of Capital: Evidence of Brazilian Companies*, 13 EMERGING MKTS. REV. 411, 413 (2012) (citing examples of companies from Hong Kong, Mexico, China, and India that also suffered from the high volatility of global foreign exchange (Fx) markets, and had to be sold, be incorporated, or even file for bankruptcy); Dodd, *supra* note 1 (stating that an estimate of 50,000 firms in emerging markets such as Indonesia, Korea, Brazil, Mexico, Poland, Sri Lanka, and China have been severely affected by the exotic derivatives). *See generally* Robert N. McCauley & Patrick McGuire, *Dollar Appreciation in 2008: Safe Haven, Carry Trades, Dollar Shortage and Overhedging*, BIS Q. REV. 85 (Dec. 2009), http://www.bis.org/publ/qtrpdf/r_qt0912i.pdf (discussing the factors that caused the surprising dollar appreciation in the second half of 2008).

losses.[110] Aracruz experienced massive mark-to-market losses reaching over US$ 2.1 billion,[111] an amount that exceeded Aracruz's annual net operating revenue.[112] Sadia in turn initially announced a loss of R$ 760 million (US$ 410 million) related to its currency hedging contracts on September 25, 2008.[113] In the end, Sadia's negative net income with the derivative transactions amounted to approximately R$ 2.5 billion.[114] The financial woes affecting the two companies,

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110. *See, e.g.*, Mariana Barbosa, *Votorantim perde R$ 2,2 bi com derivativos* [*Votorantim Loses R$ 2.2 bi with Derivatives*], O ESTADO DE SÃO PAULO, Oct. 11, 2008, at B14; Mari Omos & Graziella Valenti, *Embraer tem perda com o dólar mas espera reversão* [*Embraer Loses with the Dollar, but It Expects a Reversal*], VALOR ECONÔMICO, Nov. 5, 2008, at D3 (on file with author); Graziella Valenti, *Braskem perde R$ 849 milhões, derivativos somam 35% da perda financeira* [*Braskem Loses R$ 849 Million, Derivatives Add up 35% from the Financial Loss*], VALOR ECONÔMICO, Nov. 5, 2008; L. Cunha, *Ajinomoto tem perda de R$ 180 mi com câmbio* [*Ajinomoto Has Loss of R$ 180 mi with Exchange Rates*], VALOR ONLINE, Jan. 22, 2009 (on file with author); Gustavo Porto, *Santelisa negocia R$ 500 mi no BNDES* [*Santelisa Negotiates R$ 500 mi in BNDES*], O ESTADO DE SÃO PAULO, Jan. 24, 2009, at B10; David Friedlander & Maribba Aragão, *Tok & Stok é vítima dos derivativos* [*Tok & Sotck Is a Victim of Derivatives*], O ESTADO DE SÃO PAULO, Jan. 25, 2009, at B10; Da Reportagem Local, *Vicunha Têxtil perde R$ 70 mi com câmbio* [*Vicunha Textile Loses R$ 70 Million with Exchange Rates*], FOLHA DE SÃO PAULO, Nov. 11, 2008; Mariana Barbosa, *Vicunha negocia com bancos liquidação de derivativos* [*Vicunha Negotiates with Banks Derivatives Liquidation*], O ESTADO DE SÃO PAULO, Nov. 3, 2008, at B12; *Gol perde R$ 48 milhões com operações de hedge* [*Gol Loses R$ 48 Million with Hedge Transactions*], AGÊNCIA ESTADO, Nov. 17, 2008.

111. Aracruz Celulose S.A., Report of Foreign Private Issuer (Form 6-K) (Nov. 4, 2008), http://www.sec.gov/Archives/edgar/data/883952/000118003108000108/f081104a.htm.

112. In the two subsequent days, Aracruz's ADRs plummeted over twenty-five percent in value. On October 3, 2008, the company filed a new Form 6-K with the SEC announcing that the "fair value" of its currency-related derivatives contracts was negative by R$ 1.95 billion, or US$ 1.02 billion, as of September 30, 2008. Aracruz Celulose S.A., Report of Foreign Private Investor (Form 6-K) (Oct. 3, 2008), http://www.sec.gov/Archives/edgar/data/883952/000118003108000087/f081003a.htm; Carlos Augusto Lira Aguiar, CEO, Aracruz Celulose S.A., *Fato Relevante* (Oct. 2, 2008), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=178053&funcao=visualizar&Site=C.; *see also* Aracruz Amended Class Action Complaint, *supra* note 27, at 29. Aracruz's reported net operating revenues were approximately US$ 1.7 billion, US$ 1.8 billion, and US$ 1.9 billion in 2006, 2007, and 2008, respectively. *Id.* at 7.

113. Sadia S.A., Report of Foreign Private Investor (Form 6-K) (Sept. 25, 2008), https://www.sec.gov/Archives/edgar/data/1130968/000120135608000080/sda092508mf_6k.htm [hereinafter Sadia Form 6-K (Sept. 25, 2008)]; Welson Teixeira Junior, Director, Sadia S.A., *Fato Relevante* (Sept. 25, 2008), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=177562&funcao=visualizar&Site=C [hereinafter *Fato Relevante* (Sept. 25, 2008)].

114. Sadia S.A., Mensagem da Administração, *supra* note 98, at 8 (commenting that Sadia losses due to the derivative transactions reached R$ 2.484 billion in 2008, the "first

long considered Brazilian powerhouses, were largely exposed in media cover stories and prompted strong criticism from multiple sources, including the Brazilian president.[115]

In both cases, because the companies' undisclosed trading with currency derivatives largely exceeded their supposed hedge policies, their "hedging" contracts had actually *increased* the exchange rate risk of the companies' cash flows rather than reducing it.[116] With the severe downturn in international financial markets, investors then had to absorb losses of billions of dollars from the undisclosed trading. For Aracruz, those losses equaled an entire fiscal year's revenue.[117]

As a result of the heavy losses from speculative trading, Aracruz's and Sadia's stocks plummeted to their lowest levels in fourteen years. After the disclosure of Aracruz's bad currency deals, its ADRs immediately plunged 25% in value, eventually reaching a 57%

annual loss in the 64 years of its history"); *see also* Comissão de Valores Mobiliários, Extrato da Sessão de Julgamento, Processo Administrativo Sancionador No. 18/08, at 42, 14.12.2010, http://www.cvm.gov.br/export/sites/cvm/sancionadores/sancionador/anexos/2010/20101214_PAS_1808.pdf (commenting that the approximately R$ 700 million figure was the value immediately incorporated in the cash flows statements); Graziella Valenti, *Sadia fechou operação bilionária cinco dias antes do Início da Crise* [*Sadia Has Closed Billionaire Deal Five Days Before the Crisis Beginning*], VALOR ECONÔMICO, Apr. 7, 2009, at D4.

115. Then-Brazilian President Luiz Inácio Lula da Silva publicly declared, "The companies that bet and lost will have to face up to their responsibilities." Antonio Regalado & John Lyons, *Big Currency Bets Backfire—Huge Losses From Dollar's Gains Surface at Companies in Developing World*, WALL ST. J. (Oct. 22, 2008), http://www.wsj.com/articles/SB122463251866656551. He also voiced that "It was not because of the crisis, but because of speculation . . . . They were speculating against the Brazilian currency. They were practicing, through greed, speculation that is in no way recommendable." Joaquim Alessi, *Lula acusa Aracruz e Sadia de especulação gananciosa* [*Lula Accuses Aracruz and Sadia of Greedy Speculation*], ESTADÃO (Oct. 4, 2008), http://economia.estadao.com.br/noticias/geral,lula-acusa-aracruz-e-sadia-de-especulacao-gananciosa,253360.

116. The Brazilian companies thus contradicted academic findings for a sample of U.S. non-financial firms. *See* Söhnke M. Bartram, Gregory W. Brown & Jennifer Conrad, *The Effect of Derivatives on Firm Risk and Value*, 46 J. FIN. & QUANTITATIVE ANALYSIS 967, 967 (2011) (finding "strong evidence that the use of financial derivatives reduces both total risk and systematic risk"); Wayne Guay & S.P Kothari, *How Much Do Firms Hedge with Derivatives?*, 70 J. FIN. ECON. 423, 423 (2003) ("Corporate derivatives use appears to be a small piece of non-financial firms' overall risk profile."). *See generally* Ludger Hentschel & S.P. Kothari, *Are Corporations Reducing or Taking Risks with Derivatives?*, 36 J. FIN. & QUANTITATIVE ANALYSIS 93 (2001); Gina-Gail S. Fletcher, *Hazardous Hedging: The (Unacknowledged) Risks of Hedging with Credit Derivatives*, 33 REV. BANKING & FIN. L. 813 (2014) (providing a recent critique of the financial regulation imposed by the Dodd-Frank Act).

117. Aracruz Amended Class Action Complaint, *supra* note 27, at 2.

drop in the following weeks.[118] Sadia's ADRs dropped by 37.79% in a single day.[119] Credit rating agencies downgraded both Aracruz and Sadia.[120] Aracruz's Chairman of the Board, several board members, and the CFO all resigned.[121] The company had to cancel various projects and expansion plans, and an intended merger with Votorantim Celulose e Papel S.A. had to be delayed for nearly a year.[122] Sadia fired its CFO, and both its Chairman and Vice Chairman resigned from the company.[123] It also postponed several capital projects in order to cover the financial shortfall.[124]

In May 2009, shortly after suffering such great financial losses, Sadia consolidated with Perdigão S.A.; both corporations were succeeded by BR Foods S.A.[125] The transaction was harshly ques-

118. *Id.* at 4.

119. *Saxena White P.A. Has Filed a Securities Fraud Class Action*, MKT. WIRED (Nov. 5, 2008), http://www.marketwired.com/press-release/saxena-white-pa-has-filed-securities-fraud-class-action-suit-against-sadia-sa-southern-nyse-sda-917313.htm ("[T]he American Depository Receipts of Sadia S.A. closed at $9.50 per share, down from the previous day's close of $15.27, a decline of 38%."); *Sadia fechou operação bilionária cinco dias antes do início da crise*, *supra* note 114.

120. Memorandum from Moody's Inv'rs Serv., *Rating Action: Moody's Downgrades Aracruz to Baa3, Rating Remains Under Review for Downgrade*, MOODY'S (Oct. 15, 2008), https://www.moodys.com/research/Moodys-downgrades-Aracruz-to-Baa3-rating-remains-under-review-for—PR_165100 (downgrading Aracruz from Baa2 to Baa3); Memorandum from Moody's Inv'rs Serv., *Rating Action: Moody's Downgrades Sadia's Ratings to B1; Outlook Stable*, MOODY'S (Nov. 6, 2008), https://www.moodys.com/research/Moodys-downgrades-Sadias-ratings-to-B1-outlook-stable—PR_166722 (downgrading Sadia from Ba3 to B1); *see also* Sadia Consolidated Amended Complaint, *supra* note 105, at 27.

121. Cristiane Barbieri, *Seis conselheiros e suplentes da Aracruz renunciam aos cargos* [*Six Aracruz's Board Members and Surrogates Depart Their Positions*], FOLHA ONLINE (Nov. 29 2008), http://www1.folha.uol.com.br/fsp/dinheiro/fi2911200828.htm. Defendant Isac Zagury, Aracruz's former CFO, was forced to resign on October 3, 2008. Carlos Caminada & Laura Price, *Aracruz Fails to Settle $2.13 Billion Derivative Loss*, BLOOMBERG (Dec. 12 2008), http://www.bloomberg.com/news/articles/2008-12-12/aracruz-banks-fail-to-agree-213-billion-derivatives-loss.

122. Amauri Segalla & Tatiana Vaz, *Um Ermírio com papel global* [*One Ermírio with a Global Role*], ISTO É DINHEIRO (Jan. 23, 2008), http://www.terra.com.br/istoedinheiro-temp/edicoes/590/imprime123921.htm; Aracruz Amended Class Action Complaint, *supra* note 27, at 4.

123. *Walter Fontana deixa conselho da Sadia; Furlan retorna* [*Walter Fontana Leaves Sadia's Board; Furlan Returns*], VALOR ONLINE (Oct. 6, 2008), http://www.valor.com.br/arquivo/596353/walter-fontana-deixa-conselho-da-sadia-furlan-retorna.

124. Luiz Sonda, *Sadia revê plano de expansão* [*Sadia Reviews Expansion Plan*], GAZETA DO POVO (Oct. 17, 2008), http://www.gazetadopovo.com.br/economia/conteudo.phtml?id=818619; Sadia Consolidated Amended Complaint, *supra* note 105, at 27.

125. Antonio Regalado & Kenneth Rapoza, *Corporate News: Brazil Food Merger Creates Export Giant*, WALL ST. J., May 18, 2009, at B2 ("The deal was forced by financial

tioned for establishing different stock exchange values within the same class of stocks to the benefit of the former controlling shareholders. CVM declared that the transaction provided "particular benefit" to controlling shareholders and barred them from voting in the meeting that would approve the transaction.[126] On December 31, 2009, Aracruz merged into Fibria Celulose S.A. (formerly Votorantim Celulose e Papel or VCP), with Fibria as the surviving entity.[127] This transaction also prompted strong criticism by minority preferred shareholders who argued that they unfairly bore the burden of the derivatives losses in the stock-for-stock exchange proposal.[128] The Brazilian CVM challenged the transaction, which prompted the offer of a new exchange proposal to preferred shareholders with the same conditions as to ordinary shareholders.[129] Fibria is now the world's

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troubles. Both firms posted quarterly losses this year on a drop of exports, and Sadia has struggled after huge losses on currency bets last year left it burdened by debt."); BR Foods S.A., Sadia S.A., *Fato Relevante* (Aug. 3, 2009), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=210740&funcao=visualizar&Site=C.

126. Sadia S.A., Comunicado ao Mercado (May 26, 2009), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=204096&funcao=visualizar&Site=C; Marcelo Loureiro, *Solução criativa* [*Creative Solution*], 70 REV. CAPITAL ABERTO 42 (June 2009), http://capitalaberto.com.br/temas/solucao-criativa/#.VtTHWJwrLjY; Marcos Pinto, Razões de Voto, CVM nºRJ/2009/4691 (Aug. 11, 2009), http://www.cvm.gov.br/export/sites/cvm/decisoes/anexos/0006/6584-2.pdf.

127. On August 27, 2009, a Form 6-K filed with the SEC announced a shareholder's meeting had approved the merger of Aracruz with Votorantim Celulose e Paper S.A. Aracruz Celulose S.A., Report of Foreign Private Issuer (Form 6-K) (Aug. 27, 2009), http://www.sec.gov/Archives/edgar/data/883952/000118003109000113/f090826a.htm; Votorantim Celulose e Papel S.A. & Aracruz Celulose S.A., *Fato Relevante* (Aug. 26, 2009), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=213709&funcao=visualizar&Site=C.

128. According to class action plaintiffs, the losses with derivatives resulted in decreased consideration received by the company in the merger deal with Votorantim Celulose e Papel S.A. *See* Danilo Gregório, *Sirvam-se, minoritários* [*Minorities, Serve Yourselves*], 66 REV. CAPITAL ABERTO 32 (2009), http://www.capitalaberto.com.br/temas/sirvam-se-minoritarios/#.VBNiZPldVYI ("A impressão dos investidores é que somente os preferencialistas da Aracruz estão arcando com o prejuízo causado pelos derivativos.") ("The perception of the investors is that only preferred shareholders are carrying the burden of the losses caused by derivatives.").

129. The Brazilian CVM contested the exchange value offered to preferred shares. *See* Parecer do Comité de Termo de Compromisso, CVM nºRJ 2010/9941 (July 20, 2011), http://www.cvm.gov.br/export/sites/cvm/decisoes/anexos/0008/7782-0.pdf. This led to a review in the exchange offer of stocks. *See* Cesar Bianconi, *VCP iguala substituição de ações da Aracruz após parecer da CVM* [*VCP Equals Aracruz's Stock Exchange After CVM's Legal Opinion*], ESTADÃO (Aug. 25, 2009), http://economia.estadao.com.br/noticias/geral,vcp-iguala-substituicao-de-acoes-da-aracruz-apos-parecer-da-cvm,424224; *Preferencialistas felizes* [*Happy Preferred Shareholders*], 73 REVISTA CAPITAL ABERTO 16,

largest producer of market pulp.[130] Defendant Carlos Augusto Lira Aguiar, who was Aracruz's Chief Executive Officer (CEO), continued to serve as Fibria's CEO after the merger until June 2011, when he was appointed to Fibria's Board.[131]

In one concurrent development, U.S. attorneys filed class actions against both companies on behalf of U.S. institutional investors. Brazilian shareholders approved "derivative suits" by both corporations against their CFOs. CVM conducted investigations in both cases. The next Parts examine the actions of private and public enforcers in detail.

III. PRIVATE ENFORCEMENT ACTIONS IN THE UNITED STATES AND IN BRAZIL

While recently emphasizing the role of enforcement, the literature is bereft of any detailed qualitative case studies analyzing how different jurisdictions employ different enforcement measures for the same type of alleged wrongdoing. In this and the following Parts, this Article adopts the literature's distinction between private and public enforcement to analyze the enforcement actions taken in the Aracruz and Sadia cases. This Part focuses on private enforcement and the next on public enforcement.

A. The U.S. Class Action Lawsuits Against Sadia and Aracruz

1. The Sadia Case

In the Sadia case, lead plaintiffs Westchester Putnam Counties Heavy and Highway Laborers Local 60 Benefit Funds (Westchester) filed a federal securities class action on November 5, 2008, in the U.S. District Court for the Southern District of New York on behalf of themselves and others similarly situated.

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http://www.capitalaberto.com.br/temas/preferencialistas-felizes/#.VGZDB5hOWRu (last visited Feb. 29, 2016). The Brazilian CVM filed an administrative proceeding against board members of Aracruz Celulose S.A. and Votorantim Celulose e Papel S.A. *See* Parecer do Comité de Termo de Compromisso, *supra*.

130. André Magnabosco, *Anunciada criação da Fibria, fusão entre Aracruz e VCP* [*Announced the Creation of Fibria, Merger Between Aracruz and VCP*], AGÊNCIA ESTADO (Sept. 1, 2009), http://www.abril.com.br/noticias/economia/anunciada-criacao-fibria-fusao-aracruz-vcp-514631.shtml.

131. Graziella Valenti, *CVM acusa 10 ex-diretores da Aracruz* [*CVM Charges 10 Former Aracruz Managers*], VALOR ECONÔMICO, June 22, 2010, at D2.

Westchester claimed securities fraud on behalf of all purchasers who acquired Sadia's ADRs between April 30, 2008, and September 26, 2008.[132] It alleged violations of Section 10(b), including Rule 10b-5 promulgated thereunder, and Section 20(a) of the Securities Exchange Act of 1934. It also argued that individual defendants had acted as controlling persons of Sadia within the meaning of Section 20(a) and were liable by virtue of their controlling positions.[133]

Defendants in the Sadia case were (i) Sadia; (ii) Luiz Fernando Furlan, who had served as Chairman of the Board of the company since October 6, 2008; (iii) Gilberto Tomazoni, who served as CEO since April 2005 and signed the company's Form 20-F filed during the class period as well as its attached Sarbanes Oxley Certification; (iv) Welson Teixeira Junior, the company's CFO since September 26, 2008, who signed the company's Forms 6-K and 20-F and the attached Sarbanes Oxley Certification during the class period; (v) Adriano Lima Ferreira, who served as CFO during the class period and was terminated on September 26, 2008; (vi) Walter Fontana Filho, who served as the company's President and Chairman until his resignation on October 6, 2008; and (vii) Eduardo Fontana d'Avila, who served as the company's Vice Chairman during the class period and until his resignation on October 6, 2008.[134]

In the Aracruz case, plaintiff City Pension Fund for Firefighters and Police Officers in the City of Miami Beach (Miami Beach) filed a federal securities class action on November 26, 2008, in the U.S. District Court for the Southern District of Florida, Miami Divi-

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132. Plaintiff filed a class action pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3). The complaint read:

> [The New York court] has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§ 1331 and 1307 and Section 27 of the Exchange Act, 15 U.S.C. § 78aa. The Court has personal jurisdiction over this action because Sadia does business in this District and its stock trades as American Depository Shares (as evidenced by American Depository Receipts) on the New York Stock Exchange ("NYSE") under the symbol "SDA."

Sadia Consolidated Amended Complaint, *supra* note 105, at 3. The court consolidated five related securities class actions and appointed Westchester, Alan Hyman, Phil Carey, Steve Geist, and Peter Stricker, collectively called "the Sadia Investor Group," as lead plaintiff, Saxena White P.A. and Barroway Topz Kessler Meltzer & Check LLP as co-lead counsel, and the Law Offices of Curtis V. Trinko, LLP as liaison counsel for the class in an order dated January 26, 2009. *In re* Sadia S.A. Sec. Litig., 643 F. Supp. 2d 521 (S.D.N.Y. July 29, 2009). A Consolidated Amended Complaint was filed on March 16, 2009, under the designation "*In re* Sadia S.A. Securities Litigation." *See generally* Sadia Consolidated Amended Complaint, *supra* note 105.

133. Sadia Consolidated Amended Complaint, *supra* note 105, at 41.

134. *Id*. at 5–7.

sion on behalf of itself and others similarly situated.[135] Miami Beach claimed securities fraud on behalf of all purchasers who acquired Aracruz's ADRs between April 7, 2008, and October 2, 2008.[136] It alleged violations of Section 10(b), including Rule 10b-5 promulgated thereunder, and Section 20(a) of the Securities Exchange Act of 1934.[137]

The suit was brought against (i) Fibria Celulose S.A., Aracruz's successor, and certain executive officers and directors, namely (ii) Carlos Alberto Vieira, a member of the Board of Directors of Aracruz since April 15, 1988, and Chairman of the Board from April 2004 until his resignation on March 6, 2009; (iii) Aguiar, the company's CEO and President during the class period; and (iv) Isac Roffé Zagury, the company's CFO and Director of Investor Relations during the class period and until his resignation in October 2008 following the disclosure of the losses associated with the currency derivatives contracts.[138]

Lead plaintiffs in both cases claimed that defendants misrepresented the nature and extent of currency hedging strategies that were in violation of company policies. Because it remained undisclosed that Sadia and Aracruz had entered into hedges that were larger and riskier than necessary, the prices of Sadia and Aracruz ADRs were inflated during the class period, causing financial injury to members of the class when the prices later dropped.[139] Both groups of plaintiffs alleged that during the class period the individual defendants, as senior executive officers and/or directors, were privy to

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135. Aracruz Amended Class Action Complaint, *supra* note 27, at 49 ("Venue is proper in this District pursuant to Section 27 of the Exchange Act and 28 U.S.C. §1391. Aracruz operates a wholly owned subsidiary, Aracruz Celulose (USA) Inc. in this District and maintains offices at Aventura Harbour Centre, 18851 NE 29th Ave., Suite 530 Aventura, FL 33180.").

136. Plaintiff filed a class action pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3). The court appointed Miami Beach as lead plaintiff and Saxena White P.A. as lead counsel in an order dated August 7, 2009. Order on Motions for Lead Plaintiff Status and for Approval of Selection of Lead Counsel (D.E. 4, 7, 9, 14), City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Aug. 7, 2009), ECF No. 27. Miami Beach then filed an amended class action complaint on October 5, 2009. Aracruz Amended Class Action Complaint, *supra* note 27.

137. The claims also included 15 U.S.C. §§ 78(i)(b), 78(t), and 78t-1(a).

138. Aracruz Amended Class Action Complaint, *supra* note 27, at 50 ("Defendants are sued as primary participants in the wrongful and illegal conduct charged herein. The Individual Defendants are also sued herein as controlling persons of Aracruz, as alleged herein.").

139. *Id*. at 42–43; Sadia Consolidated Amended Complaint, *supra* note 105, at 5–7.

confidential, proprietary, and materially adverse non-public information concerning their companies' operations, finances, financial conditions, and present and future business prospects. As a consequence, they knew, or recklessly disregarded, that adverse facts were being concealed from the investing public.[140]

In particular, each complaint alleged that, throughout the relevant class period, defendants failed to disclose:

> (1) that Sadia [and Aracruz] entered into currency derivatives contracts to hedge against U.S. dollar exposure that were far larger than necessary; (2) that such contracts violated Sadia's hedging policy [and Aracruz's financial and internal control policies and public statements concerning the nature of such policies]; (3) that Sadia [and Aracruz] lacked adequate internal and financial controls; and (4) that, as a result of the foregoing, the [c]ompan[ies'] statements about [their] financial well-being and future business prospects were lacking in any reasonable basis when made.[141]

Both groups of plaintiffs claimed that defendants:

> (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices and a course of business which operated as a fraud and deceit upon the purchasers of the [c]ompan[ies'] securities in an effort to maintain artificially high market prices for Sadia [and Aracruz] ADRs in violation of §10(b) of the Exchange Act and Rule 10b-5.[142]

Both Aracruz and Sadia class action suits employed the fraud on the market doctrine, according to which the market for Aracruz and Sadia ADRs was efficient at all relevant times. Plaintiffs claimed that the materially false and misleading statements and disclosure failures of Aracruz and Sadia caused the ADRs to be traded at artificially inflated prices during the class periods. They also claimed loss causation between the revelation of the companies' ex-

140. Sadia Consolidated Amended Complaint, *supra* note 105, at 39; Aracruz Amended Class Action Complaint, *supra* note 27, at 19, 51–52.

141. Aracruz Amended Class Action Complaint, *supra* note 27, at 13, 24, 42; Sadia Consolidated Amended Complaint, *supra* note 105, at 3, 22.

142. Aracruz Amended Class Action Complaint, *supra* note 27, at 50; Sadia Consolidated Amended Complaint, *supra* note 105, at 37.

posure to currency derivative contracts and the great fall in their securities prices.[143]

On April 30, 2008, Sadia filed with the SEC its Form 6-K, signed by Teixeira, reporting interim financial information for the three-month period ending March 31, 2008. The company reported its use of currency contracts as a *hedging* strategy and the amount of assets exposed to exchange-rate variations. On July 31, 2008, Sadia filed a Form 6-K with the SEC reporting financial results for the six-month period ending on June 30, 2008, and, keeping to its story, provided further information regarding its "conservative hedge strategy."[144]

However, on September 25, 2008, Sadia filed a Form 6-K with the SEC announcing that it would take a loss of approximately R$ 760 million (US$ 410 million) related to its investments in currency contracts hedging against the U.S. dollar.[145] This loss dwarfed the earlier disclosed "value at risk" figures—R$ 187 million as of March 31, 2008, and R$ 241 million as of June 30, 2008.[146] In addition, the company had repeatedly informed investors that its currency contracts were for "nominal" amounts and thus not recorded in the interim financial information. As a result of these revelations, on September 26, 2008, Sadia's ADR price decreased US$ 5.77, or nearly thirty-eight percent to close at US$ 9.50 after heavy trading of over 5 million shares. The following business day, the company's ADRs dropped another US$ 1.51 per share, or nearly sixteen percent, to close at US$ 7.99.[147]

Aracruz, in turn, reported in its April 7, 2008, Form 6-K, signed by defendant Aguiar and filed with the SEC, that "[t]he company's foreign currency risk and interest rate management strategy may use derivative instruments to protect against foreign exchange and interest rate volatility."[148] Furthermore, in its quarterly earnings report for the first quarter of 2008, it characterized a R$ 270 million

143. *See, e.g.*, Sadia Consolidated Amended Complaint, *supra* note 105, at 30–31, 35.

144. *Id.* at 17–22.

145. *See supra* note 113.

146. Sadia S.A., Report of Foreign Private Issuer (Form 6-K) (July 31, 2008), http://www.sec.gov/Archives/edgar/data/1130968/000120135608000061/sda063008fs_6k.htm (six-month period ending June 30, 2008); Sadia S.A., Report of Foreign Private Issuer (Form 6-K) (May 1, 2008), http://www.sec.gov/Archives/edgar/data/1130968/000120135608000041/sda033108fs_6k.htm (three-month period ending March 31, 2008).

147. Sadia Consolidated Amended Complaint, *supra* note 105, at 23–24.

148. Aracruz Celulose S.A., Report of Foreign Private Investor (Form 6-K) 34 (Apr. 7, 2008), http://www.sec.gov/Archives/edgar/data/883952/000118003108000024/f080407a.htm.

short position representing five months of future exposure on the U.S. dollar as "cash flow currency protection."[149] Plaintiffs claimed that these statements were materially false and misleading.

In its Form 6-K filed with the SEC on July 7, 2008, Aracruz affirmed that "exposure of U.S. Dollar denominated liability does not represent a risk from an economic and financial standpoint . . . ."[150] On September 26, 2008, Aracruz filed a Form 6-K with the SEC announcing that the "maximum loss volume on derivative transactions and also the total exposure to futures contracts based on U.S. dollars may have exceeded the limits set forth in the Company's Financial Policy approved by the Board of Directors."[151] While it stated that it did not yet know the amount of total losses incurred, it reassured the market that the company's cash amounted to approximately US$ 500 million and that there was no indication that adjustments related to the pending derivatives contracts would "materially affect the Company's cash account."[152] In addition, it revealed that its CFO and Director of Investor Relations Zagury was formally requesting a leave of absence from the company.[153] Plaintiffs claimed that defendants falsely represented to investors the extent of the losses in order to minimize damage and that Zagury knew about the company losses three weeks prior to this partial disclosure.[154]

In the two subsequent days, Aracruz's ADRs plummeted over twenty-five percent in value. On October 3, 2008, the company filed a new Form 6-K with the SEC announcing that the "fair value" of its currency-related derivatives contracts was negative by R$ 1.95 billion, or US$ 1.02 billion, as of September 30, 2008. Plaintiffs claimed that, following this revelation, the company's ADRs plummeted over fifty-one percent in value. Subsequently, Aracruz announced that it was canceling plans to pay interest on capital to shareholders on the order of US$ 41 million due to the financial losses.[155] On November 4, 2008, a new Form 6-K reported a loss of US$

149. ARACRUZ, ARACRUZ RESULTS: HIGHLIGHTS OF THE FIRST QUARTER 2008, at 2 (2008), http://www.latibex.com/act/esp/resulta/2008/1Q2008release_USGAAP.pdf.

150. Aracruz Celulose S.A., Report of Foreign Private Investor (Form 6-K) 30 (July 7, 2008), http://www.sec.gov/Archives/edgar/data/883952/000118003108000059/f080707a.htm.

151. Aracruz Celulose S.A., Report of Foreign Private Investor (Form 6-K) (Sept. 26, 2008), http://www.sec.gov/Archives/edgar/data/883952/000118003108000085/f080926a.htm.

152. Aracruz Amended Class Action Complaint, *supra* note 27, at 26.

153. *Id*. at 27.

154. *Id*. at 28.

155. *Id*. at 29.

2.13 billion in currency contracts, which according to plaintiffs was "equivalent to 39 months' worth of cash flow exposure and over one year's worth of net operating revenue."[156]

Plaintiffs in both lawsuits claimed that the misleading disclosures violated U.S. and Brazilian securities laws as well as Sadia's and Aracruz's policies. Plaintiffs quoted interviews given by the CFOs of Sadia and Aracruz, Ferreira and Zagury, respectively, to Brazilian magazines and newspapers to support the claim that individual defendants knew and intentionally supported the fraudulent currency hedging scheme.[157] Individual defendants, in this view, had incentives to artificially inflate the revenue of the company in order to increase their personal compensation through bonuses and other financial rewards.[158]

Sadia and Aracruz moved to dismiss the complaints on April 27, 2009,[159] and November 13, 2009,[160] respectively. At the time that both motions to dismiss were filed, the individual defendants listed in the two complaints had not yet been served and as a consequence did not join in the filings of Sadia's and Aracruz's initial motions. The delay in service was due to the fact that individual defendants were Brazilian citizens residing in Brazil, and therefore service had to be effected pursuant to the Inter-American Convention on Letters Rogatory.

The process included the translation and legalization of documents, which required the Clerk of Court to "exemplify" the complaints and summonses. The Department of Justice and the Department of State had to stamp and seal the exemplified documents and

156. *Id.* at 14 (emphasis omitted); Aracruz Celulose S.A., Report of Foreign Private Issuer (Form 6-K) (Nov. 4, 2008), http://www.sec.gov/Archives/edgar/data/883952/000118003108000108/f081104a.htm; Aracruz Celulose S.A., *Fato Relevante*, (Nov. 3, 2009), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=180952&funcao=visualizar&Site=C.

157. Aracruz Amended Class Action Complaint, *supra* note 27, at 15, 16; Sadia Consolidated Amended Complaint, *supra* note 105, at 31.

158. Aracruz Amended Class Action Complaint, *supra* note 27, at 19.

159. *See* Memorandum of Law in Support of Defendant Sadia S.A.'s Motion to Dismiss, *In re* Sadia S.A. Sec. Litig., 643 F. Supp. 2d 521 (S.D.N.Y. Apr. 27, 2009) (No. 1:08-cv-09528), ECF No. 29.

160. Defendant Aracruz Celulose S.A.'s Motion to Dismiss the Amended Class Action Complaint for Violation of the Federal Securities Laws and Memorandum of Law in Support of Defendant Aracruz Celulose S.A.'s Motion to Dismiss the Amended Class Action Complaint for Violation of the Federal Securities Laws, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Nov. 13, 2009), ECF Nos. 35–36 [hereinafter Aracruz Motion to Dismiss Amended Class Action Complaint].

then transmit them to the Brazilian Consulate and Embassy. In the Sadia litigation, lead plaintiffs began the process of serving the initial complaint in early March 2009, but only in May 2011 did the individual defendants join the action.[161] Because of this long and burdensome process,[162] Miami Beach, plaintiff in the Aracruz case, used a different strategy and requested that the court authorize alternative service on the individual defendants via registered mail and personal service under the Federal Rules of Civil Procedure Rule 4(f)(3);[163] the court ordered so.[164]

161. Memorandum of Law in Support of Plaintiff's Motion for Final Approval of Settlement and Plan of Allocation at 11, *In re* Sadia S.A. Sec. Litig., No. 1:08-cv-9528 (SAS), 2011 WL 6825235 (S.D.N.Y. Nov. 17, 2011), ECF No. 116.

162. Effecting service of process in Brazil has been described by *Legal Language* as "a lesson in perseverance." *Service of Process in Brazil*, LEGAL LANGUAGE SERV., http://www.legallanguage.com/services/service-of-process/brazil (last visited Mar. 6, 2016). According to data published by the Department of Justice, of the 100 requests for service under the Inter-American Convention on Letters Rogatory and Additional Protocol between 2003 and 2007, only two have been successfully executed in Brazil. *See* Synthes v. G.M. Dos Reis Jr., No. 07cv0309, 2007 BL 200929, at *8 n.8 (S.D. Cal. Aug. 2, 2007). *See generally* Plaintiff's Response to Order to File Status Report Regarding Service of Process of Brazilian Defendants at 3, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Feb. 9, 2010), ECF No. 51 (describing the service of process in Brazil as a "complex," "bureaucratic," "laborious," and "multi-step process").

163. Plaintiff's Motion & Incorporated Memorandum of Law for Alternative Service of Process on Defendants Carlos Alberto Vieira, Carlos Augusto Lira Aguiar, and Isac Roffe Zagury, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. July 22, 2010), ECF No. 60.

164. Order Granting Plaintiff's Motion for Alternative Service of Process on Individual Defendants (D.E. 60), City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. July 22, 2010), ECF No. 65. Defendants presented an affidavit arguing that "service through a letter rogatory is mandatory and exclusive under Brazilian law" and that "the lack of due and correct service on the defendant voids the entire process and makes any judgment that follows unenforceable in Brazil." Affidavit of Professor Arnoldo Wald at 5, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. Oct. 15, 2010) (No. 08-23317-CIV), ECF No. 76. The Brazilian *Ministério da Justiça* received the letters rogatory on August 31, 2010, and then passed the documents to the Brazilian federal courts. Lead Plaintiff's Motion for Final Approval of Settlement & Award of Attorneys' Fees & Reimbursement of Expenses & Incorporated Memorandum of Law in Support at 7, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. May 24, 2013), ECF No. 195. The Brazilian STJ granted the *exequatur*, which allowed the letters rogatory to be executed for Defendants Aguiar and Vieira on November 26, 2010. *Id.* Both of them were served in February 2011. *Id.* Zagury, who initially challenged the *exequatur*, but missed the deadline in doing so, was finally served on May 14, 2011. *Id.* The motion continues to describe the service of process:

In its motion to dismiss, Sadia argued that the complaint failed to comply with the pleading requirements of the Federal Rules of Civil Procedure Rule 9(b). It claimed that (i) the complaint failed to identify any actionable misstatement or omission made in any of the company's public disclosures during the class period; (ii) the complaint failed to plead facts giving rise to a strong inference of scienter; (iii) the complaint alleged no specific facts identifying any hedging contract that violated those limits during the period covered by the public disclosures upon which lead plaintiffs based their claim; (iv) the complaint failed to allege facts showing that the specific limits were publicly known or relied upon by investors; and (v) the violation of an internal hedging policy is not actionable under the federal securities laws. It argued that the nominal or face amount of the hedging contracts had been disclosed, that "the offending contracts were entered into *after* the financial disclosures" in the class period, that Sadia was fully in compliance with the hedging policy when it disclosed the information, and that, even if it *had* exceeded the limits of its hedging policy, the allegation that a company "engaged in risky transactions" is equivalent to a claim that the "business was mismanaged"—an allegation insufficient to support a securities fraud claim under Section 10(b).[165]

> With service complete, the executed letters rogatory were then returned to Process Forwarding International (the U.S. Central Authority). The complete files for Aguiar and Vieira number almost 600 pages each, while Zagury's file exceeds 1,200 pages. On August 16, 2011, Miami Beach filed a Notice of Service of Process (Dkt. No. 108), informing the court that all of the Individual Defendants were served pursuant to the Inter-American Convention.

Id.

165. Memorandum of Law in Support of Defendant Sadia, S.A.'s Motion to Dismiss at 3, 10, 18, 19, *In re* Sadia S.A. Sec. Litig., 643 F. Supp. 2d 521 (S.D.N.Y. 2009) (No. 08 Civ. 9528 (SAS)), ECF No. 29 (quoting *In re* Citigroup, Inc. Sec. Litig., 330 F. Supp. 2d 367, 375 (S.D.N.Y. 2004) and Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 467 (1977)). Plaintiff rebutted defendant's allegations, arguing that *Citigroup* did not apply to the Sadia case because in *Citigroup* the court held that the plaintiffs failed to allege fraudulent activity "in connection with the market for Citigroup's own securities," which was the case regarding Sadia's own shares. Plaintiffs' Memorandum of Law in Opposition to the Motion to Dismiss of Defendant Sadia S.A. at 12, *In re* Sadia S.A. Sec. Litig., 643 F. Supp. 2d 521 (S.D.N.Y. 2009) (No. 08 Civ. 9528 (SAS)), ECF No. 32. Plaintiff also argued that, unlike the court's findings in *Citigroup*, "it is indisputable that a reasonable investor would consider material the information that Sadia was engaging in high-risk, speculative hedging activity to supplement its operating profits . . . in direct violation of its stated 'non-speculative' and conservative hedging policy." *Id.* at 11–12. On June 22, 2009, Sadia replied that the currency hedging contracts were in fact disclosed and that the alleged violation of the company's hedging policy was not actionable as securities fraud. Reply Memorandum of Law in Further Support of Defendant Sadia, S.A.'s Motion to Dismiss at 2, 5, 8, *In re* Sadia S.A. Sec. Litig., 643 F. Supp. 2d 521 (S.D.N.Y. 2009) (No. 08 Civ. 9528 (SAS)), ECF No. 36 (arguing that "[n]either the amended complaint nor the extrinsic

The court denied Sadia's motion to dismiss the complaint by opinion and order dated July 29, 2009. The court conceded that the term "nominal" referred to the notional amounts of the currency hedging as opposed to their actual value, and could not be interpreted by investors to mean "negligible." However, it ruled that plaintiffs had met their pleading requirements regarding Sadia's mischaracterization of its currency hedge exposure as risk-reducing and non-speculative; that plaintiffs' allegations concerning Sadia's failure to reveal that it had entered hedging contracts in violation of its internal hedging policy was sufficient to state a Rule 10b-5 claim; and that the complaint sufficiently pleaded that the company's agents and officers committed culpable acts with the requisite scienter.[166]

After preliminary discovery, plaintiffs on December 14, 2009, presented a memorandum in support of a motion for class certification, along with an expert report analyzing the efficiency of the market for Sadia's ADRs. The report established artificial inflation of approximately US$ 5.62 per share in the price of Sadia's ADRs by the end of the proposed class period—or approximately thirty-seven percent of the pre-disclosure price—by means of an event study analysis of price variation in Sadia shares.[167] Defendant Sadia presented its memorandum in opposition to plaintiffs' motion for class certification on March 15, 2010, along with an expert report critiquing the methodology adopted by plaintiffs' expert.[168]

'evidence' cited by plaintiffs contain[ed] any facts to support the claim of securities fraud"; "Plaintiffs' policy violation claims sound[ed] in mismanagement, not securities fraud"; "Plaintiffs' SOX-based claim [had to] be dismissed"; and "the amended complaint fail[ed] to raise a strong inference of scienter").

166. *In re* Sadia S.A. Sec. Litig., 643 F. Supp. 2d 521, 528, 530–32, 535 (S.D.N.Y. 2009) ("While Sadia's public filings disclosed the total amount of all of the Company's currency hedging contracts, these disclosures were neither conspicuous nor in close proximity to the Company's description of the currency hedging contracts as risk-reducing and non-speculative. . . . Accordingly, it is plausible that a reasonable investor could have been misled by Sadia's characterizations of the Company's exposure under its currency hedging contracts."). The court also considered that *Citigroup* was distinguishable from Sadia's case in that its alleged failure to comply with "Company policy was intended to deceive *its own* shareholders, not investors in the securities of other companies." *Id*. at 532. Nonetheless, the court dismissed the claims that Sadia misrepresented the existence of adequate internal controls for monitoring the currency hedging activity and that Sadia's class period public statements disguised the true financial condition of the company. *Id.* at 533–34.

167. Plantiffs' Memorandum of Law in Support of Motion for Class Certification, *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298 (S.D.N.Y. 2010) (No. 08 Civ. 9528 (SAS)), ECF No. 48; *see* Expert Report of Marc Vellrath, Ph.D., CFA., *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298 (S.D.N.Y. 2010) (No. 08 Civ. 9528 (SAS)), ECF No. 48-2.

168. Defendant Sadia, S.A.'s Memorandum of Law in Opposition to Plaintiffs' Motion

Depositions of expert witnesses and class representatives were conducted. Sadia argued that it could not be proven that any of the alleged misrepresentations or omissions had any impact on the trading of Sadia's ADRs prior to August 2008, which, if true, would preclude a finding of "predominance" and prevent class certification. According to this rationale, the price could not have been inflated during most of the class period, because the unwinding of Sadia's contracts would have generated a gain until August 14, 2008, and there was no material price inflation prior to September 5, 2008.[169]

In an opinion and order dated July 20, 2010, the judge reviewed the reports, evidence presented, and depositions taken, ultimately granting plaintiffs' motion for class certification.[170] The judge acknowledged that the financial impact of the wrongdoing could have varied considerably throughout the class period, because Sadia's contracts could have resulted in a net profit had they been unwound earlier. Nonetheless, she found that the materiality requirement was met by plaintiffs, because they had "provided sufficient evidence to establish that the undisclosed information would have been viewed by a reasonable investor as having significantly altered the total mix of available information" to the public.[171] The preponderance requirement was met once plaintiffs showed that they could prove transaction and loss causation class-wide.[172] Sadia fur-

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for Class Certification, *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298 (S.D.N.Y. 2010) (No. 08 Civ. 9528 (SAS)), ECF No. 52; *see* Expert Report of Professor Rene M. Stulz, *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298 (S.D.N.Y. 2010) (No. 08 Civ. 9528 (SAS)), ECF No. 54.

169. Defendant Sadia, S.A.'s Memorandum of Law in Opposition to Plaintiffs' Motion for Class Certification, *supra* note 168, at 6–10. Defendants argued that transaction loss causation on a class-wide basis would be precluded. *Id.*; *see also* Expert Report of Professor Rene M. Stulz, *supra* note 168, at exh. 6. Plaintiffs' Reply was filed on May 6, 2010, along with a Surrebuttal Expert Report. Plaintiffs' Reply Memorandum in Further Support of the Motion for Class Certification, *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298 (S.D.N.Y. 2010) (No. 08 Civ. 9528 (SAS)), ECF No. 61; Surrebuttal Expert Report of Marc Vellrath, Ph.D., CFA, *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298 (S.D.N.Y. 2010) (No. 08 Civ. 9528 (SAS)), ECF No. 62-2. A Reply Report of Professor René M. Stulz was submitted on May 21, 2010. Reply Report of Professor Rene M. Stulz, *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298 (S.D.N.Y. 2010) (No. 08 Civ. 9528 (SAS)), ECF No. 65.

170. *In re* Sadia S.A. Sec. Litig., 269 F.R.D. 298, 311–21 (S.D.N.Y. 2010). The judge excluded purchasers who sold shares prior to the close of the market on September 25, 2008. *Id*. at 321.

171. *Id.* at 302. The judge supported the opinion with the adoption of the "total mix" standard of materiality, which is framed in terms of how the information is viewed by a reasonable investor, rather than in terms of actual impact on market price. *Id.* at 308 (quoting *In re* Salomon Analyst Metromedia Litigation, 544 F.3d 474, 482 (2d Cir. 2008)).

172. *In re Sadia S.A. Sec. Litig.*, 269 F.R.D. at 317. The judge recognized flaws in plaintiff's methodology for damages calculation, but sustained that conflicts over damages

ther petitioned the U.S. Court of Appeals for the Second Circuit for permission to appeal, alleging that the court erred in its ruling. After further briefing, on October 8, 2010, the Second Circuit denied Sadia's petition.[173]

Because of the complications related to service of process, some individual defendants in the Sadia case did not move to dismiss the amended complaint until May 27, 2011, two years after Sadia filed its motion to dismiss. Walter Fontana Filho, Eduardo Fontana d'Avila, and Ferreira argued that the court lacked personal jurisdiction over them.[174] In addition, on June 20, 2011, all individual defendants moved to dismiss on the grounds that the complaint failed to state a claim because it (i) failed to satisfy the pleading requirements for alleging scienter under Section 10(b); (ii) failed to plead that any of the individual defendants "made" Sadia's alleged public filing misrepresentations; and (iii) failed to plead the facts necessary to establish the elements of Section 20(a) control person liability.[175] Plaintiffs then opposed the individual defendants' motions to dismiss; defendants' reply memoranda followed.[176]

The individual defendants' motions to dismiss were *sub judice* when the parties reached their tentative agreement to settle the class action in August 2011. After several months of mediation efforts, the parties proposed a cash settlement of US$ 27 million, which was preliminarily approved by court order of September 22, 2011.[177]

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could not bar class certification at an early stage of the litigation. *Id.* at 318–21.

173. Joint Declaration of Christopher L. Nelson & Joseph E. White, III in Support of Final Approval of Settlement, Plan of Allocation and Application for an Award of Attorneys' Fees & Expenses & Reimbursement to the Class Representatives at 11–12, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS), 2011 WL 6825235 (S.D.N.Y. Dec. 28, 2011), ECF No. 119.

174. Memorandum of Law in Support of Individual Defendants' Motion to Dismiss for Lack of Personal Jurisdiction, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS) (S.D.N.Y. May 27, 2011), ECF No. 92.

175. Memorandum of Law in Support of Individual Defendants' Motion to Dismiss Pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS) (S.D.N.Y. June 20, 2011), ECF No. 100.

176. *See* Memorandum of Law in Opposition to Individual Defendants' Motion to Dismiss for Lack of Personal Jurisdiction, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS) (S.D.N.Y. June 20, 2011), ECF No. 96; Reply Memorandum of Law in Further Support of Individual Defendants Motion to Dismiss for Lack of Personal Jurisdiction, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS) (S.D.N.Y. July 8, 2011), ECF No. 101; Reply Memorandum of Law in Further Support of Individual Defendants' Motion to Dismiss Pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS) (S.D.N.Y. Aug. 1, 2011), ECF No. 107.

177. For a detailed discussion of the settlement negotiations, see Joint Declaration of

Assuming liability on the part of defendants, experts showed that maximum provable damages ranged between US$ 35.5 and US$ 91 million, depending on the assumptions and models employed. Under this prediction, the settlement represented a recovery between thirty and seventy-six percent of the class's maximum provable damages.[178] Class counsels requested an award of attorneys' fees of 33.33% of the net settlement fund, reimbursement of US$ 723,228 in out-of-pocket expenses (plus interest) advanced collectively while prosecuting the action, and an aggregate award of US$ 14,178 for the reasonable costs and expenses incurred in connection with their representation of the class.[179]

As per its December 28, 2011, memorandum opinion and order, the court approved the settlement as fair, reasonable, adequate, and in the best interests of the class. It awarded attorneys' fees in the amount of thirty percent of the net settlement fund, amounting to US$ 8.1 million, plus US$ 723,228 in expenses and interest. The court also awarded US$ 14,178 to the class representatives for their related costs and expenses.[180] As of January 31, 2013, the balance of the net settlement fund was US$ 18,012,712.[181] Approximately 14.9 million Sadia ADRs were acquired and potentially damaged during the class period and held through the close of the market on September 25, 2008. The average recovery under the settlement amounted to US$ 1.81 per allegedly damaged ADR, before deductions of court-approved costs and attorneys' fees.[182]

Christopher L. Nelson & Joseph E. White, III in Support of Final Approval of Settlement, Plan of Allocation and Application for an Award of Attorneys' Fees & Expenses & Reimbursement to the Class Representatives, *supra* note 173, at 16–17.

178. Memorandum of Law in Support of Class Counsels' Application for an Award of Attorneys' Fees & Expenses & an Award of Costs & Expenses to the Class Representatives at 14, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS) (S.D.N.Y. Dec. 28, 2011), ECF No. 118 .

179. *Id.* at 25. Counsels stated they had collectively spent over 20,890 hours in the litigation as of November 17, 2011, which would result in a total lodestar of US$ 8,036,010.00 (and a multiplier of 1.09). *Id*. at 10.

180. The judge reviewed the attorney declarations and lowered the rates for support staff as well as eliminated fees for investigatory work done by non-lawyers, ultimately approving a US$ 7,797,961.50 lodestar fee corresponding to approximately 20,530 work hours. The expenses (US$ 723,228.36) total approximately three percent of the value of the settlement. *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS), 2011 WL 6825235, at *2–4 (S.D.N.Y. Dec. 28, 2011).

181. Joint Declaration of Joseph E. White, III & Jennifer L. Enck in Support of Class Representatives' Motion for Distribution of Net Settlement Fund at 3, *In re* Sadia S.A. Sec. Litig., No. 08 Civ. 9528 (SAS) (S.D.N.Y. Feb. 13, 2013), ECF No. 128.

182. The average cost per damaged ADR was estimated as US$ 0.66 before court

An important question is who met the burden of the Sadia settlement in the United States. One constraint in answering this is that neither U.S. nor Brazilian securities regulations require the specific disclosure of Directors & Officers liability insurance (D&O) policies.[183] Financial statements subsequently provided by Sadia's successor Brasil Foods S.A. indicate that the payment of the settlement was covered by Sadia's operating income.[184]

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approval of attorneys' fees. The final value should have decreased as the judge decided for a smaller fee percentage (30%) than the one requested by the lawyers (33.33%). According to counsel, the class member's actual recovery would depend on:

> (1) the number of claims filed; (2) when Class Members purchased and/or acquired their Sadia ADRs; (3) whether Class Members sold their Sadia ADRs and, if so, when; (4) administrative costs, including the costs of notice for the Action; (5) the amount awarded by the Court for attorneys' fees and expenses; and (6) the amount awarded by the Court to the Class Representatives in connection with their representation of the Class.

See Joint Declaration of Christopher L. Nelson & Joseph E. White, III in Support of Final Approval of Settlement, Plan of Allocation & Application for an Award of Attorneys' Fees & Expenses & Reimbursement to the Class Representatives, *supra* note 173, at exh. 1(A) 1–2.

183. In the United States, disclosure of D&O insurance is not mandatory. In Brazil, the CVM began requiring D&O insurance disclosure in 2009, but with much leeway given to companies to disclose what they saw fit. CVM Instruction No. 480, annex 24, item 12.11 (Dec. 7, 2009), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/CVM-Instruction-480.pdf. A correct assessment of out-of-pocket liability costs to companies and individual defendants would require detailed disclosure of D&O policies. In Canada, for example, such disclosure of D&O insurance is mandatory. *See generally* John E. Core, *The Directors' and Officers' Insurance Premium: An Outside Assessment of the Quality of Corporate Governance*, 16 J.L. ECON. & ORG. 449 (2000).

184. BR Foods succeeded Sadia S.A. *See supra* note 125 and accompanying text; *see also* Brasil Foods S.A., Standard Financial Statements 161 (Mar. 22, 2012), http://ri.brf-global.com/arquivos/dfp2011_en.pdf ("The subsidiary Sadia and some of its current and former executives were named as defendants in five class actions suits arising from investors of American Depositary Receipts ('ADRs') issued by Sadia and acquired in the period from April 30, 2008 to September 26, 2008 (Class Period). These claims were filed in the Southern District of New York federal court in the United States of America, seeking remediation in accordance with U.S. Securities Exchange Act of 1934 arising from losses on foreign exchange derivative contracts entered during the Class Period. By order of the U.S. court, the five class actions suits were consolidated into a single case (Class Action) on behalf of the Sadia's investors group. During the second semester of 2011, the Company reached a final agreement with the plaintiffs homologated by the U.S. judicial authority and as a consequence settled the case with a payment of US$27,000. The Company's [sic] previously recorded a provision superior to the amount of the settlement, therefore, a reversal in the amount of R$118,684 was recorded in the other operating income. The Company understands that the likelihood of having new lawsuits related to this Class Action is remote.").

2. The Aracruz Case

Turning to the Aracruz case, in its motion to dismiss Aracruz argued that: (i) Miami Beach failed its service of process because it served Aracruz's agent in the United States and not in Brazil; (ii) the complaint did not identify any actionable misstatement or omission in any of Aracruz's public disclosures during the class period; (iii) the complaint did not plead facts giving rise to a strong inference of scienter; (iv) the complaint failed to plead loss causation; and (v) all Aracruz's public statements were protected by the PSLRA "safe harbor" provisions.[185]

The individual defendants connected to Aracruz also moved to dismiss the complaint. Aguiar and Vieira argued that (i) because they lacked necessary minimum contacts with the United States, the court lacked personal jurisdiction over them; (ii) Aguiar was protected by the fiduciary shield doctrine; (iii) they did not possess scienter or motive that could characterize liability; and (iv) the complaint failed to establish control person claims against them.[186] Zagury presented similar arguments and additionally alleged that the case against him should be stayed due to international comity and dismissed on grounds of *forum non conveniens*.[187]

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185. Aracruz Motion to Dismiss Amended Class Action Complaint, *supra* note 160. Aracruz answered the complaint on October 20, 2010. Defendant Aracruz Celulose S.A.'s Answer to the Amended Class Action Complaint for Violation of the Federal Securities Laws, City Pension Fund for Firefighters & Police Officers in the City of Miami Beach v. Aracruz Celulose S.A., No. 08-23317-CIV (S.D. Fla. Oct. 20, 2010), ECF No. 87.

186. Memorandum of Law in Support of Defendants Carlos Alberto Vieira's & Carlos Augusto Lira Aguiar's Motion to Dismiss the Amended Class Action Complaint for Violation of the Federal Securities Laws, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. 2011) (No. 08-23317-CIV), ECF No. 77.

187. Isac Roffe Zagury's Motion to Stay These Proceedings & Dismiss the Amended Complaint and Incorporated Memorandum of Law, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. Oct. 15, 2010) (No. 08-23317-CIV), ECF No. 79 (alleging that the more convenient forum against Zagury was Brazil); *see also* Reply Memorandum of Law in Further Support of Defendants Carlos Alberto Vieira's & Carlos Augusto Lira Aguiar's Motion to Dismiss the Amended Class Action Complaint for Violation of the Federal Securities Laws at 18, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. Dec. 3, 201) (No. 08-23317-CIV), ECF No. 99 (arguing that the Settlement Report of the CVM presented by plaintiffs negates any inference of scienter against Vieira and Aguiar); Zagury's Reply to Plaintiff's Opposition to Zagury's Motion to Stay & Dismiss the Amended Complaint, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. June 20, 2011) (No. 08-23317-CIV), ECF No. 100 (requesting that the court strike the CVM Document as inappropriate pursuant

The Brazilian STJ provided information that the letter rogatory requesting the notification of service of process on Vieira was duly completed on April 15, 2011 and for Aguiar on March 28, 2011.[188] On September 16, 2011, the U.S. court granted in part and denied in part the motions to dismiss. The court considered that Aracruz was properly served by the service on its U.S. agent. It found it reasonable that the United States exercise jurisdiction over Aguiar and Zagury, but dismissed the U.S. claims against Vieira due to a lack of personal jurisdiction and minimum contacts with the United States.[189] The court declined to extend the fiduciary shield doctrine to Aguiar and rejected Zagury's arguments about international abstention and *forum non conveniens*. On the merits, the court held that it "finds the analysis in *In re Sadia* highly persuasive and concludes that a similar result is appropriate in this case."[190] It found that plaintiffs stated a valid claim based on Aracruz's April 7 and July 7, 2008, Form 6-K statements regarding the purpose, nature, and extent of its currency

FRCP 12(b)(6) and certain affidavits and declarations); Comissão de Valores Mobiliários, Termo de Compromisso e de Ajustamento de Conduta [CVM Settlement Agreement], Processo Administrativo Sancionador CVM No. 16/2008, 31.7.2013, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 10.9.2013 (Braz.); Lead Plaintiff's Memorandum of Law in Opposition to Isac Roffe Zagury's Motion to Strike, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. Jan. 10, 2011) (No. 08-23317-CIV), ECF No. 103 (opposing Zagury's motion); Isac Roffe Zagury's Reply to Plaintiff's Memorandum of Law in Opposition to Motion to Strike at 6, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369 (S.D. Fla. Jan. 20, 2011) (No. 08-23317-CIV), ECF No. 104 (arguing that plaintiffs' statement tried to play on a negative stereotype to create a false image of Zagury). Aguiar answered on October 7, 2011. Defendant Carlos Augusto Lira Aguiar's Answer to the Amended Class Action Complaint for Violation of the Federal Securities Laws, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Oct. 7, 2011), ECF No. 116. Zagury answered on January 18, 2012. Defendant Isac Roffe Zagury's Answer to Plaintiffs' Amended Class Action Complaint, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Jan. 18, 2012), ECF No. 137.

188. Notice of Status of Service of Process for Defendants Carlos Alberto Vieira, Carlos Augusto Lira Aguiar & Isac Roffe Zagury at exhs. A–B, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Aug. 16, 2011), ECF Nos. 108-1, 108-2.

189. The court stated that Aguiar signed both the April and July 2008 6-Ks filed with the SEC containing alleged misstatements, and that Zagury also authored and signed statements of the CFO Comments section of the earning reports at stake. City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 41 F. Supp. 3d 1369, 1382–83 (S.D. Fla. Sept. 16, 2011).

190. *Id.* at 1392. Plaintiffs' counsel in *Aracruz* also represented the plaintiffs in *In re Sadia*.

hedging activities. The court held that plaintiffs also stated a valid claim based on Aracruz's failure to disclose that the derivatives contracts had violated the company's own internal policies.[191] The court dismissed claims regarding Aracruz's failure to disclose its inadequate internal controls, financial conditions, cash flow protection, and dollar-denominated liabilities. The court found that the complaint adequately pleaded scienter for the company and for Zagury, but not for Aguiar. Therefore, the claims against Aguiar under Section 10(b) were dismissed. The court nonetheless sustained Section 20(a) claims against both Aguiar and Zagury. It also found that the complaint sufficiently pleaded loss causation and that the Aracruz statements at issue were not shielded by the "bespeaks caution" doctrine or the PSLRA safe harbor.[192]

On July 20, 2012, lead plaintiffs filed a motion for class certification with a class period of April 7 to October 2, 2008, along with an expert witness declaration that the market for Aracruz ADRs was efficient.[193] Defendants rebutted the fraud on the market presumption, submitting an expert declaration that the alleged false statements

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191. *Id.* at 1393.

192. *Id*. at 1394, 1397, 1401, 1404, 1409. The court also denied Zagury's Motion to Strike and declined to take judicial notice of the CVM report except of its existence. *Id*. at 1386–87. After this order, Zagury terminated his counsel and decided to proceed *pro se*. *See* Coffey Burlington, P.L.'s Motion to Withdraw as Counsel for Isac Roffe Zagury, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Sept. 21, 2011), ECF No. 111; Order Granting Coffey Burlington, P.L.'s Motion to Withdraw as Counsel for Isac Roffe Zagury, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Sept. 21, 2011), ECF No. 111-1. Zagury alleged that, "Since I'm no professional activity and health problems [sic], I do not have sufficient resources to honor the payment of attorney's fees for future stages." Motion to Withdraw as Counsel for Defendant Isac Roffe Zagury at exh. 2, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Oct. 7, 2011), ECF No. 117-2; Response to Order to Show Cause by Isac Roffe Zagury, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Nov. 14, 2011), ECF No. 126. Zagury also affirmed that the insurance company would not reimburse him for personal liability under this action. Responses & Objections to the Lead Plaintiff's First Set of Requests by Isac Roffe Zagury, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. Jan. 24, 2012), ECF No. 138.

193. Lead Plaintiff's Motion for Class Certification & Incorporated Memorandum of Law, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. July 20, 2012), ECF No. 143; *see* Declaration of Chad Coffman, CFA, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. July 20, 2012), ECF No. 143-1.

had no measurable impact on the price of Aracruz ADRs on either April 7 or July 7, 2008—and indeed no impact at all until September 4, 2008, when the dollar/real exchange rate affected the value of the derivative contracts. In so doing they opposed the date chosen for the start of the class period.[194] During discovery and document production, plaintiffs collected electronic data from files on Aracruz's local shared network, including company documents, e-mails from individual defendants, and documents from third parties.[195] On January 23, 2013, the parties submitted a request pursuant to Rule 23(e) of the Federal Rules of Civil Procedure for a judicial order preliminarily approving the settlement of the class action and the fairness of the terms and conditions of the "Stipulation and Agreement of Settlement and Release."[196]

After mediation efforts, the settlement agreement established a cash fund in the amount of US$ 37.5 million to compensate Aracruz investors and resolve all claims in the action.[197] Approximately 11,000,000 Aracruz ADRs were traded during the class period, and the average recovery under the settlement amounted to US$ 3.41 per allegedly damaged ADR, before deductions of court-approved costs and attorneys' fees.[198] According to legal counsel, requested fees

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194. Defendants Aracruz Celulose S.A.'s and Carlos Augusto Lira Aguiar's Memorandum of Law in Opposition to Lead Plaintiff's Motion for Class Certification at 7, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Sept. 28, 2012), ECF No. 155. See Declaration of Robert Glenn-Hubbard, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Sept. 28, 2012), ECF No.157, in which defendants argue that Aracruz, in fact, did not own any STFs on April 7, 2008, and that it purchased its first STF contract on April 29, 2012, weeks after the disclosure.

195. An e-discovery vendor traveled to Brazil to collect data. *See* Declaration of Douglas P. Baumstein, Esq. at exhs. 4–8, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Oct. 24, 2012), ECF No. 170 (containing correspondence between plaintiffs' and defendants' lawyers).

196. Lead Plaintiff's Motion for Final Approval of Settlement & Award of Attorneys' Fees & Reimbursement of Expenses & Incorporated Memorandum of Law in Support at 39, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. May 24, 2013), ECF No. 195.

197. According to counsel, this value would correspond to nearly five times the recovery of comparable securities fraud cases. *Id.* at 1.

198. According to counsel, the class member's actual recovery will depend on:

> (1) the number of claims filed; (2) when Class Members purchased their Aracruz ADRs; (3) whether Class Members sold their Aracruz ADRs and, if so, when; (4) administrative costs, including the costs of Notice for the Action; (5) the amount awarded by the Court for attorneys' fees and expenses; and (6) the amount awarded by the Court to the Lead Plaintiff in connection with its

would amount to "an average of US$ 1.13 per allegedly damaged ADR."[199]

On March 14, 2013, the court issued an Order Preliminarily Approving Settlement, Certifying Class, and Providing for Notice of Settlement, in which it certified the class and established the class period as between April 7, 2008, and October 2, 2008, inclusive.[200] The class action prerequisites set by Rule 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure were considered satisfied for the purpose of the settlement.[201] The court preliminarily approved the settlement and the plan for its allocation as fair, adequate, and reasonable. According to the Stipulation and Agreement of Settlement and Release, Aracruz agreed to pay US $37.5 million to the settlement fund.[202] The court awarded 33.33% in attorneys' fees, or US$ 12.5 million of the settlement fund.[203] It also allowed reimbursement for expenses incurred in connection with the lawsuit in the amount of US$ 839,703, and a US$ 40,000 award for reasonable costs and expenses incurred in representing the class.[204]

Regarding the question of who bore the settlement costs, a report from the administration commenting on the 2012 financial statements of Fibria—the firm that succeeded Aracruz—revealed that the costs of the U.S. Aracruz litigation were "significantly" supported

representation of the Class.

Notice of Pendency of Class Action & Proposed Settlement, Motion for Attorneys' Fees & Expenses, & Settlement Fairness Hearing at 2, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Jan. 24, 2013), ECF No. 189.

199. *Id.* at 3.

200. Order Preliminarily Approving Settlement, Certifying Class Action & Providing for Notice of Settlement, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Mar. 14, 2013), ECF No. 192.

201. *Id.* at 2.

202. Stipulation & Agreement of Settlement & Release at 6, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Jan. 24, 2013), ECF No. 189.

203. The attorneys claimed to have expended 13,090.25 hours on research, investigation, prosecution, and resolution of the case. Lead Plaintiff's Motion for Final Approval of Settlement & Award of Attorneys' Fees & Reimbursement of Expenses & Incorporated Memorandum of Law in Support at 39, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. May 24, 2013), ECF No. 195; *see id.* at 40. ("[The] total lodestar is $5,952,410.00, which represents a multiplier of 2.09.").

204. *Id.* at 57.

by Fibria's D&O insurance policy.[205]

Having discussed the results of the U.S. lawsuits, I now turn to the Brazilian private enforcement actions.

B. The Brazilian Derivative Lawsuits

The private enforcement actions in Brazil were initiated by Sadia's and Aracruz's shareholders. Law 6.404/76, Article 159 authorizes a corporation to file a liability suit against its directors or officers upon approval of a general meeting of shareholders, which can be an ordinary annual meeting or an extraordinary meeting.[206]

The logic of this lawsuit is consistent with the ownership structure of Brazilian corporations, in which shareholders tend to hold larger blocks of voting shares than do their U.S. counterparts.[207] Consequently, as shareholders in Brazil are properly incentivized to

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205. FIBRIA CELULOSE S.A., CONSOLIDATED FINANCIAL STATEMENTS 2012, at 3 (2012), http://www.fibria.com.br/rs2012/fibria-financial-statements-2012.pdf ("In December, Fibria ratified an agreement in respect of class action suit brought against the Company in November of 2008 by potential ADR buyers from April 7 to October 2, 2008, who alleged violations of the Securities Exchange Act when the company provided insufficient information about losses from certain transactions involving derivative instruments. Under the agreement, the Company and its co-defendants agreed to pay a total of US$37.5 million to all the ADR holders during the period mentioned above. Because Fibria has D&O insurance with cover extending to the company that will reimburse a significant part of this expense, there will be no material effect on the company."); *see also* Stella Fontes, *Heranças da Aracruz e VCP custam R$ 1,7 bilhão à Fibria* [*Inheritance from Aracruz and VCP Costs R$ 1.7 Billion to Fibria*], INTELOG (Dec. 17, 2012), http://intelog.net/site/default.asp?TroncoID=907492&SecaoID=508074&SubsecaoID=818291&Template=../artigosnoticias/user_exibir.asp&ID=263792&Titulo=Heran%E7as%20da%20Aracruz%20e%20VCP%20custam%20R%24%201%2C7%20bilh%E3o%20%E0%20Fibria.

206. Lei No. 6.404, de 15 de Dezembro de 1976, art. 159, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("Compete à companhia, mediante prévia deliberação da assembléia-geral, a ação de responsabilidade civil contra o administrador, pelos prejuízos causados ao seu patrimônio. § 1º A deliberação poderá ser tomada em assembléia-geral ordinária e, se prevista na ordem do dia, ou for conseqüência direta de assunto nela incluído, em assembléia-geral extraordinária.") ("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.").

207. *See* Gorga, *supra* note 97, at 486–87 (finding that the shareholders held thirty-six percent of voting shares, on average, in *Novo Mercado*, BM&FBovespa listing segment that achieves the largest dispersion of ownership structures in 2007).

monitor and vote in corporate affairs, the law entrusts them with the power to authorize their corporations to sue.

However, if a corporation fails to bring a suit authorized by its shareholders for three months after the shareholders' general meeting approval, paragraph 3 of Article 159 establishes that any shareholder will be entitled to file the action on behalf of the corporation.[208] Further, if the majority of shareholders in a general meeting fails to approve the lawsuit, it may be initiated by any shareholder who owns at least five percent of the company's stock capital.[209] In these two cases, any damages recovered by the successful plaintiff will be transferred to the corporation, which will reimburse the shareholder plaintiff for her costs.[210]

This is the Brazilian equivalent of the U.S. shareholder derivative suit. The logic is similar in that the suit derives from authorization or initiation by shareholders. In the U.S. system, the suit is brought on behalf of the corporation by the individual shareholder and any recovery generally belongs to the corporation.[211] Both Brazilian and U.S. derivative suits can target a corporation's directors and officers.[212]

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208. Lei No. 6.404, de 15 de Dezembro de 1976, art. 159, ¶ 3, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("Qualquer acionista poderá promover a ação, se não for proposta no prazo de 3 (três) meses da deliberação da assembléia-geral.") ("Any shareholder may bring the action if proceedings are not instituted within three months from the date of the resolution of the general meeting.").

209. *Id.* at art. 159, ¶ 4 ("Se a assembléia deliberar não promover a ação, poderá ela ser proposta por acionistas que representem 5% (cinco por cento), pelo menos, do capital social.") ("Should the general meeting decide not to institute proceedings, they may be instituted by shareholders representing at least five per cent of the capital."). Because of this restriction on who can file, Brazil scored, on a 0 to 1 scale measuring the availability of "private enforcement of directors' duties," a 0.5, the same score as Argentina, India, Spain, and the United Kingdom. *See* Siems, *supra* note 15, at 107, 110.

210. Lei No. 6.404 at art. 159, ¶ 5 ("Os resultados da ação promovida por acionista deferem-se à companhia, mas esta deverá indenizá-lo, até o limite daqueles resultados, de todas as despesas em que tiver incorrido, inclusive correção monetária e juros dos dispêndios realizados.") ("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.").

211. JAMES D. COX & THOMAS LEE HAZEN, COX AND HAZEN ON CORPORATIONS §§ 15.02, 15.04 (2002) (noting that in a limited set of circumstances, the individual shareholder can seek an individual recovery).

212. According to Article 145 of Law 6.404/76, the word "administrador" used by Article 159 of Law 6.404/76 refers to both directors and officers. Lei No. 6.404 at art. 145;

While similar in substance, Brazilian and U.S. derivative suits differ procedurally. Some U.S. states, Delaware in particular, impose the procedural requirement that, prior to bringing the suit, the shareholder first make a demand on the directors to have the corporation bring the suit itself.[213] Instead of making such a demand on the board, plaintiffs are permitted to plead that such a demand would be futile. Doing so requires demonstrating a reasonable doubt that the board would independently make a fair decision as to pursuing litigation against its own directors or managers.[214] Even if demand is shown to be futile, the Board of Directors can create an independent special litigation committee that may still ultimately decide not to pursue charges.[215] This is why scholars conjecture that the procedural barriers in connection with derivative suits discourage such actions when the same claim could be brought through other litigation forums.[216]

The Brazilian "derivative suit" can assume two variations: the corporation against the director or officer or, as discussed above, the shareholder on behalf of the corporation against the director or officer. The shareholders may vote to approve the corporation's suit, or, in the case that such approval fails, may in some circumstances sue managers themselves on behalf of the corporation. In this regard, the Brazilian derivative suit depends on shareholder decisions, whether by authorization in a general meeting, by the action of filing

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see, e.g., Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749, 1771 (2010) (indicating, against conventional wisdom, that "derivative suits, especially public company derivative suits, target directors and officers alike, although more directors than officers find themselves in the litigation crosshairs").

213. MODEL BUS. CORP. ACT § 7.42(1) (AM. BAR ASS'N 2002) (requiring prior written demand with notice upon the directors). Delaware corporate law distinguishes between direct suits and derivative suits based on the nature of the harm and the recipient of the benefit of damages. If the harm was directly to the shareholder herself, she could bring a direct suit; if the harm was primarily to the corporation, the shareholder must bring a derivative suit. Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1035 (Del. 2004). Delaware Court of Chancery Rule 23.1 lays down the procedure for bringing a derivative suit, which requires the plaintiff shareholder to first make a demand on the board to sue the director/officer in question. DEL. CT. CH. R. 23.1. Directors have the opportunity to dismiss the suit as not in the best interests of the corporation. If the board refuses, then the shareholder can bring a derivative suit. *Id.* In Brazilian law, the equivalent shareholder derivative suit is allowed by paragraphs 3 and 4 of Article 159 of Law 6.404/76. *See supra* notes 208–09.

214. Aronson v. Lewis, 473 A.2d 805, 810 (Del. 1984).

215. Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Suits*, 57 VAND. L. REV. 1747, 1758–59 (2004).

216. *Id*. at 1773.

a suit when a corporation fails to bring it, or by denial of authorization by the majority shareholders in a general meeting. In the last case, a significant minority shareholder—with at least five percent of the stock capital—is still able to bring action against corporate managers.[217] It is worth noting once more that this action is not a direct suit based on shareholder losses or individual claims,[218] but instead is brought by the shareholder on behalf of the corporation for "losses caused to the corporation's property."[219]

Therefore, even if the U.S. and Brazilian derivative actions present important technical and practical differences—which largely reflect historical differences in the ownership structure of U.S. and Brazilian corporations—they are functional substitutes.[220]

A brief comparison with derivative actions in Asia and Europe is enlightening. Brazilian derivative actions have much in common with those of Asian countries. Puchniak describes the legal regimes of Asia's leading economies as differing from that of the United States in a number of key ways. They lack the U.S.-style contingent fee system and have "lower levels of D&O liability insurance, a narrower scope for pre-trial discovery, lower damage awards, and some form of a 'loser-pays costs rule.'"[221] Further, with the exception of Japan, the civil law countries require that shareholders own a minimum percentage of shares in order to pursue a derivative action.[222] All these characteristics largely apply to Brazil, as I discuss below.[223] However, unlike countries such as Japan and South Korea, Brazil has not experienced an upsurge in derivative litigation brought

217. MODESTO CARVALHOSA, 3 COMENTÁRIOS À LEI DE SOCIEDADES ANÔNIMAS [COMMENTS TO THE CORPORATION LAW] 388 (2009) (noting that the minority suit is "secondary" or "subsidiary," that is, it cannot be filed prior to the shareholder meeting decision).

218. Paragraph 7 is very clear in providing that the Brazilian "derivative suit" does not preclude the other types of actions that a shareholder or third party may bring. Lei No. 6.404, de 15 de Dezembro de 1976, art. 159, ¶ 7, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("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.").

219. Lei No. 6.404 at art. 159.

220. *See generally* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (2001).

221. Dan W. Puchniak, *The Derivative Action in Asia: A Complex Reality*, 9 BERKELEY BUS. L.J. 1, 17–18 (2012).

222. *Id*.

223. *See supra* notes 206–19 and accompanying text; *infra* notes 226–34 and accompanying text.

about by non-profit shareholders and social activist organizations that seek to exert political influence in the corporate sphere.[224] Therefore, derivative suits remain uncommon in Brazil.

Analyzing European derivative actions, Gelter enumerates four preconditions that facilitate derivative shareholder suits: (i) favorable standing requirements without minimum ownership thresholds, (ii) favorable allocation of litigation risk so as to overcome minority shareholders' rational apathy, (iii) sufficient information access enabling plaintiffs to litigate, and (iv) the possibility of derivative suits against not only directors but also controlling shareholders.[225]

With these preconditions in mind, note first that Brazilian law demands a minimum ownership of five percent of the company's total capital as a condition to file.[226] That is a higher ownership threshold than those in several European countries, which have recently undergone reforms reducing the minimum requirements for filing such claims. For example, Germany has reduced the threshold from 10% or DM 2,000,000 to 5% stock ownership or 500,000 euros in 1998. In 2005, it further dropped the threshold to only 1% or 100,000 euros. Italian law adopted a 5% threshold in 1998, which was reduced to 2.5% in 2006. Belgium requires a 1% threshold or 125,000 euros, while France and Switzerland do not require any individual minimum ownership.[227]

Regarding litigation costs, Brazil adopts the "English Rule" that the losing party has to reimburse the winning party's litigation expenses. This rule may create the significant risk that minority shareholders, who are not certain about litigation outcomes, will have

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224. Dan W. Puchniak & Masafumi Nakahigashi, *Japan's Love for Derivative Actions: Irrational Behavior and Non-Economic Motives as Rational Explanations for Shareholder Litigation*, 45 VAND. J. TRANSNAT'L L. 1, 7 (2012) ("[S]ocial activists seeking political (non-economic) benefits are the single largest force driving derivative litigation in Japan."); Hyeok-Joon Rho & Kon-Sik Kim, *Invigorating Shareholder Derivative Actions in South Korea*, *in* THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH 186, 194–95 (Dan W. Puchniak, Harald Baum & Michael Ewing-Chow eds., 2012).

225. Martin Gelter, *Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?*, 37 BROOK. J. INT'L L. 843, 856, 891 (2012).

226. Lei No. 6.404, de 15 de Dezembro de 1976, art. 159, ¶ 4, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf; *see* CARVALHOSA, *supra* note 217, at 391 (criticizing the minimum ownership threshold).

227. *See* CARVALHOSA, *supra* note 217, at 858–60 (explaining the rules in detail, such as the demand requirement introduced in the German reform and the ownership requirements for French groups of shareholders and shareholders associations).

to pay the defendants' costs—a risk that may prevent those shareholders from bringing actions in the first place.[228] The risk is considerable in a system in which private benefits of control are high and courts have traditionally favored controlling shareholders who benefit from established legal doctrines.[229] Even more important, contingent fee arrangements are not allowed in Brazil,[230] which prevents entrepreneurial lawyers from assuming the risks that stop investors from filing suits. 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.[231] Finally, there is a debate in the literature as to whether Brazilian law allows controlling shareholders who participated in the wrongdoing to be sued in derivative actions, or whether only directors and officers may be defendants;[232] most of the literature, however, supports the latter.[233] As in most European countries, the legal basis for derivative suits is found in a section of Brazilian corporate law governing director and officer liability.[234] Because of this gap in the governing law, Gelter's conclusion that derivative suits are more restricted in scope in Europe than in the United States applies similarly to Brazil

228. *See* Gelter, *supra* note 225, at 862–66 (discussing the theoretical doubts on the effects of the English rule on filing of suits and observing that it depends on "the assumption that shareholder suits have a low probability of winning," which I believe to be the case regarding Brazil); *see also infra* note 313. Gelter also concludes that this rule will depend on burden of proof needs and information-gathering ability. Gelter, *supra* note 225, at 866.

229. *See* ÉRICA GORGA, DIREITO SOCIETÁRIO ATUAL 59–74 (2013) (discussing evidence of high private benefits of control in Brazil).

230. *See* Keith S. Rosenn, *Civil Procedure in Brazil*, 34 AM. J. COMP. L. 487, 518–19 (1986).

231. *See* Ferrarini & Giudici, *supra* note 13, at 162, 203 (explaining that the weakness of derivative suits in Italy is mainly a consequence of the lack of discovery). *See generally* Érica Gorga & Michael Halberstam, *Litigation Discovery & Corporate Governance: The Missing Story About "The Genius of American Corporate Law,"* 63 EMORY L.J. 1383 (2014).

232. *See, e.g.*, CARVALHOSA, *supra* note 217, at 396 (defending that controlling shareholders can be sued through derivative suits). *But see generally* Mauro Brandão Lopes, *A responsabilidade dos administradores das sociedades anônimas*, REVISTA BRASILEIRA DE DIREITO COMERCIAL (arguing that only directors and officers can be sued derivatively) (on file with author).

233. *See generally* Lopes, *supra* note 232 (reviewing the literature).

234. Gelter, *supra* note 225, at 876. The liability action of Law 6404/76, Article 159 is found in Section IV governing Duties and Responsibility of Managers. This Article also restricts the claims to damages caused to the property of the corporation. The liability of controlling shareholders is included in Section IV, Article 117, which makes no reference to derivative suits.

as compared to the United States.[235]

1. The Sadia Derivative Suit Against CFO Ferreira

After this introduction to Brazilian derivative suits, I now turn to the developments that originated the suit filed by Sadia against former CFO Ferreira. On October 6, 2008, after official notice of the financial losses was made public,[236] *Caixa de Previdência dos Funcionários do Banco do Brasil* (PREVI)—a public pension fund representing the employees of *Banco do Brasil* with 7.32% of Sadia's voting shares—filed a request with Sadia for a special shareholder meeting and provided notice of this request to the CVM and the SEC.[237] PREVI demanded that the company call the Board of Directors, managers, fiscal council, audit, finance and investor relation committees, and external auditors to explain the financial losses.[238] The pension fund asked for detailed financial information, for a special independent audit of the transactions in question, and for a deliberation concerning the filing of a liability suit.[239]

The company complied with these requests. On November 3,

235. *See* Gelter, *supra* note 225, at 877.

236. *See* Sadia Form 6-K (Sept. 25, 2008), *supra* note 113; *Fato Relevante* (Sept. 25, 2008), *supra* note 113.

237. Letter from Joilson Rodrigues Ferreira, Diretor de Participações, Caixa de Previdência dos Funcionários do Banco do Brasil, to Luiz Fernando Furlan, Presidente do Conselho de Administração, Sadia S.A. (Oct. 6, 2008), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=179675&funcao=visualizar&Site=C; *see also* Ação de Responsabilidade Civil contra Administrador [Civil Liability Suit Against Manager], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 7 (Braz.) (on file with author). This request is based on Article 123(c) of Law 6.404/76. Lei No. 6.404, de 15 de Dezembro de 1976, art. 123, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf (*"*Compete ao conselho de administração, se houver, ou aos diretores, observado o disposto no estatuto, convocar a assembléia-geral. . . . A assembléia-geral pode também ser convocada: . . . c) por acionistas que representem cinco por cento, no mínimo, do capital social, quando os administradores não atenderem, no prazo de oito dias, a pedido de convocação que apresentarem, devidamente fundamentado, com indicação das matérias a serem tratadas.") ("Subject to the bylaws, general meetings shall be called by the [board of directors], if any, or by the directors. . . . A general meeting may also be called: . . . c) whenever the corporation officers do not, within eight days, comply with their justifiable request that a meeting be called, indicating the matters to be discussed, by shareholders representing at least five per cent of the capital.).

238. Letter from Joilson Rodrigues Ferreira, *supra* note 237.

239. *Id.*

2008, an extraordinary shareholder meeting (first meeting) was held with a quorum of shareholders representing more than two-thirds of the company's voting capital. Shareholders unanimously decided to conduct a special audit to determine the possible liability of the administration and to hire BDO Trevisan for this purpose. A detailed report was to be delivered in ninety days, at which time another general shareholder meeting would be conducted to consider the results.[240]

Sadia held a subsequent special shareholder meeting on April 6, 2009 (second meeting).[241] This meeting was attended by shareholders representing more than sixty-three percent of Sadia's voting capital. According to the minutes, the BDO Trevisan audit report was presented and discussed, and shareholders unanimously voted for the corporation to file suit under the terms of Article 159 of Law 6.404/76 against former CFO Ferreira for losses to the company stemming from its transactions in the derivatives markets.[242]

On April 27, 2009, a general shareholder meeting (third meeting) was held to discuss, among other matters, approval of the company's 2008 financial statements. Stockholders representing sixty-six percent of the voting capital attended the meeting and unanimously approved the accounts of the corporation referring to year-end 2008, "without any reservations";[243] the terms of this approval would later sit at the center of the formal legal tangle that determined the outcome of the case.

Based on the decision made in the second meeting, Sadia filed suit against sole defendant Ferreira in São Paulo on June 18, 2009.[244] It claimed that the defendant made business decisions in

240. Sadia S.A., Ata Sumária da Assembléia Geral Extraordinária Realizada em 3 de Novembro de 2008 [Minutes of Special Shareholder Meeting Held on 3 November 2008], http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=180884&funcao=visualizar&Site=C.

241. Sadia S.A., Ata Sumária da Assembléia Geral Extraordinária Realizada em 6 de Abril de 2009 [Minutes of Special Shareholder Meeting Held on 6 April 2009], http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=206367&funcao=visualizar&Site=C.

242. *Id.*

243. Sadia S.A., Ata Sumária da Assembléia Geral Ordinária Realizada em 27 de Abril de 2009 [Minutes of the Annual General Meeting Held on 27 April 2009], http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=199652&funcao=visualizar&Site=C [hereinafter Sadia, Minutes of the Annual General Meeting] (approving unanimously and without reservations, in the terms of Article 134 paragraph 3 of Law 6.404/76, the accounts of the administration and the financial statements referring to the year-end December 31, 2008).

244. Ação de Responsabilidade Civil contra Administrador, Petição Inicial [Civil

blatant disregard of Sadia's financial policies, which established clear limits for derivative hedging contracts. Ferreira had violated these policies with regard to both contracting limits and risk exposure. Sadia also claimed that Ferreira had been warned on August 19, 2008, and on September 2, 2008, about the limits set by the company's financial policy and that, despite these notices, he took no action to rework the financial contracts.[245] Sadia argued the defendant was negligent and imprudent and deliberately hid information from the Board of Directors and its committees. According to these allegations, defendant Ferreira violated the fiduciary duties of care and loyalty as defined by Law 6.404/76, Articles 153 and 155, respectively.[246] Sadia further alleged causality between the actions and omissions of Ferreira and the financial harms caused to the company.[247] Based on these arguments, Sadia sought indemnification from the defendant for the financial harm he had caused.[248]

Liability Suit Against Manager, Initial Petition], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 1 (Braz.) (on file with author).

245. *Id.* at 3–4.

246. Lei No. 6.404, de 15 de Dezembro de 1976, art. 153, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("O administrador da companhia deve empregar, no exercício de suas funções, o cuidado e diligência que todo homem ativo e probo costuma empregar na administração dos seus próprios negócios.") ("In the exercise of his duties, a corporation officer shall employ the care and diligence which an industrious and honest man customarily employs in the administration of his own affairs."); *id.* at art. 155 ("O administrador deve servir com lealdade à companhia e manter reserva sobre os seus negócios, sendo-lhe vedado: I—usar, em benefício próprio ou de outrem, com ou sem prejuízo para a companhia, as oportunidades comerciais de que tenha conhecimento em razão do exercício de seu cargo; II—omitir-se no exercício ou proteção de direitos da companhia ou, visando à obtenção de vantagens, para si ou para outrem, deixar de aproveitar oportunidades de negócio de interesse da companhia; III—adquirir, para revender com lucro, bem ou direito que sabe necessário à companhia, ou que esta tencione adquirir.") ("An officer shall serve the corporation with loyalty, shall treat its affairs with confidence and shall not: I—use any commercial opportunity which may come to his knowledge, by virtue of his position, for his own benefit or that of a third party, whether or not harmful to the corporation; II—fail to exercise or protect corporation rights or, in seeking to obtain advantages for himself or for a third party, fail to make use of a commercial opportunity which he knows to be of interest to the corporation; III—acquire for resale at a profit property or rights which he knows the corporation needs or which the corporation intends to acquire.").

247. Ação de Responsabilidade Civil contra Administrador, Petição Inicial [Civil Liability Suit Against Manager, Initial Petition], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 1, at 28, 34 (Braz.) (on file with author).

248. *Id.* at 15, 22, 26–27. The demand was grounded in Article 158, I and II, of Law 6404/76. Lei No. 6.404, de 15 de Dezembro de 1976, art. 158, DIÁRIO OFICIAL DA UNIÃO

Defendant Ferreira moved to dismiss the claim, alleging that the action failed to meet formal requirements in a number of ways. First, he claimed that because the third shareholder meeting approved all the accounts relating to the time period during which the financial losses were incurred without any reservations, according to Article 134 paragraph 3 of Law 6.404/76, any liability Ferreira could have had in relation to the mentioned transactions was precluded. Under this rationale, the more recent decision would exculpate the defendant for his actions and prevail over the earlier shareholder decision to sue.[249] Second, the defendant argued that the civil court lacked com-

[D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("O administrador não é pessoalmente responsável pelas obrigações que contrair em nome da sociedade e em virtude de ato regular de gestão; responde, porém, civilmente, pelos prejuízos que causar, quando proceder: I—dentro de suas atribuições ou poderes, com culpa ou dolo; II—com violação da lei ou do estatuto.") ("An officer shall not be personally liable for the obligations he undertakes on behalf of the corporation and by virtue of action taken in the ordinary course of business; he shall, however, be liable for any loss caused when he acts: I—within the scope of his authority, with fault or fraud; II—contrary to the provisions of the law or of the bylaws."). The indemnification request was a broad one encompassing the actual losses suffered (*prejuízos causados*), the emerging losses (*danos emergentes*), and losses of future profits (*lucros cessantes*). Ação de Responsabilidade Civil contra Administrador, Petição Inicial [Civil Liability Suit Against Manager, Initial Petition], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 1, at 40–41 (Braz.) (on file with author). One of the most controversial issues was evidence consisting of the audit report prepared by BDO Trevisan, which showed that a series of derivative transactions during 2008 with several international banks engaged by the company under the authority and supervision of the CFO presented a "notional potential" exposure exceeding the limit established by internal policies. According to this report's analysis of company e-mails and interviews with managers and board members, the CFO had received information from the risk manager (*gerente de risco*) about the company's exposure and the lack of compliance with the pre-established limits as early as July 7, 2008. However, there were no indicia that he had formally informed or discussed those transactions with the company's Board of Directors or its committees. In addition, the report noted a failure of the Board of Directors to oversee and monitor the activities of the CFO as well as the lack of care of the accounting manager. Ação de Responsabilidade Civil contra Administrador, Petição Inicial [Civil Liability Suit Against Manager, Initial Petition], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 1 (Braz.) (on file with author); 3 BDO TREVISAN, RELATÓRIO DE EVENTOS IDENTIFICADOS COM BASE EM PROCEDIMENTOS PREVIAMENTE ACORDADOS [REPORT OF IDENTIFIED EVENTS ON BASIS OF PROCEEDINGS PREVIOUSLY AGREED] 147, 182–83, 185–88, 197, 198 [hereinafter BDO REPORT] (on file with author).

249. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 2 (Braz.) (on file with author); Lei No. 6.404, de 15 de Dezembro de 1976, art. 134, ¶ 3, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("A aprovação, sem

petence to hear the suit, because he was subordinated to the company's chairman while employed; as his actions were performed as part of an employment relationship, the suit should have been filed in the labor court.[250] Third, Ferreira argued that a *litis consortium* was necessary, that is, the President of the Board of Directors—Mr. Walter Fontana—must have been included as a defendant since he was in-

reserva, das demonstrações financeiras e das contas, exonera de responsabilidade os administradores e fiscais, salvo erro, dolo, fraude ou simulação (artigo 286).") ("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)."). This reasoning was based on the standard legal argument that a subsequent legal action prevails over the former in case these acts are contradictory, also known as *lex posterior derogat priori*. *See* Lex posterior derogat priori, BLACK'S LAW DICTIONARY (10th ed. 2014).

250. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 38–41 (Braz.) (on file with author). Ferreira filed a labor complaint against Sadia on June 5, 2009. Reclamação Trabalhista, 61ª Vara Trabalhista do Tribunal Regional do Trabalho da 2ª Região, No. 01258005820095020061 (Braz.) (on file with author). He argued that Sadia destroyed his professional reputation and his personal and family equilibrium while seeking to make him solely responsible for the losses suffered during the 2008 financial crisis. The goal of Sadia's campaign, he alleged, was to unburden the directors and controlling shareholders (the Furlan and Fontana families) from charges from the minority shareholders by making Ferreira the sole scapegoat of the company's failure. *See generally* Leonardo Attuch, *Furlan comanda a operação resgate: Após prejuízo financeiro recorde com operações cambiais, Sadia convoca o ex-ministro do desenvolvimento para recolocar a casa em ordem e voltar a crescer*, ISTOÉ DINHEIRO, Oct. 15, 2008 (Braz.) (reporting that Furlan, a member of the family of controlling shareholders, was appointed CEO after the losses from the derivatives transactions; that Furlan claimed Ferreira had obstructed from the Board of Directors a report from the risk manager and that an audit process was in place to verify any relationship between former CFO Ferreira and the banks that sold the derivative transactions; and that, in Furlan's views, there was no corporate governance problem in the company). Ferreira further claimed that he was fired by Sadia without fair cause (*justa causa*) on September 26, 2008. Because of the harmful publicity, his wife had given birth prematurely. Ferreira claimed he started as an employee in Sadia under the Brazilian Consolidation of Labor Laws regime in 2002, and that, despite being formally elected CFO by Sadia's Board of Directors in September 2006, he continued to be subordinated to the President of the Board of Directors. In his labor complaint, Ferreira requested the acknowledgment of his employment relationship, with payment of labor rights (FGTS, fines, vacation, incorporation of the bonus-meta and stock options in the payment package, previous dismissal warning (*aviso prévio*), indemnification of the material and moral harms suffered, and publication of the payment in the media). Sadia filed its motion to dismiss on July 19, 2009, denying the existence of an employee relationship and maintaining that Ferreira had breached fiduciary duties, violated the limits of the financial policies of the company, and acted with negligence between August 19, 2008, when he had been informed about the risk exposure, and September 12, 2008, when he finally brought the matter to the Board of Directors. Sadia also argued that he had individually decided to engage in the risky transactions and rebutted all Ferreira's claims.

formed of and ratified all the transactions in question.[251] Fourth, the demand was insufficient in that it failed to specify a precise monetary value for the indemnification requested. For all these reasons, Ferreira argued, the plaintiffs lacked any legal basis for the suit.

Ferreira further argued that he had acted in good faith and in the best interests of the company and that for these reasons the exculpatory provision of Article 159, Section 6 applied.[252] He claimed that the Board of Directors knew about the transactions at all times and approved the derivatives contracts, as they were part of the regular activities of the company.[253] He could not be blamed as the single person responsible for a catastrophic financial crisis that had affected international financial markets and generated losses for companies all

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251. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 41–45 (Braz.) (on file with author). Ferreira argued that this was evident in that the accounting recording of each transaction exceeding R$ 200 million required the authorization of the company's system by means of a password exclusive of the financial committee and the President of the Board, Mr. Walter Fontana. *Id.* at 9–10.

252. Lei No. 6.404, de 15 de Dezembro de 1976, art. 159, ¶ 6, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("O juiz poderá reconhecer a exclusão da responsabilidade do administrador, se convencido de que este agiu de boa-fé e visando ao interesse da companhia.") ("A judge may excuse the officer from liability, when convinced that he acted in good faith and in the interests of the corporation.").

253. Ferreira argued that Sadia was used to engage in financial transactions for more than twenty years through its own brokerage branch *Corretora e Distribuidora de Valores Mobiliários* (*Concórdia*) and its treasury. This was evident in that in the last six years, the financial gains of the company corresponded to approximately forty-seven percent of its gains and global results in the period. From 1996 to 2007, forty-three percent of the results of the company originated from financial transactions. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 7–9 (Braz.) (on file with author). He quoted Oscar Malvessi, *Onde a Sadia perdeu o jogo* [*Where Sadia Lost the Game*], EXAME.COM (June 3, 2009), http://exame.abril.com.br/revista-exame/edicoes/944/noticias/onde-sadia-perdeu-jogo-473359 (arguing that "que alavancar a empresa financeiramente sempre foi um objetivo" [to financially leverage the business has always been a goal] for Sadia, and that he had alerted officers about the risks of this strategy in presentations made to Sadia). According to Ferreira, the founding family withdrew from the executive suite after incurring heavy losses in an investment portfolio in 2004. Since that time, then-CEO Mr. Walter Fontana became the Chairman of the company, with other family members occupying directorial positions, including in the committees of the Board. Professional managers were then hired to compose the executive suite. Nonetheless, the CFO remained subordinate to the President of the Board (former CEO) and not to the new CEO of the company. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 8 (Braz.) (on file with author).

over the world, including Sadia. He alleged that his actions and decisions were in accordance with usual market practices and therefore protected by the business judgment rule. He did not engage in unlawful acts, and he had acted with care and prudence at all times, proposing several measures to improve the internal financial controls of the company.[254] He affirmed that as soon as he learned about the real risks that the company was exposed to, he suggested unwinding the transactions in order to avoid even higher losses, an action which the company did not undertake after he was fired.[255] Sadia subsequently filed its further memorandum in response to Ferreira (*Réplica*) on August 31, 2009,[256] and Ferreira further responded (*Tréplica*) on September 22, 2009.[257]

On October 30, 2009, the judge determined that he was competent to decide the complaint, denying labor justice authority over the object of the demand. The judge considered that the action stemmed from defendant's position as the CFO to whom the finance department reported, rejecting defendant's request of inclusion of the chairman in the passive side. The judge allowed the demand to proceed, finding that all legal prerequisites for the action had been satisfied.[258] Ferreira then filed a type of appeal known as Request for Clarification (*Embargos de Declaração*) on November 13, 2009, pointing out the judge's failure to acknowledge the applicable exculpatory provision of Article 134, Section 3, under which the approval of accounts without reservations exonerate any liability, an earlier shareholder decision to sue notwithstanding.[259] Ferreira argued that

254. Ferreira challenged the methodology of the BDO REPORT, *supra* note 248, arguing that the BDO Report did not rely on the company's official approach to calculate the risk exposure, which was based on the VaR and Stress Test, and did not include all the e-mails and interviews of the issues at stake. He stated that relevant information and e-mails were not collected from the Chairman's computer, which made the report partial and intentionally distorted in order to make Ferreira solely responsible for all the losses and a scapegoat for the company's failure. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 35–38 (Braz.) (on file with author).

255. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 7–8, 59–60 (Braz.) (on file with author).

256. Réplica, 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 11 (Braz.) (on file with author).

257. Tréplica, 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 12 (Braz.) (on file with author).

258. Despacho Saneador, 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 12 (Braz.) (on file with author).

259. Embargos de Declaração, 9ª Vara Cível do Foro Central da Comarca de São Paulo,

this preliminary issue had to be addressed.[260] The judge received the request for clarification on November 25, 2009, but maintained the decision that the action should proceed according to the terms of Article 159 of Law 6404/76.[261]

Defendant then brought the matter to the higher court by filing a Bill of Review (*Agravo de Instrumento*) challenging the judge's decision on December 11, 2009.[262] On September 27, 2010, the São Paulo Justice Court (*Tribunal de Justiça de São Paulo*) reversed the first decision and affirmed the applicability of Article 134, reasoning that the examination and approval of the accounts without any reservations in the third shareholder meeting of April 27, 2009,[263] exonerated all managers from liability related to the derivatives transactions.[264] The court concluded that, as a result of this exculpation, the plaintiff lacked any legal basis for its suit, thus extinguishing the matter without judging its merits.[265] Sadia was then required to pay the procedural costs of both parties and the honorarium of lawyers (*honorários sucumbenciais*) of fifteen percent of the value of the suit. This decision also lifted the "secrecy of justice," allowing public access to the suit.

Following this judicial order dismissing the complaint, Sadia filed a number of different appeals with the second instance court and the higher court, all of which were denied.[266] At the end of a long

No. 583.00.2009.163865-3, 12 (Braz.) (on file with author).

260. *Id.*

261. *Id.*

262. Agravo de Instrumento No. 696308.4/2, 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 13 (Braz.) (on file with author).

263. *See* Sadia, Minutes of the Annual General Meeting, *supra* note 243.

264. T.J.S.P., No. 990.09.362587-3., Relator: Des. Enio Zulani, DIÁRIO DE JUSTIÇA [D.J.], 27.9.2010, 792 (Braz.) (on file with author).

265. *Id.* This decision had one dissenting vote. *Id.* The court relied on Article 267, IV, of the Código de Processo Civil (C.P.C.). Lei No. 5.869, de 11 de Janeiro de 1973, art. 267, IV, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.1.1973 (Braz.).

266. Sadia filed a Request for Clarification (*Embargos de Declaração*) on October 1, 2010, which was rejected by the *4ª Câmara de Direito Privado do Tribunal de Justiça de São Paulo* on November 25, 2010. *See* T.J.S.P., Embargos de Declaração No. 990.09.362587-3/50000, Relator: Des. Enio Zuliani, DIÁRIO DE JUSTIÇA [D.J.], 25.10.2010, 1065 (Braz.) (on file with author). Next, it filed a special appeal (*recurso especial*) on December 20, 2010. *See* T.J.S.P., Recurso Especial, 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 14 (Braz.) (on file with author). This appeal—based on Articles 496 VI and 541 et seq. of the C.P.C., Lei No. 5.869, de 11 de Janeiro de 1973, arts. 496, 541, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.1.1973 (Braz.)—claimed that the authorization to sue a manager pursuant to Article 159 of Law 6404/76 implicates the automatic rejection of the corporate accounts; that there is a window of ninety

and intricate appeals war revealing how complex, time-consuming, and burdensome civil procedure issues can be under Brazilian law, Sadia was ordered to pay the actual cost of the legal action (R$ 853,921 after monetary corrections).[267]

2. The Aracruz Derivative Suit Against CFO Zagury

Meanwhile, the Aracruz case was progressing as well. The company filed a legal complaint against its former CFO Zagury, alleging liability for the company's financial losses. Aracruz shareholders representing more than 96.5% of the voting capital met in an extraordinary shareholder meeting on November 24, 2008, in which the majority of shareholders approved the suit against Zagury;[268] one notable contrary vote was cast by investment fund *Fundo Latino Americano CIBC*.[269] Brazilian National Bank for Economic and So-

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days to file the complaint after the shareholder authorization, within which the shareholders filed; that the objects of both shareholder meetings were independent and that the ordinary shareholder meeting that approved the accounts was mandatory and was called before the extraordinary meeting but took place after it; and that both shareholder meetings' decisions were independent and must coexist in harmony. Sadia also filed an Extraordinary Appeal (*Recurso Extraordinário*) on December 20, 2010, claiming that the legal dispute involved a constitutional matter of general interest, based on Articles 496 VII and 543-A § 1° of C.P.C. *See* T.J.S.P., Recurso Extraordinário, 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 14 (Braz.) (on file with author); Lei No. 5.869, de 11 de Janeiro de 1973, arts. 496, 543-A, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.1.1973 (Braz.). The President of the São Paulo Justice Court denied the proceedings of special and extraordinary appeals on September 9, 2011. T.J.S.P., Embargos de Declaração—Recurso Especial, Relator: Des. Maia da Cunha, DIÁRIO DE JUSTIÇA DE SÃO PAULO [D.J.S.P.], 05.10.2011, 967 (Braz.) (on file with author). The STJ upheld the arguments of the São Paulo Justice Court. S.T.J., ResP. No. 1.313.725—SP (2011/0286947-4), Relator: Min. Ricardo Villas Bôas Cueva, DIÁRIO DO JUDICIÁRIO ELETRÔNICO [D.J.E.], 19.2.2013 (Braz.) (on file with author). Sadia also filed other appeals related to incidental matters, which are not discussed here, on October 13, 2011, November 16, 2011, and April 2, 2012. Finally, on March 8, 2013, the parties announced they had engaged in extrajudicial negotiations and that Sadia had dropped a pending extraordinary appeal (*Recurso Extraordinário*) and that each party would pay their respective lawyers. At first instance, the judge rejected this tentative settlement, which generated another appeal filed by Sadia, which was also rejected.

267. These costs are underestimated, not reflecting the full value spent on lawyers and legal opinions from outside jurists hired to support each party's argument.

268. Aracruz Celulose S.A., Ata da Assembléia Geral Extraordinária da Aracruz Celulose S.A., realizada em 24 de novembro de 2008 [Minutes of Special Shareholder Meeting of Aracruz Celulose S.A. Held on 24 November 2008], http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=183439&funcao=visualizar&Site=C. This meeting was called by the company chairman, Mr. Carlos Alberto Vieira. *Id.*

269. *Id.*

cial Development (*BNDES Participações S.A.*), another relevant shareholder, abstained from voting, with its representative alleging she lacked sufficient information to cast her vote.[270]

The suit was brought under Article 159 of Brazilian corporate law, presenting the same legal basis as the Sadia suit. However, the Aracruz suit differed from the Sadia one in that the shareholders in the Aracruz meeting approved the accounts reflecting the financial losses *with* reservations.[271] This specific statement would preclude Zagury from using the exculpatory provision set forth in Article 134, Section 3 of Law 6404/76 as did Ferreira.[272]

An analysis of the detailed development of the Aracruz "derivative suit" against former CFO Zagury is not possible because of access restrictions to the docket, which is held in "secrecy of justice."[273] The Brazilian CVM, notwithstanding, provided some information on the outcome of the case when it referenced the R$ 1.5 million judicial settlement as the basis for the settlement of its own administrative proceeding[274]—a matter discussed *infra* in Part IV.B.3.

C. Comparative Analysis

This Part presents a comparative examination of the main results and findings revealed by the U.S. and Brazilian Sadia and Aracruz private lawsuits and their enforcement.

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270. *Id.*

271. Aracruz Celulose S.A., Ata da Assembléia Geral Ordinária [Minutes of the Annual General Meeting] (Apr. 30, 2009), http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=201106&funcao=visualizar&Site=C.

272. *See supra* note 243 and accompanying text.

273. I petitioned the Rio de Janeiro court for access to the judicial suit in December 2013, asking that the case be retrieved from its archives. However, after paying retrieval fees, I was told that the suit was not available for public access from the court officials, as the case had proceeded in "secrecy of justice," an issue I further discuss *infra* Part III.C.1.

274. *See* CVM Settlement Agreement, *supra* note 187; Ata da Reunião do Colegiado No. 26 de 9.7.2013, http://www.cvm.gov.br/decisoes/2013/20130709_R1.html; Decisão do Colegiado de 09/07/2013, Apreciação de Nova Proposta de Termo de Compromisso—PAS 16/2008—Aracruz Celulose S.A., Reg. No. 7207/10, Relator: SGE (Braz.), http://www.cvm.gov.br/decisoes/2013/20130709_R1/20130709_D02.html; Relatório, Parecer do Comitê de Termo de Compromisso, Processo Administrativo Sancionador [Report, Committee for Settlement Proposals, Administrative Sanction Procedure] CVM No. 16/08 (June 11, 2013), http://www.cvm.gov.br/export/sites/cvm/decisoes/anexos/0007/7207-2.pdf.

1. Availability of Information in the United States and in Brazil

The availability of information regarding corporate wrongdoing and the way it is investigated, charged, and punished is considered important for the development of capital markets.[275] This information produces signaling and deterrent effects for the market.[276] In fact, the degree to which available information is assimilated by securities prices is one classical measure of market efficiency.[277] As a corollary, information access is the founding basis of capital markets regulation.[278] The disclosure of information about wrongdoing not only diminishes information asymmetry, ensuring that investors price securities properly, but also enables public monitoring of the behavior of plaintiffs, defendants, and decision-makers such as judges and regulators.[279] Accordingly, these two case studies provide an unusual opportunity to compare the flow of information and its quality in a developed and an emerging market.

I was able to collect virtually all documents from both the U.S. Aracruz and Sadia lawsuit dockets in the form of electronic files from the *Bloomberg Law* database. These dockets included all parties' petitions, motions, expert reports, and rebuttal reports, including documents that had been labeled "confidential" by parties to the litigation. Examples of these documents include excerpts of depositions of expert witnesses and declarations of company managers.

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275. *See* Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 786 (2001). *See generally* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

276. *See* Richard H. McAdams, *An Attitudinal Theory of Expressive Law*, 79 OR. L. REV. 339, 340 (2000).

277. *See generally* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970) (proposing three forms of efficiency, i.e., weak, semi-strong, and strong, depending on how the market reacts to past and present publicly available information as well as private information).

278. *See generally* Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1 (1983); Merrit Fox, *Required Disclosure and Corporate Governance*, 62 LAW & CONTEMP. PROBS. 113 (1999).

279. The literature on the benefits of public access to judicial proceedings in the United States is extensive. *See, e.g.*, Jessup v. Luther, 277 F.3d 926, 928 (7th Cir. 2002) (noting that "the public cannot monitor judicial performance adequately if the records of judicial proceedings are secret"); Judith Resnik, *Courts: In and Out of Sight, Site and Cite: The Norman Shachoy Lecture,* 53 VILL. L. REV. 771, 804 (2008) ("Open court proceedings enable people to watch, debate, develop, contest, and materialize the exercise of both public and private power."); Rhonda Wasserman, *Secret Class Action Settlements*, 31 REV. LITIG. 889, 942 (2012) (defending public access to class action settlement agreements as a critical prerequisite to public monitoring of the judicial approval process).

In contrast, there are a number of constraints in attempting to obtain documents from the Brazilian suits. The Sadia docket was held in "secrecy of justice" from the beginning of the suit until the decision of the São Paulo upper court Tribunal de Justiça on September 27, 2010, which lifted the "secrecy of justice." Even after this decision, due to the bureaucracy and lack of knowledge of the upper court decision by low level court officials, the latter were still holding the lawsuit in "secrecy of justice," preventing any general public access.[280] Even more troubling is that the "secrecy of justice" in the Sadia case was granted despite lacking a strong legal basis in a suit involving controversies inside the largest manufacturer in the Brazilian food industry and one of the most important publicly held Brazilian corporations.

The Brazilian Federal Constitution provides for the publicity of legal procedures.[281] The general rule of Brazilian Code of Civil Procedure also provides that legal procedures be public,[282] and that lawsuits can proceed in "secrecy of justice" only in the case of two specified exceptions[283]: family legal matters (Article 155 II), and when the "public interest" requires (Article 155 I). The interested party must request the "secrecy of justice" to the judge, who either grants or denies it based on the mentioned rules.

Once granted, the "secrecy of justice" prevents anyone who is not a direct party in the suit from accessing its contents. As such, third parties, as well as shareholders of a participating corporation (if they are not named in the complaint), are barred from accessing any of the legal documents. As a consequence of the "secrecy of justice," shareholders, investors, and the market are denied access to the factual and legal issues discussed, as well as evidence produced in the case. Neither can they see the reasoning behind a particular judgment, which hinders any monitoring of the judicial process. Because it renders confidential *all* the content of a protected suit, the Brazilian

280. Ultimately, after pointing out to officials the upper court decision lifting the veil, they finally allowed access to all the documents. It took about two weeks of going every day to the courthouse in order to manually retrieve copies of all the documents in the physical docket.

281. *See* CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 5º LX (Braz.). See also Art. 5º XXXIII, 37 caput., art. 93 IX, and Law No. 12.527/2011 (regulating access to information according to Constitutional provisions) ("Article 5. All persons are equal before the law, without any distinction whatsoever, Brazilians and foreigners residing in the country being ensured of inviolability of the right to life, to liberty, to equality, to security and to property, on the following terms: LX—the law may only restrict the publicity of procedural acts when the defense of privacy or the social interest require it.").

282. CÓDIGO DE PROCESSO CIVIL (C.P.C.) art. 155 (Braz.).

283. *Id.*

"secrecy of justice" is therefore more expansive than secret settlements that have been so harshly criticized in the United States.[284]

Sadia used the "public interest" general provision as a basis for requesting "secrecy of justice"[285] for its case, arguing that the confidentiality of legal procedures would "preserve the interests" of the parties and "prevent turmoil" in the notary (*cartório*).[286] It did not further elaborate why and how the interests of the parties would be protected or what kind of "turmoil" the publicity of the suit could generate. The judge, even with that incomplete argument, granted the "secrecy of justice" on June 18, 2009, accepting the one-paragraph, six-line argument made by the plaintiff and without

284. *See generally* Wasserman, *supra* note 279; David A. Dana & Susan P. Koniak, *Secret Settlements and Practice Restrictions Aid Lawyer Cartels and Cause Other Harms*, 2003 U. ILL. L. REV. 1217 (2003).

285. *See* Ação de Responsabilidade Civil contra Administrador, Petição Inicial [Civil Liability Suit Against Manager, Initial Petition], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 1, at 2 (Braz.) (on file with author) ("Justifica-se esse pedido para, de um lado, preservar os interesses de ambas as partes, especialmente em face de juntada de documentação empresarial de acesso não público, que, portanto, deve ser restringido e limitado; e, de outro lado, evitar que, ante o aceso interesse que esta demanda, decerto, ensejará, haja tumulto e que isso prejudique o normal andamento dos trabalhos do Cartório, denotando, com isso, também o interesse público subjacente à providência pleiteada. Outrossim, procedimentos investigativos instaurados junto à CVM, são conduzidos sob sigilo, conforme o art. 5°, e §§, da Deliberação CVM 481/05 (doc. 03), o que guarda semelhança com o caso concreto.") ("This request is justified, on one hand, to preserve the interests of both parties, especially in the face of attached non-public corporate documentation; whose access therefore should be restricted and limited; and, on the other hand to prevent turmoil which this demand will certainly generate in regard of its lit interest, which will disturb the normal execution of the works of the notary, denoting thereby the underlying public interest of this request. Furthermore, investigative procedures initiated by the CVM are conducted in secrecy, as art. 5, and §§ of CVM Deliberation 481/05 (doc. 03), which keeps similarity with the particular case."); CÓDIGO DE PROCESSO CIVIL (C.P.C.) art. 155 (Braz.).

286. Ação de Responsabilidade Civil contra Administrador, Petição Inicial [Civil Liability Suit Against Manager, Initial Petition], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 1, at 2 (Braz.) (on file with author); CÓDIGO DE PROCESSO CIVIL (C.P.C.) art. 155 (Braz.). The *cartório* (notary) is the official place where the suit is kept by public officials. Because suits are not always available in electronic filings, anyone interested in examining the suit has to go to the *cartório*. Ironically, the justification provided by the lawyer and accepted by the judge went directly against the very public nature of a *cartório*. *See* Lei No. 8.935, de 18 de Novembro de 1994, COL. LEIS REP. FED. BRASIL, 12: 4398, Novembro 1994 Art 1º (Braz.) ("Serviços notariais e de registro são os de organização técnica e administrativa destinados a garantir a publicidade, autenticidade, segurança e eficácia dos atos jurídicos.") ("Registration and notary services are the technical and administrative organization[s] *designed to guarantee publicity*, authenticity, security and efficiency of legal acts.") (emphasis added).

providing further legal reasoning for his decision.[287]

It is worth noting that legal procedures are public precisely because the Brazilian Constitution intended to foster people's interest in consulting them. The more interest a given lawsuit attracts, the greater importance it must have to the public, which therefore reinforces the very necessity of maintaining its publicity. To grant "secrecy of justice" on the reasoning that a suit will generate "turmoil" if too many people try to view its contents reverses the entire public interest rationale. Legal procedures are public precisely so that a large number of people can monitor them. If the intention of the law were to prevent people from reviewing lawsuits, in order to avoid "turmoil," then Brazil would have a system of full secrecy, and not of full publicity, as the current Constitution assures.[288]

While one could argue in favor of protecting a company's trade secrets and other proprietary information,[289] hardly any such issues would be discussed in Sadia's litigation, which was inherently about corporate and securities law—a legal arena that enjoys a regime of especially robust disclosure and publicity. For reasons I developed elsewhere, I believe that maintaining entire confidentiality of lawsuits that discuss corporate wrongdoings of publicly held companies violates the Brazilian corporate law regime and the Constitution.[290] When necessary, one solution is to request specific authorization from the judge to redact documents to protect particular information requiring confidentiality—for example, trade secrets or other proprietary information. Access to the remaining documents must be freely available to ensure that the suit is open to public scrutiny.

In his motion to dismiss (*contestação*), defendant Ferreira asked the judge to lift the "secrecy of justice" for the following rea-

287. Vistos em Saneador, 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009 (Braz.) (on file with author).

288. It is important to contextualize the political meaning of the publicity regime that the Constitution promotes. The Brazilian Constitution was enacted in 1988, after the end of the military and autocratic regime in Brazil. In this sense, it guarantees publicity as a democratic value, precisely to prevent the type of authoritarian governmental proceedings that used to happen during the autocratic regime.

289. *See generally* Stephen E. Darling, *Confidential Settlements: The Defense Perspective*, 55 S.C. L. REV. 785 (2004).

290. Érica Gorga, *Arbitragem, governança corporativa e retrocesso no mercado de capitais brasileiro* [*Arbitration, Corporate Governance and Regression in the Brazilian Capital Markets*], *in* O FUTURO DA GOVERNANÇA CORPORATIVA: DESAFIOS E NOVAS FRONTEIRAS 215, 217–32 (Joaquim Rubens Fontes Filho & Ricardo Pereira Câmara Leal eds., 2013).

sons: (i) the Brazilian constitutional rule requires publicity of legal procedures; (ii) "secrecy of justice" is an exceptional remedy applied only when it can be shown to be in the public interest; (iii) it is not sufficient to generally allege "public interest" without more specific demonstration; (iv) the plaintiff has justified its request only vaguely, failing to demonstrate a particular public interest at stake; and (v) as the plaintiff publicly attacked the reputation of the defendant in the national and international press, the defendant had the right to answer those accusations in an equally public manner, which could only be accomplished if the "secrecy of justice" were lifted.[291] In response, the judge denied the defendant's request, alluding to the "secrecy of justice" extant in the labor complaint filed by Ferreira as a justification for keeping this one.[292] That is, the judge relied on the "secrecy of justice" in a parallel suit to justify the secrecy of the derivative suit, a troubling argument illustrating the doctrine's cascade effect in light of the limited exceptions on publicity prescribed by the Brazilian Constitution.[293]

With regard to the Aracruz docket, since the documents were not available either electronically or in the local court distributor, I had to file a formal petition with the courthouse in Rio de Janeiro to retrieve the docket from its archives.[294] Nonetheless, I was unable to access the Aracruz documents because, in response to my filed petition, I was informed that the Aracruz suit was also processed in "secrecy of justice" at all times. In this case, one cannot even assess on which legal grounds the "secrecy of justice" was authorized.

To summarize, the dockets of both U.S. class action lawsuits are promptly available electronically to any U.S. or foreign investor situated in any location.[295] Meanwhile, it is extremely burdensome to

291. Ação de Responsabilidade Civil contra Administrador, Contestação [Motion to Dismiss], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 7, at 64 (Braz.) (on file with author).

292. Vistos em saneador, 9ª Vara Cível do Foro Central da Comarca da Comarca de São Paulo, No. 583.00.2009.163865-330.9, 30.09.2009 (Braz.) (on file with author).

293. The point is that the law does not allow such an expansive use of the "secrecy of justice" so as to justify its application in one case on the basis of the secrecy status of another. To the contrary, Brazilian law makes it clear that "secrecy of justice" is an exceptional condition to be applied only on a case-by-case basis after careful consideration. *See supra* notes 281–83.

294. I also had to pay a fee of R$ 131.08 to request the suit from its archives, which in this case was a waste, since the goal of getting access to the suit was never achieved.

295. To be sure, the U.S. dockets include a small number of confidential documents under seal, especially regarding discovery proceedings. *See, e.g.*, Confidentiality & Protective Order, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., 1:08-cv-23317 (S.D. Fla. Jan. 26, 2012).

access documents from either Brazilian suit. After consistent effort and several trips to the local Brazilian courts in both São Paulo and Rio de Janeiro, I gained access only to documents pertaining to the Sadia lawsuit—after the higher court lifted the secrecy authorized by the lower court. The Aracruz derivative suit remains entirely in secrecy in Brazil, despite discussing corporate wrongdoings and liability issues that parallel those in the broadly available U.S. suits.

One could argue that this asymmetry in information availability is merely a matter of technological development, and that Brazilian courts will soon close this gap once they implement more sophisticated technological storage systems. Supporting this argument, some Brazilian courts are in fact migrating to an electronic system, which will make electronically available most documents, challenging the organization of current *cartórios*.[296]

Nonetheless, this argument misses the fact that, ultimately, the lack of public information concerning the Sadia and Aracruz suits did not hinge merely on the availability of electronic filings, but also on the application of the "secrecy of justice" doctrine. This doctrine has been applied in an unduly expansive way and without strong legal support against the principle of broad publicity of legal procedures assured by the Brazilian Constitution.[297] In fact, judges have failed to take into account the distinct disclosure regime to which publicly held corporations are subject by means of special statutory regimes.[298]

To conclude, in the United States, public disclosure of the documents has enabled legal discussions on the litigation of corporate wrongdoing in both the Sadia and Aracruz cases since their beginning. In contrast, in Brazil, the equivalent information was held in a black box during the entire time that the Sadia and Aracruz lawsuits were developing—with the approval of the Brazilian judiciary. Access to the Sadia lawsuit was only allowed after its conclusion, but the Aracruz litigation has remained in the black box after its end. Therefore, it is undeniable that a U.S. capital market investor has ac-

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296. *See* Ação de Responsabilidade Civil contra Administrador, Petição Inicial [Civil Liability Suit Against Manager, Initial Petition], 9ª Vara Cível do Foro Central da Comarca de São Paulo, No. 583.00.2009.163865-3, 18.06.2009, 1 (Braz.) (providing a definition of *cartórios*) (on file with author); *see also Implementation Schedule of "PUMA"* [*Plano de Unificação, Modernização e Alinhamento*] *of Tribunal de Justiça de São Paulo*, AASP, http://processoeletronico.aasp.org.br/cronograma-implantacao-puma-tjsp/ (last visited Apr. 20, 2016). PUMA is a program aimed at providing electronic files of judicial documents.

297. *See supra* notes 281–83 and accompanying text.

298. Laws 6.385/76 and 6.404/76 create a special transparency regime for publicly held companies.

cess to more information about corporate litigation and wrongdoing than does an investor in the Brazilian market—not because of a technology gap, but for legal enforcement failures.

2. Types of Suits: U.S. Class Actions vs. Brazilian Derivative Suits

The types of private suits available in each system are important because they not only provide enforcement mechanisms to remedy corporate and shareholder losses, but also establish *who* can recover damages and who can be held liable for the damages caused to corporations and, ultimately, to securities investors.

Corporate and securities laws usually provide for direct shareholder suits, derivative suits, and class actions. Direct suits, which can provide direct recovery to shareholders, were not an issue in the Sadia and Aracruz cases, because no shareholder has filed such suits either in the United States or in Brazil.[299] Derivative actions generally provide recovery for the company and only indirectly to shareholders.[300] Class actions, on the other hand, provide recovery exclusively to the class of shareholders that suffered the alleged damage. In this Part, I focus on the last two types and provide a positive explanation as to *why* these particular types of suits were filed in each jurisdiction.

While derivatives actions can be filed in the United States as well as in Brazil, in the Sadia and Aracruz cases class actions were filed only in the United States, due to the technical and practical

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299. In theory, direct shareholder suits would be possible both in the United States and in Brazil. *See* Lei No. 6.404, de 15 de Dezembro de 1976, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf. However, the fact that no shareholder has tried to use these suits reinforces the standard perception that these are costly enforcement mechanisms for shareholders to individually pursue, even when they have significant share ownership as some Sadia and Aracruz minority shareholders did.

300. This last assertion depends on the reaction of the company's securities prices to the outcome of the derivative suit; for example, shareholders receive indirect recovery if securities prices increase in the secondary markets after plaintiffs win their suit. *But see* A. C. Pritchard & Stephen P. Ferris, *Stock Price Reactions to Securities Fraud Class Actions Under the Private Securities Litigation Reform Act* (Univ. of Mich., John M. Olin Ctr. for Law & Econ., Paper No. 01-009, 2001), http://ssrn.com/abstract=288216 (finding a large negative price reaction to the revelation of potential fraud, and a smaller but still statistically significant negative reaction to the filing of a lawsuit, but not finding a significant price reaction to the outcome of litigation). *See generally* Paul A. Griffin, Joseph A. Grundfest & Michael A. Perino, *Stock Price Response to News of Securities Fraud Litigation: An Analysis of Sequential and Conditional Information*, 40 ABACUS 21 (2004).

problems of Brazilian class actions, which I explain below. One question, then, is why private plaintiffs in the United States chose to file federal securities class actions and not derivative suits.[301]

There is one dominant explanation for this choice of litigation procedure. Besides the arguments that U.S. derivative suits involve substantial procedural hurdles that constrain plaintiffs in their efforts to vindicate corporate claims,[302] derivative actions against foreign companies face one additional barrier. These suits would place the corporations on the plaintiff side, with only directors remaining as defendants. Having foreign directors or officers who reside in a foreign country as the only defendants[303] raises significant civil procedural problems that could severely delay and reduce the plaintiff's chances of success.[304] This problem is circumvented when the foreign issuer corporation is placed on the defendant side in a security class action. Both the Aracruz and Sadia securities class lawsuits, for example, initially proceeded against the corporations while service of process was still pending for the individual defendant officers and directors. In addition, in the case of suing only foreign directors or managers with no assets in the United States, problems of international enforcement and actual recovery may render a U.S. judicial decision ineffective in practice—in the non-application of D&O insurance coverage.

In the case of the Brazilian lawsuits, the concentrated ownership structure of both Aracruz and Sadia provided Brazilian shareholders greater incentives to approve the derivative suits in general shareholder meetings, as confirmed by high shareholder attendance at

301. Indeed, U.S. plaintiffs could have chosen from a number of forums, including state court class action, federal securities class action, state derivative suit, or federal derivative suit. Thompson & Thomas, *supra* note 215, at 1773. *See generally* Erickson, *supra* note 212 (analyzing the phenomenon of shareholder derivative suits filed in federal courts on behalf of companies mostly incorporated outside of Delaware); Randall S. Thomas & Kenneth J. Martin, *Using State Inspection Statutes for Discovery in Federal Securities Fraud Actions*, 77 B.U. L. REV. 69 (1997).

302. *See* Thompson & Thomas, *supra* note 215, at 1773; *see also* Erickson, *supra* note 212, at 1780–87.

303. Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 895 (2003) ("State law fiduciary duty complaints are brought against directors, but federal claims are made against officers.").

304. *See, e.g.*, Erickson, *supra* note 212, at 1782 ("To address the impact of the demand requirement, I first examined the percentage of cases in which the plaintiff made a pre-suit demand. I excluded nine cases filed on behalf of foreign corporations because the demand rules were unclear in these foreign jurisdictions.").

those meetings.[305] The Brazilian corporations Sadia and Aracruz themselves were plaintiffs because of the nature of these derivative suits.[306] But one could ask why the Brazilian shareholders decided to sue only their former CFOs,[307] in contrast to the U.S. class action suits that included more defendants.[308] To be sure, the concentrated ownership structure and the relationships between controlling shareholders and managers/board members also provide explanations for shareholders having authorized their corporations to file lawsuits exclusively against their CFOs. One hypothesis is that these defendants were chosen as scapegoats in an attempt to protect other top managers and board members involved in the wrongdoings who had relationships with the controlling shareholders or were controlling shareholders themselves.[309]

Turning to class actions, I would note that, in theory, these could have been filed in any jurisdiction. In practice, however, they were filed only in the United States. The underlying explanation for this disparity resides in the absence of sufficient private enforcement mechanisms in the Brazilian capital markets, even while substantive law provides a class action mechanism that has been praised by some scholars.[310]

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305. See *supra* notes 237–43, 271 and accompanying text, for a discussion of shareholder meetings decisions. As I discuss below, controlling shareholders would not have incentives to sue themselves or their loyal executives but would have incentives to sue someone to divert attention from their possible misconduct.

306. *See supra* notes 217–20 and accompanying text.

307. Erickson also points out that U.S. federal derivative complaints included the CFO in 81.6% of the cases in her sample. Erickson, *supra* note 212, at 1772.

308. In both parallel U.S. class action suits, the CEOs and Chairmen were also included as defendants. Further, in the U.S. Sadia suit, another previous CFO (d'Avila) and the Vice-Chairman were also sued. This difference may be mainly related to Sarbanes–Oxley Certification provisions that hold CEOs accountable for the financial information provided by their companies. Section 302 requires that the company's "principal officers," typically the CEO and CFO, certify and approve the integrity of their company financial reports quarterly. Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241.

309. *See generally* Gorga, *supra* note 97 (discussing the ownership structure of Brazilian corporations and controlling shareholder incentives for the extraction of private benefits of control).

310. Gidi argues that Quebec and Brazil are "the only civil law systems that have developed a sophisticated system of class actions suits." He compares the Brazilian system of class actions with the U.S. one, concluding that the "Brazilian experience demonstrates that civil law systems can employ a class suit procedure but cannot transplant the American class actions model into their systems without substantial adaptation." Antonio Gidi, *Class Actions in Brazil—A Model for Civil Law Countries*, 51 AM. J. COMP. L. 311, 312–14 (2003).

Indeed, Brazilian law has enabled a general class action framework since 1985, when the so-called Brazilian Public Civil Action was enacted.[311] In 1989, a new statute (Law 7.913) was passed providing that public civil actions could also be used to remedy losses to security holders. According to this statute, financial damages recovered through public civil actions would go to investors in proportion to their losses.[312] However, practical problems hinder the existing class action system, especially in the case of class actions related to capital markets losses.

Brazil adopts the European fee-shifting or loser-pays rule, by which the losing party is responsible for paying the attorney's fees and expenses incurred by the winning party. The public civil action statute has tried to deal with the structural incentive problems imposed by this system by changing the loser-pays rule and providing that plaintiffs do not need to pay defendants' fees and expenses if they lose the case.[313] However, a major problem still remains. A Brazilian public civil action can only be filed by public prosecutors, civil associations that have been duly constituted for more than one year, foundations, or other public entities.[314] Hence, private lawyers cannot file claims on behalf of a class of investors who face collective action problems. Furthermore, even if lawyers could file these claims, the prohibition of contingent fees would still hinder the origination of these suits.[315] Public prosecutors, on the other hand, lack

311. *See* Lei da Ação Civil Pública [Public Civil Action Law], Lei No. 7.347, de 24 de Julho de 1985, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 25.7.1985 (Braz.). Note that the equivalent to the U.S. private class action is called a "public civil action" in Brazil. This is because, as I will explain, these class actions were generally intended to be brought by public prosecutors.

312. Lei No. 7.913, de 7 de Dezembro de 1989, art. 2, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 11.12.1989 (Braz.).

313. Gidi, *supra* note 310, at 340–41 ("In any country that adopts the general rule of fee shifting (loser-pays), the risk of incurring legal costs in case of loss is a serious deterrent to the bringing of any lawsuit. This risk is intensified in Brazil, because the amount of attorney's fees that the loser pays the winner is determined not by the time spent by the attorneys in preparing and arguing the case, nor by a predetermined lump sum, but by a percentage of the amount in controversy (usually between 10 and 20%). This rule considerably raises the stakes for the parties in class suits. One important innovation in Brazilian class action statutes protects class representatives from the responsibility for defendant's attorney's fees, costs and expenses in case of loss, except in cases of bad-faith litigation. This protection, however, is limited to class plaintiffs: defendants are liable for attorney's fees, costs and expenses in case of loss, under the traditional rule of fee shifting. . . . In addition, class action plaintiffs do not have to advance the payment of court costs, fees, experts' fees or any other expenses.").

314. *See* Lei No. 7.347 at art. 5; *see also* Rosenn, *supra* note 230, at 522–23.

315. *See supra* note 230 and accompanying text.

the incentives and expertise necessary to file these claims on behalf of investors.

In contrast, even if ownership is more dispersed and shareholders face more severe collective action problems in the United States than in Brazil, U.S. private attorneys litigate on a contingent fee basis and advance all expenses related to the prosecution of the case. The contingent fee system incentivizes filing the claims.[316] If they win or settle the case, the award of attorneys' fees in class actions is governed by the common fund doctrine. That is, as the Sadia and Aracruz cases showed, when the lawyers obtain a recovery for the class, they are paid a percentage of that recovery. The U.S. Supreme Court has long recognized that "a litigant or a lawyer who recovers a common fund for the benefit of persons other than himself or his client is entitled to a reasonable attorney's fee from the fund as a whole."[317] These fees and expenses must be approved by the court, and their range must reflect the complexity and effort of work expended by the attorneys.[318] This compensatory system based on contingent fees does not exist in Brazil.[319]

Another shortcoming lies in the inadequate procedural and technical rules of the Brazilian class action. For example, the approval of settlements is severely constrained.[320] According to an im-

316. Gidi, *supra* note 310, at 341 n.74; *see* MODEL RULES OF PROF'L CONDUCT r. 1.8(e)(1) (AM. BAR ASS'N 1983) ("[A] lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter."); *see also* Rand v. Monsanto Co., 926 F.2d 596 (7th Cir. 1991). This rule is still taboo in most civil law systems, with rare exceptions.

317. Boeing Co. v. Van Gemert, 444 U.S. 472, 478 (1980). The Eleventh Circuit rejected the so-called "lodestar" approach, holding, "Henceforth in this circuit, attorneys' fees awarded from a common fund shall be based upon a reasonable percentage of the fund established for the benefit of the class." Camden I Condo. Ass'n, Inc. v. Dunkle, 946 F.2d 768, 774 (11th Cir. 1991).

318. In *Camden*, the Eleventh Circuit held that in order to determine whether a fee is reasonable, a court should consider a list of twelve factors. *Camden*, 946 F.2d at 772 n.3 (citing Johnson v. Ga. Highway Express, Inc., 488 F.2d 714, 717–19 (5th Cir. 1974)).

319. See Rosenn, *supra* note 230, at 518–19, for a discussion of attorneys' fees in Brazil that remains largely accurate today. Judges generally fix from ten percent to twenty percent of the amount of the judgment as attorneys' fees. Lawyers do not rely exclusively on these awards, as both sides may enter into independent fee agreements with their own lawyers. Some firms may also charge hourly rates or fixed rates for each particular service. In contrast to the U.S. system, Rosenn remarks, "Fee arrangements totally contingent upon success on litigation are not used and would be regarded as a violation of the attorney's ethical duty to charge a fair amount his services." *Id.* at 519.

320. Gidi, *supra* note 310, at 342–43 ("Another major shortcoming of Brazilian class action law is the absence of regulation and procedures for approval of settlements. This aspect was neglected by the legislature, most likely because the rate of settlement in Brazil is

portant body of doctrine, settlement agreements do not bind absent members who disagree with their terms. This means that the same class action could be brought again to protect dissatisfied class members. Gidi has pointed out the incentive problems inherent in this system: "[I]n Brazil the representatives can make no real concessions on behalf of the class, therefore this is not a real settlement agreement. If settlements are binding on defendants and not on the class, there is no incentive for the defendant to enter into real settlement negotiations in the first place."[321]

U.S. private attorneys, on the other hand, negotiate all settlement conditions with the opposing party on behalf of class plaintiffs. They can make concessions and may even partially or totally waive rights of absent class members. As the Sadia and Aracruz cases showed, the ability to settle the class action claim is legitimized by a sophisticated regulatory apparatus, one which includes judicial approval of the settlement, notice to absent members, an evidentiary hearing, the right to intervene and challenge the terms of the settlement, the right to opt out, and other measures. In contrast, in Brazil, as long as the lack of adequate proceedings for court approval and notice to the group persists, the inability to bind absent class members lessens the legal incentives of the parties to reach a class-wide settlement.[322] Another shortcoming of the procedural mechanisms in Brazil is the lack of discovery procedures for collecting relevant evidence to prove a case.[323]

Because of these flaws in the current Brazilian class action regime, these lawsuits are uncommon and inappropriate to provide recovery to security investors. Consistent with this account, no class actions were filed on behalf of Sadia and Aracruz minority shareholders in spite of their significant stock ownership and alleged desire to take legal action against the wrongdoers. These minority shareholders had no other satisfactory private enforcement mecha-

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almost insignificant. . . . [T]he powers of the Brazilian class representative are very limited. Since the rights do not belong to the representative, but to the group as a whole, plaintiff cannot freely dispose of the group's rights ('inalienable rights'). Therefore, representatives are allowed to make only peripheral concessions over the manner in which the defendant will adjust its behavior to the law, regarding time and place, for example.").

321. *Id.* at 343 n.85; *see* JOSÉ VIGLIAR, TUTELA JURISDICIONAL COLETIVA 166 (1999); Marcelo Dawalibi, *Limites subjetivos da coisa julgada em ação civil pública*, *in* AÇÃO CIVIL PÚBLICA: LEI 7.347/1985-15 Anos 526, 538–42 (2001).

322. Gidi, *supra* note 310, at 342.

323. *Id.* at 333 n.50 ("In Brazil, as in other developing nations, the lack of scientific expertise and effective procedural devices, such as discovery, often proves to be an obstacle not only to proving causation, but also to detecting mass damages in the first place."); *see also* Gorga & Halberstam, *supra* note 231, at 1485.

nism outside of derivative suits. Accordingly, they did not directly recover anything from the judicial proceedings. Another consequence of Brazil's flawed class action regime is that corporations and wrongdoers do not face a reliable threat of robust private enforcement. As a result, one can expect reduced deterrence of corporate wrongdoing in Brazil.

In contrast, the analysis of the Sadia and Aracruz cases does show the capacity for at least partial shareholder recovery under the U.S. system. The Sadia and Aracruz cases resulted in a net settlement fund of US$ 18,012,712 and US$ 23,905,050.02, respectively, to be distributed to ADR holders of the companies.[324] These results seem to question the general view that class actions are merely rent-seeking devices and suggest a stronger deterrent effect of private enforcement in the United States. The circularity problem usually pointed out as a significant constraint of the U.S. class action system[325] did not seem to be a concern to these particular cases either, because Brazilian controlling shareholders bore a significant piece of the litigation costs.[326]

Therefore, in spite of the standard critique of the U.S. class action system,[327] the examination of the Sadia and Aracruz case studies supports the hypothesis of stronger private enforcement in the United States than the one in the home jurisdiction of the cross-listed companies. Nonetheless, this enforcement activity is not necessarily corroborated when it comes to public enforcement, as Part IV discusses.

3. U.S. and Brazilian Lawsuit Outcomes: Dismissal, Settlement Characteristics, and Monetary Recovery

Three out of the four civil cases were settled. In the United States, the two class actions suits against Sadia, Aracruz, and their

324. Affidavit of Stephen J. Cirami in Support of Motion for Final Distribution of the Net Settlement Fund, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV-LENARD (S.D. Fla. Nov. 25, 2015).

325. *See* Coffee, *supra* note 8, at 1556–61 (arguing that the U.S. securities class actions suffer from a circularity problem, which involves diversified shareholders transferring wealth to diversified shareholders, once the settlement costs imposed on the defendant corporation falls ultimately on its own shareholders); Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 632 (1992).

326. One could make the argument that in fact there was a distribution of wealth from Brazilian shareholders to U.S. ADR holders. *See* Gorga, *supra* note 79, at 166–68.

327. *See supra* note 325.

individual defendants were settled. In Brazil, the suit brought by Aracruz against former CFO Zagury was also settled, but the court dismissed the suit brought by Sadia against former CFO Ferreira without judging its merits.

One interesting question is why most of these cases were settled rather than litigated. While it is well known that in the United States the large majority of class actions settle, in general the rates of settlements in civil law jurisdictions are considerably lower than in common law jurisdictions.[328] This is indeed the case in Brazil, where settlements are not the most likely outcome of a civil suit.[329]

One explanation for the low rate of settlements in Brazil is that even when a party does not have a strong case, its lawyers usually pursue the strategy of proceeding with the lawsuit, making use of all available interlocutory appeals (*recursos*) until reaching full trial and judgment. If the result is different from what the party wanted, the lawyer could continue with the strategy of filing a number of different appeals.[330] This was indeed the case in the Sadia suit against defendant Ferreira. Sadia appealed the dismissal numerous times, with no success in having the case heard on the merits.[331] Once appeals can be filed on matters of facts and law,[332] the attorney is at least able to considerably delay the execution of a judicial ruling, even if a favorable decision is not reached.

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328. In civil law jurisdictions, which do not employ broad discovery, settlement rates are lower. Chang-Huang discusses an interesting development stemming from a legal reform that introduced civil discovery in Taiwan in 2000 and resulted in a consistent increase over time in settlement rates for civil cases in all district courts. *See generally* Kuo Chang-Huang, *Does Discovery Promote Settlement? An Empirical Answer*, 6 J. EMPIRICAL LEGAL STUD. 241 (2009). The law and economics literature further corroborates this claim. *See* Lucian Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 RAND J. ECON. 404, 413 (1984) (stating that, in an economic model of litigation and settlement decisions under imperfect information, discovery legal requirements increase the probability of settlement); *see also* Robert D. Cooter & Daniel L. Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435, 436 (1994) ("[D]iscovery increases settlements and decreases trials by organizing voluntary exchange of information."). *See generally* Joel Sobel, *An Analysis of Discovery Rules*, 52 LAW & CONTEMP. PROBS. 133 (1989) (noting that in a model with one-sided discovery, mandatory discovery rules reduce the probability of trials).

329. Gidi, *supra* note 310, at 319 (pointing out that the rate of settlements in Brazil is lower than in common law jurisdictions).

330. Brazil is well known for having a civil procedure system that allows for a large number of different types of appeals. *See* Rosenn, *supra* note 230, at 489 (noting that "a party bent on delay can keep litigation moving at a snail's pace").

331. *See supra* note 266.

332. Gidi, *supra* note 310, at 319.

In this scenario, one might ask why CFO Zagury opted to settle the Aracruz lawsuit instead of trying to prolong its conclusion. The most plausible explanation is that defendant Zagury pushed for a settlement of the Rio de Janeiro suit because he feared that a civil condemnation in Brazil—even with low damages—would strengthen the case of the class action plaintiffs in the United States. This would worsen his odds in the U.S. suit and increase the risk of a higher damages value. Therefore, a settlement was the best option for defendant Zagury.

A second related question is why the value of the Brazilian settlement (R$ 1.5 million, equivalent to US$ 710,900) was significantly lower than the value of the settlement in the U.S. lawsuit (US$ 37.5 million) in which Zagury was a defendant. It is worth noting that while Zagury was the only defendant in the Brazilian derivative suit, he was one of two individual defendants, alongside main defendant Aracruz, in the U.S. class action suit. Because the U.S. suit involved more defendants and included a corporation among them, one could hypothesize a direct relationship between the number of defendants and the value of the settlement.

However, according to some scholars, a more important determinant of settlement values in U.S. corporate litigation is the coverage of D&O insurance protecting the defendant corporation and its executives.[333] D&O policies may include individual-level coverage that protects officers and directors against covered losses. Most common, however, are entity-level policies protecting the corporation from losses resulting from indemnification obligations to individuals and directors, and from losses to the corporation itself as a defendant in a shareholder claim.[334]

Therefore, a plaintiff's decision to target multiple defendants is likely a calculated attempt to obtain damages or a settlement up to the ceiling set by the defendant corporation's D&O insurance. Under this reasoning, lawyers will sue the largest number of defendants possible because, even if the insurance company does not cover expenses for an officer who engaged in "egregious behavior," it will cover the expenses and settlement of other directors.[335] In this

333. Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1806 (2007) (reporting that "almost all shareholder litigation settles within the limits of available D&O insurance").

334. *Id*. at 1802.

335. U.S. commentators say that insurers will not pay reasonable defense costs in cases involving "incredibly egregious behavior," a standard presumably met only in "a final adjudication of actual wrongdoing." *Id.* at 1815 n.96, 1820 (discussing moral hazard exclusions from D&O policies). Although there was no final adjudication of actual

framework, U.S. lawyers are incentivized to push for a higher settlement value, as they earn a considerable percentage of that settlement as attorneys' fees—in fact, they earned 30% and 33.3% in *Sadia* and *Aracruz*, respectively.

Because Fibria—the company that succeeded Aracruz—did not disclose the detailed terms and limits of its D&O insurance policy or officer indemnification agreements either in the United States or in Brazil, I cannot confirm the hypothesis that attributes settlement values as a function of the limits of insurance coverage. But Fibria did disclose that the Aracruz settlement was "significantly" supported by Fibria's D&O insurance policy.[336]

Standard U.S. D&O policies reimburse defendants for the costs of their defense.[337] A puzzling fact, however, is that defendant Zagury, former CFO of Aracruz, decided to proceed *pro se* in the U.S. litigation after the U.S. District Court for the Southern District of Florida denied his motion to dismiss.[338] This decision suggests that he was not being reimbursed for his defense costs either by the company or by its D&O insurance.[339] Indeed, there is no other compelling explanation as to why a foreign defendant without a law degree would choose to forego the assistance of local lawyers with appropriate technical expertise if another party was paying for his legal expenses.

This issue then begs the question of why Zagury's costs were not covered by either his company or its D&O insurance. The most probable explanation is related to the type of coverage eventually held by Fibria, along with the public law enforcement aspects of the case in Brazil. One hypothesis is that Fibria's D&O policy in the United States was restricted to entity-level coverage and such a policy would not cover Zagury's individual legal expenses.

Furthermore, it is possible that Aracruz/Fibria would not reimburse Zagury's U.S. legal expenses in light of the charges made against Zagury in an administrative proceeding brought by the CVM

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wrongdoing against Zagury, the fact that he was sued by the company and by the regulator (CVM) in Brazil and settled these cases may have influenced the coverage of his expenses in the U.S. suit. As noted in *supra* note 192, Zagury declared he had no insurance coverage. See discussion of Zagury's settlements in the Judiciary and with the CVM in Parts III.B.2 and IV.B.3.

336. *See supra* note 205 and accompanying text.

337. Baker & Griffith, *supra* note 333, at 1814 (contending that "rather than providing and controlling the defense, D&O insurers reimburse their policyholders' defense costs").

338. *See supra* note 192.

339. In fact, Zagury alleged he was not benefiting from D&O insurance coverage. *See id.*

and in the civil liability derivative suit filed against him by Aracruz itself in Brazil.[340] To be sure, the Aracruz derivative suit against Zagury, as discussed above, did not result in civil liability, as the case was settled for a payment of R$ 1.5 million.[341] Similarly, the CVM also settled its administrative charge against him for R$ 1.5 million.[342] Nonetheless, the fact that Zagury faced both administrative and judicial proceedings in Brazil may have motivated the bargain struck between him and Aracruz.

It is unlikely that Aracruz would agree to settle its civil liability suit against Zagury and still pay his legal expenses. It is possible that even if Zagury originally enjoyed the benefits of an officer indemnification agreement with Aracruz, Aracruz may have required as a condition to settling the Brazilian derivative suit against him that he relinquish his right to indemnification and pay his own legal expenses in the U.S. class action suit.[343] The relatively low value of the settlement paid by Zagury in the Brazilian derivative suit also seems to corroborate the hypothesis that no D&O insurance covered his expenses in Brazil.[344]

Another potential factor influencing settlement value may be a given legal regime's corporate litigation standards on damage measurement. Although financial methodologies have long been employed in U.S. securities litigation and go unnoticed by comparative corporate scholars, the same methods are not found in other jurisdictions.[345] The fact that, in the United States, class actions em-

340. Baker & Griffith, *supra* note 333, at 1799 n.14 (arguing that D&O insurance coverage usually excludes "fines" from public enforcers such as the SEC and, furthermore, that regulatory agencies like the SEC have "the ability to specify in settlement agreements that amounts paid may not be recovered from insurance companies"). Liability standards in Brazilian law are less stringent than those applied in U.S. law, and a finding of negligence would be sufficient to render Zagury liable in the administrative or the judicial proceeding, justifying a possible exclusion of his reimbursement by the D&O insurer.

341. *See supra* Part III.B.2.

342. *See infra* Part IV.B.3.

343. *See supra* note 335.

344. Given the limited information available and the fact that the details of the companies' D&O policies were not disclosed in either the United States or Brazil, as well as the absolute lack of empirical studies on D&O policies and indemnification agreements used by Brazilian companies, I cannot verify in practice the absolute validity of these hypotheses. *See generally* Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Policies*, 154 U. PA. L. REV. 1147 (2006) (advocating disclosure of D&O policy details, including premiums, limits, and retentions under each type of coverage).

345. This is an additional consequence of the unique aspects of the U.S. civil procedural discovery regime. *See generally* Gorga & Halberstam, *supra* note 231; Sven

ploy expert witnesses with finance expertise who are able to apply statistical and economic models to assess the actual financial losses associated with a drop in securities prices may significantly influence settlement values. First, expert witnesses, such as business professors and finance experts, present statistical and econometric models to assess the real value of damages associated with the share value of class members. Experts then calculate the value of the damages to be obtained in a settlement for the class group according to the probability of a final judgment favoring class members and accordingly apply a discount factor to the projected award.

Compare that approach to what happens in Brazil. Although the court docket was not available, it is possible that plaintiff's lawyers could have demanded that CFO Zagury indemnify *all* of the billion-dollar losses suffered by Aracruz, as was demanded in Sadia's equivalent derivative complaint. But considering the enormous value of the losses, parties could not realistically agree to such a proxy in their settlement calculations.

In contrast to U.S. lawsuits, Brazilian lawsuits generally do not make use of financial methodologies to evaluate the actual financial losses investors suffered as a consequence of securities fraud. As the proxies used for settlement values do not bear any relation to actual losses in share prices, they may instead push damages and settlement values lower. A realistic interpretation of the R$ 1.5 million settlement is that it bore no relation to the damages suffered by the company or by its shareholders but was instead an arbitrary value agreed upon by both parties, bearing on what Zagury was able and willing to pay for the settlement.[346] In addition, the supposed absence of D&O insurance coverage for Zagury provided him with the right incentives to fight for a lower settlement.[347] The low value of

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Timmerbeil, *The Role of Expert Witnesses in German and U.S. Civil Litigation*, 9 ANN. SURV. INT'L & COMP. L. 163 (2003).

346. Interview with Otavio Yazbek, Commissioner, CVM, (Jan. 22, 2014) (Commissioner Otavio Yazbek issued the CVM opinion in the Aracruz case); Gidi, *supra* note 310, at 320 (advancing the argument that, in civil law jurisdictions, "career judges, being conservative civil servants, are more likely to award modest amounts of damages"). Because civil law judges tend to be appointed at earlier ages in their careers, they have less experience with private practice than do common law judges; this would allegedly influence a judicial bias in civil law jurisdictions toward lower damages. If the value of settlements is related to the potential value of damages, this argument would explain lower settlement values.

347. As discussed *supra* note 192, Zagury has denied possessing D&O insurance. When defendants have D&O coverage, as is usually the case in U.S. class actions, plaintiffs are heavily encouraged to fight over the value at stake, while defendants are less incentivized to do so as long as the value at stake lies within the limits set by their D&O

his settlement in the civil suit was doubly advantageous, as it was also used as a proxy for his settlement with the CVM in its administrative proceeding, as the next Part discusses.[348]

In spite of the lower settlement, the fact that Zagury ended up paying the judicial settlement as well as the administrative settlement with the CVM "out of his own pockets" suggests a stronger deterrent effect in Brazilian private enforcement when it comes to officer liability.[349]

Nonetheless, in terms of investor financial recovery, U.S. private enforcement was superior.[350] Because the U.S. litigation in both the Sadia and Aracruz cases resulted in settlement payments to the class of ADR holders,[351] while the Brazilian litigation did not result in any such direct recovery,[352] one can also conclude that Brazilian shareholders of both companies bore non-pro rata distributions of shareholder value to U.S. ADR holders. In other words, the cases resulted in a transfer of wealth from Brazilian shareholders to U.S. ADR holders, even while both groups of investors suffered from the same securities fraud.[353]

IV. PUBLIC ENFORCEMENT ACTIONS IN THE UNITED STATES AND IN BRAZIL

This Part focuses on the public enforcement aspects of the Aracruz and Sadia cases. I start by discussing the lack of action by the U.S. securities public enforcer, and then turn to a detailed analy-

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policies; this translates into a larger settlement value.

348. The CVM adopted the same value of the judicial settlement for its own administrative settlement. *See infra* notes 379–80 and accompanying text.

349. In the United States, class action settlements are mostly paid by D&O insurance and the defendant corporation. Managers responsible for alleged fraud usually do not pay costs out-of-pocket.

350. See discussion *supra* note 324 et seq.

351. *See supra* Part III.A.

352. *See supra* Part III.B.

353. For a detailed articulation of these arguments, see generally Gorga, *supra* note 79 (discussing the constraints that prevented Brazilian shareholders from joining the U.S. lawsuits and the effects of the Supreme Court decision in *Morrison*, which exacerbates distributional wealth problems in transnational litigation in global securities markets). Considering that Brazil does not currently have a collective action framework that could allow shareholder recovery in cases of securities fraud, one question is whether these shareholders could benefit from the U.S. class action framework. After the U.S. Supreme Court decision in *Morrison*, they largely cannot.

sis of the proceedings initiated by the Brazilian public regulator.

A. Lack of Action by the SEC

No evidence was found of enforcement actions taken by the SEC against either Aracruz or Sadia, even after searching for information on the SEC website and in media articles about the cases. Furthermore, the fact that neither the Brazilian regulator nor the U.S. private plaintiffs referred to any action of the U.S. securities authority corroborates the evidence of its lack of action. If there were any action taken by the SEC in relation to these cases, it would be in the interests of both U.S. private plaintiffs and the Brazilian regulator to discover and publicize it so as to further support their arguments.[354]

Even though an important body of literature has recently measured the SEC's large enforcement expenditures[355] and proposed that public enforcement is superior to private enforcement in the United States,[356] this analysis shows flaws in the U.S. public enforcement system. The Sadia and Aracruz cases corroborate the previous findings of Siegel concerning the failures of public enforcement in relation to foreign U.S.-listed companies.[357]

In fact, there are several theoretical hypotheses that may explain why the SEC does not investigate all wrongdoings in the U.S. capital markets.[358] Given the constraints faced by the public regulator, this study provides evidence that the U.S. capital markets rely on the work of private attorneys to oversee market participants and to initiate lawsuits, especially in the case of foreign cross-listed companies.

A number of reasons can explain why the enforcement of wrongdoings committed by foreign corporations in the U.S. market is laxer than enforcement of those committed by domestic corporations. As discussed, the costs associated with investigating these companies may be substantially higher. Nonetheless, this same reason could also justify, in theory, the lack of private enforcement as well. In this way it was surprising to see private enforcement actions in both the

354. In fact, the CVM mentioned the existence of the derivative suits against former CFO defendants in both the Sadia and Aracruz administrative proceedings. It also mentioned the class actions filed by U.S. private plaintiffs. U.S. private plaintiffs also refer to the CVM proceedings in their cases.

355. *See generally* Jackson & Roe, *supra* note 6.

356. *See generally* Bratton & Wachter, *supra* note 62.

357. *See generally* Siegel, *supra* note 31.

358. Gorga & Halberstam, *supra* note 231, at 1428–29.

Sadia and Aracruz cases. Because both were foreign corporations with foreign managers, all of them without any U.S. assets, investigating and litigating against them presented a number of pitfalls. Problems such as the lack of subpoena power to compel the appearance of Brazilian fact witnesses or to gather documents in Brazil, as well as the uncertainty associated with civil procedural issues such as serving process and enforcing a final judgment decision through the Brazilian Superior courts raised considerably the risks that private attorneys faced in filing those actions.[359] And yet, all those difficulties did not inhibit private gatekeeping in these cases. The Sadia and Aracruz cases provide concrete evidence to corroborate the hypotheses of the literature on the fundamental role of private attorneys as gatekeepers in the U.S. capital markets.[360]

It is worth noting that the SEC and CVM have had a cooperation agreement since 1988, which, in theory, could have facilitated the exchange of documents, information, personal testimonies, and investigatory results concerning these cases.[361] It could potentially diminish the alleged transaction costs faced by the SEC in investigating the Brazilian companies. Despite this agreement, the SEC did not investigate the two cases, which raises questions of whether collaboration between regulators is effective in practice. From a normative perspective, this study suggests that there is much room for improvement in such international regulatory exchanges.

B. The Brazilian CVM Administrative Proceedings

1. Proceedings Against Sadia's Board Members and Officers

The CVM brought Administrative Sanctioning Proceeding No. 18 (2008) (*Processo Administrativo Sancionador* or PAS 18/08) to investigate the potential liability of Sadia's officers and board members in connection with the trading of derivative contracts and disclosure of information.

After a long report—in which the CVM described the STF financial transactions; the findings of independent auditors BDO Tre-

359. Lead Plaintiff's Motion for Final Approval of Settlement & Award of Attorneys' Fees & Reimbursement of Expenses & Incorporated Memorandum of Law in Support, City Pension Fund for Firefighters and Police Officers in the City of Miami Beach v. Aracruz Celulose S.A. et al., No. 08-23317-CIV (S.D. Fla. May 24, 2013), ECF No. 195.

360. *See generally* Coffee, *supra* note 2.

361. *See* Memorandum of Understanding from United States Securities and Exchange Commission and Comissão de Valores Mobiliários, Art. II Scope of Assistance (Brazil) (July 1, 1988), https://www.sec.gov/about/offices/oia/oia_bilateral/brazil.pdf.

visan and KPMG; the responsibilities imposed by the financial policies, stop-loss, hedge and stress test policies; the conduct of the managers; and statutory competencies of Sadia's financial committee, financial office, Board of Directors, president, and audit committee—the following managers and board members were indicted: (i) Ferreira, CFO, for failing to exercise the necessary diligence and violating Sadia's financial policies, characterizing a breach in the duty of care described in Article 153 of Law 6404/76; (ii) Walter Fontana, Chairman and member of the financial committee; Alcides Tápias, coordinator of the financial committee and member of the audit committee; Cássio Casseb, coordinator of the financial committee; Evaldo Nigro, Marcelo Fontana, and Roberto Faldini, members of the financial committee; Francisco Céspede, coordinator of the audit committee; and José Comparato, member of the audit committee, all of them for failing to apply the necessary diligence in the exercise of their functions, failing to supervise the enforcement of Sadia's financial policies and to monitor the actions of the financial office, violating Articles 153 and 160 of Law 6404/74;[362] (iii) Eduardo Fontana d'Avila, Vice-President of the Sadia Board of Directors, and Diva Furlan, Luiza Helena, and Vicente Falconi, board members, all of them for failing to apply the necessary diligence, showing lack of knowledge and omission in relation to the most important aspects of the financial policy and violating Article 153 of Law 6404/74.

After the defenses had been presented, Commissioner Broedel, who was in charge of the vote, argued that at the core of the case was a discussion of the duty of care in adopting and monitoring the control systems for the purpose of ensuring compliance with Sadia's internal policies. According to his opinion, the CVM should not judge the company's choice to assume risk, but rather should constrain its analysis to verifying compliance of the board members and directors with the company's internal policies.[363]

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362. Lei No. 6.404, de 15 de Dezembro de 1976, art. 160, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("As normas desta Seção aplicam-se aos membros de quaisquer órgãos, criados pelo estatuto, com funções técnicas ou destinados a aconselhar os administradores.") ("The provisions of this Section shall apply to the members of any body created by the bylaws with specialist functions or appointed as consultants to the corporation's officers."); *id.* at art. 153 ("O administrador da companhia deve empregar, no exercício de suas funções, o cuidado e diligência que todo homem ativo e probo costuma empregar na administração dos seus próprios negócios.") ("In the exercise of his duties, a corporation officer shall employ the care and diligence which an industrious and honest man customarily employs in the administration of his own affairs.").

363. Comissão de Valores Mobiliários, Extrato da Sessão de Julgamento, Processo

Based on the analysis of the financial statements of the company, the commissioner concluded that the company did not comply with the risk limits established in its financial policies "in absurdum."[364] Moreover, the company did not implement an appropriate monitoring system to supervise its financial transactions.[365] The board members had the duty to monitor whether proper mechanisms of risk control were in place. Since they did not, board members violated their duty of care and their duty to inform themselves.[366] In the case of the members of the specific committees of the board, they also violated the duty to investigate inherent to the duty of care, and should be held responsible to a greater degree.[367]

Sadia board members Eduardo Fontana d'Avila, Diva Furlan, Luiza Helena, Norberto Fatio, and Vicente Falconi, who were not part of the financial and audit committees, were convicted and issued fines of R$ 200,000 each. Board members Walter Fontana, Francisco Céspede, Everaldo Nigro, and José Comparato, who were members of Sadia's financial or audit committees, were convicted and issued fines of R$ 400,000 each. Former Sadia CFO Ferreira was convicted and forbidden to hold a managerial position in a publicly held company for three years. Directors Alcides Tápias and Marcelo Fontana as well as Cássio Casseb and Roberto Faldini were absolved.[368] The majority of the *Colegiado*, the decisionary instance of the CVM, followed Commissioner Broedel's vote.[369]

2. Proceedings Against Sadia's Independent Auditors

The CVM filed Administrative Sanctioning Proceeding No. 2010/7631 (*Processo Administrativo Sancionador* or PAS RJ 2010/7631) against Sadia's independent auditors, KPMG Auditores

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Administrativo Sancionador CVM No. 18/08, ¶ 22, 14.12.2010, http://www.cvm.gov.br/export/sites/cvm/sancionadores/sancionador/anexos/2010/20101214_PAS_1808.pdf.

364. *Id.* ¶ 32.

365. *Id.* ¶ 38.

366. *Id.* ¶¶ 39, 44.

367. *Id.* ¶ 71.

368. *Id*. ¶¶ 88–90. Directors Alcides Tápias and Marcelo Fontana were not part of the board by the time evidence surfaced revealing the financial transactions exceeded the limits set by the company's financial policies. Cássio Casseb and Roberto Faldini assumed their term only after April 2008 and therefore did not have enough time to take the measures that are expected from a board member. *Id.*

369. *See id.* There was just one dissent vote cast by Diretor Eli Loria, who wanted more severe fines.

Independentes (KPMG Independent Auditors) and its partners Adelino Dias Pinho and Carlos Augusto Pires for issuing a clean opinion and failing to comply with regulations on disclosure of risk in financial statements. After defense and negotiations, the suit was settled for R$ 1,500,000.[370]

3. Proceedings Against Aracruz's Board Members and Officers

The CVM also initiated the Administrative Sanctioning Proceeding No. 16/2008 (*Processo Administrativo Sancionador* or PAS 16/2008) to investigate potential liability of the officers and board members of Aracruz connected to the alleged irregularities in the trading with derivative financial contracts and in the company's disclosure of information.[371]

The following officers of Aracruz were indicted: (i) Aguiar, CEO, for not disclosing the risk related to STF trading, for not reporting the market value of the trades, as well as the premises and criteria adopted for their calculation, in the explanatory notes of the Quarterly Financial Information,[372] and also for failing to follow the financial policy and for not familiarizing himself with new operations engaged by the CFO, which would characterize a breach in the duty of care, in violation of Article 153 of Law 6404/76;[373] (ii) Luciano Soares, Valdir Roque, and João César de Queiroz Tourinho, members of the financial committee, for lacking due care in the exercise of their functions, failing to obtain information necessary to evaluate the results of the financial policy adopted by the CFO and to assure its compatibility with the objectives defined by the Board of Directors, in violation of Article 153 of Law 6404/76; Mauro Agonilha, Sergio

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370. *See* Decisão do Colegiado de 09/07/2013, Apreciação de Nova Proposta de Termo de Compromisso—PAS RJ 2010/7631—KPMG Auditores Independentes, http://www.cvm.gov.br/decisoes/2011/20110419_R1/20110419_D01.html (Braz.).

371. Comissão de Valores Mobiliários, Sumário do Parecer do Comitê de Termo de Compromisso, Processo Administrativo Sancionador CVM nº16/2008, http://www.cvm.gov.br/export/sites/cvm/decisoes/anexos/0007/7207-0.pdf.

372. The *Informações Trimestrais* was released in June 2008. These practices violated the sole paragraph of Article 1º of Instruction CVM n. 235/95. *See* Sadia S.A., Informações Trimestrais, *supra* note 98.

373. Lei No. 6.404, de 15 de Dezembro de 1976, art. 153, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.), *translated in* Law No. 6.404 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf ("In the exercise of his duties, a corporation officer shall employ the care and diligence which an industrious and honest man customarily employs in the administration of his own affairs.").

Duarte Pinheiro, and Isaac Selim Sutton, members of the audit committee, for lacking due care in the exercise of their functions, for failing to obtain necessary information for the supervision of activities and internal controls, and for failing to participate in the elaboration of internal controls and to help the financial officer, even, in the case of Isaac Sutton, after receiving reports from the CFO about the positions assumed by the company in STF contracts, in violation of Article 153 of Law 6404/76; Luiz Aranha Corrêa do Lago and Raul Calfat, board members, for failing to obtain more information about STF contracting after getting notice of these contracts in reports of the CFO and for failing to observe red flags, in violation of Article 153 of Law 6404/76.

In the factual analysis, the CVM report (*Relatório*) details the competence of Aracruz's financial committee and audit and internal controls committee, which were supposed to meet often. The financial policy of the company established a maximum loss of US$ 40 million in derivative contracts in each quarter. Any decision to exceed this limit had to be shared with the Board of Directors and meet specific thresholds for future exchange trading. In the analysis of the operations of the STF, the CVM's report states that the total risk exposure of Aracruz amounted to more than three times the one authorized by its financial policies. In addition, the deposition of the company's Manager of Financial Operations (*Gerente de Operações Financeiras*) revealed that while the potential gains in the currency trading were fixed, the potential for losses were unlimited and leveraged by an exponential factor. In addition, the calculations used in the reports of the trading and the monthly accounting of the STF deals were flawed, showing that the company was not prepared to control and price the derivative contracts. These mistakes led to misleading disclosures, as those in the Quarterly Information of June 2008, in which the company stated that the notional values of the transactions initiated in April were R$ 573 million, when they were actually US$ 2.410 million. There were also mistakes in the terms of the transactions. While the company reported that the contracts would close between July and November of 2008, some in fact would not be closed until some time between July and October of 2009.[374]

Based on these premises, the CFO and CEO of Aracruz sent a letter to the company's independent auditors, stating that in their view disclosures that the gains in the derivatives trading were fixed while potential losses were unlimited were immaterial for the quar-

374. Comissão de Valores Mobiliários, Sumário do Parecer do Comitê de Termo de Compromisso, Processo Administrativo Sancionador CVM nº16/2008, http://www.cvm.gov.br/export/sites/cvm/decisoes/anexos/0007/7207-0.pdf.

terly information to be disclosed on June 30, 2008. Nonetheless, just a few months later, when the U.S. dollar rose against the real, the company suffered heavy losses. While not disclosed to investors, the CVM report mentions that the risk of devaluation of the real has always existed and was well known to Aracruz's CFO and CEO. It then concludes that the obligation to report details about the derivative contracts and their risks was not met, in violation of Article 1 of Instruction CVM n. 235/95, and was fulfilled only after the company already suffered financial losses.

The report also concludes that the CFO did not have enough knowledge or an expert team to assess the exact value and risk of the STF transactions. The CEO also appeared to have little knowledge of the trades, referring to them as mere hedge instruments. Therefore, the report concluded that the CFO and the CEO did not meet their duties of care, the former for taking actions without the proper diligence and the latter for failing to monitor the activities of the former. The report reached similar conclusions regarding the duties of care of members of the Financial and Audit Committee, as well as board members who either had the duty to be familiar with those transactions or had access to relevant information but failed to take any monitoring action.

In the first joint settlement proposal, each executive indicted in PAS 16/2008 offered to pay R$ 200,000, with the exception of Aguiar, who offered to pay R$ 400,000 for the extinction of the action. The Specialized Federal Prosecutor (*Procuradoria Federal Especializada*) argued for the rejection of this offer, reasoning that the proponents had not proposed to indemnify Aracruz for its losses, but only to make payments to the CVM.[375] The Committee for Settlement Proposals (*Comitê de Termo de Compromisso*) also recommended the rejection of the offer based on the inconvenience of a settlement in this case, due to the financial losses involved, the context in which the infractions happened and the gravity of the illicit behavior. It further requested a pronouncement from the *Colegiado* that could guide market participants in future analogous cases, and questioned CVM's interests in settling the case.[376] On September 9, 2010, the *Colegiado* adopted the opinion of the Committee and rejected the proposal for settlement involving all indicted executives.

On July 18, 2012, a new settlement was proposed. In this new proposal all executives indicted in PAS 16/2008 offered to pay R$ 800,000 each,[377] with the exception of Aguiar, who offered to pay

375. *Id.* at 8 n.67.

376. *Id.* at 8 n.68.

377. PAS CVM 16/2008 also mentions proposals from Carlos Alberto Vieira, João

R$ 1,200,000. At this time, Fibria Celulose S.A., the ultimate successor of Aracruz, manifested its formal acquiescence to the settlement proposed. It presented a document in which it attested that the social accounts of 2008 were approved by the extraordinary shareholder meeting, indicating the discharge of liability of all the managers, with the exception of former CFO Zagury, who, in that meeting, was found expressly liable for his behavior. In this vein, Fibria declared that it is not entitled to any indemnification from the indicted executives. For this reason, it would not oppose a settlement agreement by which the indicted executives were not obliged to indemnify the company.[378]

The Committee for Settlement Proposals observed the better offer in the pending proposal, but nonetheless maintained its previous recommendation to reject the settlement offer. It defended this position because of the magnitude of financial losses involved, the context in which the infractions happened, and the gravity of the illicit behavior. Further, it insisted that the *Colegiado* provide further guidance on the merits of the case in order to guide the future actions of market participants.

In opposition to the opinion of the Committee for Settlement Proposals, the *Colegiado* unanimously approved the settlement, alleging that the value paid by the managers would be sufficient to deter similar behavior. With respect to former Aracruz CFO Zagury, it approved a settlement proposal for R$ 1.5 million.[379] The CVM justified it as the value of the settlement reached in the suit of the Rio de Janeiro court.[380]

4. Proceedings Against Aracruz's Independent Auditors

The CVM also started Administrative Sanctioning Proceeding

Carlos Chede, Ernane Galvêas, Haakon Lorentzen, Eliezer Batista da Silva, and Alexandre Silva D'Ambrosio who were not indicted by the PAS 16/2008, but also presented proposals due to a request from Commissioner Otávio Yazbek from November 26, 2010, at page 1. This order unfortunately has not been made available by the CVM.

378. Comissão de Valores Mobiliários, Sumário do Parecer do Comitê de Termo de Compromisso, Processo Administrativo Sancionador CVM nº16/2008, at 9 n.70, http://www.cvm.gov.br/export/sites/cvm/decisoes/anexos/0007/7207-0.pdf (Braz.).

379. Aracruz Celulose, Ata da Reunião do Colegiado nº 26 de 09.07.2013, Apreciação de Nova Proposta de Termo de Compromisso—PAS 16/2008—Aracruz Celulose (Braz.), http://www.cvm.gov.br/decisoes/2013/20130709_R1.html

380. *CVM e MPF celebram novo Termo de Compromisso e de Ajustamento de Conduta em procedimentos administrativo e civil público*, PORTAL DO INVESTIDOR (July 11, 2013), http://www.portaldoinvestidor.gov.br/noticias/Noticia110613-2.html.

No. 2010/4524 (*Processo Administrativo Sancionador* or PAS RJ 2010/4524) against Aracruz's independent auditors, Deloitte Touche Tohmatsu and its partner José Carlos Monteiro for issuing a "clean opinion" and failing to comply with regulation on disclosure of risk in financial statements. After defense and negotiations, this suit was settled for R$ 1,000,000.[381]

5. Comparative Analysis

The CVM's enforcement actions show that public enforcement resulted in relevant sanctions and discipline of board members and managers, contrasting with the absolute lack of any public action in the United States. These public enforcement outcomes therefore question the traditional hypothesis that foreign cross-listed firms face stronger enforcement actions in the United States than in their home countries.[382]

The CVM reached substantially different legal conclusions in the two cases, despite assessing similar wrongful behaviors. It convicted managers and board members of Sadia but settled with the managers and board members of Aracruz. An analysis of these contradictory results shows that the Aracruz settlement actually placed a greater financial burden on its managers and board members than the fines levied on Sadia's convicted counterparts. The explanation for these contrasting regulatory outcomes relies on outdated legal provisions of Article 11 of Law 6,385/76, which provides a low limit for fines applied by the Brazilian regulator. Under this legal framework, the CVM cannot impose higher fines than R$ 500,000.[383] Hence, if the CVM wanted to impose higher pecuniary sanctions to managers of Aracruz than allowed by the legal ceiling, it would have to settle the case. This was in fact the approach chosen by the CVM in the settlement with Sadia's and Aracruz's independent auditors and Aracruz's managers and board members.[384]

381. *See* Decisão do Colegiado de 13/09/2011, Apreciação de Nova Proposta de Termo de Compromisso—PAS RJ2010/4524—Deloitte Touche Tohmatsu Auditores Independentes, http://www.cvm.gov.br/decisoes/2011/20110913_R1/20110913_D01.html.

382. *See supra* notes 81–82 and accompanying text.

383. Lei No. 6.385, de 7 de Dezembro de 1976, art. 11 ¶ 1(I), DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 9.12.1976 (Braz.), *translated in* Law No. 6.385 of Dec. 15, 1976 (Braz.), http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.385-ing.pdf.

384. *See* Comissão de Valores Mobiliários, Parecer do Comitê de Termo de Compromisso, Processo Administrativo Sancionador CVM No. RJ2010/4524, ¶ 24, 09.11.2010, http://www.cvm.gov.br/export/sites/cvm/decisoes/anexos/0007/7381-0.pdf. The

This discussion demonstrates a current paradox in the Brazilian system of public enforcement, according to which the regulator has to settle with violators in the most egregious cases rather than convicting them. Therefore, a legal reform is necessary to drop the anachronistic legal limit for fines established by the law.

Considering both cases, only one manager was issued a non-pecuniary penalty. This was the case of Ferreira, the former CFO of Sadia who was prohibited from exercising managerial positions in publicly-held companies for three years. This non-pecuniary sanction was issued after the conviction in the Sadia administrative proceeding, and obviously resulted in pecuniary and reputational costs. Therefore, Ferreira's penalty was allegedly more severe than the R$ 1.5 million payment inflicted on Aracruz's former CFO in the settlement with the CVM.[385]

CONCLUSION

This Article provides detailed case studies of two Brazilian non-financial corporations, Sadia and Aracruz, which suffered great losses during the financial crisis. The rapid devaluation of the Brazilian exchange currency in relation to the U.S. dollar generated unexpected losses from derivative exchange contracts entered into by the companies.

U.S. private attorneys filed class actions against both companies on behalf of investors, claiming that the companies recklessly engaged in speculative trading in violation of their corporate policies. According to their thesis, investors acquired securities of Sadia and Aracruz at artificially inflated prices during the class period. Company executives were accused of making materially false and misleading statements concerning Sadia's and Aracruz's trading practices, misrepresentation of earnings and financial conditions of the companies, and failure to disclose material information. In Brazil, both Sadia's and Aracruz's shareholders authorized the companies to sue their former CFOs Ferreira and Zagury in derivative suits alleging breach of fiduciary duties. The financial problems also brought about administrative proceedings from the CVM, the Brazilian securities market regulator.

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violators then, based on the fine limit, argued that the settlement proposals cannot be so "disproportional" in relation to the maximum limit allowed by the law. *Id.*

385. *See* Choi & Pritchard, *supra* note 64, at 2 (stating that public regulators have the power to restrict individuals from serving as directors and officers of public companies and arguing that this is a "career death sentence for the individual subjected to a bar").

I examined the outcomes of private and public enforcement actions taken in the United States and in Brazil. In relation to private enforcement, the U.S. class actions filed by private attorneys provided financial recovery to Sadia and Aracruz investors, while in Brazil shareholders of both companies had to bear their financial losses. The only modest financial indemnification was paid to the company Aracruz by its former CFO Zagury in the settlement of a derivative suit in the Rio de Janeiro court. The derivative suit filed by Sadia against former CFO Ferreira was dismissed in the São Paulo court. Therefore, from the perspective of a self-interested investor concerned with her micro-case, it is better to invest in securities traded in the United States than those traded in Brazil, as the potential for damage recovery is significant in the former but seriously constrained in the latter.

Yet, while private enforcement in the U.S. was more effective, public enforcement failed. In contrast, private enforcement in Brazil was weak, but the Brazilian securities public regulator charged officers and board members of both Sadia and Aracruz. An intracase comparison provides that equivalent cases were treated differently by the Brazilian regulator. The CVM convicted the managers of Sadia and settled the case with managers of Aracruz. Nonetheless, Aracruz's settlement inflicted higher financial penalties on its managers than those imposed on Sadia's convicted managers. Ferreira, the former CFO of Sadia, was the only manager issued a strong nonpecuniary sanction, as he was restrained from the exercise of managerial offices for three years.

These outcomes show that public enforcement was stronger in Brazil than it was in the United States, as the SEC did not take any action. They also cast doubt on the traditional hypothesis that foreign cross-listed firms face stronger enforcement actions in the United States than in their home country.[386] A blunt comparison of results of the private enforcement in the United States and public enforcement in Brazil reveals that many more officers and directors were indicted and suffered greater pecuniary and reputational sanctions in Brazil than in the United States. Key individuals convicted in administrative proceedings had to pay fines or bear settlement costs from their own pockets. Therefore, it is fair to say that the Brazilian enforcement—largely public—in the end resulted in stronger sanctions than did U.S. private enforcement, both in terms of individuals charged and/or convicted and fines levied or settlements costs imposed.

This Article points out areas for enforcement improvement.

386. *See supra* notes 81–82 and accompanying text.

In Brazil, class actions deserve special attention in the realm of capital markets and require drastic reform. The legal limits on fines imposed by the public enforcer should be dropped or largely increased. In the United States, public enforcement against foreign companies should be improved. The Article also points out that joint actions between public regulators can be enhanced.