Institutional bypass and third party protection

José Miguel Mendoza
Head of Judicial Enforcement
'Nothing can be so unjust as a few persons abounding in wealth to offer a portion of their excess for the formation of a company, to play with that excess, to lend the importance of their whole name and credit to the company, and then, should funds prove insufficient to answer all creditors, to retire into the security of their unhazarded fortune, and leave the bait to be devoured by the poor deceived fish'.

Editorial, the Times of London, 1824
‘Corporation: An ingenious device for obtaining individual profit without individual responsibility’.

Ambrose Bierce, *The Devil’s Dictionary* (1911)
‘If we look at a corporation as a legal person, it may not be that difficult to actually draw the transition between psychopathy in the individual to psychopathy in the corporation’.

Robert Hare in The Corporation (2003)
Introduction

Historical aversion to allow unrestricted access to legal entities with limited liability

- Corporate scandals, abuse of the corporate form

The flexibility required for hybrid business forms to work can rekindle these old misgivings

- Pushback against the introduction of HBFs
Introduction

Easy access to HBF  ?  Protection against abuse

Highly context-dependent

Level of development
Institutional infrastructure
Cultural mores
Legal system
In Theory
(ex ante vs ex post protection)

In Practice
The Colombian experience
Ex ante vs Ex post

**Ex ante (rules)**
- Minimum legal capital
- Public deeds
- Closed purpose clauses
- Bans and restrictions

**Ex post (standards)**
- Fairness reviews
- *Abus de droit*
- Equal treatment rules
- Piercing the veil

Tracks the rule vs standards debate

- R Gilson and A Schwartz (2012)
- C Sunstein (1994)
## Ex ante vs Ex post

<table>
<thead>
<tr>
<th></th>
<th>Easy access to HBFs</th>
<th>Protection against abuse</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ex ante rules</strong></td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Ex post standards</strong></td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>
Ex ante vs Ex post

Ex post mechanisms are the superior alternative to achieve easy access to HBF and adequate protection.

The catch: The institutional infrastructure required for ex post mechanisms to work is costly and cannot be developed overnight.
Ex ante vs Ex post

Corporate judicial expertise

Interpreting relevant language
Evaluating trial evidence

Inferring intended performance from rendered performance
Industry-relevant experience

R Gilson and A Schwartz (2012)

The catch-22: Judicial expertise cannot be developed unless individuals start relying on ex post mechanisms. Individuals will not use ex post mechanisms unless the judiciary has the relevant expertise.
The Colombian experience

The Simplified Stock Corporation Act (2008)

**Easy access to limited liability for microentrepreneurs**

- Suppressed ex ante mechanisms
- No public deed
- Open purpose clause
- Suppression of bans and restrictions

- Emphasis on ex post protection
- Piercing remedy
- Abuse of voting rights
- Corporate disputes
The Colombian experience

Latin American judiciaries

<table>
<thead>
<tr>
<th>Country</th>
<th>Length</th>
<th>Cost (% claim)</th>
<th>Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>590</td>
<td>16.50%</td>
<td>97.4</td>
</tr>
<tr>
<td>Brazil</td>
<td>616</td>
<td>16.50%</td>
<td>101.6</td>
</tr>
<tr>
<td>Mexico</td>
<td>415</td>
<td>32%</td>
<td>132.8</td>
</tr>
<tr>
<td>Uruguay</td>
<td>720</td>
<td>19%</td>
<td>136.8</td>
</tr>
<tr>
<td>Chile</td>
<td>480</td>
<td>28.60%</td>
<td>137.3</td>
</tr>
<tr>
<td>Ecuador</td>
<td>588</td>
<td>27.20%</td>
<td>159.9</td>
</tr>
<tr>
<td>Peru</td>
<td>468</td>
<td>36%</td>
<td>167.1</td>
</tr>
<tr>
<td>Paraguay</td>
<td>591</td>
<td>30%</td>
<td>177.3</td>
</tr>
<tr>
<td>Bolivia</td>
<td>591</td>
<td>33.20%</td>
<td>196.2</td>
</tr>
<tr>
<td>Venezuela</td>
<td>510</td>
<td>43.70%</td>
<td>222.9</td>
</tr>
<tr>
<td>Colombia</td>
<td>1346</td>
<td>52.60%</td>
<td>708.0</td>
</tr>
</tbody>
</table>

Lack of training and expertise in corporate matters
Judicial system clogged by significant backlog
Insufficient personnel, resources

Doing Business (2011)
The Colombian experience

**Institutional bypass**: Combines the human and financial resources of regulators with the independence of judiciaries

Regulator with full judicial powers for corporate affairs
The Colombian experience

Superintendencia de Sociedades

Law

Year


446  1258  1429  1450  1564

piecemeal allocation  SAS  SAS extended

446  1258  1429  1450  1564
The Colombian experience

Data
2008-2012 (June)

Average: **14 months**

Yearly average: **7 decisions**
The Colombian experience

Restructuring

Insolvency Division

DJE

Division of judicial enforcement
The Colombian experience

Preliminary data
2012 (july to december)

- No. of decisions: 17
- Average length of proceedings: 4 months
- Preliminary injunctions: 20
In closing

1. HBFs may require improving framework for ex post enforcement

2. Ex post enforcement must be grounded on solid infrastructure

3. Judiciaries in developing countries may not be up to the task

4. Institutional bypass (mixed private enforcement) can provide effective solutions
In closing

‘It doesn’t matter whether a cat is black or white, as long as it catches mice’

D. Xiaoping