CAPITAL MARKETS

CVM CHANGES ITS UNDERSTANDING ON CONFLICTS OF INTERESTS

26 SEPTEMBER 2022

AUTHORS

ADRIANA PALLIS
PARTNER / SÃO PAULO

ELIANA AMBRÓSIO CHIMENTI
PARTNER / SÃO PAULO

GUSTAVO RUGANI
PARTNER / BELO HORIZONTE

For several years and at various times, there has been discussion not only in the scholarly sphere, but also in the administrative sphere of the Brazilian Securities and Exchange Commission (CVM) regarding the nature of conflicts of interests and the consequent prohibition on voting rights, whether the prohibition is absolute or whether it is necessary to analyze the merits of the decision (substantive theory). Over the years, we have seen the CVM's understanding varying from an understanding of formal conflict to one of a substantive conflict. Until now, the understanding that prevailed was that of a formal conflict.

On August 16th, again, an analysis in an administrative proceeding evaluated by the board of the CVM brought the topic to discussion, but with a majority already formed, which changes the understanding until then in force.

As the last change in the CVM's position occurred in 2010, it is necessary to recapitulate the whole discussion and the hectic history of decisions, but not without first going back to the legal provision that generated the different interpretations.

Article 115 of Law 6,404/76 (the Brazilian Corporations Law) treats as abusive and vetoes votes exercised with the purpose of causing damage to the company or to other shareholders; or that by which the shareholder seeks to obtain an advantage to which he is not entitled and that results or may result in damage to the company or to other shareholders. In practice, various situations can constitute abuse of voting rights.

Although voting is a shareholder's right, it cannot be exercised for a purpose other than the interest of the company, hence exercising the vote in this manner is considered abusive.

Abuse of voting rights can be committed by both the controlling shareholder and minority shareholders, because the Brazilian Corporations Law makes no distinction when dealing with abusive voting, and the rule applies to any shareholder who exercises the right to vote, in any kind of general meeting.

Voting with the purpose of causing damage to the company seeks only to harm the other shareholders.

Voting by means of which a shareholder seeks to obtain, for himself or another person, an advantage to which he is not entitled and which results or may result in harm to the company or to the other shareholders, is also considered abusive. In this case, the vote is contrary to the company's interests and also seeks to obtain an illegitimate individual advantage.

But the aforementioned article of the Brazilian Corporations Law, in paragraph 1, also establishes three scenarios for resolutions in which the shareholder is **prohibited from voting** and in which there is an absolute prohibition, since it is assumed that there is a formal conflict of interest between the shareholder and the company:

- approval of the appraisal report of the assets with which he contributes to the formation of the capital stock;
- approval of his accounts as an officer; and
- that can benefit him in a personal way.

Article 115 also mentions a scenario for impediment against voting when there is an interest conflicting with that of the company, precisely the subject of analysis by the CVM's board that we will bring up in this article and discuss later.

The analysis even goes further and mentions a situation of private benefit as part of the same materialistic theory, and not as a case of formal conflict. But this is a controversy worth its own article.

The rule in paragraph 1 of article 115 of the Brazilian Corporations Law is exhaustive and does not allow interpretations that extend the prohibition, since the right to vote is considered an essential right of the shareholder and is also essential for the resolution passed at the meeting, in which the corporate interest is manifested. For this reason, the prohibition on exercising this right must be restricted to the reasons expressly provided for in the Brazilian Corporations Law.

In the three scenarios referred to in paragraph 1, the shareholder is prohibited from voting, although the prohibition on voting does not prevent him from attending the meeting and discussing the matters put up for resolution. The impediment is on voting, not on attending and expressing an opinion on the matters on the agenda, because the shares of the impeded shareholder make up the quorum required to convene the meeting, which is different from the quorum for resolutions.

The first scenario for prohibition on voting is related to approval of the valuation report of the shareholder's assets to be contributed to the capital stock. There is an absolute presumption that the shareholder, in this case, has no impartiality to vote, either on the choice of the experts or on the report prepared by them. In this

situation, the prohibition effectively prevents the shareholder from approving a report that may overvalue his assets. Since the prohibition is absolute, the shareholder's intention or the content of his vote is irrelevant.

The second scenario for an impediment, provided for in paragraph 1, refers to approval of accounts, when the shareholder is also a company officer. The Brazilian Corporations Law also prohibits officers from voting as shareholders or proxies in this case (article 134, paragraph 1). The prohibition here is also absolute, since no one can be a judge in his own cause. Since the shareholder cannot separate the two roles he plays, the Brazilian Corporations Law prevents him from voting.

The third scenario of absolute impediment on voting is the one that occurs when the resolution may benefit the shareholder in a **personal way**, an expression identical to the one used in the 1940 law[1], which keeps the questions about what "personal benefits" would be, as well as its distinction from "conflicting interest", given the vagueness of the concepts. And, in this situation, as already mentioned, the new CVM decision puts in doubt whether it would even be a case of absolute impediment, even though paragraph 4 of article 115 cites only votes conflicting with the company's interests as null and void.

The personal benefit exists due to resolutions of the general meeting that result in an **exclusive** advantage for a certain shareholder, which does not benefit the other holders of shares issued by the company.

However, there is (still) great controversy about the extent of the concept of "personal benefit": whether it would only be established by virtue of advantages attributed to the shareholder in his **capacity as a partner** of the company or whether it would also apply in cases of advantages that **do not arise from the corporate relationship** itself or that are not directly related to the resolution to be taken.

According to part of the legal scholarship, only the lawful advantage conferred to certain shareholders in their capacity as shareholders, which exceeds the principle of equality among partners, constitutes a personal benefit.[2] In other words, the establishment of a personal benefit presupposes the granting of an advantage of a corporate nature to a certain shareholder.[3] According to this understanding, what the law intends to avoid is breaking of the relationship of equality among the shareholders, preventing one of them from deciding to assign to himself, through his vote, an advantage, even if legitimate, within the scope of corporate relations.

In its most recent opinions on the matter, the CVM found that a personal benefit would also cover advantages not linked to the corporate relationship, such as those arising from contracts signed between the shareholder and the company.[4]

Despite the above controversy, we can say that a **personal benefit** is present when the resolution can bring about an **exclusive** advantage to a certain shareholder, which is not extendable to the other shareholders of the company.

In the three[5] scenarios mentioned, the shareholder could not vote, regardless of his intention or the merits of the resolution. If he casts his vote, the chairman will not compute it. The resolution of the meeting, passed in the exercise of this vote, when necessary to form a majority, will be voidable. A resolution passed with a prohibited vote can be annulled, even if no damage occurs to the company.[6]

Now we come to the issue of conflicts of interests, the subject of the current analysis and the change in the CVM's position: as we said, the final part of paragraph 1 also refers to the prohibition on voting when the shareholder has interests conflicting with those of the company, which generated all the discussion in legal scholarship and in the CVM's administrative sphere regarding the nature of the prohibition, whether it would be an absolute prohibition, as occurs in other cases, or whether it would be necessary to analyze the merits of the decision in each concrete case.

Situations of conflict of interest arise, as a rule, from the existence of a legal relationship involving, on the one hand, the shareholder and, on the other, the company. In these situations, a conflict arises when the shareholder's interest is incompatible with the corporate interest, and one of them cannot be satisfied without harming the other.

For some authors, scenarios of conflict of interest should be analyzed under a merely **formal** criterion, according to which the shareholder would be **prohibited** from intervening in any resolution in which he has an interest that **potentially** conflicts with the company, regardless of the merits of the decision or the factual circumstances in which it was adopted.[7] Violation of this prohibition would render the resolution null and void, even if the vote cast by the shareholder has not caused any damage to the company.

For this school of thought, a formal conflict of interest exists in every bilateral legal transaction in which the shareholder and the company are contracting parties. Bilateral business, in itself, already implies the existence of diverse interests between the parties. Thus, there will always be a formal conflict, even if the legal transaction brings about equitable benefits for the company and its shareholder.[8]

For other authors, however, corporate law regulates situations of conflict of interest from a **substantive** standpoint.[9] Therefore, the possible illegality of the interference of the shareholder in the resolutions in which he is in a situation of potential conflict of interest with the company constitutes a factual issue, to be assessed ***a posteriori***, based on an analysis of the merits of the decision, according to the concrete circumstances of each case.

The substantive (or material) conflict is only established when the vote is used in misuse of purpose, to promote shareholder interests incompatible with the corporate interest. In these cases, the shareholder's vote is unlawful, since he is sacrificing the corporate interest in favor of his own interest.

In the case of an absolute prohibition, the conflict of interests would be formal, found even before the vote is

cast, by the simple position occupied by the shareholder and the company in a certain legal relationship. On the other hand, if the merits of the resolution were to be analyzed, the conflict would be of a substantive (or material) nature.[10]

Let's take a look at the history of changes in the CVM's position on the subject: in a case in 2001, the understanding was that there is an absolute prohibition for a shareholder to participate in a resolution in which he had an interest potentially conflicting with the company, therefore considering it to be a case of a **formal** conflict of interest.[11]

Indeed, in **Administrative Inquiry TA RJ 2001/4977**, the rapporteur board member Norma Parente expressed her opinion to the effect that the conflict is formal, when she decided that: "In the present case, it is unquestionable, in my opinion, that the benefit of the controller derives from the contract itself because he is on both sides, which is why he should abstain from voting, regardless of whether the contract is equitable. This is a case of negotiating with oneself. When referring to resolutions that may benefit the shareholder, the law does not assume that the shareholder is contracting with the company against the corporate interest. On the other hand, a conflict of interest does not presuppose that the interests are opposite but that the shareholder has dual interests. A conflict of interest, in fact, is established to the extent that the shareholder not only has a direct interest in the company's business but also has his own interest in the deal that is independent of his status as a shareholder because he is the counterparty to the deal. The conflict does not need to be divergent or opposing, or that there be an advantage for one and a loss for the other. The law employs the word conflict in a broad sense covering any situation in which the shareholder is negotiating with the company."

In 2002, the CVM's board understood differently and its opinion was that article 115 of the Brazilian Corporations Law regulates situations of conflicts of interest based on a substantive analysis, in which there is no absolute prohibition on the shareholder's participation in the general meeting's resolutions.[12]

In this sense, in **Administrative Inquiry No. TA RJ 2002/1153**, through the prevailing opinion of board member Luiz Antonio Sampaio Campos, the understanding was settled that the conflict of interest would be **substantive** (material): "The line that finally came to prevail for cases of conflict of interest, as shall be shown below, was that for which the conflict of interest should be assessed in the concrete and specific case, in a substantive and not formal manner, and in my opinion it is the one that best defends the corporation's assets and is integrated in the corporation system. This understanding, as I have already had the opportunity to explain, is a majority both in Brazil and abroad, and it is rare for anyone to hold the contrary, especially in Brazil (...) In Brazil, the subject has not been forgotten either. The view has always been that conflicts of interest are a question of fact, to be examined on a case-by-case basis, and that conflicts would need to be evident, colliding, strident, irreconcilable."

To the same effect was the judgment of **Administrative Proceeding CVM RJ 2004/5494**. The Appeals Board of the National Financial System - CRFSN, in appellate decision 4706/04, understood the conflict to be **formal**, since, when analyzing paragraph 1 of article 115 of the Brazilian Corporations Law, it concluded that: "The most appropriate interpretation for the final part of the provision in question - which deals with the personal benefit or conflicting interest - should be the one that concludes that the vote of the shareholder who considers himself to be in conflict is prohibited *a priori*, but only in the event that this voting shareholder, in his value judgment, finds himself in a situation of conflict. (...) The central issue is that, if there is, as there was, an interest of the external affiliate and indirectly of its subsidiary and this appellant in the execution of the contract, the latter should have abstained from voting, which would have avoided materialization of the conflict."

In a new change of position, in 2010, the board of the CVM returned to the position, in response to a consultation submitted by a publicly-traded company, that article 115, paragraph 1, of the Brazilian Corporations Law deals with cases of **formal** conflicts of interests, with the shareholder being absolutely prohibited from voting in any resolution in which he has interests potentially conflicting with the company.[13]

In fact, in the decision of Administrative Proceeding CVM RJ 2009/13179, in which the rapporteur was board member Alexsandro Broedel Lopes, the agency stated again that the conflict was formal. Dissenting in this judgment was board member Eli Loria, who understood that the conflict of interest can only be found after the meeting is held and upon proof of the damage caused to the company. Here, the formal conflict was used despite the attempt to mitigate it, with the creation of a special independent committee in accordance with the provisions of Opinion 35, created for situations of corporate reorganization transactions in which parent and subsidiary companies are involved, representing "a single will".

In this decision, the CVM also pointed to the possibility of adopting a less rigid alternative, which would mitigate the excessive rigor of the defenders of the formal current, according to which cases of conflict of interests can be divided into two distinct groups:

> those in which the conflict is evident and appears *a priori*, in which the impediment to vote should be in force summarily; and

> those in which the conflict is not evident, for which the prohibition on voting must be justified if it is invoked by other shareholders.[14]

In 2015, the board reaffirmed the formal theory in the Eletrobrás case, by deciding against the Federal Government's vote in the resolution for the renewal of the generation and transmission concessions of Eletrobrás' subsidiaries, although this decision was later modified by the CRFSN through a casting vote by the chairman of the board.

The same position, by the formalist theory, was confirmed in a new case reviewed in 2020, in which the board modifying the decision of the technical department, allowed the vote of the shareholders of Linx S.A. in the merger transaction STNE Part. S.A., on the understanding that there would be no conflict of interest or personal benefit in the situation.

In this case, two board members even affirmed that there was no personal benefit, because there was no breach of the equality of treatment or direct relationship with the resolution, as well as no "flagrant opposition between the interests of the appellants and the corporate interest", and there was no conflict capable of preventing Linx S.A. shareholders from voting.

In the administrative sanctions proceeding whose judgment was initiated at the board session on August 16, 2022 (case 19957.003175/2020-50), the board concluded that the**materialist** theory of conflict of interests should be adopted, changing its position, given that "the historical analysis added to the majority principles and presumption of good faith and strengthening of the means of remedial protection of minority shareholders' rights in the Brazilian capital market is not consistent with the adoption of a formal analysis with regard to the impediment on voting by shareholders in the cases analyzed in paragraph 1 of article 115 of the Brazilian Corporations Law."

This already seemed to be a trend, not only because of the attempt to soften the formal theory (although maintaining it) in 2010, but also because in 2021, in a case involving Cyrela - FII Grand Plaza, "bases of the material theory of conflict of interests" had already been used to allow the vote of a majority shareholder of an investment fund in a resolution passed at a shareholders' meeting regarding the spin-off of an investment fund, even though the formal theory was still confirmed, as we said above.

In fact, there was no settled case law on the subject, which was positioned either by the formal theory or the material theory.

We are now waiting for the board decision to change the position and, if so, for how long it will prevail.

---

[1] Article 82 of Decree-Law 2,627/40 stated the following: "shareholders cannot vote on resolutions of the general meeting regarding the valuation report of assets contributed to formation of the capital stock, nor on those that benefit him in a personal way." However, article 95 of the same law provided that: "a shareholder who, having interests contrary to those of the company in a transaction, votes on a resolution that reaches the necessary majority with his vote shall be held liable for losses and damages." EGBERTO LACERDA TEIXEIRA. ***Das Sociedades por Quotas de Responsabilidade Limitada*** ["Limited Liability Companies"] - updated according to the New Civil Code by Syllas Tozzini and Renato Berger. 2nd edition, São Paulo: Quartier Latin, 2007, p. 176, criticizes its wording, noting that: "The legislator, in our opinion, would have been better advised to not make the subtle and dangerous distinction between 'personal benefit' and 'interests contrary to those of the company' because, in fact, the two errors can easily be confused, they being the modalities of the 'self-contract' or 'contract with oneself'".

[2] ERASMO VALLADÃO AZEVEDO E NOVAES FRANÇA.**Temas de Direito Societário, Falimentar e Teoria da Empresa** ["Topics in Corporate and Bankruptcy Law and Theory of the Company"]. São Paulo: Malheiros, 2009, p. 576/577

[3] Vote of Officer Luiz Antonio de Sampaio Campos in a decision by the Board of the CVM in CVM Administrative Proceeding TA/RJ2001/4977.

[4] Decision of the Board of the CVM inCVM Case RJ 2009/13179 and in CVM RJ 2009/5811.

[5] Except for the mention made in PAS 19957.003175/2020-50 as noted herein.

[6] JOSÉ ALEXANDRE TAVARES GUERREIRO, "Conflicts of Interest between Controlling Companies and Subsidiaries and between Affiliates, in the Exercise of Voting Rights at General Meetings and Corporate Meetings", **Revista de Direito Mercantil, Industrial, Econômico e Financeiro** ["Journal of Commercial, Industrial, Economic, and Financial Law"]. São Paulo: Ed. Revista dos Tribunais, v. 51, July-September, 1983, p. 29-32.

[7] MODESTO CARVALHOSA. ***Comentários à Lei de Sociedades Anônimas*** ["Comments on the Law of Corporations"], São Paulo: Saraiva, 2003, vol. 2, pp. 464/465; NORMA PARENTE. "*O Acionista em Conflito de Interesses*" ["Shareholders in Conflicts of Interests"]. In:***Direito Empresarial (Aspectos Atuais de Direito Empresarial Brasileiro e Comparado)*** ["Business Law (Current Aspects of Brazilian and Comparative Business Law)"]. Ecio Perin Junior, Daniel Kalansky, and Luis Peyser (Coord.). São Paulo: Método, p. 3229 et seq.

[8] NELSON EIZIRIK. ***Temas de Direito Societário*** ["Topics in Corporate Law"]. Rio de Janeiro: Renovar, 2005, p.72.

[9] NELSON EIZIRIK. ***A Lei das S/A Comentada*** ["Comments on the Brazilian Corporations Law"]. São Paulo: Quartier Latin, 2011, vol. I, pp. 662/663. To the same effect: ERASMO VALADÃO AZEVEDO E NOVAES FRANÇA. ***Conflito de Interesses nas Assembléias de S.A.*** ["Conflicts of Interest in Corporate Meetings"]. São Paulo: Malheiros, 1993, p. 89. LUIZ GASTÃO PAES DE BARROS LEÃES. ***Estudos e Pareceres sobre Sociedades Anônimas*** ["Studies and Opinions on Corporations"]. São Paulo: RT, 1989, p. 25; TRAJANO DE MIRANDA VALVERDE. ***Sociedades por Ações*** ["Corporations"]. Rio de Janeiro: Forense, 1959, p. 26.

[10] Understanding that this is a formal conflict of interest: MODESTO CARVALHOSA.***Comentários à Lei de Sociedades Anônimas*** ["Comments on the Brazilian Corporations Law"]. v. 2 ..., p. 470; NORMA PARENTE, according to opinion issued in CVM Administrative Inquiry TA RJ 2001/4977, decided on December 19, 2001, and article published in **Direito Empresarial: Aspectos Atuais de Direito Empresarial Brasileiro e Comparado**["Current Aspects of Brazilian and Comparative Business Law"]. São Paulo: Método, 2005, p. 329-343. Considering that this is a substantive conflict: LUIZ GASTÃO PAES DE BARROS LEÃES, "*Conflito de Interesses*" ["Conflicts of Interests"]. In: ***Estudos e Pareceres sobre Sociedades Anônimas*** ["Studies and Opinions on Corporations"]. São Paulo: Revista dos Tribunais, 1989, p. 25-26; FABIO KONDER COMPARATO, "*Controle Conjunto, Abuso no Exercício do Voto Acionário e Alienação Indireta de Controle Empresarial*" ["Joint Control, Abuse in the Exercise of Shareholder

Voting and Indirect Disposal of Corporate Control"]. In: **Direito Empresarial: Estudos e Pareceres**. São Paulo: Saraiva, 1990, p. 91; ERASMO VALLADÃO AZEVEDO E NOVAES FRANÇA, "*Conflito de Interesses: Formal ou Substancial? Nova Decisão da CVM sobre a Questão*" ["Conflict of Interests: Formal or Substantive? New CVM Decision on the Issue"]; **Revista de Direito Mercantil, Industrial, Econômico e Financeiro**["Journal of Commercial, Industrial, Economic, and Financial Law"]. São Paulo: Ed. Malheiros, v. 128, October-December, 2002, p. 259; TRAJANO DE MIRANDA VALVERDE. ***Sociedades por Ações*** ["Corporations"]... v. II, p. 116 and 315; CARLOS FULGÊNCIO DA CUNHA PEIXOTO. **Sociedades por Ações** ["Corporations"]. v. 3, São Paulo: Saraiva, 1972, p. 81; EGBERTO LACERDA TEIXEIRA and JOSÉ ALEXANDRE TAVARES GUERREIRO. **Das Sociedades Anônimas no Direito Brasileiro** ["Corporations in Brazilian Law"]. v. 1, São Paulo: José Bushatsky, 1979, p. 278; PEDRO A. BATISTA MARTINS, "*Responsabilidade de Acionista Controlador – Considerações Doutrinária e Jurisprudencial*" ["Responsibility of Controlling Shareholders - Considerations from Legal Scholarship and Case Law"], ***Revista de Direito Bancário e do Mercado de Capitais*** ["Journal of Banking and Capital Markets Law"]. São Paulo: Ed. Revista dos Tribunais, v. 27, January-March, 2005, p. 58-63. On this subject, see also LUIZA RANGEL DE MORAES, "*A Jurisprudência no Tocante aos Conflitos de Interesse no Exercício do Voto em Sociedades Anônimas*" ["Case Law Regarding Conflicts of Interest in the Exercise of the Vote in Corporations"], ***Revista de Direito Bancário, do Mercado de Capitais e Arbitragem*** ["Journal of Banking and Capital Markets Law and Arbitration"]. São Paulo: Ed. Revista dos Tribunais, v. 11, January-March, 2001, p. 281-288; and JAIRO SADDI, "*Conflitos de Interesse no Mercado de Capitais*" ["Conflicts of Interest in the Capital Markets"]. In: Rodrigo R. Monteiro de Castro and Leandro Santos de Aragão (Coord.). ***Sociedade Anônima – 30 Anos da Lei 6.404/76***["Corporations - 30 Years of Law 6,404/76"]. São Paulo: Quartier Latin, 2007, p. 344-346. The dispute was summarized in the article "Is a Formal Conflict of Interest Enough to Stop a Shareholder or Board Member from Voting?", in the Antithesis Section, **Revista Capital Aberto** ["Open Capital Journal"]. No. 89, January, 2011, pp. 30-31.

[11] CVM Administrative Inquiry 2001/4977.

[12] CVM Administrative Inquiry TA-RJ 2002/1153

[13] CVM Board Decision in Case RJ2009/13179.

[14] In this regard, it is worth transcribing the following excerpt from the opinion of board member Alexsandro Broedel: "59. The text above conveys the idea that there will be, in cases of conflict of interests, two distinct situations: (i) one in which such conflict is apparent *a priori*, when, then, the impediment on voting must be in force summarily; (ii) another in which this conflict is not so evident, it being possible, obviously, to consider the prohibition on voting, which, however, must be justified, when invoked by other shareholders. (...) 62. I fully agree with Comparato's interpretation of article 115, paragraph 1. I believe that the conflict of interest can be found both *a priori*, in cases where it can be easily evidenced, and*a posteriori*, in situations where it does not shine through."