Is the 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

by

Érica Gorga
Yale Law School, São Paulo School of Fundação Getulio Vargas FGV
DIREITO SP
Is the 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

Érica Gorga

Abstract

The corporate governance literature usually refers to the U.S. enforcement superiority to explain the premium that foreign firms experience when cross-listing in U.S. stock exchanges. This paper casts doubt on this hypothesis by analyzing two comparative case-studies of private 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 – Aracruz Celulose S.A. and Sadia 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 actions in New York and Florida on behalf of ADR holders. Both corporations sued their Chief Financial Officers in derivative suits in Sao Paulo and Rio de Janeiro. The Brazilian Securities and Exchange Commission (CVM) started administrative proceedings against the companies, their officers, board members, and auditors; yet the SEC did not take any action.

Because the alleged wrongdoing was the same in the U.S. and the 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 paper shows that U.S. enforcement is superior in terms of private shareholder financial recovery, but inferior when it comes to public discipline and out-of-pocket liability for corporate actors. The paper then advances normative conclusions for improving private and public enforcement, and for the comparative corporate governance debate.

---

1 Associate Research Scholar in Law at Yale Law School and the John R. Raben/Sullivan & Cromwell Executive Director for the Yale Law School Center for the Study of Corporate Law. Professor of Law, Fundação Getulio Vargas Law School at São Paulo (FGV Direito SP). E-mail: erica.gorga@yale.edu. The author is thankful to Aaron Dhir, Luca Enriques, Assaf Hamdani, John Morley, Roberta Romano, Natalya Shnitzer, Barak Yarkoni and to participants at the International Conference on Financial Regulation and Comparative Corporate Governance held at Tel Aviv University Buchmann Faculty of Law in January of 2014, of the Yale Law School Center for the Study of Corporate Law Occasional Lectures in February of 2014, of the Dennis J. Block Center for the Study of International Business Law 2014’s Scholar’s Roundtable held at Brooklyn Law School, and of the Corporate & Securities Litigation Workshop held at the University of Richmond in October of 2014 for comments received on an earlier version. The author also would like to thank the research support of Matheus Lopes Ferreira de Sousa and the editing work of Laura Femino. The author is grateful to FAPESP (São Paulo Research Foundation) and to the Yale Law School Center for the Study of Corporate Law for financial support of this research.
Is the 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

Érica Gorga

I. Introduction.................................................................1
II. Review of the Relevant Literature.....................................10
III. “Hedging” with Derivatives: The Sadia and Aracruz Cases..............15
IV. Private Enforcement Actions in the United States and in Brazil............21
   IV.1. The U.S. Class Action Lawsuits against Sadia and Aracruz ..............21
   IV.2. The Brazilian “Derivative” Lawsuits................................35
   IV. 3. Comparative Analysis .............................................45
      IV.3.1. Availability of Information in the United States and in Brazil......45
      IV.3.2. Types of Suits: U.S. Class Actions vs. Brazilian “Derivative” Suits ....49
      IV.3.4. American and Brazilian Lawsuit Outcomes: Dismissal, Settlement
              Characteristics and Monetary Recovery .............................54
V. Public Enforcement Actions in the United States and in Brazil.............59
   V.1. Lack of Action of the U.S. Securities and Exchange Commission (SEC) .......59
   V.2. The Brazilian CVM Administrative Proceedings ........................60
      V.2.1. Proceedings Against Sadia’s Board Members and Officers ............60
      V.2.2. Proceedings Against Aracruz’s Board Members and Officers ..........62
      V.2.3. Comparative Analysis .............................................64
VII. Conclusion........................................................................65

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

I. Introduction

Theoretical hypotheses in the academic literature and empirical data support a general belief among academics, policy makers and market players that the U.S. enforcement of capital markets regulation is one of the strongest in the world. According to a number of indexes and measures, the United States earns one of the

---

2 See Randall Dodd, Playing with Fire, FINANCE & DEVELOPMENT 40 (June, 2009).
3 John C. Coffee, Jr., Law and the Market: The Impact of Enforcement, 156 U. PA. L. REV. 229, 242, 244 (2007) (“intensity 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 supporting empirical evidence infra note 4.
highest scores in enforcement of investor rights. This enforcement is considered particularly robust because it relies on a complex set of private and public mechanisms. The United States has an active private enforcement system unparalleled by any other market in the world. Similarly, the resource-based expenditure by the Securities and Exchange Commission is one of the highest in capital markets public enforcement, and features the largest monetary sanctions. Together, these private and public enforcement actions constitute vigorous overall enforcement.

This is of course not to say that the U.S. securities enforcement is flawless. It has indeed been the target of severe criticism as to its effectiveness, costs, rent-seeking incentives and deterrence power. Yet the literature has generally taken for granted that U.S. enforcement is stronger than that of most countries. 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 reflects the

4Simeon Djankov, Rafael La Porta, Florencio Lopes-de-Silanes & Andrei Shleifer, The Law and Economics of Self-Dealing, 88 J. FIN. ECON. 430, 461 (2008) (finding that common law countries outperform civil law countries in a index of shareholder protection against self-dealing transactions in 72 countries, which implicitly suggests U.S. superiority, since the United States is the most important representative of the common law tradition besides the U.K.); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, 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, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, Law and Finance, 106 J. POL. ECON. 1113, 1142-1143 (1998) (assessing the quality of enforcement of legal rules protecting corporate shareholders and creditors in 49 countries. The United States is only systematically outperformed by a few countries such as Canada, New Zeland, the Netherlands, Switzerland and notably the Scandinavian ones.); 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).

5The literature usually classifies enforcement as public or private. See Coffee, supra note 3, 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 4, at 2-3.

6Coffee, Jr., supra note 3, at 240 (arguing that the U.S. system of private enforcement “has no true functional analogue anywhere else in the world”).


8For instance, the SEC has recently announced a probably unbeatable record of $3.4 billion in monetary sanctions applied against wrongdoers. SEC Announces Enforcement Results for FY 2013, available at http://www.sec.gov/News/PressReleaseDetail/PressRelease/1370540503617


10See, e.g. Coffee, Jr., supra note 3, 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.”

11Craig 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). See also Craig Doidge, G. Andrew Karolyi & René M. Stulz, Has New York Become Less
stronger U.S. regulatory system.\textsuperscript{12}

Despite the theory, however, the empirical literature on enforcement of securities regulation is still insufficient to provide evidence for the standard U.S. superiority assumption. On the one hand, most enforcement studies have been restricted to an exclusive assessment of public and private enforcement in the U.S.\textsuperscript{13} 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.\textsuperscript{14} They cannot in \textit{abstracto} establish that foreign enforcement is weaker than that of the United States. And 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 comparisons of different facts and cases at different times in different jurisdictions under diverse systems of enforcement.\textsuperscript{15}

\textit{Competitive than London in Global Markets? Evaluating Foreign Listing Choices Over Times, 91 J. FIN. ECON 253 (2009)} (finding 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”).\textsuperscript{12}See Coffee, \textit{supra} note 3, at 230 (“higher enforcement intensity gives the U.S. economy a lower cost of capital and higher securities valuations. This higher intensity attracts some foreign listings”). \textit{But see G. Andrew Karolyi, Corporate Governance, Agency Problems and International Cross-Listings: A Defense of the Bonding Hypothesis, 13 EMERGING MARKETS REVIEW 516, 524 (2012) (in his recent review of the extant literature, Professor Karolyi acknowledges that “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”).}


\textsuperscript{15}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., 130 S. Ct. 2869 (2010) (No. 08-1191) (asserting that nations police securities fraud by means of incompatible regulatory schemes, and that France has made a considered
On the other hand, the majority of the available comparative enforcement studies rely on quantitative data and indexes of public and private enforcement, without engaging in a deeper qualitative analysis. 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. 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. Lawyers’ assessments may be biased by their own practices, for example, 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 at all. Similarly, studies that exclusively analyze the use of derivative suits or class actions in international jurisdictions 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 filled in connection to 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 filled in jurisdictions that do not provide for class action mechanism. This type of substitution between the two private litigation avenues –

choice to rely on public actions (l’action publique) rather than private class actions.

---


17 Djankov et al., supra note 4, at 432-433, and La Porta et al., What Works in Securities Laws, supra note 4, at 5 (2006) (basing all their analyses, respectively, in a hypothetical example of a self-dealing transaction, and in an abstract assessment of “the regulation of the promoter’s problem.” Subsequently the authors rely on the answers of lawyers about the possible legal enforcement consequences to both of these problems in 49 jurisdictions).

18 Djankov et al., supra note 4, at 433 (arguing that the lawyers “provided the text of laws, statutes, judicial precedent, and regulatory opinions used to answer our questionnaire”).

19 See Jackson & Roe, supra note 7, at 210-211 (acknowledging a number of shortcomings in their methodology). In the same vein, La Porta et al., Law and Finance, supra note 4, 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. They also rely on the quality of a country’s accounting standards. La Porta et al., What Works in Securities Laws?, supra note 4, at 9, 11-13, use a “public enforcement index” calculated by the arithmetic means of “(1) supervisor characteristics index; (2) rule-making power index; (3) investigative powers index; (4) orders index.” They use a disclosure index composed by the arithmetic mean of the 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 indexes as proxies for measuring enforcement intensity.


21 This is exactly what happened in the case-studies of securities fraud discussed in this article. See infra section IV for detailed factual description. See also John Armour, Bernard Black, Brian Cheffins, & Richard Nolan, Private Enforcement of Corporate Law: An Empirical Comparison of the
derivative vs. class actions – in a specific case is better revealed through a qualitative comparative analysis.

Yet so far very few studies have pursued this kind of qualitative analysis of real enforcement cases along several dimensions of inquiry. One particularly interesting study, in this respect, was conducted by Armour et al. \(^{22}\) The authors compare the private enforcement approaches for corporate law in the United States and the U.K. While the study shows an indisputably larger number of enforcement actions in the United States than in the U.K., it concludes that most U.S. actions are dismissed and hardly ever result in out-of-pocket liability. \(^{23}\) In other words, their deterrence effect is questionable. Based on this research one can hardly conclude that the U.S. enforcement approach is stronger than that of the U.K. \(^{24}\)

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 at the U.S. and Brazilian markets during the most recent 2008 financial crisis.

During the crisis, as the Brazilian real unexpectedly plummeted in relation to the U.S. dollar, 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. \(^{25}\) Both of these non-financial companies had previously disclosed that they adopted conservative financial policies. They reported in their financial statements that they relied on hedging instruments 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 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 for the

\[\text{United Kingdom and the United States}, \ 6 \text{J. EMPIRICAL LEGAL STUD.} \ 687, 721 (2009) ("Differences in general rules governing class actions, contingency fees, and who pays the winner’s legal expenses, in tandem with rules specific to corporate law that govern the availability of derivative actions and direct claims by shareholders, may do much to explain the large differences in levels of private enforcement").\]

\(^{22}\) \textit{Id.}\n
\(^{23}\) \textit{Id. at} 710, 722.

\(^{24}\) \textit{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.

\(^{25}\) \textit{Many other companies from emerging markets suffered losses with currency exchange derivatives. See infra} note 95. \textit{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 96.

\(^{26}\) \textit{See infra} notes 97 and 98.

\(^{27}\) \textit{Amended Class Action Complaint at} 1-2, \textit{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 (Oct. 5, 2009), \textit{ECF No. 30.}
corporations to file “derivative” suits against their former Chief Financial Officers in São Paulo and Rio de Janeiro. Comissão de Valores Mobiliários (CVM), the Brazilian Securities and Exchange Commission, started administrative proceedings against both corporations, their managers, board members, and independent auditors. Interestingly, I did not find any evidence of actions taken by the U.S. securities market regulator, the Securities and Exchange Commission (SEC), against either of the companies.

As the settlement hearings for the Sadia and Aracruz cases have recently been conducted in the United States, and the legal actions in Brazil have also concluded, I have the timely opportunity to conduct the first comprehensive comparative study of both cases. Because the alleged factual wrongdoing is 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 paper 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 of all, because both cases involve shareholders in a developed common-law jurisdiction alongside those in an emerging market that is usually classified as a poor-performing French civil law jurisdiction, 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. Third, as the analysis encompasses two case studies, it also allows intra-case comparisons of where and how the two differ. Fourth, it is unusual for the same allegedly 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 themselves considered rare. Therefore the two cases provide additional evidence regarding current theories of U.S. public and private enforcement against U.S. cross-listed firms. In sum, this approach attempts to fill in 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

---

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 4 (classifying Brazil as a French civil jurisdiction, which, according to their work, scores the lowest in investor legal protection).
30 See infra at Section II.
32 See discussion infra at Section II.
newspapers and magazines and collected all electronic files of the U.S. securities class actions against Sadia and Aracruz available on Bloomberg Law. I also gathered documents concerning the administrative proceedings against Sadia and Aracruz available on the CVM’s website, as well as documents from the Brazilian Judiciary in São Paulo, Rio de Janeiro and the upper courts regarding the “derivative” suits filed. Because the Brazilian lawsuits in both São Paulo and Rio de Janeiro are largely unavailable electronically from either the court public 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. Because the Aracruz suit was held in “secrecy of Justice” (sigilo de justiça) in Rio de Janeiro, I was not able to access it.

In spite of the two cases arising from the same alleged facts, I show that they in fact generated very different legal developments in the United States and in Brazil, including different legal actions initiated by different private players and 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 many more legal documents than does 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 fraud on the market doctrine. 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’ chief financial officers and seeking personal liability for fiduciary duty violations. Accordingly, these different lawsuits were built on distinct legal arguments, resulting in very different outcomes.

The Sadia U.S. suit was settled by US$ 27 million and the Aracruz U.S. suit by US$ 37.5 million. Most of the cash recoveries went to U.S. investors. In contrast, in the Sadia Brazilian suit, the Superior Tribunal de Justiça (“STJ”), Brazil’s highest

---

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 via the Internet. 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 December 28, 2013). 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 document available electronically is the decision of the Superior Tribunal de Justiça (STJ) in the Sadia case. STJ is Brazil’s highest court of appeal for corporate matters. See also infra note 37.

36 I discuss the problem of “secrecy of justice” infra section IV.3.1.
court for corporate law, confirmed the judicial decision dismissing the action against the CFO based on the formal argument that a shareholders 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) was paid to the company, constituting only a 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, belongs to the company and not to its shareholders. 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. This disparity in results was driven by the lack of effective private litigation mechanisms in Brazil. The most suitable mechanism for protecting Brazilian investors interests in these cases is the class action; nonetheless, derivative suits were used instead because of flaws of the Brazilian class action legal apparatus.

While class actions do exist in Brazilian law, they suffer from a number of shortcomings. First there are problems of initiation. In the United States, private attorneys are better incentivized to initiate private law suits and thus act as gatekeepers. Brazilian private attorneys do not have the same policing incentives and therefore do not play the same gatekeeping role. Second, Brazilian class actions suffer from technical flaws in civil procedure, especially with respect to fact investigation and potential settlements. In these aspects, U.S. class action suits apply higher levels of specialization and expertise in evaluating the facts and potential damages. I conjecture that the higher level of professionalism and valuation methods applied to 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. My analysis corroborates scholarly hypotheses about the more significant role played

---

37 Brazil has two upper Courts. In general, the Brazilian Supremo Tribunal Federal (STF) is the highest appeal court for constitutional matters, and the Superior Tribunal de Justiça (STJ) is the highest appeal court for matters of private law.

38 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. Available at http://www4.bcb.gov.br/pec/taxas/port/ptaxnpesq.asp?id=txcotacao.

39 Indeed, this is a problem not only faced by Brazil, but also by most European jurisdictions. See Samuel Issacharoff & Geoffrey P. Miller, Will Aggregate Litigation Come to Europe?, 62 Vand. L. Rev. 179, 191-208, 209 (2009) (discussing European problems with organizational standing, litigation funding and opt-in systems, and pointing out that “[f]rom 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) (noting that “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, 2-3 Eur. Comp. Fin. L. Rev 246, 263-264 (2009) (“the civil procedure system must be radically reviewed in order to generate a true, effective level of private enforcement in Italy”).

40 See infra notes 53-55 and accompanying text.
by private enforcement in the United States viz-a-viz public enforcement in relation to U.S.-listed foreign firms.\textsuperscript{41}

In contrast to the lack of public response in the United States, in Brazil both the Sadia and Aracruz cases originated public enforcement actions, though producing 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. Here, I note once more that financial recoveries went to the CVM itself or to a universal fund, not back to investors.\textsuperscript{42} CVM further settled the two cases with the company’s independent auditors.

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 created a stronger deterrence effect. In sum, the comparative findings of the Sadia and Aracruz case studies cast doubt on a number of hypotheses raised by 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: Section II sets forth the theoretical framework, discussing the underlying academic literature related to the case studies and putting forward the hypotheses that the study addresses. Section III describes the Sadia and Aracruz controversies, discussing the factual background and alleged wrongdoings of officers and directors at both corporations. Section IV 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. Section V discusses actions of public enforcement, which were taken only in Brazil against board members, officers and independent auditors. Section VI 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. Section VII concludes.

Last, a caveat is important. I acknowledge the limits of my analysis due to 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 paper 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.

\textsuperscript{41} See infra notes 46-49 and accompanying text.
\textsuperscript{42} SEC settlements can result in shareholder financial indemnification as discussed in infra notes ___ and accompanying text.
II. 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. In particular, this literature has explored which variables in enforcement practices best promote strong capital markets.

Scholars distinguish between public and private enforcement. The latter refers to the enforcement of corporate and securities 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.

Some studies have proposed that private enforcement is more important than public enforcement. Coffee highlights 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. La Porta, Lopez-De-Silanes and Shleifer analyze securities laws regulating the public issuance of new equity in forty-nine countries. They focus on mandatory disclosure, liability standards and public enforcement, creating indexes 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. In contrast, public enforcement, which they quantify in an index of formal regulatory powers, is not statistically significant in their regressions.

On the other hand, Armour et al. suggest that private enforcement is less central to strong securities markets than the previous literature assumes. Based on an empirical survey of corporate law suits, 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.

Other critics such as Jackson and Roe argue that private lawsuits do not penalize the relevant actors, distort incentives, and are many times less efficacious than public enforcement. They measure public enforcement by the regulatory budgets and staffing levels of securities regulators, finding that resources spent on

---

43 See, e.g., Coffee, Jr., supra note 3 at 232; Jackson & Roe, supra note 7, at 207; La Porta et. al, What Works in Securities Laws, supra note 4; Siems, supra note 16; Armour et al. supra note 21.
44 See supra note 5.
45 JOHN C. COFFEE, JR., GATEKEEPERS 2 (2006) (“a 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.
46 Coffee, Jr., supra note 3, at 245.
47 La Porta et al., What Works in Securities Laws?, supra note 4.
48 Id.
49 Id. See also Djankov et al., supra note 4 (positing the key role of private contracting and enforcement for financial development and deemphasizing the role of public enforcers).
50 Armour at al., supra note 21, at 687.
51 Armour at al., supra note 21, at 722 (citing only three instances of liability in a eight-year period).
52 Jackson & Roe, supra note 7, at 208.
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 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 at least as important.\(^53\) 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.\(^54\) Rose goes as far as to propose a ban on “expensive” mechanisms of private enforcement, instead convening all security fraud enforcement actions under a single public regulator.\(^55\)

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 deterrence value as – “if not more” than – public enforcement.\(^56\) The authors then question the hypothesis that SEC investigations are superior to private ones.\(^57\)

A related body of literature important to this paper focuses on capital markets enforcement actions against cross-listed foreign firms. Scholars have identified a premium associated with the cross-listing of foreign companies in the U.S. market.\(^58\) This premium is usually attributed to self-bonding, that is, managers deliberately submitting to a stricter regulatory regime – that of the United States.\(^59\) 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

---

\(^53\) Jackson & Roe, supra note 7, at 237.

\(^54\) 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”).


\(^57\) Id., at 38-39 (“our findings offer little support to commentators who call for a shift from private actions to greater public enforcement. We found that class action-only filings focus on securities violations that are comparable to, and in some tests, greater than the violations on which the SEC alone focuses. Our results suggest that private plaintiffs’ attorneys, if anything, provide greater deterrence against more serious securities law violations compared with the SEC”).

\(^58\) Craig Doidge, G. Andrew Karolyi & René M. Stulz, Why are Foreign Firms..., supra note 11. See also Craig Doidge, G. Andrew Karolyi & René M. Stulz, Has New York Become..., supra note 11.

diminishes the ability of controlling shareholders and managers to extract private benefits, a premise reflected in the increase in share prices upon cross-listing.\(^{60}\)

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.\(^{61}\) 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).\(^{62}\) 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 actions were taken than against domestic firms.\(^{63}\) Therefore, actual public enforcement of securities laws questions the legal bonding hypothesis.\(^{64}\)

U.S. private enforcement against foreign issuers also suffers from a number of shortcomings.\(^{65}\) A recent study by Cheng et al. finds that U.S.-listed foreign companies face securities class actions 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 transactions costs incurred in pursuing litigation against foreign firms.\(^{66}\) Once a foreign firm’s main business operations, decisions, 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, as well as 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 being sued in U.S. class actions was close to that of U.S. firms — 11.79% versus 13.80%, respectively.\(^{67}\) This means that one in every eight foreign firms trading in the U.S. was sued at least once during the investigated time frame, a frequency that has

\(^{60}\)Id. See also Craig Doidge, G. Andrew Karolyi, Karl V. Lins, Darius P. Miller & René M. Stulz, 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, influence the cross-listing decision. Higher levels of control, and therefore higher private benefits, are associated with less cross-listing).

\(^{61}\)See Siegel, supra note 31, at 321 and 335, 342-343.

\(^{62}\)Id. at 321 and 335. He mentions that they were not prosecuted by private actions, either.

\(^{63}\)Shnitser, supra note 31, at __.

\(^{64}\)Karolyi, supra note 60, at __ (pointing out flaws of the legal bonding hypothesis while still defending it. Karolyi also reviews the new literature on reputational bonding).

\(^{65}\)See Siegel, supra note 31, at 343-349.

\(^{66}\)See Beiting Cheng, Suraj Srinivasan & Gwen Yu, Securities Litigation Risk for Foreign Companies Listed in the U.S. (2012), http://ssrn.com/abstract=2163864 (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 engaged 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 for U.S. domestic firms. S. Srinivasan, A. S. Wahid & G. Yu, Admitting Mistakes: An Analysis of Restatements by Foreign Firms Listed in the U.S. (Working Paper, Harvard University, 2012).

steadily increased overtime from 6% to 14% of the total U.S. private enforcement activity. Firms from 36 countries were targeted. In addition to the pecuniary indemnification paid by these foreign firms – $9 billion in settlements – they also faced substantially larger monetary penalties due to market discounts to their stock value – overall a $73 billion loss. Corporate insiders also bore significant costs in losses associated with their shareholdings. 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*, the U.S. Supreme Court limited the extraterritorial reach of U.S. securities laws over foreign firms. *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. 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. 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 enforcement by public 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 still less litigated by U.S. private agents, then we can expect less liability, punishment and deterrence effect for foreign firms compared to their U.S. 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 it does its domestic issuers, that weaker policing may still constitute a tougher regime than

68 Id. The number for U.S. domestic firms is one in every seven firms being sued.
69 Id., at 4-5.
72 According to Section 929 P (b) (2) this authority is granted if the fraud involves conduct within the United States constituting “a significant step 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. Section 929P(b)(2) of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The SEC has recently issued a “Study on the Cross Border Scope of the Private Right of Action Under Section 10(b) of the Securities Exchange Act of 1934,” April 2012. Available at [http://www.sec.gov/news/studies/2012/929y-study-cross-border-private-rights.pdf](http://www.sec.gov/news/studies/2012/929y-study-cross-border-private-rights.pdf).
foreign issuers face at home. That would justify the cross-listing bonding premium. 73 Finance scholars, too, have relied on the assumption of U.S. enforcement superiority to test their models related to cross-listing. 74 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 paper 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 paper 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.” 75 They have studied the Enron case in the United States, the Mannesmann case in Germany, the SK case in Korea, China Aviation Oil in China, and Yukos in Russia. While this methodology arguably reveals the inner logic, weaknesses and prospects for reform in the jurisdictions analyzed, 76 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, 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. 77 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. 78 The authors review court decisions regarding audit liability, concluding that Italian private enforcement in this area is very weak. 79 They further point out flaws in the Italian court system, civil procedure, especially the lack of efficient discovery rules and their toll to class actions. 80 Although, the authors report that investors have brought civil actions related to Parmalat in the United States, 81 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

73 Coffee, Jr., supra note 3, 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.

74 Doidge et al., supra note 58, 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.


76 Id. at 9 and 46.

77 Ferrarini & Giudici, supra note 14.

78 Id. at 180, 184.

79 Id. at 185-186.

80 Id. at 194, 201.

81 Id. at 170-171, 206.
private enforcement against these firms,\textsuperscript{82} which he claims makes the case against the legal bonding hypothesis of the U.S. market. Siegel, nonetheless, fails to establish that Mexican public or private enforcement against the same perpetrating companies was any better than in the United States. For this reason, we cannot establish whether U.S. enforcement was overall weaker than the Mexican enforcement, or whether the Mexican enforcement was also severely flawed.\textsuperscript{83} Therefore, none of the existing case studies on securities market regulation fully assess the U.S. enforcement superiority hypothesis that is the topic of this paper.

Through the analysis of the Aracruz and Sadia case-studies this paper explores the following questions discussed by recent scholarship: a) whether the wrongdoings of U.S.-listed foreign issuers Aracruz and Sadia 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, and, similarly, Brazilian private or public actions; 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 section with a factual background of the Aracruz and Sadia cases.

III. “Hedging” with Derivatives: The Sadia and Aracruz Cases

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

Sadia was founded in 1944 and headquartered in Concórdia, Santa Catarina. Sadia was a major Brazilian food and beverages company whose principal activities included production, distribution, exporting and marketing of refrigerated and frozen food products. 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.\textsuperscript{84} Sadia’s stocks traded on the BM&FBovespa, the São Paulo Stock Exchange. In April 2001, it joined the Level 1 listing segment trading its common shares under the symbol “SDIA3” and its non-

\textsuperscript{82} Siegel, supra note 31, at 335.
\textsuperscript{83} Id. at 333. Siegel provides only very brief summaries of the kind of “public accusation” these insiders suffered in Mexico. 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 ten reported cases, the accused was suing the government to recover damages suffered, was acquitted or had her charges dismissed. 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). 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.
\textsuperscript{84} 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.”
voting preferred shares under “SDIA4 BZ.” At the same time, Sadia listed Level II ADRs on the New York Stock Exchange trading under the symbol “SDA.” The sponsored ADRs referenced Sadia’s non-voting preferred shares and in June of 2008 represented 26.7% of the total number of these shares and 18.94% of Sadia’s total capital. Sadia also listed its non-voting preferred shares in November of 2004 on the Spanish Market for Latin-American Stocks in Euros (“LATIBEX”) under the symbol “XSDI SM” in the Madrid Stock Exchange. In the end of 2008, the Spanish securities represented 2.1% of the total number of preferred shares of the company.

Aracruz was founded in 1967 and headquartered in Aracruz, Espírito Santo, Brazil. It was a major forest products manufacturer and wood pulp producer. 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 on the New York Stock Exchange (NYSE). Aracruz securities began trading on the NYSE in 1992 under the symbol Level 1 is a special segment from the São Paulo Stock Exchange (BM&FBovespa) that requires compliance with enhanced disclosure requirements. The preferred non-voting shares of Sadia S.A. afforded investors priority in the proportional payment of the non-cumulative minimum dividend of 25% of the net profits of the exercise. They also qualified for the tag along provision of Law 6.404/76 article 254-A, which means they would receive 80% of the premium of the control value paid to ordinary voting shares. See Sadia S.A., Estatuto Social da Sadia S.A., art. 12 (2008), available at: http://siteempresas.bovespa.com.br/dxw/AbrirDoc.asp?gstrIdTDESCRICAONUMERO=18.01&gstrIDQdro=ianesta. See Érica Gorga, *Culture and Corporate Law Reform: A Case Study of Brazil*, 27 U.PA. J. INT'L ECON. L. 803, 842-844 (2006) (discussing the rights of non-voting preferred shares in Brazil).

86 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 become subject to the same reporting requirements imposed by the SEC and the trading exchanges as are 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, meanwhile Level II ADRs do not. As a consequence, Level III ADRs are the highest form of sponsored ADRs and are 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. See JP Morgan, Depositary Receipts Reference Guide, https://www.adr.com/Home/LoadPDF?CMSID=88b09551120043eface03554006845cb. 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 Erica 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, 486-487 (2009).


88 Id. I have not found any enforcement action in connection with the alleged securities fraud discussed in this paper in the Spanish market.
“ARA.” At the end of 2007, the sponsored ADRs referenced Aracruz’s non-voting preferred shares (type B), representing 64.90% of the total number of these shares and 33.89% of Aracruz’s total capital. 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.

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. Sadia, too, exported approximately 1,000 different products to more than 100 countries. For this reason, currency exchange hedging was an essential strategy for both companies in assuring future revenue and managing cash flows.

Foreign exchange risk hedging was supposed to lock in future revenue values by managing the oscillations of the Brazilian real relative to the U.S. dollar. By definition, a hedge is designed to fend a company’s risk exposure and help to 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. 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. However, as a consequence of the crisis,
the value of the U.S. dollar unexpectedly increased against the Brazilian real.\footnote{See J\'o\~{a}o 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 MARKETS 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, incorporated or even file for bankruptcy). See Robert N. McCauley & Patrick McGuire, Dollar Appreciation in 2008: Safe Haven, Carry Trades, Dollar Shortage and Overhedging, BIS QUARTERLY REVIEW (2009), available at SSRN: http://ssrn.com/abstract=1519814 or http://www.bis.org/publ/qtpdf/r_qt0912i.pdf (discussing the factors that caused the surprising dollar appreciation in the second half of 2008). See Dodd, supra note 2, at 40 (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).} After the rapid real price decrease, many companies suffered considerable financial losses.\footnote{See, e.g., Mariana Barbosa, Votorantim perde R$ 2,2 bi com derivativos [Votorantim Loses R$ 2,2 bi with Derivatives] O ESTADO DE S\'AIO PAULO, Oct. 11, 2008, at B14. Mari Omos and Graziella Valenti, Embracer tem perda com o d\'lar mas espera revers\'ao, [Embracer Loses with the Dollar, but It Expects a Reversal] VALOR ECON\'OMICO, NOV. 5, 2008, at D3. 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 ECON\'OMICO, NOV. 5, 2008. L. Cunha, Ajinomoto tem perda de R$ 180 mi com c\'ambio, [Ajinomoto Has Loss of R$ 180 mi with Exchange Rates] Valor on line, January 22, 2009. Gustavo Porto, Santelisa negocia R$ 500 mi no BNDES, [Santelisa Negotiates R$ 500 mi in BNDES], O Estado de S\'a Paulo, January 24, 2009, at B10. David Friedlander & Maribba Arag\'ao, Tok & Stok \'e v\'ima dos derivativos, [Tok & Sotck Is a Victim of Derivatives] O Estado de S\'a Paulo, January 25, 2009, at B10. Da Reportagem Local, Vicunha T\'exitil perde R$ 70 mi com c\'ambio [Vicunha Textile loses R$ 70 million with exchange rates], Folha de S\'ao Paulo, November 11, 2008. Mariana Barbosa, Vicunha negocia com bancos liquida\'ao de derivativos, [Vicunha Negotiates with Banks Derivatives Liquidation], O ESTADO DE S\'AIO PAULO, NOV. 3, 2008, at B12. Gol perde R$ 48 milhões com oper\'c\'oes de hedge, [Gol loses R$ 48 Million with Hedge Transactions], A\'GEN\'CIA ESTADO, NOV. 17, 2008. Material Information Release, 02.10.2008. Available at: http://www.sec.gov/Archives/edgar/data/883952/000118003108000087/081003a.htm. Fato Relevante, Oct 2\textsuperscript{nd}, 2008, available at http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=178053 &funcao=visualizar&Site=C. See Amended Class Action Complaint at 29, 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 (Oct. 5, 2009), ECF No. 30. The Company’s reported net operating revenues were approximately $1.7 billion, $1.8 billion and $1.9 billion in 2006, 2007 and 2008 respectively. Id. at 7. See Form 6-K containing Notice of Material Event dated as of Sept. 25, 2008. Available at: https://www.sec.gov/Archives/edgar/data/1130968/000120135608000080/sda092508mf_6k.html. Fato Relevante, Sept. 25, 2008, available at http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=177562 &funcao=visualizar&Site=C.} Aracruz experienced massive mark-to-market losses reaching over US$ 2.1 billion, an amount that exceeded Aracruz’s annual net operating revenue.\footnote{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 MARKETS 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, incorporated or even file for bankruptcy). See Robert N. McCauley & Patrick McGuire, Dollar Appreciation in 2008: Safe Haven, Carry Trades, Dollar Shortage and Overhedging, BIS QUARTERLY REVIEW (2009), available at SSRN: http://ssrn.com/abstract=1519814 or http://www.bis.org/publ/qtpdf/r_qt0912i.pdf (discussing the factors that caused the surprising dollar appreciation in the second half of 2008). See Dodd, supra note 2, at 40 (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).} Sadia in turn initially announced a loss of R$ 760 million (US$ 410 million) related to its currency hedging contracts on Sept. 25\textsuperscript{th}, 2008.\footnote{See J\'o\~{a}o 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 MARKETS 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, incorporated or even file for bankruptcy). See Robert N. McCauley & Patrick McGuire, Dollar Appreciation in 2008: Safe Haven, Carry Trades, Dollar Shortage and Overhedging, BIS QUARTERLY REVIEW (2009), available at SSRN: http://ssrn.com/abstract=1519814 or http://www.bis.org/publ/qtpdf/r_qt0912i.pdf (discussing the factors that caused the surprising dollar appreciation in the second half of 2008). See Dodd, supra note 2, at 40 (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).} In the end, Sadia’s negative net income with the derivative transactions amounted to approximately R$ 2.5 billion.\footnote{See J\'o\~{a}o 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 MARKETS 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, incorporated or even file for bankruptcy). See Robert N. McCauley & Patrick McGuire, Dollar Appreciation in 2008: Safe Haven, Carry Trades, Dollar Shortage and Overhedging, BIS QUARTERLY REVIEW (2009), available at SSRN: http://ssrn.com/abstract=1519814 or http://www.bis.org/publ/qtpdf/r_qt0912i.pdf (discussing the factors that caused the surprising dollar appreciation in the second half of 2008). See Dodd, supra note 2, at 40 (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).}
The financial woes affecting the two companies, which had been long considered Brazilian powerhouses, were largely exposed in media cover stories, prompting strong criticism from multiple sources, including the Brazilian president.100

In both cases, because the companies' undisclosed trading with currency derivatives largely exceeded their supposed hedge policy, their hedging contracts had actually increased the exchange rate risk of the company’s cash flows rather than reducing it.101 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.102

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% drop in the following weeks.103 Sadia’s ADRs dropped by 37.79% in a single day.104 Credit rating agencies downgraded both Aracruz and Sadia.105 Aracruz’s chairman of the board, several board members and the chief financial officer all resigned.106 The company had to cancel various projects and

---

100 Then Brazilian President Luiz Inácio Lula da Silva publicly declared, “The companies that bet and lost will have to face up to their responsibilities.” Big Currency Bets Backfire, WALL ST. J., Oct. 22, 2008. He also voiced that “[i]t 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.” Lula Accuses Aracruz and Sadia of Massive Speculation, ESTADAO,Oct. 4, 2008, http://estadao.com.br.


102 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. supra note __ at 2.


104 Saxena White P.A. Has Filed a Securities Fraud Class Action, BLOOMBERG, Nov. 05, 2008, available at: http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a6mRXfLWh5o (“the 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%”). Graziella Valenti, Sadia fechou operação bilionária cinco dias antes do início da crise [Sadia has closed billion transaction five days before the crisis beginning]. VALOR ECONÔMICO, Apr. 7, 2009, at D4.


expansion plans, and an intended merger with Votorantim Celulose e Papel S.A. had to be delayed for nearly a year. Sadia fired its chief financial officer, and both its chairman and vice chairman resigned from the company. It also postponed several capital projects in order to cover the financial shortfall.

On May of 2009, shortly after suffering such great financial losses, Sadia consolidated with Perdigão S.A.; both corporations were succeeded by BR Foods S.A. The transaction was harshly questioned 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. On December 31, 2009, Aracruz merged into Fibria Celulose S.A. (formerly Votorantim Celulose e Papel or VCP), with Fibria as the surviving entity. 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.


113 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, Sirvim-se, minoritários [Minorities Serve Yourselves], 66 REVISTA CAPITAL ABERTO 32, Feb. 2009. Available at: http://www.capitalaberto.com.br/temas/sirvam-se-minoritarios/#.VBNIzPldVYI (“A impressão dos investidores é que somente os preferencialistas da
challenged the transaction, which prompted the offer of a new exchange proposal to preferred shareholders with the same conditions as to ordinary shareholders.\textsuperscript{114} Fibria is now the world’s largest producer of market pulp.\textsuperscript{115} Defendant Carlos Aguiar, who was Aracruz’s CEO, continued to serve as Fibria’s CEO after the merger until June 2011, when he was appointed to Fibria’s Board.\textsuperscript{116}

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. I examine the actions of private and public enforcers in detail in the next sections.

IV. 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 sections, I adopt the literature’s divide between private and public enforcement to analyze the enforcement actions taken in the Aracruz and Sadia cases. I focus in this section on private enforcement, and in the next on public enforcement.

IV.1. The U.S. Class Action Lawsuits against Sadia and Aracruz

In the Sadia case, lead plaintiffs Westchester Putnam Counties Heavy & Highway Laborers Local 60 Benefit Funds (hereafter referred as “Westchester”) filed...
a federal securities class action on November 5, 2008, in the United States District Court for the Southern District of New York on behalf of themselves and others similarly situated. Westchester claimed securities fraud on behalf of all purchasers who acquired the ADRs of Sadia S.A. between April 30, 2008 and September 26, 2008. 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.

Defendants in the Sadia case were: (i) Sadia S.A.; (ii) Luiz Fernando Furlan (“Furlan”), who had served as Chairman of the Board of the company since October 6, 2008; (iii) Gilberto Tomazoni (“Tomazoni”), who served as Chief Executive Officer since April of 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, Jr. (“Teixeira”), the company’s Chief Financial Officer since September 26, 2008, who signed the company’s Forms 6-K, 20-F, and the attached Sarbanes Oxley Certification during the class period; (v) Adriano Lima Ferreira (“Ferreira”), who served as Chief Financial Officer during the class period and was terminated on September 26, 2008; (vi) Walter Fontana Filho (“Filho”), who served as the Company's President and Chairman until his resignation on October 6, 2008; (vii) Eduardo Fontana d’Avila (“d’Avila”), who served as the company's Vice Chairman during the class period and until his resignation on October 6, 2008.

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 United States District Court for the Southern District of Florida, Miami Division on behalf of itself and others similarly situated. Miami Beach claimed securities fraud on behalf of all purchasers who acquired the ADRs of Aracruz Celulose S.A between April 7, 2008 and October 2, 2008. It

---


119 Id., at 5-7.

120 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 Avenida Harbour Centre, 18851 NE 29th Ave., Suite 530 Aventura, FL 33180.” Amended Class Action Complaint at 49, 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 (Oct. 5, 2009), ECF No. 30.

121 Plaintiff filed Class action pursuant to Federal Rule 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 on
alleged violations of Section 10(b), including Rule 10b-5 promulgated thereunder, and Section 20(a) of the Securities Exchange Act of 1934.\textsuperscript{122}

The suit was brought against (i) Fibria Celulose S.A., successor to Aracruz Celulose, S.A., 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 of 2004 until his resignation on March 6, 2009; (iii) Carlos August Lira Aguiar (“Aguiar”), the company’s Chief Executive Officer and President during the class period; (iv) Isac Roffé Zagury (“Zagury”), the company’s Chief Financial Officer and Director of Investor Relations during class period and until his resignation in October of 2008 following the disclosure of the losses associated with the currency derivatives contracts.\textsuperscript{123}

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.\textsuperscript{124} Both groups of plaintiffs alleged that during the class period the individual defendants, as senior executive officers and/or directors, were privy to confidential, proprietary and material adverse non-public information concerning their companies' operations, finances, financial conditions and present and future businesses prospects. As a consequence they knew, or recklessly disregarded, that adverse facts were being concealed from the investing public.\textsuperscript{125}

In particular, each complaint alleged that, throughout the relevant class period, defendants failed to disclose: “(1) that Sadia [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 hedge policy [Aracruz's financial and internal control policies and public statements concerning the nature of such policies]; (3) that Sadia [Aracruz] lacked adequate internal and financial controls; and (4) that, as a result of the foregoing, the [c]ompany’s statements about its financial well-being and future business prospects were lacking in any reasonable basis when made.”\textsuperscript{126}

\textsuperscript{122} The claims also included 15 U.S.C. §§78(i)(b), 78(t) and 78t-1(a).

\textsuperscript{123} Amended Class Action Complaint at 50, 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 (Oct. 5, 2009), ECF No. 30: “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.”


\textsuperscript{126} Amended Class Action Complaint at 13, 24 and 42, 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 (Oct. 5, 2009), ECF
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]ompany's securities in an effort to maintain artificially high market prices for Sadia [Aracruz] ADRs in violation of §10(b) of the Exchange Act and Rule 10b-5.”\textsuperscript{127}

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’ exposure to currency derivative contracts and the great fall in their securities prices.\textsuperscript{128}

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 hedge 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.”\textsuperscript{129}

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 (U.S. $410 million) related to its investments in currency contracts hedging against the U.S. dollar.\textsuperscript{130} This loss dwarfed the earlier disclosed "value at risk" figures – R$ 187 million as of March 31, 2008 and R$ 241 million as of June 30, 2008.\textsuperscript{131} 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 $5.77, or nearly 38%, to close at $9.50 after heavy trading of over 5 million shares. The following business day, the company’s ADRs dropped another $1.51 per share,
or nearly 16%, to close at $7.99.\textsuperscript{132} 

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.” Furthermore, in its quarterly earnings report for the first quarter of 2008, it characterized a R$ 270 million short position representing five months of future exposure on the U.S. dollar as “cash flow currency protection.” Plaintiffs claimed that these statements were materially false and misleading.

In its Form 6-K filed with the SEC on July 7, Aracruz affirmed that “exposure of U.S. dollar denominated liability does not represent a risk from an economic and financial standpoint.”\textsuperscript{133} On Sept 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.” 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.”\textsuperscript{134} In addition, it revealed that its CFO/Investor Relations Officer Zagury was formally requesting a leave of absence from the company.\textsuperscript{135} 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.\textsuperscript{136}

In the two subsequent days, Aracruz’s ADRs plummeted over 25% 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 51% in value. Subsequently, Aracruz announced that it was cancelling plans to pay interest on capital to shareholders on the order of $41 million due to the financial losses.\textsuperscript{137} On November 4, 2008, a new Form 6-K reported a loss of US$ 2.13 billion in currency contracts, which according to plaintiffs was “equivalent to 39 month’s worth of cash flow exposure and over one year’s worth of net operating revenue.”\textsuperscript{138}

\textsuperscript{133} Amended Class Action Complaint at 20, 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 (Oct. 5, 2009), ECF No. 30.
\textsuperscript{134} Id. at 26.
\textsuperscript{135} Id. at 27.
\textsuperscript{136} Id. at 28.
\textsuperscript{137} Id. at 29.
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, respectively, Ferreira and Zagury, to Brazilian magazines and newspapers to support the claim that individual defendants knew and intentionally supported the fraudulent currency hedging scheme. Individual defendants, in this view, had incentives to artificially inflate the revenue of the company in order to increase their own personal compensation through bonuses and other financial rewards.

Sadia and Aracruz moved to dismiss the complaints on April 27, 2009 and November 13, 2009, 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 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 of 2011 did the individual defendants join the action. Because of this long and burdensome process, Miami Beach, plaintiff in the Aracruz case, used a different strategy and requested that the courts authorize alternative service on the individual defendants via registered mail and personal service under the Federal Rules of Civil Procedure Rule 139 Id. at 15, 16. Consolidated Amended Complaint at 31, In re Sadia, S.A. Securities Litigation, 643 F. Supp. 2d 521 (S.D.N.Y. 2009), No. 1:08-cv-09528 (S.D.N.Y. Mar. 16, 2009), ECF No. 25.
140 Id. at 19.
142 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 (Nov. 13, 2009), ECF Nos. 35-36.
144 Effecting service of process in Brazil has been described by Legal Language as “a lesson in perseverance.” LEGAL LANGUAGE SERVICES, http://www.legallanguage.com/services/service-of-process/brazil (last accessed May 24, 2013). 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 (U.S.A.) v. G.M. Dos Reis Jr. See generally Plaintiff’s Response to Order to File Status Report Regarding Service of Process of Brazilian Defendants, 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 (Feb. 9, 2010), ECF No. 51, at 3 (describing the service of process in Brazil as a “complex,” “bureaucratic,” “laborious” and a “multi-step process”).
4(f)(3); the court ordered so.

In its motion to dismiss, Sadia argued that the complaint failed to comply with the pleading requirements of the Federal Rule of Civil Procedure 9(b). It claimed the complaint: (i) failed to identify any actionable misstatement or omission made in any of the Company’s public disclosures during the Class Period; (ii) failed to plead facts giving rise to a strong inference of scienter; (iii) 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) failed to allege facts showing that the specific limits were publicly known or relied upon by investors; and that (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).147

145 Plaintiff’s Motion and 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, 1:08-cv-23317 (Apr. 20, 2010), ECF No. 60.
146 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, 1:08-cv-23317 (Sept. 23, 2010), ECF No. 66. Defendants presented an affidavit of Professor Arnoldo Wald, id., ECF No. 76, at 5 (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”). The Brazilian Ministério da Justiça received the letters rogatory on August 31, 2010 and then passed the documents to the Brazilian federal courts. The Brazilian Superior Tribunal the Justiça granted the exequatur, which allowed the letters rogatory to be executed, for Defendants Aguiar and Vieira on November 26, 2010. Both of them were served in February of 2011. Zagury, who initially challenged the exequatur but missed the deadline in doing so, was finally served on May 14, 2011. Lead Plaintiff’s Motion for Final Approval of Settlement and Award of Attorneys’ Fees and Reimbursement of Expenses and 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, 1:08-cv-23317 (Apr. 20, 2010), ECF No. 195: “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.” Notice of Status of Service of Process for 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, 1:08-cv-23317 (Aug. 16, 2010), ECF No. 108.
147 Memorandum of Law in Support of Defendant Sadia S.A.’s Motion to Dismiss at 3, 10, 18, 19, In re Sadia, S.A. Securities Litigation, 643 F. Supp. 2d 521 (S.D.N.Y. 2009), No. 1:08-cv-09528 (S.D.N.Y. Apr. 27, 2009), 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). In the Plaintiff's Memorandum of Law in Opposition to the Motion to Dismiss of Defendant Sadia S.A., plaintiff rebutted defendants’ 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. Plaintiff also argued that, different from 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-
The Court denied Sadia’s motion to dismiss the complaint by opinion and order dated July 29, 2009. Even conceding 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,” 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 sufficed to state a Rule 10b-5 claim; and that the complaint sufficiently plead that the company’s agents and officers committed culpable acts with the requisite scienter.148

After preliminary discovery, plaintiffs on December 14, 2009 presented a memorandum in support of 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 $5.62 per share in the price of Sadia’s ADRs by the end of the proposed class period – or approximately 37% of the pre-disclosure price – by means of an event study analysis of price variation in Sadia shares.149 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 plaintiff’s expert.150

Depositions of expert witnesses and class representatives were conducted. Sadia argued that it could not be proven that any of the alleged misrepresentations or speculative” and conservative hedging policy.” Memorandum of Law in Opposition to the Motion to Dismiss of Defendant Sadia S.A., at 11-12, In re Sadia, S.A. Securities Litigation, 643 F. Supp. 2d 521 (S.D.N.Y. 2009), No. 1:08-cv-09528 (S.D.N.Y Jun. 1, 2009), ECF No. 32. In the Reply Memorandum of Law in Further Support of Defendant Sadia, S.A.’s Motion to Dismiss filed on June 22, 2009, Sadia sustained that the currency hedging contracts were in fact disclosed, and 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 and 8, In re Sadia, S.A. Securities Litigation, 643 F. Supp. 2d 521 (S.D.N.Y. 2009), No. 1:08-cv-09528 (S.D.N.Y. Jun. 22, 2009), ECF No. 36. (In summary Sadia argued that “[n]either the amended complaint nor the extrinsic ‘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 that “the amended complaint fail[ed] to raise a strong inference of scienter”).

148 In re Sadia, S.A. Securities Litigation, 643 F. Supp. 2d 521, ___ (S.D.N.Y. 2009) 15, 19, 25 and 33. (“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.)” Id. at 20-21. The court also considered that In re Citigroup, Inc. Securities Litigation 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 24. 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 27-28.


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 14th, 2008, and there was no material price inflation prior to Sept. 5th, 2008.  

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. 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. The preponderance requirement was met once plaintiffs showed that transaction and loss causation could be proven class-wide. Sadia further petitioned the United States 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 Appeals Court denied Sadia’s petition.  

Because of the complications related to service of process, some individual defendants in the Sadia case moved to dismiss the amended complaint only on May 27, 2011, two years after Sadia filed its motion to dismiss. Walter Fontana Filho, Eduardo Fontana D’Ávila and Adriano Lima Ferreira argued that the Court lacked personal jurisdiction over them. In addition, on June 20, 2011, all 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 [i]ndividual [d]efendants ‘made' Sadia’s alleged public filing misrepresentations; and (iii) failed to plead the facts necessary to

\[\text{151}\] Defendant Sadia, S.A.’s Memorandum of Law in Opposition to Plaintiffs’ Motion for Class Certification, at 6-9. In re Sadia, S.A. Securities Litigation, 269 F.R.D. 298 (S.D.N.Y. 2010), 1:08-cv-09528, ECF No. 52. This is illustrated by Exhibit 5 to the Stulz Report, supra note __. Defendants argued that this would preclude transaction loss causation on a class-wide basis. Plaintiffs’ reply memorandum in further support of the motion for class certification was filed on May 6, 2010, with a Surrebuttal Expert Report of Marc Vellrath, id., respectively ECF Nos. 61 and 62 Exhibit 1. A Reply Report of Professor René M. Stulz was submitted on May 21, 2010, id., ECF 65.  

\[\text{152}\] In re Sadia, S.A. Securities Litigation, 269 F.R.D. 298, __ (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 57.  

\[\text{153}\] Id. at 3-5. 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 (citing In re Salomon Analyst, 544 F.3d at 482, citing Basic, 485 U.S. at 245). Id. at 35.  

\[\text{154}\] Id. at 56. The judge recognized flaws in plaintiffs’s methodology for damages calculation, but sustained that conflicts over damages could not bar class certification at early stage of the litigation.  


\[\text{156}\] Memorandum of Law in Support of Individual Defendants’ Motion to Dismiss for Lack of Personal Jurisdiction, In re Sadia, S.A. Securities Litigation, 1:08-cv-09528 (S.D.N.Y. May 27, 2011), ECF No. 92.
establish the elements of Section 20(a) control person liability.” Plaintiffs then opposed the individual defendants’ motions to dismiss; defendants’ reply memorandums followed.

The individual defendants’ motions to dismiss were sub judice when the parties reached their tentative agreement to settle the class action in August of 2011. After several months of mediation efforts, the parties proposed a cash settlement of $27 million, which was preliminarily approved by court’s order of September 22, 2011. Assuming liability on the part of defendants, experts showed that maximum provable damages ranged between $35.5 and $91 million, depending on the assumptions and models employed. Under this prediction, the settlement represented a recovery between 30% and 76% of the class’s maximum provable damages.

Class counsels requested an award of attorneys’ fees of 33.33% of the net settlement fund, reimbursement of $723,228.36 in out-of-pocket expenses (plus interest) advanced collectively while prosecuting the action, and an aggregate award of $14,177.50 for the reasonable costs and expenses incurred in connection with their representation of the class.

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 30% percent of the net settlement fund, amounting to $8.1 million, plus $723,228.36 in expenses and interest. The Court also awarded $14,177.50 to the class representatives for their related costs and expenses. As of January 31, 2013, the balance of the net settlement fund was $18,012,711.96. 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

---


159 For a detailed discussion of the settlement negotiations, see Joint Declaration of Christopher L. Nelson and Joseph E. White, III in Support of Final Approval of Settlement…, supra note 155, at 16-17.

160 Memorandum of Law in Support of Class Counsel’s Application for an Award of Attorney’s Fees and Expenses and an Award of Costs and Expenses to the Class Representatives, at 14, In re Sadia, S.A. Securities Litigation, 1:08-cv-09528, 2011 WL 6825235, ECF No. 118, at 14.

161 Id. at 25. Counsels stated they had collectively spent over 20,890 hours in the litigation as of November 15, 2011 which would result in a total lodestar of $8,036,010.00 (and a multiplier of 1.09). Id. at 10.

162 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 $7,797,961.50 lodestar fee corresponding to approximately 20,530 work hours. The expenses ($723,228.36) total approximately 3% of the value of the settlement. In re Sadia, S.A. Securities Litigation, 1:08-cv-09528, 2011 WL 6825235.

$1.81 per allegedly damaged ADR, before deductions of court-approved costs and attorneys’ fees.\textsuperscript{164}

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 regulation require the specific disclosure of D&O insurance policies.\textsuperscript{165} I was able to find information in the financial statements subsequently provided by Sadia’s successor Brasil Foods S.A. that the payment of the settlement was covered by Sadia’s operating income.\textsuperscript{166}

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.\textsuperscript{167}

\textsuperscript{164}The average cost per damaged ADR was estimated as $0.66 before the court approval of attorney fees. The final value should have decreased as the judged decided for a smaller fee percentage (30%) than the one requested by the lawyers (33-1/3%). 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 Exhibit 1, Exhibit A, Notice of Pendency of Class Action and Proposed Settlement, Motion for Attorney’s Fees and Expenses and Settlement Fairness Hearing, at 1-2, In re Sadia, S.A. Securities Litigation, 1:08-cv-09528, 2011 WL 6825235, ECF No. 119-1.

\textsuperscript{165}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. See infra notes __, and accompanying text. In Canada, for example, disclosure of D&O insurance is mandatory. See John Core, The Directors’ and Officers’ Insurance Premium: An Outside Assessment of the Quality of Corporate Governance, 16 JOURNAL OF LAW, ECONOMICS AND ORGANIZATION 449 (2000).


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 Depository 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.

\textsuperscript{167}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-
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. 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.

The Brazilian Superior Court of Justice provided information that the letter rogatory requesting the notification of service of process on Carlos Alberto Vieira was duly completed on April 15, 2011; that for Carlos Augusto Lira Aguiar on March 28, 2011. 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 U.S. 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.” It found that plaintiffs stated a valid claim based on Aracruz’s April 7 and July 7 2008 Form 6-Ks statements regarding the purpose, nature and extent of its currency hedging activities.


Memorandum of Law in Support of Defendants Carlos Alberto Vieira’s and 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, 1:08-cv-23317 (Oct. 15, 2010), ECF No. 77.

Isac Roffe Zagury’s Motion to Stay These Proceedings and 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, 1:08-cv-23317 (Oct. 15, 2010) ECF No. 79 (alleging that the more convenient forum against Zagury was Brazil). See also Reply Memorandum of Law in Further Support of Defendants Calors Alberto Vieira’s and Carlos Augusto Lira Aguiar’s Motion to Dismiss the Amended Class Action Complaint for Violation of the Federal Securities Laws at 18, id. (Dec. 3, 2010), ECF No. 99 (arguing that the Settlement Report of CVM presented by Plaintiffs negate any inference of scienter against Vieira and Aguiar). See also Zagury’s Reply to Plaintiff’s Opposition to Zagury’s Motion to Stay and Dismiss the Amended Complaint, id. (Dec. 3, 2010), ECF No. 100 (requesting that the Court strikes the CVM Document as inappropriate pursuant FRCP 12(b)(6) and certain affidavits and declarations). See also Lead Plaintiff’s Memorandum of Law in Opposition to Isac Roffe Zagury’s Motion to Strike, id. (Jan. 10, 2011) ECF No. 103 (opposing Zagury’s motion). See also Isac Roffe Zagury’s Reply to Plaintiff’s Memorandum of Law in Opposition to Motion to Strike, at 6, id. (Jan. 20, 2011), ECF No. 104 (arguing that plaintiff’s statement tried to play on a negative stereotype to create a false image of Zagury). Aguiar answered on October 7, 2011, Nos. 116 and 137. (Zagury on Jan. 18, 2012).


The Court states 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. Omnibus Order on Motions to Dismiss (D.E. 35, 74, 79) and Defendant Zagury’s Motion to Strike (D.E. 102) at 51-52, 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 (Sept. 16, 2011), ECF No. 109.

Id. at 27. Plaintiff’s counsel in Aracruz also represented the plaintiffs in In re Sadia.
Plaintiffs also stated a valid claim, the court held, based on Aracruz’s failure to disclose that the derivatives contracts had violated the company’s own internal policies. 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 pled 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 pled loss causation, and that the Aracruz statements at issue were not shielded by the “bespeaks caution” doctrine or the PSLRA safe harbor.

On July 20th, 2012, lead plaintiffs filed a motion for class certification with a class period of April 7 to October 8, 2008, along with an expert witness declaration that the market for Aracruz ADRs was efficient. Defendants rebutted the fraud-on-the-market presumption, submitting an expert declaration that the alleged false statements had no measurable impact on the price of Aracruz ADRs on either April 7th or July 7th, 2008, and indeed no impact at all until September 4 of 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. 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. In 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.”

After mediation efforts, the settlement agreement established a cash fund in the amount of US$ 37,500,000 to compensate Aracruz investors and resolve all

173 Id. at 28.
174 Id. at 30, 37, 44, 50-53, 59. 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 16. After this order, Zagury terminated his counsel. 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, 1:08-cv-23317 (Sept. 21, 2011), ECF Nos. 111 and 111-1, and decided to proceed pro se. He alleged that “Since I’m no professional activity and health problems, I do not have sufficient resources to honor the payment of attorney’s fees for future stages” (sic), id., ECF Nos. 117-2 and 126. Zagury also affirmed that the insurance company would not reimburse him from an liability under this action., id., ECF No. 138.
175 Lead Plaintiff’s Motion for Class Certification 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, 1:08-cv-23317 (Jul. 20, 2012), ECF No. 143. See Declaration of Chad Coffman, CFA, id., (Jul. 20, 2012), ECF No. 143-1.
177 An e-discovery vendor traveled to Brazil to collect data. See Defendants’ Objections and Responses to Plaintiff’s First Set of Documents Requests Dated December 9, 2011, and correspondences between plaintiffs’ and defendants’ lawyers in 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 (Oct. 24, 2012), ECF No. 170.
claims in the action. Approximately 11 million Aracruz ADRs were traded during the class period, and the average recovery under the settlement amounted to $3.41 per allegedly damaged ADR, before deductions of court-approved costs and attorneys’ fees. According to legal counsel, requested fees would amount to “an average of $1.13 per allegedly damaged ADR.”

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. The class action prerequisites set by Rules 23(a) and (b)(3) of the Federal Rules of Civil Procedure were considered satisfied for the purpose of the settlement. 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$ 37,500,000 to the settlement fund. The court awarded 33.33% in attorneys’ fees, or $12,500,000.00 of the settlement fund. It also allowed reimbursement for expenses incurred in connection with the lawsuit in the amount of $839,703.18, and a $40,000.00 award for reasonable costs and expenses incurred in representing the class.

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 S.A. – revealed that the costs of the U.S. Aracruz litigation were “significantly” supported by Fibria’s (D&O) insurance policy.

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

---

178 According to legal counsel, this value would correspond to nearly five times the recovery of comparable securities fraud cases.
179 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 representation of the Class.”
180 The attorneys claimed to have expended 13,090.25 hours on efforts of research, investigation, prosecution, and resolution of the case. Lead Plaintiff’s Motion for Final Approval of Settlement and Award of Attorneys’ Fees and Reimbursement of Expenses and Incorporated Memorandum of Law in Support at 39, Aracruz Doc No?. Incluir Load Star mimic Sadia. “Total lodestar is $5,952,410.00, which represents a multiplier of 2.09.” Id. at 40
181 Id.
182 FIBRIA CELULOSE S.A., DEMONSTRAÇÕES FINANCEIRAS [CONSOLIDATED FINANCIAL STATEMENTS] 3, 50 (2012), available at 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$37.5 million to all the ADR holders during the period mentioned above. Because Fibria has Directors and Officers (D&O) insurance with cover extending to the company that will reimburse a significant part of this expense, there will be no material effect on the company.”) See also Stella Fontes. Heranças da Aracruz e VCP custam R$ 1,7 bilhão à Fibria. Valor Online, (17 Dec., 2012).
IV.2. 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.\textsuperscript{183}

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.\textsuperscript{184} Consequently, as shareholders in Brazil are properly incentivized to 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.\textsuperscript{185} 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 5% of the company’s stock capital.\textsuperscript{186} 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.\textsuperscript{187}

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.\textsuperscript{188} Both Brazilian and U.S. derivative suits can target a corporation’s directors and officers.\textsuperscript{189}

\textsuperscript{183} Law 6.404/76, Article 159. "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."

\textsuperscript{184} See Gorga, supra note __ (finding that the shareholders held 36% of voting shares, in average, in Novo Mercado, BM&FBovespa listing segment that achieves the largest dispersion of ownership structures in 2007).

\textsuperscript{185} Law 6.404/76, Article 159, Paragraph 3. "Any shareholder may bring the action if proceedings are not instituted within three months from the date of the resolution of the general meeting."

\textsuperscript{186} Id. at paragraph 4. "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 0.5 in a 0 to 1 scale measuring the availability of “private enforcement of directors’ duties,” the same score as Argentina, India, Spain, and the UK. See Siems, supra note 16, at 107 and 110.

\textsuperscript{187} Id. at paragraph 5. "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.”

\textsuperscript{188} JAMES D. COX & THOMAS LEE HAZEN, COX AND HAZEN ON CORPORATIONS § 15.02 (2002). In a limited set of circumstances, the individual shareholder can seek an individual recovery. See id. at § 15.04.

\textsuperscript{189} 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. See, e.g., Jessica Erickson, Corporate Governance in the Courtroom: an Empirical Analysis, 51 WM & MARY L. REV. 1749, 1771 (2009-2010) (indicating,
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 directors to have the corporation bring the suit itself. Instead of making such a demand on the board, plaintiffs are permitted instead 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. Even if demand is shown to be futile, the board of directors can create a special independent litigation committee that may still ultimately decide not to pursue charges. 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.

The Brazilian "derivative suit" can assume two variations: the corporation against the director or officer or, as we discuss 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, or by the action of filing a suit when a corporation fails to bring it or authorization is denied by the majority shareholders in a general meeting. In either of the last two cases, a significant minority shareholder – with at least 5% of the stock capital – is still able to bring action against corporate managers. It is worth noting once more that this action is not a direct suit based on shareholder losses or individual claims, but instead is brought by the shareholder on behalf of the corporation for “losses caused to the corporation’s property.”

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

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 American-style contingency fee system, 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.”\footnote{Dan W. Puchniak, The Derivative Action in Asia: A Complex Reality, 9 BERKELEY BUS. L. J. 1, 17-18 (2012).} 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.\footnote{Id.} All these characteristics largely apply to Brazil, as I discuss below.\footnote{See infra notes 203-212 and accompanying text. See also infra notes ___ and accompanying text. See infra notes ___ and accompanying text. 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) (“social 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 Korea, in THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH 194-195 (Dan W. Puchniak, Harald Baum & Michael Ewing-Chow eds., 2012).} However, unlike countries such as Japan and Korea, Brazil has not experienced an upsurge in derivative litigation brought about by non-profit shareholders and social activist organizations that seek to exert political influence in the corporate sphere.\footnote{Martin Gelter, Why do Shareholder Derivative Suits Remain Rare in Continental Europe, 37 BROOK. J. INT’L L. 843, 856, 891 (2012).} So derivative suits remain uncommon in Brazil.

Analyzing European derivative actions, Gelter enumerates four preconditions that facilitate derivative shareholder suits: 1) favorable standing requirements without minimum ownership thresholds, 2) favorable allocation of litigation risk so as to overcome minority shareholders’ rational apathy, 3) sufficient information access enabling plaintiffs to litigate, 4) possibility of derivative suits against not only directors but also controlling shareholders.\footnote{Law 6.404/76, Article 159 § 4º. See CARVALHOSA, supra note 194 at 391-391 (criticizing the minimum ownership threshold).} With these preconditions in mind, note first that Brazilian law demands a minimum ownership of 5% of the company’s total capital as a condition to file.\footnote{Id., at 858-860 (explaining the rules in detail, such as the demand requirement introduced in the German reform and ownership requirements for French groups of shareholders and shareholders associations).} That is a higher ownership threshold than several European countries which have recently undergone reforms reducing the minimum requirements for filing such claims. For example, Germany has reduced 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 1,250,00 euros, while France and Switzerland don’t require any individual minimum ownership.\footnote{Dan W. Puchniak, Why do Shareholder Derivative Suits Remain Rare in Continental Europe, 37 BROOK. J. INT’L L. 843, 856, 891 (2012).}

\footnote{Law 6.404/76, Article 159 § 4º. See CARVALHOSA, supra note 194 at 391-391 (criticizing the minimum ownership threshold).}\footnote{Id., at 858-860 (explaining the rules in detail, such as the demand requirement introduced in the German reform and ownership requirements for French groups of shareholders and shareholders associations).}
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 to pay the defendants’ costs – a risk that may prevent those shareholders from bringing actions in the first place.\(^{205}\) The risk is considerable in a system in which the private benefits of control are high and courts have traditionally favored controlling shareholders who benefit from established legal doctrines.\(^{206}\) Even more important is that contingency fees arrangements are not allowed in Brazil,\(^{207}\) 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 to corporate information because of its lack of discovery proceedings.\(^{208}\) 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;\(^{209}\) most of the literature, however, supports the latter.\(^{210}\) 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.\(^{211}\) 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 as well to Brazil as compared to the United States.\(^{212}\)

After this introduction to Brazilian "derivative" suits, I now turn to the developments that originated the suit filed by Sadia against former CFO Ferreira. After official notice of the financial losses was made public,\(^{213}\) 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 on October 6th, 2008 a request with Sadia for a special shareholder meeting and provided notice of this request to the CVM and the SEC.\(^{214}\) PREVI demanded that the

\(^{205}\) Gelter, supra note 202, at 862-866 discusses the theoretical doubts on the effects of the English rule on filing of suits, observing that it depends on “the assumption that shareholders suits have a low probability of winning” (at 865), which I believe to be the case regarding Brazil. See infra note 206 and accompanying text. He also concludes that this rule will depend on burden of proof needs and information gathering ability. Id. at 866.

\(^{206}\) See ÉRICA GÓRGA, DIREITO SOCIETARIO ATUAL 59-74 (discussing evidence of high private benefits of control in Brazil).

\(^{207}\) See Keith S. Rosenn, Civil Procedure in Brazil, 34 AM. J. COMP. L. 487 (1986).

\(^{208}\) See Érica Gorga & Michael Halberstam, Litigation Discovery & Corporate Governance: The Missing Story about “The Genius of American Corporate Law,” 63 EMORY L.J. 1383 (2014); Ferrarini & Giudici, supra note 14, at 162. 203, explain the weakness of derivative suits in Italy maily as a consequence of the lack of discovery. See Rosenn, supra note 207, at ___.

\(^{209}\) See, e.g., CARVALHOSA, supra note 194, at 396 (defending that controlling shareholders can be sued through derivative suits). But see 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).

\(^{210}\) Lopes, id. (reviewing the literature).

\(^{211}\) Gelter, supra note 202, at 876. The liability action of Article 159 of Brazilian Corporate Law 6404/76 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.

\(^{212}\) Id., at 877.

\(^{213}\) See Fato Relevante and Notice of Material Event, supra note 98.

company call the board of directors, the managers, fiscal council, audit, finance and investor relation committees and external auditors to explain the financial losses.\textsuperscript{215} 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.\textsuperscript{216}

The company complied with these requests. On November 3\textsuperscript{rd}, 2009, 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 90 days, at which time another general shareholder meeting would be conducted to consider the results.\textsuperscript{217}

Sadia held the subsequent special shareholder meeting on April 6\textsuperscript{th}, 2009 (“second meeting”).\textsuperscript{218} This meeting was attended by shareholders representing more than 63\% of the voting capital of Sadia S.A. 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 Adriano Lima Ferreira for losses caused to the company stemming from its transactions in the derivatives markets.\textsuperscript{219}

In April 27\textsuperscript{th}, 2009 another ordinary shareholder meeting (“third meeting”) was held to discuss, among other matters, approval of the company’s 2008 financial statements. Stockholders representing 66\% of the voting capital attended the meeting and unanimously approved the accounts of the corporation referring to year-end 2008, “without any reservations;\textsuperscript{220} the terms of this approval would later sit at the center of the formal legal tangle that determined the outcome of the case.

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, vol. 7 (Jun 18, 2009) (Braz.). This request is based on Article 123, solely paragraph, “c” of Law 6.404/76: “Article 123. Subject to the bylaws, general meetings shall be called by the administrative council, if any, or by the directors. Sole Paragraph. 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.”

\textsuperscript{215} Id.

\textsuperscript{216} Id.

\textsuperscript{217} Sadia S.A., Ata Sumária Da Assembléia Geral Extraordinária da Sadia S.A., 3 de Novembro de 2008, [Minutes of Sadia’s Special Shareholder Meeting on November 3rd, 2008.].


\textsuperscript{219} Id.

Based on the decision made in the second meeting, Sadia S.A. filed suit against sole defendant Ferreira in São Paulo on June 18, 2009.\(^{221}\) It claimed that the defendant had made business decisions in blatant disregard of Sadia’s financial policies, which established clear limits for derivatives hedge contracts. Ferreira had violated these policies in regard to both contracting limits and risk exposure. Sadia S.A. also claimed that Ferreira had been warned on August 19th, 2008 and on September 2nd, 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.\(^{222}\) It argued the defendant was negligent and imprudent, in addition to having deliberately hidden information from the board of directors and its committees. According to these allegations, defendant violated the fiduciary duties of both care and loyalty as defined by Law 6.404/76, articles 153 and 155.\(^{223}\) Sadia further alleged causality between the actions and omissions of Ferreira and the financial harms caused to the company.\(^{224}\) Based on these arguments, Sadia sought indemnification from the defendant for the financial harm he had caused.\(^{225}\)

---

\(^{221}\) 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, vol. 1 (Jun 18, 2009) (Braz.).

\(^{222}\) Id. at 3-4.

\(^{223}\) Brazilian Corporation Law, Duty of Diligence Article 153: “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”; Duty of Loyalty Article 155:

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.

\(^{224}\) Petição Inicial, supra note 221, at 28 and 34.

\(^{225}\) Petição Inicial, supra note 221, at 15, 22, 26-27, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol. 1. (Braz.). The demand was grounded in Article 158, I and II, from Law 6404/76, which states that:

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 subjected to civil liability for losses he caused when he acted:

I - within the scope of his authority or power, with negligence or intent; II – in violation 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”). Id. at 40-41. 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 preestablished limits at least as early as July 7th, 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, supra note 221, Relatório de Eventos Identificados com Base em Procedimentos Previamente Acordados, BDO Trevisan [Report of Identified Events on Basis of Proceedings Previously Agreed, BDO Trevisan] vol.3, at 147, 182-183, 185-188, 197, 198.
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 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. Second, the defendant argued that the civil court lacked competence to hear the suit because while employed he was subordinated to the company’s chairman; as his actions were performed as part of an employment relationship, the suit should have been filed in the labor court. Third, Ferreira argued that a “litisconsortium” was necessary, that is, the president of the board of directors – Mr. Walter Fontana – must be included as a defendant since he was informed of and ratified all the transactions in question. 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.

226 Contestação, at 2, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 7, (Braz.) Law 6.404/76 Art. 134 Paragraph 3 (“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 know as “Lex posteriori derogat priori.” See BLACK’S LAW DICTIONARY.

227 Id., at 38-41. Ferreira filed a labour complaint against Sadia S.A. on June 5th, 2009. Reclamação Trabalhista, 61ª Vara Trabalhista do Tribunal Regional do Trabalho da 2ª Região No 01258005820095020061 (Braz.) He argued that Sadia destroyed his professional reputation, 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 disburden the directors and controlling shareholders (the families Furlan and Fontana) from charges from the minority shareholders by making Ferreira the sole scapegoat of the company’s failure. See 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, 576 ISTO É DINHEIRO (BRAZ.) 10 (2008) (reporting that Furlan, member of the family of controlling shareholders, was appointed as CEO after the losses from the derivatives transactions. Furlan claimed that 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. 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 Sept. 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 CLT labor regime in 2002, and that, in spite of being formally elected CFO by Sadia’s board of Directors in September of 2006, he continued to be subordinated to the President of the board of directors. In his Labour complaint, Ferreira requested the acknowledgement 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 midia). 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 forward 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.

228 Id., at 41-45. This was evident in that the accounting recording of each transaction exceeding $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.
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 § 6° applied. 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. 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 over the world, including Sadia S.A. 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. 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. Sadia subsequently filed its further memorandum in response to Ferreira (“Réplica”) on August 31st, 2009, and Ferreira further responded (“Tréplica”) on September 22th, 2009.

On October 30th, 2009, the judge determined that he was competent to decide the complaint, denying the labor justice authority over the object of the demand. The judge considered that the action stemmed from defendant’s position as the chief financial officer 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. Ferreira then filed a type of appeal known as Request for Clarification

---

229 According to article 159 § 6° of Law 6.404/76: “Article 156, Paragraph 6. A judge may excuse the officer from liability, when convinced that he acted in good faith and in the interests of the corporation.”

230 Ferreira argued that Sadia was used to engaging in financial transactions for more than twenty years through its 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 47% of its gains and global results in the period. From 1996 to 2007, 43% of the results of the company originated from financial transactions. Contestação, at 7-9. 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 7, (Braz.). He quoted Oscar Mulvesi, Onde a Sadia perdeu o jogo: ou por que a Perdigão comprou a Sadia - e não o contrário, 940 ÉPOCA (Braz.) 14 (2009), (arguing that “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 at Sadia). Id., at 14. 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 Chief Executive Officer 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 subordinated to the President of the board (former CEO) and not to the new CEO of the company. Id. at 8.

231 He challenged the methodology of the BDO report, supra note 225, arguing that it did not rely on the company’s official approach to calculate the risk exposure, which was based on the VaR and Stress Test, and it 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 would make 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. Id. at 35-38.

232 Id. at 7-8, 59-60.

233 Réplica, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 11 (Braz.).

234 Tréplica, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 12 (Braz.).

235 Despacho Saneador, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 12 (Braz.).
(“Embargos de Declaração”) on November 13, 2009, pointing out the judge’s failure to acknowledge the applicable exculpatory provision of article 134 § 3, under which the approval of accounts without reservations exonerate any liability, an earlier shareholder decision to sue notwithstanding. Defendant argued that this preliminary issue had to be addressed. The judge received the request for clarification on November 25th, 2009, but maintained the decision that the action proceed according to the terms of article 159 Law 6404/76.

Defendant then brought the matter to the upper Court by filing a bill of review ("agravo de instrumento") challenging the judge’s decision on December 11, 2009. On September 27th, 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 27th, 2009 exonerated all managers from liability related to the derivatives transactions. 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. Sadia was then required to pay the procedural costs of both parties and the honorarium of lawyers (“honorários sucumbenciais”) of 15% 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. At the end of a long and intricate appeal war revealing of how

236 Embargos de Declaracao, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 12 (Braz.).
237 Id.
238 Id.
239 Agravo de Instrumento No. 696308.4/2, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 13 (Braz.).
240 See Minutes of Sadia’s Special Shareholder Meeting on April 27th, 2009, supra note 220.
242 Id. The court relied on article 267, IV, of Brazilian CPC. This decision had one dissenting vote.
243 Sadia filed a request for clarification (“embargos de declaração”) on October 1st, 2010, which was rejected by the 4ª Câmara de Direito Privado do Tribunal de Justiça de São Paulo on November 25th, 2010. See T.J.S.P. Embargos de Declaracao No. 990.09.362587-3/50000. Relator: Des. Enio Zuliani, DIÁRIO DE JUSTIÇA [D.J.] 25.10.2010, 1065 (Braz.). Next, it filed a special appeal (“recurso especial”) on December 20, 2010. See Recurso Especial, Superior Tribunal de Justiça de São Paulo, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 14 (Braz.). This appeal – based on article 496 VI and 541 et seq. of Brazilian CPC – claimed that the authorization to sue a manager per article 159 of Law 6404/76 implicates the automatic rejection of the corporate accounts; that there is a window of 90 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 shareholders meeting 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 § 1º of CPC. See Recurso Extraordinário, Superior Tribunal de Justiça de São Paulo, 9ª Vara Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 14 (Braz.). The President of the São Paulo Justice Court denied the proceedings of especial and extraordinary appeals on September 9, 2011. T.J.S.P. Embargos de Declaracao – Recurso Especial. Rel. Des. Maia da Cunha. Diário de Justiça de São Paulo [D.J.S.P.] 05.10.2011, 967. T.J.S.P. Embargos de Declaracao – Recurso Extraordinario. Rel. Des. Maia da Cunha. Diário de Justiça de São Paulo [D.J.S.P.] 05.10.2011, 967 (Braz. The Superior Tribunal
complex, time-consuming and burdensome civil procedure issues can be under Brazilian law, Sadia was ordered to pay the actual value of the legal action (R$853,921.61, after monetary corrections).244

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 24th, 2008, in which the majority of shareholders approved the suit against Zagury;245 one notable contrary vote was cast by investment fund Fundo Latino Americano CIBC.246 The shareholder BNDES Participações S.A., the large Brazilian state bank for economic development, abstained from voting, with its representative alleging she lacked sufficient information to cast her vote.247

The suit was brought under article 159 of Brazilian corporate law, presenting the same legal basis as the Sadia suit. However, the suit differed from that of Sadia in that the shareholders in the Aracruz meeting approved the accounts reflecting the financial losses with reservations.248 This would preclude Zagury from using the exculpatory provision set forth in article 134§3 of Law 6404/76 as did Ferreira.249

An analysis of the detailed development of this case is not possible because I did not have access to the docket of the Aracruz “derivative suit” against former CFO Zagury. I petitioned Rio de Janeiro courthouse for access to the judicial suit in December of 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 in section IV.3.1. The Brazilian CVM, notwithstanding, provided some information on the outcome of the case when it referenced the R$ 1.5 million de Justiça (STJ), Brazil’s highest court for corporate matters, 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 DE JUSTIÇA ELETRÔNICO [D.J.E.] 19.02.2013 (Braz.). Sadia also filed other appeals related to incidental matters which are not discussed here, respectively on October 13th, 2011 and 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 the tentative settlement, which generated another appeal filed by Sadia, which was also rejected.

244 These costs are of course underestimated, not reflecting the full value spent with lawyers and legal opinions from outside jurists hired to support each party’s argument.
246 id.
247 id.
248 id. The suit was brought under article 159 of Brazilian corporate law, presenting the same legal basis as the Sadia suit. However, the suit differed from that of Sadia in that the shareholders in the Aracruz meeting approved the accounts reflecting the financial losses with reservations. This would preclude Zagury from using the exculpatory provision set forth in article 134 §3 of Law 6404/76 as did Ferreira.
249 See supra note 226.
settlement as the basis for the settlement of its own administrative investigation – a matter I discuss infra in section IV.3.3.

IV. 3. Comparative Analysis

In this section I present a comparative examination of the main results and findings revealed by the U.S. and Brazilian Sadia and Aracruz private lawsuits.

IV.3.1. 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.250 This information produces signaling and deterrence effects for the market.251 In fact, the degree to which available information is assimilated by securities prices is one classical measure of market efficiency.252 As a corollary, information access is the founding basis of capital markets regulation.253 The disclosure of information about wrongdoing not only diminishes asymmetry of information, 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.254 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 in a few hours from the Bloomberg Law database. In these dockets I was able to find all parties' petitions, motions, expert reports, and rebuttal reports, including a number of documents that had been labeled “confidential” by parties to the litigation. Examples of these

252 Eugene Fama, Efficient Capital Markets: A Review of Theory and Empirical Work, 25 J. FIN 383 (May 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).
254 The literature on the benefits of public access to judicial proceedings in the United States is extensive. See, e.g. Judith Resnik, Courts: In and out of Sight, Site and Cite, 53 VILL. L. REV. 771, 784 (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, 32 REV. LITIG. 889, 942 (2012) (defending that public access to class action settlement agreements is a critical prerequisite to public monitoring of the judicial approval process). 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”).
documents include excerpts of depositions of expert witnesses and declarations of company managers.

In contrast, I faced 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, court officials were still holding the lawsuit in “secrecy of justice,” preventing any general public access. Ultimately, after pointing out to officials the upper court decision lifting the veil and convincing them that the documents must be open to the public, I was 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. 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.\(^{255}\) The general rule of Brazilian Code of Civil Procedure also provides that legal procedures be public,\(^ {256}\) and that lawsuits can proceed in “secrecy of justice” only in the case of two specified exceptions:\(^ {257}\) family legal matters (art. 155 II), and when the “public interest” requires (art. 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 secrecy of justice is therefore more expansive than secrete settlements that have been so harshly criticized in the United States.\(^ {258}\)

Sadia used the “public interest” general provision as a basis for requesting secrecy of justice\(^ {259}\) for its case, arguing that the confidentiality of legal procedures

\(^ {255}\) See Brazilian Federal Constitution, Art. 5º LX. See also Art. 5º XXXIII, 37 caput, art. 93 IX, and Law 12.527/2011, which has regulated access to information according to Constitutional provisions:

\textit{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.}

\(^ {256}\) Article 155 of the Civil Procedure Code (CPC) (Braz.).

\(^ {257}\) Paragraphs I and II of article 155 CPC (Braz.).


\(^ {259}\) See Petição Inicial, Ação de Responsabilidade Civil Contra Administrador, p. 2:

\textit{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}
would “preserve the interests” of the parties and “prevent turmoil” in the notary (“cartório”). 260 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 poor argumentation, granted the secrecy of justice on June 18th, 2009, accepting the one-paragraph, six-line argument made by the plaintiff and without providing further legal reasoning for his decision.

It is worth noting that legal procedures are public precisely because the 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 reason that because a suit will generate the “turmoil” of too many people trying to view its contents, and on this basis to grant secrecy of justice, is to reverse the entire rationale of the public interest. Legal procedures are public precisely so that a large number of people can monitor them. If the intention of the law was 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. 261

While one could argue in favor of protecting a company’s trade secrets and other proprietary information, hardly any such issues would be discussed at 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 provisions of the

---

260 See id. “Cartório” or 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 (Braz.). Art 1º. “Registration and notary services are the technical and administrative organization designed to guarantee publicity, authenticity, security and efficiency of legal acts” (emphasis added) (“Serviços notariais e de registro são os de organização técnica e administrativa destinados a garantir a publicidade, autenticidade, segurança e eficácia dos atos jurídicos”).

261 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.

Brazilian corporate law regime and of the Constitution. When necessary, one solution would be for the judge to authorize parties to blank or redact documents only to protect particular information that really does require confidentiality—e.g., 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 reasons: i) the Brazilian constitutional rule is the 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 was lifted.

In response, the judge denied the defendant’s request, alluding to the secrecy of justice extant in the labor complaint filled by Ferreira as a justification for keeping this one. 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 the face of the limited exceptions prescribed by the Brazilian Constitution.

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. Nonetheless, I have not had success in accessing 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 in the first place.

To summarize, the docket of both U.S. class action lawsuits are promptly available electronically to any U.S. or foreign investor situated in any location. Meanwhile, it is extremely burdensome to get information on either Brazilian suit. After consistent effort, including physically going many times to the local Brazilian courts in both Sao Paulo and Rio de Janeiro, I gained access only 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

---

263 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 217-232 (Joaquim Rubens Fontes Filho, Ricardo Pereira Câmara Leaf (Org.), 2013).
264 Contestação at 64, 9ª Vará Cível do Foro Central da Comarca de São Paulo No. 583.00.2009.163865-3, vol 7. (Braz.).
266 I refrain here from evaluating whether the labor suit exception would better justify the application of the secrecy of justice. The point is that in evaluating the application of secrecy of justice, the law does not allow such an expansive use so as to justify the secrecy of justice 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.
267 I also had to pay a fee of R$__ 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.
wrongdoings and liability issues that entirely 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. In fact, supporting this argument, some Brazilian courts are migrating to an entirely electronic system, which will ban most of hardcopy documents and, in the future, even challenge the existence and organization of current cartórios.\footnote{See Implementation Schedule of “PUMA” [Plano de Unificação, Modernização e Alinhamento] of Tribunal de Justiça de São Paulo, available at http://processoeletronico.aasp.org.br/cronograma-implantacao-puma-tjsp. PUMA is a program aimed at providing electronic files of judicial documents.}

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 Federal Constitution.\footnote{Law 6.385/76 and 6.404/76 create a special transparency regime for publicly-held companies.} In fact, judges have failed to take into account the very differentiated disclosure regime that publicly-held corporations are subjected to by means of special statutory regimes.\footnote{In theory, direct shareholder suits would be possible both in the United States and in Brazil, as per the information presented supra note 195. 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.}

In conclusion, while there was public disclosure of the documents and legal discussions on the litigation of corporate wrongdoing in both the Sadia and Aracruz cases in the United States, in Brazil the equivalent information was held in a black box during all the time that the suits were pending, with the approval of the Brazilian Judiciary, with one of those two cases largely remaining in the black box even after resolved. In this respect, it is undeniable that a U.S. capital market investor has access to more information about corporate litigation and wrongdoing than does an investor in the Brazilian markets – not because of a technology gap, but for primarily legal reasons.

IV.3.2. 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 \textit{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 shareholder direct suits, derivative suits and class actions. As direct suits 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,\footnote{In theory, direct shareholder suits would be possible both in the United States and in Brazil, as per the information presented supra note 195. 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.} in this section I focus on the last two types and try to provide a
positive explanation of why these particular types of suits were filed in each jurisdiction. Derivative actions generally provide recovery for the company and only indirectly to shareholders.\(^\text{272}\) Class actions, on the other hand, provide recovery exclusively to the class of shareholders that suffered the alleged damage.

While derivatives actions could 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 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.\(^\text{273}\)

I believe there is one dominant explanation for this choice of litigation venue. Besides the arguments that U.S. derivative suits involve substantial procedural hurdles that constrain plaintiffs in their efforts to vindicate corporate claims,\(^\text{274}\) 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 who reside in a foreign country as the only defendant parties\(^\text{275}\) raises significant civil procedural problems that could severely delay and reduce the plaintiff’s chances of success.\(^\text{276}\) This problem is circumvented when the foreign issuer corporation is placed on the defendant side in a security class action. Both 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 have rendered any U.S. judicial decision ineffective in practice.

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

---

\(^{272}\) This last assertion depends on the reaction of the company’s securities prices to the outcome of the suit; for example, shareholders receive indirect recovery if security prices increase in the secondary markets after plaintiffs win their suit. But see Adam C. Pritchard & Stephen P. Ferris, Stock Price Reactions to Securities Fraud Class Actions Under the Private Securities Litigation Reform Act (October 2001). Michigan Law and Economics Research Paper No. 01-009. Available at SSRN: 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. The authors however do not find significant price reaction to the outcome of litigation). See also 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).

\(^{273}\) Indeed, U.S. plaintiffs could have chosen from a number of forums, including state court class action, federal securities class action, state derivative suits or federal derivative suits. Thompson & Thomas, supra note 192, at 1773. See generally Erickson, supra note 189 (analyzing the phenomenon of shareholder derivative suits filed in federal courts on behalf of companies mostly incorporated outside of Delaware). See also Randall S. Thomas & Kenneth J. Martin, Using State Inspection Statutes for Discovery in Federal Securities Fraud Actions, 77 B.U. L. REV. 69 (1997).

\(^{274}\) Thompson & Thomas, supra note 192, at 1773. Erickson, supra note 189, at 1760.

\(^{275}\) Robert B. Thompson & Hillary Sale, Securities Fraud as Corporate Governance: Reflections upon Federalism, 56 VAND. L. REV. 859, 895 (2003) (“State law fiduciary complaints are brought against directors, but federal claims are made against officers”).

\(^{276}\) See, e.g., Erickson, supra note 189, 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”).
shareholder attendance at those meetings. The Brazilian corporations Sadia and Aracruz themselves were plaintiffs because of the nature of these “derivative” suits. But one could ask why the Brazilian shareholders decided to sue only their former CFOs, in contrast to the U.S. class action suits that included more defendants. To be sure, the concentrated ownership structure and the relationships between controlling shareholders and managers/board members also provides an explanation 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.

Turning to class actions, we note that in theory, these could be 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.

Indeed, Brazilian law has included a general class action framework since 1985, when the so-called Brazilian Public Civil Action was enacted. 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. 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

\[
\text{277 See supra notes 214-220 and 245 and accompanying text for a discussion of shareholder meetings decision. As I discuss below, controlling shareholders would not have incentives to sue themselves or their loyal executives, but would have incentives to sue someone to divert attention from their possible misconduct.}
\]

\[
\text{278 See supra notes 183-197 and accompanying text.}
\]

\[
\text{279 Erickson also points out that U.S. federal derivative complaints frequently include the Chief Financial Officer in 81.6% of the cases of her sample. Erickson, supra note 189, at 1772.}
\]

\[
\text{280 In both parallel U.S. class action suits, the CEOs and Chairmen were also included as defendants. Further, in the U.S. Sadia suit, another previous CFO (d'Avila) and the Vice-Chairman were also sued. This difference may be mainly related to Sarbanes–Oxley Certification provisions that hold CEOs accountable for the financial information provided by their companies. Section 302 requires that the company's "principal officers," typically the CEO and CFO, certify and approve the integrity of their company financial reports quarterly.}
\]

\[
\text{281 See infra part __ for further discussion on the companies' ownership structures and the incentives provided.}
\]

\[
\text{282 Gidi argued that Quebec and Brazil were “the only civil law systems that have developed a sophisticated system of class actions suits.” He compared the Brazilian system of class actions with the American one, concluding that the “Brazilian experience demonstrates that civil law systems can employ a class suit procedure but cannot transplant the American class actions model into their systems without substantial adaptation.” Antonio Gidi, Class Actions in Brazil – A Model for Civil Law Countries, 51 AM. J. COMP. L. 311, 311 (2003).}
\]

\[
\text{283 See Lei da Ação Civil Pública [Public Civil Action Law], Lei n. 7,347, de 24 de julho de 1985. Note that the equivalent to the U.S. private class action is called “public civil action” in Brazil. This is because, as I will explain, these class actions were intended generally to be brought by public prosecutors.}
\]

\[
\text{284 Article 2, Law 7, 913/ 1989.}
\]
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.\textsuperscript{285} 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.\textsuperscript{286} 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 contingency fees would still hinder the origination of these suits.\textsuperscript{287} Public prosecutors, on the other hand, lack the incentives and expertise necessary to file these claims on behalf of investors.

In comparison, in the United States, even if ownership is more dispersed and shareholders face more severe collection action problems than in Brazil, private attorneys litigate on a contingent fee basis and advance all expenses related to the prosecution of the case. The contingent fee incentivizes filing the claims.\textsuperscript{288} 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 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.”\textsuperscript{289} 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.\textsuperscript{290} This compensatory system based on

\textsuperscript{285} Gidi, supra note 282, at 340-341: \textit{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.

\textsuperscript{286} See article 5 of Law 7347/85. See Rosenn, supra note, at 522-523.

\textsuperscript{287} See supra note 282 and accompanying text.

\textsuperscript{288} Gidi, supra note 282, at 341 n.74. See American Bar Association Model Rules of Professional Conduct, Rule 1.8(e) (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 a taboo in most civil-law systems, with rare exceptions.

\textsuperscript{289} Boeing Co. v. Van Gemert, 444 U.S. 472, 478 (1980). In Camden I Condo. Ass’n, Inc. v. Dunkle, 946 F.2d 768, 774 (11th Cir. 1991), the Eleventh Circuit rejected the so-called "lodestar" approach, holding that “[h]enceforth 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.”

\textsuperscript{290} 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).
contingent fees does not exist in Brazil.\textsuperscript{291}

Another shortcoming lies in the inadequate procedural and technical rules of the Brazilian class action. For example, the approval of settlements is severely constrained.\textsuperscript{292} According to an important 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: “in 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.”\textsuperscript{293}

American 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.\textsuperscript{294} Another shortcoming of the procedural mechanisms in Brazil is the lack of discovery procedures for collecting relevant evidence to prove a case.\textsuperscript{295}

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 their

\textsuperscript{291} See Rosenn, supra note __, at 518-519, for a discussion of attorneys’ fees in Brazil that remains largely accurate until today. Judges generally fix from 10% to 20% of the amount of the judgment as attorneys’ fees. Lawyers don’t 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 that “[f]ee 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.

\textsuperscript{292} Gidi, supra note 282, at 342-343:

\textit{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 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.}


\textsuperscript{294} Gidi, supra note 282.

\textsuperscript{295} Gidi, supra note 282 at 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 208.
desire to take legal action against the wrongdoers. These minorities had no other satisfactory private enforcement mechanism 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 the significant 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 former and later cases resulted, respectively, in a net settlement fund of US$ 18,012,711.96 and US$ 23,760,000 to be distributed to ADR holders. These results seem to question the general view that class actions are merely rent-seeking devices and suggest the stronger deterrence 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 did not seem to be a concern of these particular cases either, because Brazilian controlling shareholders bore a significant piece of the litigation costs.

Therefore, in spite of the standard critique of the U.S. class action system, the examination of the Sadia and Aracruz case studies support the hypothesis of a stronger intensity of private enforcement in the United States than the one found in the original jurisdictions of the cross-listed companies. Nonetheless, this enforcement activity is not necessarily corroborated when it comes to public enforcement, as I discuss in section V.

IV.3.4. American 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 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

---

296 The Aracruz projected net settlement fund is based on the author’s conservative calculations of the final settlement decision of the court, since the Aracruz class notices to securities holders are still in process and the net settlement fund value has not been officially calculated.


298 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 __.

299 See supra notes __.
actions settle, in general the rates of settlements in civil law jurisdictions are considerably lower than in common law jurisdictions. This is indeed the case in Brazil, where settlements are not the most likely outcome of a civil suit.

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. Then, if the result is different from what the party wanted, the lawyer could continue with the strategy of filing a number of different appeals. 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. Once appeals can be filed on matters of facts and law, the attorney is at least able to considerably delay the execution of a judicial ruling, even if a favorable decision is not reached.

In this scenario, one might ask why Zagury opted to settle the case 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 to note that while Zagury was the only defendant in the Brazilian suit, he was one of two individual defendants, alongside main defendant Aracruz, in the U.S. suit. Because the U.S. suit involved more defendants and included a corporation among them, one might hypothesize a direct relationship between the number of defendants and the value of the settlement.

However, according to scholars, a more important determinant of settlement value in U.S. corporate litigation practice is the level of D&O insurance coverage

---

300 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 of settlement rates for civil cases in all district courts. Kuo Chang-Huang, Does Discovery Promote Settlement? An Empirical Answer, 6 J. EMP. LEG. STUD. 241 (2009). The law and economics literature further corroborates this claim. In an economic model of litigation and settlement decisions under imperfect information, Bebchuk shows that discovery legal requirements increase the probability of settlement. Lucian Bebchuk, Litigation and Settlement Under Imperfect Information, 15 RAND J. ECON. 404, 413 (1984) In a model with one-sided discovery, Sobel demonstrates that mandatory discovery rules reduces the probability of trials. Joel Sobel, An Analysis of Discovery Rules, 52 L. & CONTEMP. PROBS 133 (1989); see also Robert D. Cooter & Daniel L. Rubinfeld, An Economic Model of Legal Discovery, 23 J. LEGAL STUD. 435, 436 (1994) (“discovery increases settlements and decreases trials by organizing voluntary exchange of information”); Gidi, supra note 282, at 319 (pointing out that the rate of settlements in Brazil is lower than in common law jurisdictions).

301 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 __, at 489 (noting that “…a party bent on delay can keep litigation moving at a snail’s pace”).

302 See supra notes __.

303 Gidi, supra note 282, at 319.
protecting the defendant corporation and its executives. D&O policies may include individual-level coverage that protects officer 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.

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. In this sense, 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 1/3% 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 coverage policy or officer indemnification agreements either in the United States or in Brazil, I cannot confirm the hypothesis that attributes settlement values to the limits of insurance coverage. But Fibria did disclose that the Aracruz settlement was “significantly” supported by Fibria’s Directors and Officers (D&O) insurance policy.

Standard U.S. D&O policies reimburse defendants the costs of their defense. A puzzling fact, however, is that defendant Zagury, former CFO of Aracruz, decided to proceed pro se in the U.S. litigation after the District Court for the Southern District of Florida court denied his motion to dismiss. This fact suggests that he was not being reimbursed for his defense costs either by the company or by its D&O insurance. In fact, 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 Aracruz’s D&O policy in the U.S. was restricted to entity-level coverage; such a policy would not cover Zagury’s individual legal expenses.

---

305 Id., at 1802.
306 U.S. commentators say that insurers will not pay reasonable defense costs in cases of “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 wrongdoing against Zagury, the fact that he was being sued in Brazil may have influenced the coverage of his expenses in the American suit, as I discuss infra notes ___ and accompanying text.
307 See supra note 182 and accompanying text.
308 Baker & Griffith, supra note 304, at 1814 (contending that “rather than providing and controlling the defense, D&O insurers reimburse their policyholders’ defense costs”).
309 [Cite]
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 Brazilian Securities and Exchange Commission (CVM) and in the civil liability derivative suit against him filed by Aracruz itself in Brazil.\footnote{Baker & Griffith, \textit{supra} note 304, at 1799 n.14 (arguing that D&O insurance coverage usually excludes “fines” from public enforcers such as the SEC. Furthermore, 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. \textit{See discussion supra} note \_\_ and accompanying text.} 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.\footnote{See supra section \_.} Similarly, the CVM also settled for R$ 1.5 million its administrative charge against him.\footnote{See infra section \_.} 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. 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.\footnote{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. \textit{See} Sean J. Griffith, \textit{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). This is an additional consequence of the unique aspects of the U.S. civil procedural discovery regime. \textit{See} Gorga & Halberstam, \textit{supra} note 208. \textit{See generally} Sven Timmerbeil, \textit{The Role of Expert Witnesses in German and U.S. Civil Litigation}, 9 ANN. SURV. INT’L & COMP. L. 163 (2003).} Another potential factor influencing settlement value may be a given legal regime’s corporate litigation standards. 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.\footnote{This is an additional consequence of the unique aspects of the U.S. civil procedural discovery regime. \textit{See} Gorga & Halberstam, \textit{supra} note 208. \textit{See generally} Sven Timmerbeil, \textit{The Role of Expert Witnesses in German and U.S. Civil Litigation}, 9 ANN. SURV. INT’L & COMP. L. 163 (2003).} The fact that, in the United States, class actions employ 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 settlements 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.

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.

\footnote{Baker & Griffith, \textit{supra} note 304, at 1799 n.14 (arguing that D&O insurance coverage usually excludes “fines” from public enforcers such as the SEC. Furthermore, 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. \textit{See discussion supra} note \_\_ and accompanying text.}

\footnote{See supra section \_.}

\footnote{See infra section \_.}

\footnote{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. \textit{See} Sean J. Griffith, \textit{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). This is an additional consequence of the unique aspects of the U.S. civil procedural discovery regime. \textit{See} Gorga & Halberstam, \textit{supra} note 208. \textit{See generally} Sven Timmerbeil, \textit{The Role of Expert Witnesses in German and U.S. Civil Litigation}, 9 ANN. SURV. INT’L & COMP. L. 163 (2003).}
Contrast that approach to what happens in Brazil. Although I did not have access to the court docket, it is possible that plaintiff’s lawyers could have demanded that Zagury indemnify all of the billion-dollar losses suffered by the company, as was demanded in Sadia’s equivalent complaint. But considering the enormous value of the losses, parties could not realistically agree to such a proxy in their settlement calculations.

Different than 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. In addition, the supposed absence of D&O insurance coverage for Zagury provided him with the right incentives to fight for a lower settlement. The low value of 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 I discuss in the next section.

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 deterrence effect in Brazilian private enforcement when it comes to officer liability.

Nonetheless, in terms of investor financial recovery, U.S. private enforcement was superior. Because the U.S. litigation in both the Sadia and Aracruz cases resulted in settlement payments to the class of security holders, while the Brazilian litigation did not result in any such direct recovery, one can also conclude that Brazilian investors 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.

---

315 Interview with Commissioner Otavio Yazbek, who issued the CVM opinion in the Aracruz case. Gidi has advanced the argument that in civil law jurisdictions, “career judges, being conservative civil servants, are more likely to award modest amounts of damages.” Gidi, supra note 282, at 320. 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 towards lower damages. If the value of settlements is related to the potential value of damages, this argument would explain lower settlement values.

316 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 long as the value at stake lies within the limits set by their D&O policies; this translates into a larger settlement value.

317 The CVM adopted the same value of the judicial settlement for its own administrative settlement.

318 In the United States, class actions 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.

319 Supra notes __ ___ and accompanying text.

320 Supra notes __ ___ and accompanying text.

321 For an articulation of these arguments, see Gorga, supra note 71 (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
V. Public Enforcement Actions in the United States and in Brazil

This section focuses on the public enforcement aspects of the Aracruz and Sadia cases. I start by discussing the lack of action of the U.S. securities public enforcer, and then turn to a detailed analysis of the proceedings initiated by the Brazilian public regulator.

V.1. Lack of Action of the U.S. Securities and Exchange Commission (SEC)

I was not able to find any evidence of enforcement actions taken by the SEC against either Aracruz or Sadia, even after searching for information in 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.

Even though an important body of literature has recently measured the SEC's large enforcement expenditures and proposed that public enforcement is superior to private enforcement in the United States, my analysis shows flaws in the U.S. public enforcement system. I confirm the previous findings of Siegel concerning the failures of public enforcement in relation to foreign U.S-listed companies.

In fact, there are a number of theoretical hypotheses on why the SEC does not manage to investigate all wrongdoings in the U.S. capital markets. Given the constraints on the public regulator, this study shows 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.

One could posit a number of reasons to 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, a lack of private enforcement as well. Therefore it was surprising to see private enforcement actions in both the 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

these shareholders could benefit from the U.S. class action framework. After the U.S. Supreme Court decision in Morrison, they cannot.

322 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.

324 Jackson & Roe, supra note 43.

325 Bratton & Wachter, supra note 54.

326 Gorga & Halberstam, supra note 208.
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.\textsuperscript{327} 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.\textsuperscript{328}

From a normative perspective, I note that the SEC and CVM do have a cooperation agreement since 1988, which, in theory, could have facilitated the exchange of documents, information, personal testimonies, and investigatory results concerning these cases.\textsuperscript{329} This could diminish the alleged transaction costs faced by the SEC in investigating the Brazilian companies. Despite this agreement, the SEC still failed to investigate the two cases; therefore, collaboration in practice seems to be flawed at present. As this study suggests, there is much room for improvement in such international regulatory exchanges.

\textbf{V.2. The Brazilian CVM Administrative Proceedings}

\textbf{V.2.1. Proceedings Against Sadia’s Board Members and Officers}

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

After a long report in which CVM described the STF financial transactions; the findings of independent auditors BDO Trevisan and KPMG; the responsibilities imposed by the financial policies, stop-loss, hedge and stress test policies; the conduct of the managers; 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) Adriano Ferreira, Chief Financial Officer, 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 Tápios, coordinator of the Financial Committee and member of the Audit Committee; Cásio 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, failure to supervise the enforcement of Sadia’s Financial

\textsuperscript{327} Lead Plaintiff’s Motion for Final Approval of Settlement and Award of Attorneys’ Fees and Reimbursement of Expenses and Incorporated Memorandum of Law in Support, at 2.
\textsuperscript{328} Coffee, supra note 43.
Policy and to monitor the actions of the Financial Office, violating articles 153 and 160 of Law 6404/74; iii) Eduardo Fontana, Vice-President of the Sadia board of directors; 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 articles 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, 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.

After analyzing 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.” Moreover, the company did not implement an appropriate monitoring system to supervise its financial transactions. The board members had the duty to monitor whether proper mechanisms of risk controls were in place. Since they did not, board members violated their duty of care and their duty to inform themselves. 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.

Sadia board members Eduardo Fontana, 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 Adriano Lima Ferreira was convicted and forbidden to hold a managerial position in a publicly-held company for three years. Directors Alcides Tápias and Marcelo Fontana, who were not part of the board anymore by the time evidence surfaced revealing that the financial transactions exceeded the limits set by the company's financial policies, as well as Cássio Casseb and Roberto Faldini, who assumed their term only after April of 2008 and therefore did not have enough time to take the measures that are expected from a board member, were absolved. The majority of the Colegiado followed Commissioner’s Broedel vote.

---

330 Law 6404/76, Technical and Consultative Bodies, Article 160. "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.”


332 Id., n. 32 at 49.

333 Id., n. 38 at 50.

334 Id., n. 39 at 50 and n. 44 at 51.

335 Id., n. 71 at 55.

336 Id., n. 88-90 at 57.

337 There was just one dissent vote cast by Diretor Eli Loria, who wanted more severe fines. Processo Administrativo Sancionador CVM nº18/08 . Comissão de Valores Mobiliários. Relator: Diretor
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 S.A. connected to the alleged irregularities in the trading with derivative financial contracts and in the company’s disclosure of information.338

The following officers of Aracruz were indicted: (i) Carlos Augusto Lira Aguiar, CEO, for not disclosing the risk related to Sell Target Forward (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 339; 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;340 (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 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, for failing to participate in the elaboration of internal controls and to help the financial officer, and, in the case of Isaac Sutton, even 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 dollars 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 Deals (“Gerente de Operações

Alexandro Broedel Lopes (Braz.). Available at: http://www.cvm.gov.br/port/inqueritos/2010/ordinario/inqueritos/18-08%20SADIA.asp

338 The document made available by the CVM is called “Summary of the Opinion of the Committee of the Compromise Term” (Sumário do Parecer do Comitê de Termo de Compromisso).

339 “Informações Trimestrais” was released in June of 2008. These practices violated the sole paragraph of article 1º of Instruction CVM n. 235/95. Informações Trimestrais da Aracruz Celulose S.A. 06.2008. Available at: www.cvm.org.br.

340 Law 6404/76, Article 153. “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.”
Financeiras”) revealed that while the potential gains in the currency trading were fixed, the potential of losses were unlimited, and leveraged by an exponential factor (x2). 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 of 2008, in which the company stated that the notional values of the transactions initiated in April were R$ 573 million, when they were in reality 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 July-October of 2009.\footnote{Comissão de Valores Mobiliários, Processo Administrativo Sancionador No 16/2008, n. 12 to 17. Relator: Dir. Otavio Yazbek (Braz.).}

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 quarterly information to be disclosed on Jun. 30th, 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 1º of Instruction CVM n. 235/95, and were fulfilled only after the company already suffered financial losses.

The report also concludes that the Chief Financial Officer 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 Chief Financial Officer 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 proposed to pay R$ 200,000.00, with the exception of Mr. Carlos August Lira Aguiar, who proposed to pay R$ 400,000.00 for the extinction of the action. The Specialized Federal Prosecutor (“Procuradoria Federal Especializada” or "PFE") 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.\footnote{Comissão de Valores Mobiliários, Processo Administrativo Sancionador No 16/2008, at 8, n. 67. Relator: Dir. Otavio Yazbek (Braz.).} 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 pronunciation from the Colegiado that could guide market participants in future analogous cases,
and questioned CVM's interests in settling the case. On Sept. 9th, 2010 the Colegiado adopted the opinion of the Committee and rejected the proposal for settlement involving all indicted executives.

On July 18th, 2012, a new settlement was proposed. In this new proposal all executives indicted in PAS 16/2008 offered to pay R$ 800,000.00 each with the exception of Mr. Carlos August Lira Aguiar, who proposed to pay R$ 1,200,000.00. At this time, Fibria Celulose S.A., the ultimate successor of Aracruz S.A., 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 expressly considerably liable for his behavior. In this vein, Fibria declared that it is not entitled to any indemnification from indicted executives. For this reason, it would not oppose a settlement agreement by which the indicted executives were not obliged to indemnify the company.

The Committee for Settlement Proposals ("Comitê de Termo de Compromisso") 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 CVM 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. The CVM justified this as the value of the settlement reached in the suit of the Rio de Janeiro court.

V.2.3. Comparative Analysis

Both 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

343 Comissão de Valores Mobiliários at 8, Processo Administrativo Sancionador No 16/2008, at 8, n. 68. Relator: Otavió Yazbek (Braz.).
344 PAS CVM 16/2008 also mentions proposals from Calor Alberto Vieira, João Carlos Chede, Ernane Galvães, 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 11.26.2010, at p. 1. This order unfortunately has not been made available by the CVM.
345 Comissão de Valores Mobiliários at 9, Processo Administrativo Sancionador No 16/2008, n. 70, at 9. Relator: Dir. Otavio Yazbek (Braz.).
outcomes therefore question the traditional hypothesis that foreign cross-listed firms face stronger enforcement actions in the United States than in their home country.  

The CVM reached substantially different legal conclusions in the two cases, despite assessing similar wrongful behaviors. It convicted the managers of Sadia but settled with the managers of Aracruz. An analysis of these apparently contradictory outcomes shows that the Aracruz settlement actually placed a greater financial burden on its managers than the fines levied on Sadia's convicted managers. One exception was the case of Ferreira, the former CFO of Sadia, the only manager issued a non-pecuniary penalty, one which prohibited him from exercising managerial positions in public-held companies for three years. His penalty was more severe than the R$ 1.5 million payment inflicted on Aracruz’s former CFO in the settlement with CVM.

VII. Conclusion

This paper provides detailed case-studies of two Brazilian non-financial corporations, Sadia and Aracruz, which suffered great losses because of 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, shareholders acquired securities of Aracruz and Sadia at artificially inflated prices during the class period. Company executives were accused of making materially false and misleading statements concerning Aracruz’s and Sadia’s trading practices, misrepresentation of earnings and financial conditions of the companies, and failure to disclose material information. In Brazil, both Aracruz's and Sadia’s shareholders authorized the companies to sue their former CFOs Zagury and Ferreira. The case also brought about administrative proceedings from the CVM, the Brazilian securities market regulator.

I examined the outcomes of private and public enforcement actions taken in the United States and Brazil. In relation to private enforcement, the U.S. class actions filed by private attorneys provided financial recovery to shareholders, but in Brazil shareholders 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 liability suit in the Rio de Janeiro court. The action filed by Sadia against former CFO Ferreira was dismissed in the Sao Paulo court. Therefore, from the perspective of a self-interested shareholder concerned with her micro-case, it is better to be in the United States than in Brazil, as the potential for damage recovery is significant in the former but totally nonexistent in the latter.

348 See supra notes 73-74 and accompanying text.
349 See Choi & Pritchard, supra note 57, at 2 (discussing that public regulators have the power to restrict individuals from serving as directors and officers of public companies and arguing that these are “career death sentence for the individual subjected to a bar”).
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 intra-case 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 non-pecuniary penalty, 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. 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.350 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 their fines 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.

The paper points out areas for enforcement improvement. In Brazil, class actions deserve special attention in the realm of capital markes and require drastic reform. In the United States, public enforcement against foreign companies is flawed, and must be improved.

350 See supra notes 73-74 and accompanying text.