THE CORPORATE DEBENTURE SYSTEM OF SOUTH AMERICAN COUNTRIES

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THE financial eminence of England and the United States, together with the growth of corporation law which has attended the predominant use of the corporate form of organization, has resulted in a process of absorption by the Latin-American codes of certain elements of Anglo-American jurisprudence, particularly those relating to corporate finance. This acceptance of the principles of the new system by the codes derived from the civil law is not based on the authority of the dollar or the pound sterling. It results, rather, from the greater convenience of the financing practices of the common-law countries. Thus is reversed the process by which the English Chancellor subordinated a varying individual guide of conscience to the doctrines of the Roman jurisprudence because of their utility in filling the gaps of a new system. The difference is that while the Chancellor observed a discreet silence as to the source of his decisions, only occasionally directly adverting to the sanction of the borrowed principles,¹ the Latin jurist has acknowledged the origin and even criticized some of its aspects.²

The process has not been confined to the adoption of mere formal elements, but has been concerned with substantive matters. It has gone

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The author is indebted to Dr. Richard P. Molsen of Molsen & Freeman, New York City, and Rio de Janeiro, Brazil, for a copy of the new Brazilian decree discussed *infra*, as well as for helpful suggestions, and to Mr. Louis Bergh of Marvin & Bergh, New York City, for helpful criticism.

1. See MARKBY, *ELEMENTS OF LAW* (6th ed. 1905) § 90; 1 SPENCE, *EQUITABLE JURISDICTION OF THE COURT OF CHANCERY* (1846) 1, 413.

2. See 2 MALAGARRIGA, *CÓDIGO DE COMERCIO COMENTADO* (3d ed. 1927) 266. The author criticizes the use in the Ley de Debentures, *infra* note 3, of the English word "debenture" in preference to the Castilian "obligación." The earlier Commercial Code employed the words "bonos" and "obligaciones," but the word "debentures" had long been in popular use and was accepted by the Ley. It is recognized as being synonymous with "obligacion" in Articles 22, 37, 38, 39 and 40. Rivarola and Malagarriga are of the opinion that the use of words from other languages is justifiable only when there is no Spanish equivalent, as is the case with the word "warrant," and express the hope that in a future reform the Spanish "obligacion" will be used in the Ley. 2 MALAGARRIGA, *op. cit. supra*, at 265; MARIO RIVAROLA, *SOCIEDADES ANÓNIMAS* (2d ed. 1924) 140. The Brazilian code uses the word "obrigações" of the Portuguese idiom as well as the English word "debentures." See decreto no. 177A de 15 de Setembro de 1893, *infra* note 6, which regulates the "emissão de empréstimos em obrigações ao portador (debentures)."

as far as actual innovation. Thus while the right of a corporation to borrow money by issuing debentures is merely an application of the Roman contract of "mutuum" to a modern corporation, the introduction of the fideicomisario, or Latin equivalent of the common-law trustee, into the law of South American countries, although restricted in use to corporate finance matters, was nonetheless a startling departure for a system whose sole interest in the institution of trusteeship had been to prohibit it.

The Anglo-American system of fiduciary representation of bondholders was adopted in Argentine in the Ley of 1912.³ Under it the appointment of fideicomisarios for the protection of future debenture holders is required before the debentures may be issued, and the duties of supervising the activities of the corporate debtor and of protecting the interests of the debenture holders fall on them. The fideicomisarios alone have any standing or legal personality to take measures for the safety of the debenture holders.⁴ The individual holders, and even the assembly of debenture holders, have none.

While the Ley is thus an advance over the scant provisions of the code of commerce, it has required little interpretation from the courts. From 1924 to 1931, the period of greatest financial activity, only some twelve decisions of the commercial court of the capital involved questions necessitating interpretation. Nevertheless, the Argentine jurist Rivarola, writing in 1924, believed that progress had been made only in theory.⁵ His reason was that Argentina was not a country with great accumulations of savings; few debentures had been issued in the twelve and a half years the law had been in force. Yet the Ley had the advantage that, having kept pace with economic developments, Argentina was legislatively prepared for the time when small capital would acquire the habit of investing in debentures. Moreover, it had the highly practical merit of removing grave inconveniences which formerly blocked the local enforcement of loan contracts executed abroad by native companies.

The Brazilian Lei of 1893,⁶ which first recognized the right of a corporation to issue debentures as a "mutuario," made no provision for the appointment under trust indenture of a fideicomisario to represent the

3. LEY DE DEBENTURES OF ARGENTINE, Ley no. 8875 de 23 Febrero de 1912, referred to herein as the Ley. The Argentine jurist Malagarriga has written that the Ley was inspired by the law and practices of England and of the United States. This origin is revealed in the use of the English word "debenture," which appears fifty-five times in the Ley, instead of the Spanish word "obligación." See note 2, *supra*.

4. Cam com de la capital mayo 15 de 1925, T. 15, at 100, cited in 2 RICARDO VICTORICA, SEGUNDO DICCIONARIO DE JURISPRUDENCIA (1931).

5. 2 MARIO RIVAROLA, *op. cit. supra* note 2, at 146-147.

6. Lei no. 177A de 15 de Setembro de 1893, referred to herein as the Lei.

debenture holders. In passing this Lei the Brazilian Senate rejected a recommendation of the legislative committee that general assemblies of debenture holders be constituted with power to appoint a trustee to supervise the corporation and to rate the security of the debentures. However, the practice grew of appointing in the contract of issuance a "mandatario" with all the powers of an agent. Through this civil-law form the common-law trust purpose was achieved. In recent years, the tendency of court decisions and of legal commentators has been to recognize the similarity of the position of the "mandatario" and the trustee and to use the latter term in preference to the former. Thus Carvalho de Mendonça in his *Direito Commercial* quotes Manson and other English authorities and uses the word frequently in his exposition of the debenture system.⁷ This reliance on English sources was not characteristic of the earlier commentator, H. Inglez de Souza, whose *Titulos ao Portador no Direito Brasileiro* was long a leading authority on debentures.

The defect of the Lei in not providing a system of fiduciary representation of the debenture holders and in requiring each "debenturista"⁸ to act separately in order to conserve his rights on default, was supplied in 1914 by two accordams of the Tribunal de Justiça de S. Paulo.⁹ It was held in these cases that certain bankers who were appointed by the debenture holders as trustees with power to represent them for all purposes could validly defend the rights of the latter, in the event of the failure of the corporate debtor, without having to produce the debentures, and could enforce the preference to which the debenture holders were entitled by the terms of their security. The bankers were admitted to the "reunião de credores" (creditors' meeting) as representatives of the

7. 4 CARVALHO DE MENDONÇA, *DIREITO COMERCIAL* (1915) 151 *et seq.* The learned commentator has this praise for the English debenture system, "o systema ingleza e muito pratico."

8. Both the terms "debenturista" and "obligacionista" are used in the Brazilian law and commentaries to describe the debenture holders, while "obligacionista" is the Spanish equivalent used in the codes written in the Spanish language.

9. See Accordam do Tribunal de Justiça de S. Paulo de 13 de Julho de 1914 where the court said: "Considerando que os agravados com os poderes amplos e illimitados de *trustees* que lhes foram conferidos, tinham o direito que lhes foi garantido de serem admittidos como foram, a comparecer na reunião dos credores da fallencia da companhia, como representantes immediatos dos debenturistas e com o direito de acompanhar a todos os termos della, até final, zelando pelos direitos e interesses dos debenturistas"; Accordam do Tribunal de Justiça de S. Paulo de 22 de Outubro de 1914 which held that the bankers "fossem admittidos a fallencia da companhia emissora, como representantes dos portadores de debentures, quo não se apresentaram pessoalmente ou por procuradores especiaes, visto terem sido os ditos banqueiros reconhecidos pela companhia devedora como representantes dos obrigacionistas para todos os effeitos." 12 *Revista dos Tribunães* 20-21.

debenture holders. The Tribunal by judicial legislation thus worked a needed reform which had long been urged.¹⁰

The new Brazilian decreto of February 6, 1933,¹¹ however, now gives legislative sanction to this use of the trust which formerly depended for its recognition upon the more precarious basis of judicial decision. The collective right of the "obligacionistas" to appoint representatives to protect their joint rights is set forth in Article 10 of the decree which provides that one or more representatives may be appointed by the assembly with general power in their own discretion to take all measures which they may deem necessary for the common interests of the debenture holders, or, with limited powers to be specified by resolution, including the power to institute legal proceedings, to demand the bankruptcy of the corporate debtor and to represent the community of "obligacionistas" in the bankruptcy proceedings. The hopelessly outmoded system formerly prevailing of individual action by bondholders is thus definitely abolished; in fact such action is actually prohibited except in certain enumerated cases. The new method thus established for the enforcement of the rights of debenture holders through general assemblies with power to appoint trustees to supervise the corporation and to protect the security behind the obligations is the exact one which was unacceptable to the Senate in 1893 when the Lei was enacted.

The laws of only seven other Latin American republics have made any express provision for the issuance of bonds by domestic corporations. These are Mexico, Cuba, Panama, Paraguay, Peru, Salvador and Venezuela. The Panama Ley of 1925¹² adopts the Anglo-American trust and permits a corporation as well as an individual to act as a trustee, thus laying the basis for corporate fiduciary administration as practiced in this country and in England. The Mexican Ley of 1897 as amended in 1902,¹³ characterized as the most successful attempt before the Argen-

10. This process of judicial assimilation was overlooked by American commentators on the corporate finance laws of South America. Thus the Special Committee on Private International Law and Conflict of Laws of the Association of the Bar of the City of New York in its 1925 report, although it aptly characterized the Lei 177A as a "half-hearted and inadequate attempt" to authorize bond issues in that, *inter alia*, it failed to provide for trustees to represent the bondholders, stated only a half truth in that it overlooked the two "accordams" of the Tribunal. (1925) REPORT OF THE BAR ASSOCIATION OF THE CITY OF NEW YORK 436.

11. Decreto no. 22.431 de 6 de Fevereiro de 1933.

12. Ley 9A de 6 de Enero de 1925, art. 24. The terminology under this statute is different from that of the Ley de Debentures and other statutes. Thus the trust is a "fideicomiso," the settlor or trustor the "fideicomitente," the trustee the "fiduciario" and the cestui que trust a "fideicomisario." In all the other statutes of the Latin-American countries the "fideicomisario" is the trustee and not the beneficiary.

13. Ley de 29 de Noviembre de 1897 y Ley de 4 de Junio de 1902.

tine Ley to legalize American trust indentures,¹⁴ did not adopt certain English elements found in the earlier Brazilian Lei and the later Argentine Ley,¹⁵ such as the floating guaranty (*garantía flotante*), but conformed instead to the American practice as distinguished from the English.

As to the remaining eleven Latin countries whose laws are entirely silent on corporate bond issues, it would seem that reliance may be placed on the general legal precept that what is not prohibited by law may be stipulated by contract,¹⁶ and that the power may be exercised as a simple civil-law "*promesa de mutuo*" or "*simple préstamo*" governed by the civil code or by the "*préstamo mercantil*" of the commercial codes. Furthermore, practically every purpose of the Anglo-American trust can be accomplished by the Latin "*mandato*" or the civil-law relationship of principal and agent. As already indicated, the Brazilian Tribunal has termed a "*mandatario*" under a trust indenture a trustee.

While many jurists have contrasted the trust and different civil-law institutions such as the "*fidei-commissary*," the only substantial difference between the two seems to be that the one has title while the other does not.¹⁷ If legal title is nothing more than a group of rights, and the "*fideicomisario*" or "*mandatario*" is by statute or covenant given the same aggregate rights that legal title gives the trustee, it is difficult to find any practical distinction between the two. If the *cestui que trust*'s beneficial or equitable title imports no greater collective rights than those inhering in the Latin debenture holder, the traditional division of the common-law trust *res* into two titles is merely a formal matter and does not suffice to create other than mere differences of terminology.

II

The Power to Issue Debentures

The power of a corporation to issue bonds or obligations, whether registered or payable to bearer, was under the former provisions of the Code of Commerce of Argentine limited by the paid-in capital existing

14. BAR ASSOCIATION REPORT, *op. cit. supra* note 10, at 434.

15. The Argentine Ley was more than an attempt to naturalize American finance practices and its most characteristic features are English and not American.

16. BAR ASSOCIATION REPORT, *op. cit. supra* note 10, at 434.

17. The report of the Special Committee, in attempting to prove that the Argentine Ley failed in some degree to naturalize in Argentine the American trust concept, cites a statement of M. Jean Escarra which reveals the thin distinction between the common-law trust and the civil-law "*mandato*." This statement is as follows, "Agent, manager, testamentary executor, *fideicommissary*, guardian, none of these persons resembles the English trustee, for this topic reason that none of them could say, as does he, that he is the owner of the properties which he administers." *Id.* at 426.

at the date of the last approved balance sheet.¹⁸ This limitation was in accord with the modern civil-law principle that a corporation should not be able to borrow to an extent unwarranted by its economic power as represented by its capital, and with the fear that if no limit were placed upon its borrowing ability, the corporation might issue new obligations to pay the interest on former ones.¹⁹ The articles which contained this restriction are still in force in Paraguay by virtue of the adoption in 1903 of the Code of Commerce of Argentina as the commercial law of that country. Of the civil-law codes, the Belgian,²⁰ Portuguese²¹ and the Japanese²² impose the same restrictions. The Italian and Roumanian codes, though containing a like limitation, permit the issuance of obligations in a greater amount than the paid-in capital if the excess amount is guaranteed by the deposit in the State treasury of registered government bonds whose maturity dates correspond with those of the obligations to be issued.²³ The only exception to the rule among the continental civil-law codes is France, whose legislative system contains no restriction except in the case of certain local companies.²⁴ In fact, certain French railroad companies with less than two million dollars capital have issued obligations in an amount exceeding nine times their capital.²⁵

Other South American codes similarly restricting the issuance of bonds are those of Panama, Mexico, Venezuela and Brazil. The latter country restricts the issuance of obligations to the authorized instead of to the paid-in capital, excepting from the rule mortgage, railroad, navigation, mining and colonization companies, but like the Italian and Roumanian codes permits the issuance of debentures in excess of the capital stock on the deposit of government, state or municipal bonds in the State treasury with maturity dates coinciding with those of the obligations to be issued.²⁶ The Code of Panama similarly provides for the securing of issues in excess of the authorized amount by the deposit of commercial paper or instruments of credit satisfactory to the Treasury.²⁷

18. CÓDIGO DE COMERCIO DE ARGENTINE (1927) art. 365-368.

19. 2 MALAGARRIGA, *op. cit. supra* note 2, at 268-269; 2 VIVANTE, TRATTATO DI DIRITTO COMMERCIALE (4th ed. 1911-1914) 446; 1 CASTAGNOLA, TESTI, FONTI, MOTINI, COMMENTI DI GIURISPRUDENZA (1883-1894) 539.

20. CODE DE COMMERCE OF BELGIUM (1922) art. 99.

21. CODIGO COMERCIAL PORTUGES (1924) art. 196.

22. COMMERCIAL CODE OF JAPAN (1932) art. 200.

23. CODICE DI COMMERCIO ITALIANO (1929) art. 171; ROUMANIAN CODICE DE COMERT (1927) art. 173.

24. Loi de Juin 1880, art. 18.

25. THALLER, TRAITÉ ÉLÉMENTAIRE DE DROIT COMMERCIAL (4th ed. 1910) 388.

26. *Supra* note 6, art. 1, sub. 304.

27. CÓDIGO DE COMERCIO DE PANAMA (1931) art. 409.

The common-law countries, on the other hand, have considered the economic advantages of an unlimited borrowing power as out-weighing any theoretical disadvantages based on the abuse of the privilege. Apart from charter or statutory limits, the amount of indebtedness is not limited to the amount of the capital stock. While debt-limit provisions govern the right of most municipal corporations to incur indebtedness, there are generally no debt limits provided by constitutional provisions, statutes or charter provisions in the case of private corporations, with the exception that certain kinds of railroad companies are sometimes prohibited from incurring indebtedness beyond the amount of their capital stock or beyond a certain proportion thereof.²⁸

III

Nature of the Security of Corporate Debentures

In England the word debenture comprehends all serial obligations of the corporation whether or not secured by a charge or issued under a trust deed, the latter being generally styled debenture stock. In this country, however, debentures are defined as serial obligations or bonds not secured by any specific mortgage, lien or pledge of security, and are usually issued under an indenture in which a trust company agrees to supervise the execution of the covenants of the debtor for the benefit of all the holders.²⁹

The South American codes adopt the English meaning. There is but one generic obligation, the "obligaciones" of the Spanish-language codes and of the law of Argentine prior to the Ley de Debentures or the "debentures" of the present commercial code of that country and the "obrigações preferenciaes" (debentures) of the Brazilian code. When secured by a mortgage of real property, the debenture is one "con garantía especial" and when unsecured other than by a right of recourse on liquidation to the general assets of the corporation, it is one "sin garantía" or "con garantía flotante."³⁰ The Brazilian "obrigações-debentures" are not so classified, the Lei simply providing that corporate "empréstimos" are secured by a lien on all the assets of the corporation or specifically by mortgage, antichrèse or pledge.³¹

The debenture with special guaranty is the equivalent of our cor-

28. 2 FLETCHER, CYCLOPEDIA OF CORPORATIONS (1931) 1863, 1940.

29. BALLANTINE, MANUAL OF CORPORATION LAW AND PRACTICE (1930) 912.

30. *Supra* note 3, art. 4, 5.

31. *Supra* note 6, art. 10, subdiv. I and II. The antichrèse is a special form of mortgage by which the possession of the hypothecated real property is given to the mortgagee. 2 CARVALHO DE MENDONÇA, *op. cit. supra* note 7, at 95.

porate mortgage obligation. The debenture with floating guaranty is *sui generis*. It is not a general mortgage, for, as will be noted later, it does not have the condition attaching to that type of security under which the debtor is prevented from giving a prior lien on the same real property to a subsequent creditor. The debenture without guaranty is somewhat of a misnomer, since it has characteristics which, while not constituting a lien, are preferential in nature.

The floating-guaranty debenture finds its prototype in English company law although in the United States it seems to be non-existent. This type of charge was first recognized in the case of *In re Panama Co.*,³² where a company had charged its "undertaking" with the payment of certain debentures. In a decision characterized by Sir Francis Palmer as of the "utmost importance,"³³ Lord Justice Giffard acknowledged the legal validity of a general charge on all the property of a company, both present and future, by way of floating security. While previous thereto future property could be charged in equity, this case definitely established the floating security as an enforceable legal charge on all the present and future property of a company. Subsequent decisions elucidating still further the nature of the security, fixed the form in which it was adopted in the *Ley de Debentures*. Thus Lord Macnaghten, in *Government Stock Co. v. Manila Rail Co.*,³⁴ defined it as ". . . an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes."³⁵

As a general charge on all the assets of the corporation it crystallizes into a definite preference over all unsecured creditors on default of the corporation in the payment of interest on the debentures, or on the appointment of a receiver. This is one of the peculiar characteristics which it does not have in common with a debenture issued without the floating guaranty, the holder of the latter ranking merely with the ordinary creditors in a liquidation. An additional characteristic is one not intended by Lord Justice Giffard, who in his dictum to the effect that a company might notwithstanding the charge deal with its property and in the ordinary course of the business, specifically excluded sales or mortgages. *In re Florence Land and Public Works Co.*³⁶

32. L. R. 5 Ch. App. 318 (1870).

33. PALMER, COMPANY LAW (14th ed. 1930) 324.

34. [1897] A. C. 81.

35. *Id.* at 86.

36. 10 Ch. D. 530 (1878).

and *In re Colonial Trusts Corp.*³⁷ both recognized the power of the company with assets so charged to create specific mortgages prior in lien to the floating security and to alienate such assets. However, by subsequent judicial application of the dictum, these specific charges and alienations were restricted to dealings in the ordinary course of business.³⁸

The power of the corporate debtor in this respect, although not the attendant restriction, is recognized in the Ley de Debentures. In Brazil, at least, it seems that a corporation may legally divest itself of its assets to the prejudice of the debenture holders. This fact has led to severe criticism of the floating guaranty by the Brazilian commentator, Carvalho de Mendonça, who characterizes it as purely illusory.³⁹ Such a thought may have been in the minds of the Argentine legislators in allocating the "debenture sin garantía" and the "debentures con garantía flotante" to the same articles of the Ley and in assimilating the characters of the two as well as the powers of the fideicomisario under contracts creating both types of guaranty.

Malagarriga has, however, asserted that the use of the term "sin garantía" is a mistaken one, since every issue of debentures in Argentine is secured by a floating guaranty if by no other security.⁴⁰ But this latter statement is incorrect, as debentures issued without guaranty have special characteristics distinguishing them from those issued with floating guaranty. Furthermore, the statutory presumption in favor of the floating guaranty in those instances in which the contract does not limit the guaranty to specific assets, applies only where one of the three types of guaranty, including the so-called "sin garantía," is not effectively created.

The provision of the Ley that only such sales of assets subject to the floating charge shall be made as will not incapacitate the company in the conduct of its business operates, nevertheless, to the same purpose as the limitation of the permissive power of an English company to dealings with its property in the ordinary course of business. The early feeling manifested in *In re Colonial Trusts Corp.*⁴¹ that it would be a monstrous thing to hold that a floating security prevented the making of specific charges or alienations inasmuch as that would destroy the

37. 15 Ch. D. 465 (1879).

38. *Willmott v. London Celluloid Co.*, 34 Ch. D. 147 (1886); *Government Stock Co. v. Manila Rail Co.*, *supra* note 34; *Re Arauco Co., Limited*, 79 L. T. R. 336 (1898); *In re Hubbard and Co.*, 68 L. J. Ch. 54 (1899); *In re Victoria Steamboats, Limited*, [1897] 1 Ch. 158; *Evans v. Rival Granite Quarries, Limited*, [1910] 2 K. B. 979.

39. 2 CARVALHO DE MENDONÇA, *op. cit. supra* note 7, at 100.

40. 2 MALAGARRIGA, *op. cit. supra* note 2, at 271.

41. *Supra* note 37.

very object for which the money was borrowed (the carrying on of the business), is still determinative of English law on this point, apparently having influenced the courts in the leading Irish and English cases of *In re Old Bushmills Distillery Co.*,⁴² *Cox v. Dublin City Distillery Co.*⁴³ and *Yorkshire Railway Wagon Co. v. Maclure*.⁴⁴ In the *Bushmills* case, Lord Ashbourne, after carefully reviewing the cases, upheld a sale of whiskey which constituted the main assets of a distillery company. The sale of these assets, which were charged with a floating security, was for the purpose of raising money to carry on its business. In so doing he remarked that the "... authorities are strong and consistent to show that the courts consider that what is necessary to *bona fide* keep the works going, what is required to prevent a stoppage or paralysis will be upheld as done in the course of business."⁴⁵ Though Lord Ashbourne's dictum is broad enough to cover the sale of all the assets of the corporation, its intent is the same as the restriction of the Ley. In practice the two rules produce the same result.

The Ley further contains certain provisions analogous to the debtor's covenants of the Anglo-American trust indenture. These make the floating guaranty in Argentine a substantial one. Thus the corporation may not issue similar debentures secured by the same floating or special guaranty ranking *pari passu* with or prior to those already issued. As heretofore indicated, it may not assign or sell the whole of its assets or such part thereof as would incapacitate it in the conduct of its affairs, nor may a merger take place with another corporation.⁴⁶

The statutory enforcement of the special guaranty takes place only in the event of default in payment of interest or in sinking fund payments. The floating guaranty, however, may be enforced whenever the capital of the corporation has been impaired to the extent of one-fourth of that existing on the date the obligations were issued. It may also be enforced on the voluntary or involuntary liquidation of the company and on the cessation of its ordinary course of business.⁴⁷ In addition, the *fideicomisario* of debentures issued without guaranty or with floating guaranty has certain powers hereafter considered which the *fideicomisario* of a special guaranty debenture does not possess.

For the complete protection of the debenture holders broad, restrictive

42. [1897] 1 Ir. R. 488.

43. [1906] 1 Ir. R. 446.

44. 21 Ch. D. 309 (1882).

45. *Supra* note 42, at 502.

46. *Supra* note 3, art. 12, 9.

47. *Id.* art. 19, 8.

covenants of the Anglo-American type are necessary and in common use. Unlike Argentine, Brazil has no provisions prohibiting the corporation whose assets are subject to a floating charge from issuing similar debentures secured by the same floating or special guaranty ranking equally or prior thereto. The missing statutory provision must be supplied by a covenant. On the other hand, the scope of the Argentine statute does not affect the company's right of hypothecation and alienation of assets subject to the charge, but applies only to the issuance of subsequent debentures. To cover this point in a manner suitable to the requirements of investment bankers, additional covenants are needed. These may be drawn on the model of those used in the United States, limiting the right of pledge or sale of assets to current assets to secure or discharge an indebtedness incurred in the ordinary course of business, or insisting that the proceeds of a sale be held by the trustees for the redemption of the debentures.⁴⁸ Such provisions might be deemed of greater protective value than the general inhibition of the Ley against only such sales as would incapacitate the company.

The debenture "con garantía especial," like the "garantía flotante" or the "sin garantía," is constituted by a special contract entered into prior to the issuance of the debentures between the corporation and one or more fideicomisarios as representatives of the future bondholders.⁴⁹ The powers of the fideicomisario under this contract will be considered hereafter. It will be seen that in many respects the floating guaranty, in Argentine at least, is more efficacious than the special guaranty, and certainly not to be accorded the treatment given its Brazilian counterpart in the characterization thereof as an illusory guaranty.

Debentures without guaranty have special characteristics despite their designation, the preferences given them constituting true guarantees.⁵⁰ The advantages of these debentures are similar to those realized from the issuance of obligations with floating guaranty, since the fideicomisarios under both types of obligations have similar powers differing substantially from those of the fideicomisario under the special guaranty. The practical difference between the two debentures appears when the fideicomisarios who exercise the power given them by Article 18 of the Ley of demanding the removal of the directors and taking possession of the company, determine that the company's affairs shall be liquidated rather than continued. Such liquidation must be in accord with

48. See CONYNGTON-BENNETT, CORPORATION PROCEDURE (1927) 537-538.

49. *Supra* note 3, art. 3, 6.

50. 3 MARIO RIVAROLA, *op. cit. supra* note 2, at 172.

bankruptcy procedure and the holders of these debentures, unlike the holders of mortgages, pledges, antichrèses or debentures with floating or special guaranty, have no right of preference but must share the assets equally with the other unsecured creditors.

IV

Powers and Duties of the Trustee in Enforcing the Security

In England the remedy of a debenture holder on default where no trust deed exists is to bring a representative action for the enforcement of his securities. Where there is a trust deed the action is brought by a holder of the debentures or by the trustees, although commonly the former brings the action and joins the company and trustees as defendants.⁵¹ In the Ley the duty of enforcing the securities is on the fideicomisario whether the guaranty is special, floating or "sin guarantía," since a condition precedent to the right to issue debentures at all, no matter how secured, is the execution of a contract with one or more representatives of the future bondholders.

The fideicomisario has all the powers of a "mandatario" where the debenture carries a special guaranty. And though the trust indenture fails to so provide, or actually provides otherwise, he always has certain enumerated powers. These include the right to examine the books and accounts of the debtor, either in person or by proxy; the privilege to assist in the meetings of the directorate although without the right to vote;⁵² and the power to demand the removal of the directors. This latter power may be exercised in three situations: first, where interest or sinking fund payments are not made within thirty days after the due date; second, where the debtor has suffered an impairment of capital to the extent of one-fourth of that existing at the date of issue of the debentures; and third, in the event of a forced liquidation or bankruptcy of the corporation.⁵³

If the fideicomisario requests the removal of the directors in any of these situations, the court will forthwith remove them and substitute the former in their place. He is then entitled to receive the assets of the corporation under inventory without prejudice to the right of the removed directors within ten days to litigate the truth of the allegations of the fideicomisario. Should the directors determine on this course of action, the fideicomisario must halt the liquidation of the company

51. PALMER, *op. cit. supra* note 33, at 342.

52. This power is described by the Italian jurist Vidari as "la facoltà di chiacchierare, e nulla più." 1 VIDARI, CORSO DI DIRITTO COMMERCIALE (4th ed. 1900) 120, n. 903.

53. *Supra* note 3, art. 18.

until the issues are tried, limiting himself in the meantime to ordinary acts of conservation and administration of the debtor's assets. The preliminary order of removal may then be made final, or, if no issue is joined within twenty-eight days after the entry of said order removing the directors, it automatically becomes so.⁵⁴

The fideicomisario may then continue the business of the debtor with the widest powers of administration, including the right to alienate real or personal property, or he may liquidate the corporation should the debenture holders so decide.⁵⁵ If liquidation should be determined upon, the fideicomisario would proceed to realize on the assets subject to the floating guaranty, dividing the amount realized among the holders of the debentures after payment of those secured creditors whose liens are preferred to that of the floating guaranty. Any amount remaining would be held for the benefit of general creditors and stockholders.⁵⁶ If the business is continued, the fideicomisario must from the receipts of the business first pay current liabilities and then the interest and sinking fund payments on the debentures. When the company's affairs are adjusted, their administration passes again to whoever may be entitled to it.⁵⁷

Where the debentures are issued with special guaranty, the powers of the fideicomisario are limited to the enforcement of the security by simple foreclosure in the event of default in payment of interest or in sinking fund payments.⁵⁸ Thus the fideicomisario of a special-guaranty debenture has not the powers given by Article 18 of the Ley to fideicomisarios of debentures issued without guaranty or with floating guaranty, of examining the books and accounts of the corporation, of assisting at the meetings of the directors, and of asking for the removal of the directors in the three situations enumerated. Rather, the provisions applicable to the special guaranty are those of the civil code regarding mortgages and their enforcement and foreclosure.

It is undoubtedly this lack of the very important powers conferred by Article 18 of the Ley on other fideicomisarios and by covenants on the trustee of our mortgage indenture that has led to the criticism of this security by American commentators. The Special Committee on Private International Law and Conflict of Laws in its report describes the different modes of procedure for placing an adequate lien or security behind corporate bond issues as merely "palliatives" for a serious situa-

54. *Id.* art. 20-24.

55. The power to be exercised by the fideicomisario in this and other connections may be enlarged or restricted in the trust indenture. *Id.* art. 20.

56. *Id.* art. 22.

57. *Ibid.*

58. *Id.* art. 19.

tion in the present state of legislation in Latin America.⁵⁹ But in view of the failure of the committee to give any consideration to the substantial character of the floating guaranty as a security, this characterization is of little validity unless it is restricted to the special-guaranty debenture. When consideration is given to several additional facts, the recommendation of the committee that the only satisfactory solution of the problem which the report raises is the modernization (along American lines as the tenor of the report indicates) of the legislation of those republics which have already attempted to naturalize the American institution of the mortgage trust, appears merely as an example of juristic egocentricity. These facts are that the floating guaranty of Latin America is substantially the same legal concept and institution which England through years of experience has determined to be an adequate mechanism for the greater part of her own corporate financing,⁶⁰ and that Latin America has professedly based her corporate legislation on the English rather than on the American model.

With the consideration of the further facts that trust indentures in America are primarily regulated by conventional stipulation rather than by statutory systems such as that of the Ley, and that the substantial floating guaranty is unknown in this country, it is submitted that a study pursued in the true comparative law spirit by a less nationalistic committee might result in some profitable suggestions regarding the advisability of a statutory statement or codification of our own practice and body of judicial decisions and the introduction of the floating guaranty into our own financing practice.

As has been seen, if the debentures were issued "sin garantía" and there are other creditors, the fideicomisario must, if liquidation be determined upon, proceed under the Ley de Quiebras or the Bankruptcy Law. The duties of the fideicomisario are then to act as the "sindico" (receiver in bankruptcy) at the "concurso" (creditors' meeting), with power to alienate the assets without judicial authorization.⁶¹

59. BAR ASSOCIATION REPORT, *op. cit. supra* note 10, at 439.

60. Sir Francis Palmer has this praise for the floating guaranty, "Nevertheless the decision *Re Panama etc. & Co.*, *supra*, was one of the greatest practical importance, as it judicially recognized and established the power of a company to give a floating charge on its undertaking, a form of security which has since approved itself to the commercial community and to the investing public as of an eminently convenient type." PALMER, COMPANY PRECEDENTS (13th ed. 1927) Pt. 3, at 68.

61. *Supra* note 3, art. 23.

V

General Provisions Regarding Issuance of Debentures

Certain formalities are required in the issuance of debentures.⁶² The corporation must first execute a contract with the fideicomisario as the representative of the debenture holders. Its directors are then required to prepare a prospectus which must be published for fifteen days in the newspapers of the place where the debentures are issued. This prospectus must set forth a number of facts, such as the amount of the authorized, subscribed and paid-in capital, the kind of business transacted by the company, the names of its directors, administrators and trustees, the date of the recording of the contract between the company and the fideicomisario, the general conditions of the contract between the company and the fideicomisario, the rights of the debenture holders, a list of the "deudas con privilegio," or secured obligations of the company, together with an enumeration of previously issued debentures, and a financial statement showing assets, profits and losses. The prospectus must be signed by the directors, administrators and the fideicomisario.⁶³ The former are jointly liable for the truthfulness of the facts set forth in the prospectus. Although there is no express liability imposed upon the fideicomisario, it would seem on general principles that he too would be liable were he a party to fraud in the issuance of a prospectus containing false representations.⁶⁴

These requirements have been criticized from an American standpoint as seriously impeding bond issues as commonly made in the United States, since the law seems to contemplate only the sale of bonds directly by the corporation issuing them or by the agents of the corporation and takes no account of the possibility of market fluctuations between the time when the bonds are advertised and the time when they can be sold and payment received therefor. In the United States the underwriting firm or syndicate which usually takes the entire bond issue for resale to the public would be unwilling to agree on a price for the bonds and then wait for several weeks before the bonds could be issued. The prospectus has thus been characterized as an unnecessary obstacle.⁶⁵

Both the contract and the prospectus must be recorded in the public commercial register and if the guaranty of the debentures is special, the contract must also be recorded in the mortgage record, as it creates a "gravámen hipotecario" or lien on real property. By express pro-

62. *Id.* art. 3.

63. *Id.* art. 28, 29.

64. *Id.* art. 29; 2 MALAGARRIGA, *op. cit. supra* note 2, at 299.

65. BAR ASSOCIATION REPORT, *op. cit. supra* note 10, at 432.

vision, a foreign corporation which issues debentures with floating guaranty must within six months of the date of issuance record the contract in the public commercial register of the federal capital, if the property subject to the guaranty is located there, or partly in one province and partly in another, or in one province and in the federal capital. If the property is situated entirely in the territory of a single province, then the recording must be done in the commercial register of that province. Failure to record makes the guaranty ineffective in that country. The recording may be done by the corporation, the fideicomisario or any of the debenture holders, but the liability for failure to do so is placed upon the company which is fined one thousand pesos for each month of delay.⁶⁶

Similar provisions governing the issuance of debentures by foreign companies are found in the laws of other countries. Thus the Mexican law of 1897, which provided that obligations issued abroad should not have any legal effect in Mexico unless the issue was made in accordance with the provisions of that law, was amended in 1902⁶⁷ to permit the issuance of foreign bonds on the Mexican properties of a corporation where, inter alia, the contract authorizing the issue is protocolized in the Republic and recorded in the Register of Commerce and the mortgage guaranty recorded in accordance with the laws of the State, Federal District or Territory where the properties are located.

Debentures may be issued in registered (debentures nominales) or in bearer form (debentures al portador). The registered debentures may be transferred only by endorsement and have no effect against the corporation or third parties until the transfer has been recorded in a special bond register which must be kept by the corporation.⁶⁸ But whether in registered or in bearer form, they must contain a printed statement of the following matters: the name of the corporation; the date and place of the filing of its articles; the numbers of the series and order of each debenture; the face value thereof; the total amount of the debentures issued and whether with special or floating guaranty; the names of the fideicomisarios; the date of the recording of the prospectus and of the "contrato de prestamo"; the interest which the bonds bear; the periods and place of payment; and the method and periods of their amortization. The debentures may be accompanied by "cu-

66. *Supra* note 3, art. 30.

67. See note 13, *supra*.

68. *Supra* note 3, art. 31. Under the Brazilian Lei, *supra* note 6, art. 1, bonds could only be to bearer. The new decree, *supra* note 11, has, however, changed this and permits both bearer and registered bonds.

pones" payable to the bearer although the main debenture of which they are a part is a registered debenture.⁶⁹

The joint liability of directors, administrators and fideicomisario for false statements in the prospectus has been noted. The directors or administrators who violate the requirement that the corporation must execute a contract with the fideicomisario prior to the issuance of the debentures, or who fail to see to it that the prospectus is drawn, or who violate the other provisions of the Ley relating to the duties of directors and administrators, are jointly and severally liable for the losses sustained by the debenture holders and, if the claims of the latter are reduced to judgment and are not paid within six months of entry thereof, may be imprisoned for six months.⁷⁰ In the opinion of Malagarriga, this provision closely resembles the imprisonment for debt abolished by the Ley 514 of 1872.⁷¹ The fideicomisarios, being "mandatarios," are not personally liable for their acts in discharging the duties of the trust except in the case of grave default or negligence in the discharge of the "mandato."

The Ley also provides that a corporation which is "en poder del fideicomisario" (in the power of the fideicomisario) may not be forced into bankruptcy by other creditors, the latter having only the right to insist that their claims be paid in the order of their priority. If the corporation was declared bankrupt before the fideicomisario took charge of the administration or liquidation, he then has the right to be named as receiver.⁷² The fideicomisario may not resign his charge without judicial consent. He may, however, be removed by the court on the application of one or more of the debenture holders for good cause, and also without cause by resolution of a majority of the capital represented at a debenture holders' meeting.⁷³ Substitutions of trustees may be made on the application of the fideicomisario or of debenture holders representing one-twentieth of the amount of the debentures; the court will, on a majority vote of the capital represented, call an assembly of debenture holders to nominate a successor.⁷⁴ No one interested in the profits and losses of a corporation may act as a fideicomisario except stockholders possessing not more than one-twentieth of the issued shares.⁷⁵

69. *Id.* art. 33.

70. *Id.* art. 34.

71. 2 MALAGARRIGA, *op. cit. supra* note 2, at 304.

72. *Supra* note 3, art. 25.

73. *Id.* art. 27.

74. The report of the Special Committee criticized this provision as being inelastic. BAR ASSOCIATION REPORT, *op. cit. supra* note 10, at 432.

75. *Supra* note 3, art. 15.

This requirement has been criticized as easily avoidable, and the desirability of a general prohibition against any stockholder acting as a fideicomisario has been urged.⁷⁶

VI

The Assembly of Debenture Holders in Argentine and Brazil

The assembly of debenture holders in Argentine differs from the "assembleas de accionistas" or stockholders' assemblies in many particulars. The ordinary "assembleas generales" of stockholders meet at least once a year within four months after the close of the fiscal period and perform the usual function of ratifying the directors' reports, nominating new directors and officers and acting upon any matters specified in the notice. Any stockholders' assemblies meeting at other periods are termed "assembleas extraordinarias," the terminology, unlike the French,⁷⁷ being based not on the object of the meeting but on the period when it is called. The statute does not prescribe the specific purposes for which the latter assemblies may be called; it simply provides that they may be called in the discretion of the directors or officers, or at the demand of stockholders representing one-twentieth of the capital stock,⁷⁸ to take action on any unforeseen situations which may render the meeting necessary.⁷⁹ There are, however, certain specified purposes for which the assembly of debenture holders must be called. They do not meet regularly for the reason that "the debenture holders' only duty is to cut coupons periodically and so long as the interest is paid nothing extraordinary will occur in the execution of the loan contract. They do not have to elect directors or officers, being represented by the fideicomisario named in the contract who has no fixed time to carry out his duties nor can he renounce them without justifiable cause in the discretion of the judge."⁸⁰ In addition to these specific purposes there is a general grant of authority for the calling of such meetings whenever a resolution of the debenture holders is required. The machinery for calling the meetings of these assemblies, unlike a stockholders' meeting, can be set in motion only by the fideicomisarios, or by bondholders owning one-twentieth of the issued debentures, on application to a judge who must himself call the meeting.⁸¹

76. 1 MALAGARRIGA, *op. cit. supra* note 2, at 283.

77. 2 LYON-CAEN & RENAULT, *MANUEL DE DROIT COMMERCIAL* (10th ed. 1910) 249.

78. *Supra* note 3, art. 348.

79. 2 MALAGARRIGA, *op. cit. supra* note 2, at 220.

80. 3 MARIO RIVAROLA, *op. cit. supra* note 2, at 152.

81. *Id.* at 150.

There exist six purposes for which the Ley requires the assembly of the debenture holders: (1) the acceptance of the resignation of the fideicomisario and the appointment of a new one. Although the position has an obligatory character, renunciation is not impossible where in the opinion of the judge there is good and sufficient cause for it.⁸² (2) The removal of the fideicomisario without cause by a majority vote and the designation of a new trustee. This is not to be confused with the right of the judge to remove a fideicomisario for cause.⁸³ (3) To obtain by majority vote of the assembly of holders of debentures secured by the floating guaranty consent to issuance by the company of new debentures of the same or higher grade of preference than the debentures already issued.⁸⁴ (4) To obtain the assembly's consent by majority vote to the sale or assignment of the whole or a part of the company's assets where such sale would prevent the company from continuing in business. This consent is necessary where the debentures are secured by a floating guaranty.⁸⁵ (5) To obtain the assembly's consent to a merger or fusion of the debtor where the floating guaranty would be involved.⁸⁶ (6) To decide, in those cases in which the fideicomisario has assumed control of the administration, whether the company shall continue in business or be liquidated.⁸⁷

The Ley makes no provision, as does the new Brazilian decreto of last year, for the right of debenture holders to representation by proxy in these meetings. Their right to act depends upon the presentation or deposit of the debentures themselves, if they are bearer debentures, or if registered debentures, then on the entry of title made in the registry book which the company is required to maintain. There is nothing, however, to prevent the exercise of the right of proxy, for the Code of Commerce recognizes the rights of stockholders to appoint "mandatarios" whether they are strangers or not,⁸⁸ although it further provides that this right may be limited by the "estatutos" or by-laws. There would seem to be no basis for differentiating debenture holders from stockholders in this respect.

Unlike the Brazilian decreto which requires the deliberations of the assembly of debenture holders to be recorded and attested by the president, secretary, and representative of the debtor corporation and two

82. *Supra* note 3, art. 27.

83. *Ibid.*

84. *Id.* art. 12.

85. *Id.* art. 9.

86. *Ibid.*

87. *Id.* art. 21.

88. *Supra* note 18, art. 355.

of the debenture holders present, and then publicly registered in the Real Estate Register where the loan contract is recorded, the Ley does not provide for the keeping of a minute book of the assembly. Nevertheless, the Code of Commerce requires such a book to be kept for stockholders' assemblies.⁸⁹ Since there is again no reason for differentiation, it is thought that by analogy the same rule applies to these assemblies. The practice has thus developed of keeping a record which is signed jointly by the fideicomisario and the persons designated by the assembly.

There seems to be no doubt that the assembly is an economic entity through which the collective will of the debenture holders is expressed, and the Ley regulates it as such. And while the Ley does not recognize the assembly of debenture holders as a legal entity with juridic personality, nevertheless it confers powers on the assembly which in the opinion of Rivarola evidences a tendency to acknowledge it as such. In support of his position, Rivarola cites (1) Article 9, which provides that a corporation issuing debentures secured by a floating guaranty may not sell or assign its assets or a part thereof so as to render impossible the conduct of its affairs, and may not merge with another corporation without the consent of the assembly of debenture holders; (2) Article 12, which requires a corporation that has issued debentures with floating guaranty to obtain the consent of the assembly to any issue of other debentures of similar character which are to rank equally with or prior to the former; (3) Article 21, which gives the assembly, upon the default of the corporation, the right to determine whether the fideicomisario shall continue to carry on the business of the corporation or shall proceed to liquidate it; (4) Article 27, which provides that the fideicomisario may be judicially removed for due cause at the request of one or more debenture holders and without cause by a resolution of a majority of the debenture capital represented at the assembly, and empowers the assembly to make substitutions.⁹⁰

The latter article further provides that the assembly must be called each time a resolution is required of the debenture holders and makes applicable to these resolutions all the provisions of law relating to other corporate assemblies, such as stockholders' meetings, thereby permitting the determination by the assembly of all questions affecting the common interest.

By virtue of Article 27, declaring Articles 349 to 351 of the Commercial Code applicable to these meetings, fifteen days' notice of the meeting, setting forth the specific matters to be considered, must be

89. *Id.* art. 350.

90. 3 MARIO RIVAROLA, *op. cit. supra* note 2, at 149.

given by publication. No action having legal validity may be taken on matters not so set forth. A quorum, which is not required of stockholders' meetings, must be present, consisting of debenture holders representing at least one half of the amount of the debentures issued. This requirement, however, is waived in the event that such a quorum is not present at the first meeting and a second one is called within thirty days thereof on ten days' notice.⁹¹ All resolutions must be taken by a vote of the majority of the represented capital, except that no debenture holder may cast more than one-tenth of the votes represented by all the issued debentures nor more than one-tenth of the votes represented in the assembly.

The Ley is silent as to whether the assembly has power to modify the contract between the corporation and the fideicomisario. Castillo is apparently of the opinion that this power is embraced in the general powers of the debenture holders,⁹² although Rivarola holds this theory to be a dangerous one unless the power is said to inhere in the assembly acting by unanimous instead of majority vote.⁹³ He points out such theoretical dangers as those that the assembly might forgive the indebtedness, or suspend for twenty years the payment of interest, to the detriment of minority holders. While the Brazilian decree requires a special quorum of two-thirds of the outstanding obligations for deliberations involving vital modification of the loan agreement, action may be taken by a bare majority vote of those represented.⁹⁴ The danger of unreasonable action is obviated by the necessity of receiving judicial approval for all acts involving such modification, a safeguard which may well have been inserted in the decreto to protect the interest of minority holders and to allay such fears as those of Rivarola's. This jurist believes that power of modification exercised by unanimous vote would be acceptable, although the Ley may not be presently interpreted to grant such a power to the assembly. In substantiation thereof, he stresses the fact that Article 27, which made applicable to the assembly of debenture holders articles 349 to 351 of the Commercial Code, omitted Article 354 covering the analogous case of the changes of the "acto constitutivo," or act of incorporation, by the assembly of stockholders.⁹⁵ This omission would indicate an intent

91. This waiver of the quorum requirement applies even to an assembly of debenture holders called to remove by majority vote of the represented capital one or more of the fideicomisarios; the removal may be made at a second meeting within the same specified period, no matter what the quorum. See 2 *id.* at 298.

92. 1 CASTILLO, CURSO DE LAS SOCIEDADES COMERCIALES (1916) 286.

93. 3 MARIO RIVAROLA, *op. cit. supra* note 2, at 155.

94. See the discussion at p. 595, *infra*.

95. 3 MARIO RIVAROLA, *op. cit. supra* note 2, at 155.

that the power of modification of the contract was not to reside in the assembly of debenture holders. The most which may be inferred from the law is that the consent of the absent debenture holders may be implied when the vote of those present in a duly constituted assembly is unanimous.

An additional point on which the Ley is silent is that of whether the assembly has power to consent to or prevent amendments of the by-laws ("estatutes") of the debtor corporation. Rivarola draws the conclusion that such power exists in a simple majority or a special majority established in the contract of "emprestito." This opinion is based on the fact that Article 9 of the Ley authorizes the merger of corporations by vote of the assembly and that the act of merger is one of the amendments of the by-laws permitted by Article 354 of the Code of Commerce. Furthermore, the power to amend the by-laws is not of as grave import as that of authorizing the merger of the debtor corporation or the issuance of new debentures of equal or greater right, and in no way modifies the prime obligation of the corporation under the contract, even if it might affect the guaranty.⁹⁶

The recent decree issued by Getulio Vargas, as head of the provisional government in Brazil, creates a legal community of interest between debenture holders and confers certain powers on their assembly which vest it with juridic personality. The decree has thus gone further than the Argentine Ley. The procedural system for the enforcement of the rights of the "obrigacionistas" which is embodied in the new decree furnishes further convincing proof of the process by which the modern civil law is becoming assimilated to the common law, particularly in the field of corporate finance.

The decree gives exclusive jurisdiction over the enforcement of the rights of the debenture holders in any matter affecting the general interest to the "assembléas gerais desses portadores" or the assemblies of debenture holders,⁹⁷ individual action being prohibited except in cer-

96. 3 MARIO RIVAROLA, *op. cit. supra* note 2, at 156.

97. Formerly the only collective right enjoyed by the Brazilian debenture holders was that of appointing a "fiscal" to assist in the stockholders' meetings but without the right to vote. This right was described by the legislative commission as "a permissão de gritar"—the right to cry out. The legislative commission had the following to say of the inadequacies of the system of individual action: "Nos empréstimos sobre debentures a defesa dos direitos dos credores pulverisa-se na multidão esparsa dos portadores de obrigações. Converter essas unidades desagregadas e solitárias numa colectividade organica, unificada por uma representação commun e permanente por uma solidariedade activa, por uma tutela legal contra as negligências e abdicacões do individualismo isolado, interme, indifferente; eis um dos problemas vitais para a moralidade desta categoria de operações financeiras, para extirpação dos abusos que as arruinam, desacreditam e entorpecem."

In the event of the insolvency of the corporate debtor, individual declarations in

tain enumerated cases.⁹⁸ The community of interest is recognized as existing only among the "mutuarios" or holders of obligations issued under the same contract of "mutuo," in which the obligations are of the same class with the same guarantees and provisions as to amortization, redemption and interest. Thus each group of security holders has its own assembly whose actions are binding only upon it.⁹⁹

Unlike the situation in Argentine, where the assembly is required to be called by a judge, the Brazilian assembly is called by the issuing corporation whenever its directors shall deem a meeting necessary, or when a meeting is demanded in writing by debenture holders representing one-twentieth of the value of the debentures outstanding or by the representatives of the debenture holders nominated in a previous assembly. The demand of the "obligacionistas" must be accompanied by a certificate of deposit of their debentures in the Bank of Brazil or its agencies. It is made directly to the company and not to an intermediary as in Argentine where the request of the debenture holders must be presented to a judge.¹⁰⁰ If the meeting is not called within five days of the date of the communication of the demand to the corporation, the debenture holders may then present their demand to the judge of the district in which is located the principal place of business of the corporation, who may then order the meeting immediately and tax the costs against the corporation.¹⁰¹ Judicial recourse is thus a complementary remedy rather than an exclusive one as in Argentine.

The presiding officer of an assembly is determined according to whether the meeting is called at the instance of the corporation, by the debenture holders, or as a result of judicial intervention. The two

bankruptcy against the corporation are excluded. The defense of the rights of the "obligacionistas" of a particular category is the duty of the debenture holder elected by the general assembly. *Supra* note 11, art. 14.

98. *Id.* art. 2. Under Article 13 an individual holder may demand the payment of interest or of principal which is due, or may demand the bankruptcy of the debtor, if within a period of sixty days from the date of the default in payment, a meeting of the assembly of debenture holders is not called, either by the corporate debtor or by the representative of the assembly previously appointed, to consider ways and means of protecting the common interest. Individual action is also admitted where the default is of an amount owing to an individual holder and does not affect the collective interest of the investors.

99. *Id.* art. 3.

100. The meeting must take place at the main place of business of the corporation not less than fifteen days from the date of the first publication of the notice of the meeting in the *Diario Oficial* and in two other journals. The notice of the meeting must be published twice and must designate the day, the place, the hour of the meeting, the object of the meeting and the name of the banks in which the "obligacionistas" may deposit their securities. *Id.* art. 5.

101. *Id.* art. 4.

largest debenture holders act as secretaries and assist him. The names and residences of the debenture holders present or of their representatives, together with the exact number of obligations held by each, must be listed and the list kept open for inspection. The right to vote by proxy is thus clearly recognized. The list must be accompanied by the certificate of deposit executed in conformity with the requirements of the decree. The issuing corporation is obliged to furnish a certificate signed by its president setting forth the number of debentures in circulation. The minutes of the meeting and a formal resolution must be drawn up in detail. The resolution, the powers of attorney to the representatives and copies of the notice of meeting published in the newspapers¹⁰² are entered together in the Real Property Register where the original loan agreement was recorded.¹⁰³ To function, however, there must be a quorum consisting of the holders of three-fourths of the bonds in circulation, excluding those belonging to the issuing corporation. In the absence of a quorum, a second meeting may be called, not less than eight days after the first. If a quorum is still lacking a third meeting may be called not less than five days thereafter and the presence at this meeting of the holders of one-third of the outstanding debentures is sufficient.¹⁰⁴ Only those debenture holders may qualify as voters who shall have deposited their obligations at least two days before the date of the meeting, but the holders of proxies are not themselves required to be debenture holders. Each debenture is entitled to one vote.¹⁰⁵ The expenses incurred in calling the meeting, depositing the bonds and recording are to be paid by the issuing corporation.¹⁰⁶

The subjects of the deliberations of the assembly are sufficiently broad for all purposes.¹⁰⁷ They include: (1) All means of protecting the common interest of the debenture holders. (2) All temporary or definitive modifications of the provisions of the "contrato de empréstimo" or the contract of issuance, such as (a) the suspension for a definite period of interest and sinking fund payments, with the addition of these amounts to the principal indebtedness represented by the debentures, or the issuance of interest-bearing obligations in the amounts of the pay-

102. If the assembly is called by the corporate debtor for the purpose of considering any amendments to the provisions of the loan contract, the notice must be accompanied by a statement of the reasons for such action and by facts, figures and other pertinent data sworn to by the directors, including the opinions of two qualified accountants who shall attest to the correctness of these facts. *Id.* art. 12.

103. *Id.* art. 6. The recording of loan agreements "a inscrição de empréstimo" is governed by art. 5, par. c, no. vi of the Lei no. 4.287 de Fevereiro de 1924.

104. *Id.* art. 7.

105. *Id.* art. 8.

106. *Id.* art. 9.

107. These are specifically enumerated in *id.* art. 10.

ments thus postponed; (b) the extension of the maturity date of the loan; (c) the substitution of the method of redemption by purchase on the securities exchange for that of drawing by lots; (d) the elimination of premiums payable on obligations purchased at a premium; (e) the changing of fixed interest rates to indefinite or variable ones (income bonds); (f) the reduction of the rate of interest and principal amount of each obligation; (g) the acceptance of a novation by the substitution of a new corporation as the debtor; (h) the renunciation of specific guarantees originally inserted in the "contrato" for the benefit of the debenture holders. (3) The nomination of one or more representatives to protect the interests of the community.

The deliberations contemplated by subdivisions 2 (d), (e), (f), (g) and (h) require a quorum of at least two-thirds of the debentures in circulation, excluding those owned by the corporation itself. As in the case of ordinary deliberations, a majority vote of the debentures represented is necessary, but there is a further requirement of "homologacao judicial" or judicial confirmation. This may not, however, be withheld if all the formalities of the decree have been strictly observed and the Public Minister gives his consent.¹⁰⁸ Such judicial approbation is not necessary to any of the deliberations undertaken by Argentine debenture holders. But it would seem to represent a wise precaution in matters so fundamental as the modification of the loan contract.

The two laws also differ in the method of appointment of the trustee. In the Ley the fideicomisario is appointed by the debtor company prior to the issuance of the debenture, although in reality, as in the United States, it is the banking group undertaking the debentures which names the trustees. The contract between them is a third party beneficiary contract for the benefit of future debenture holders, who ratify it by purchasing the debentures. The fact that this ratification is specifically provided for in the Ley¹⁰⁹ has led some jurists to believe that it was not a true contract, but Malagarriga defends its juridic character as such. In Brazil the trustee (although only the word "representante" is used) is elected by the assembly of debenture holders. This practice, which is substituted for the one formerly prevailing, is predicated upon the belief that a trustee directly elected by the debenture holders is more responsive to their wishes and will more diligently supervise the enforcement of their remedies than one appointed by the corporate

108. *Id.* art. 11.

109. *Id.* art. 14.

debtor itself. It is difficult to say whether or not this position is well taken.

The decreto recognizes the former custom of appointing a fideicomisario in the "contrato de empréstito" only to the extent of providing that its remedies of collective representation and enforcement of the rights of debenture holders shall be applicable to those contracts alone, whether executed before or after the decree, which have not made such provision.¹¹⁰ In the future it will not be necessary to supply a statutory deficiency by contractual stipulation. However, there is still no express statutory authorization in the decree for the contractual appointment of trustees.

The benefit of legal commentary on the new decree is as yet unavailable. But that it is modeled to some extent on the Ley de Debentures of Argentina is apparent, for many of their provisions are identical. In many details, however, it is quite independent of the Ley and its draftsmanship is superior. The legal controversy between the Argentine commentators, Castillo and Rivarola, as to whether the assembly has the power to modify the "contrato de empréstito," a dispute which arises out of the lack of a specific grant of such power in the Ley, is avoided by the specific delegation to the assembly of the power of amendment. But like the Ley, the new decree is silent regarding the assembly's power to consent to or prevent amendments of the by-laws of the debtor corporation. Yet the general power of the assembly "to take all protective measures for the common interest" would seem to include it. There can be no doubt, however, that the decree has corrected a fundamental deficiency in the corporate law of Brazil. It may no longer be said of Brazilian debenture holders that "they do not know each other, do not meet together; they are like the dust spread everywhere, and only when it is too late does it happen that they show themselves, join together and give the appearance of action."¹¹¹

VII

Comparatives of the Anglo-American and the South American Law

The powers and duties of the fideicomisario and the remedies of the debenture holders have their prototypes and equivalents in the Chancery decisions of England and in the commonly accepted provisions of the English trust deed. It may be said that there is much to commend

110. *Id.* art. 16.

111. 4 CARVALHO DE MENDONÇA, *op. cit. supra* note 7, at 146. The only knowledge of the affairs of the corporation which the debenture holders formerly had was that obtained from the corporation's balance sheet.

the convenient method of the Ley of definitely embodying the principles enunciated by these decisions in a thorough statutory formulation needing but few corrective covenants, instead of leaving them in the uncoded and chaotic condition of a mass of Chancery decisions and contractual stipulations devoid of uniformity. The existing dissimilarities, instead of representing deviations from the practice of direct borrowing, are due to local adaptation of common-law theories and to certain formalistic differences, such as the distinction between the trustee and the fideicomisario which arises from the presence of legal title in the former and the lack of it in the latter.

The English debenture holder who is not protected by trust deed must bring an action to enforce the debentures whether they are secured by mortgage or charge or are unsecured. This, however, is the duty of the fideicomisario in any event, since every debenture holder under the Ley is protected by an indenture. Thus it is only where there is a trust deed creating the security that the English debenture holder has the advantages always enjoyed by his Argentine counterpart. None of the rights accrues to him which Article 18 of the Ley gives the fideicomisario of a debenture without guaranty, except that his right to present a petition for the winding up of a company either before or after a judgment in the action brought by him, and to have a receiver and a manager appointed, effects the same result as that when the fideicomisario exercises his prerogative of demanding the removal of the directors, assumes possession of the corporation's property and determines upon the liquidation of the company. Even under a trust deed, the responsibility of bringing an action to enforce a charge rests with the English debenture holder, for it is the common practice to have the company and trustees joined as defendants. The obligation of enforcement of the security under the Ley is of course that of the fideicomisario.

Prior to the granting of a judgment declaring the debenture to be a charge on the property and ordering a sale thereof, the English court may, if necessary, appoint a receiver and a manager. The duty of the former is confined to taking possession and protecting the property over which he is appointed, while that of the manager is the continuing of the business of the company for the benefit of its creditors. Both duties are under the Ley assigned to the fideicomisario.

Apart from an action to enforce the security, the court may appoint a receiver whenever the security is in danger. Typical situations are those where the principal or interest on the debenture is in arrears; where a company has become insolvent and has closed its plant, or where a winding up of the company takes place or is imminent, or a

company is disposing of its undertaking, or there are judgments against the company, or the company is inactive, or proposes to distribute among its members its only remaining asset.¹¹² These powers are the same as those conferred on the fideicomisario by Article 18, but are broader in their scope.

An historical cycle is completed. The common law has repaid to its Roman predecessor in part at least the ancient debt incurred by the Chancellor. It is perhaps premature to venture a judgment on the adaptability of the Anglo-American system of fiduciary representation to the Latin-American soil. In view of the many similarities existing between the civil-law "mandatario" and the common-law trustee, the necessary adjustments may involve but the formulation of a new legal theory. Present defaults on the part of many companies will afford ample opportunity for corroboration of the superior efficacy of the system as a method of enforcing the rights of the holders of debenture obligations.

112. *McMahon v. North Kent Iron Works Co.*, [1891] 2 Ch. 148; *In re Victoria Steamboats, Limited*, *supra* note 38; *Hodson v. Tea Co.*, 14 Ch. D. 859 (1880); *Wallace v. Universal Automatic Machines Co.*, [1894] 2 Ch. 547; *Hubbuck v. Helms*, 56 L. T. R. 232 (1887); *Edwards v. Standard Rolling Stock Syndicate*, [1893] 1 Ch. 574; *Higginson v. German Athenaeum*, 32 T. L. R. 277 (1916); *In re Tilt Cove Copper Co.*, [1913] 2 Ch. 588.