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Shareholders' Rights & Shareholder Activism 2021

Colombia
Law & Practice
and
Trends & Developments

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COLOMBIA

Law and Practice

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1. SHAREHOLDERS' RIGHTS

1.1 Types of Company

Types of Companies

There are many types and subtypes of companies that can be incorporated in Colombia. However, in only three of these corporate structures are company owners referred to as shareholders and their interests in the company referred to as shares of stock (*acciones*). These are (i) limited partnerships with shares (*sociedades en comandita por acciones*), (ii) stock corporations (*sociedades anónimas*), and (iii) simplified stock corporations (*sociedades por acciones simplificadas* or SAS). In each of these companies, equity is divided into shares and proof of equity-holding is incorporated into share certificates.

This guide will deal almost exclusively with stock corporations and simplified stock corporations, which will be referred to as Corporations and SAS, respectively.

Law 1258 of 2008 (Law 1258) introduced SAS to the Colombian corporate landscape. Today, a vast majority of Colombian companies are SAS. This type of company cannot be registered in the National Registry of Securities and Issuers (*Registro Nacional de Valores y Emisores*), and its shares cannot be traded on the Colombian Stock Exchange (*Bolsa de Valores de Colombia*) (Law 1258, Article 4). Under the COVID-19 emergency, however, the government temporarily allowed SAS to issue debt securities to be offered in the secondary market. These debt securities can be registered in the National Registry of Securities and Issuers, and they can also be traded on the Colombian Stock Exchange. This temporary exception will be in force for two years (Decree 817 of 2020).

Corporations, however, can always go public and register their shares in the National Registry of Securities and Issuers. Thus, these equity securities can be traded on the Colombian Stock Exchange.

Foreign investors can also incorporate foreign company branches (*sucursales*) in Colombia. A branch is a commercial establishment or group of assets linked to the operation of a business (*establecimiento de comercio*), not a type of company with separate legal personality. Therefore, a foreign company branch and its parent company are deemed to be the same legal entity. The branch must have equity and a legal representative in Colombia to start operations. Moreover, foreign financial and capital markets entities interested in incorporating a branch in Colombia require authorisation from the Colombian Superintendence of Finance to do so.

Qualification Criteria for Investments

As a rule, there are no qualification criteria, whether regarding nationality or residence status, that restrict investments in Colombian companies. Exceptions relate to toxic or dangerous waste, and activities dealing with national defence or security matters. Under Colombian law, foreign investment and domestic investment are afforded the same treatment. Consequently, discriminatory measures cannot be established in favour of or against foreign investors (Article 2, Decree 2080 of 2000).

However, there are certain requirements regarding the number of shareholders that can incorporate each type of company. To avoid mandatory liquidation, Corporations must have at least five shareholders. SAS, however, may be incorporated by, and continue to operate with, a single shareholder.

1.2 Types or Classes of Shares

In Colombia, Corporations and SAS must have nominative shares. That said, they can both issue different classes and series of shares, including the following.

Common Shares

Common shares grant their holders rights to vote and deliberate in meetings, receive profits, inspect the company's books and records, transfer and dispose of their shares, and be reimbursed their capital contributions in the event of liquidation (in the terms explained in **1.4 Main Shareholders' Rights**).

Economically Privileged Shares

In addition to the rights attached to common shares, economically privileged shares may vest their holders with a preferential right (vis-à-vis common shareholders) to be reimbursed their capital contributions in the event of liquidation. They may also grant a preferential right to receive a specific percentage of company profits, the payment of which may be postponed for accumulation with the profits of subsequent years. This aggregation of profits, however, may not extend beyond five years. Additional economic rights may be attached to these shares in the company's by-laws or in the share issuance and placement regulations, as applicable.

Shares with Preferential Dividend and without Voting Rights (Preferred Shares)

These shares may not represent more than 50% of the company's subscribed capital. Their holders may be entitled to receive the preferential payment of a minimum fixed dividend before profits are distributed to common shareholders. Likewise, they may be granted the preferential right (vis-à-vis common shareholders) to be reimbursed their capital contributions in the event of liquidation (see **1.4 Main Shareholders' Rights**). Ultimately, preferred shares enjoy all other rights inherent to common shares, except for the right to participate in and vote at the general shareholders' meeting.

Share issuance and subscription regulations may also attach additional rights to preferred shares. Among others, preferred shareholders can be granted the right to participate, in the same proportion as common shareholders, in the company's remaining profits after minimum dividends have been distributed.

Exceptionally, holders of these shares will also have the right to vote, namely: (i) when voting on a proposed amendment to the company's by-laws which may impair the rights of preferred shares, and (ii) when voting to convert preferred shares into common shares. In both cases, these decisions must be approved by not less than 70% of the company's issued and outstanding shares. This special majority must represent, in turn, at least 70% of the company's preferred shares. Share issuance and placement regulations may include additional events in which preferred shares are entitled to vote.

Industrial or Payment Shares

These shares are used to reward a shareholder for its contribution of services, labour, technological assistance, industrial and commercial secrets, or any other activity performed for the company's benefit. The use of shares to pay for labour-related obligations is subject to the special restrictions imposed by labour laws on maximum salary percentages that can be paid in kind.

Additional Considerations

In Corporations, every share is entitled to a single vote. In SAS, by-laws may create special shares that grant multiple votes to its holders. They may also provide for shares with a fixed annual dividend.

In both Corporations and SAS, the rights attached to each type of share must appear on the back of each share certificate.

1.3 Primary Sources of Law and Regulation

The primary sources of law and regulation relevant to shareholders' rights are:

- the Code of Commerce (Decree 410 of 1971), as amended by subsequent legislation;
- Law 222 of 1995, whereby certain provisions of the Code of Commerce were amended and other rules regarding shareholders' rights and corporate matters were introduced;
- Law 446 of 1998, which contains a special provision for the protection of minority shareholders of publicly traded companies;
- the Securities Exchange Law (Law 964 of 2005);
- theUnified Decree for the Financial, Insurance and Capital Markets sectors (Decree 2555 of 2010);
- Law 1258 of 2008, governing SAS;
- the Unified Decree for the Commercial, Industrial, and Tourism sectors (Decree 1074 of 2015);
- Decree 398 of 2020, dealing with virtual shareholders' meetings;
- Decree 817 of 2020, which temporarily allowed SAS to issue debt securities to be offered in the secondary market;
- the Entrepreneurship Law (Law 2069 of 2020), whereby certain provisions of the Code of Commerce regarding shareholders' rights were amended; and
- the Code of Best Corporate Practices (Country Code) issued by the Superintendence of Finance, which contains corporate governance guidelines for publicly traded companies.

1.4 Main Shareholders' Rights

The following are the main rights common to all shareholders.

- The right to participate, deliberate, and vote in all shareholders' meetings. Preferred Shareholders are not entitled to do so, except in the events explained in **1.2 Types or Classes of Shares**.
- The right to negotiate, transfer, and dispose of their shares freely, unless the by-laws set forth a right of first refusal (pre-emptive purchase) in favour of the company's shareholders or the company itself.
- The right to share in the company's profits, should these exist.
- The right to inspect the company's books and records during a specific period of time preceding ordinary shareholders' meetings (see **1.7 Access to Documents and Information**).
- The right to be reimbursed their capital contributions and any excess thereof, in proportion to their ownership stakes, if applicable, in the event of liquidation and following payment of the company's obligations with third parties.
- A pre-emptive subscription right in any new issuance of shares, unless otherwise provided in the company's by-laws or otherwise approved by 70% or more of the shares represented at the relevant shareholders' meeting. If this is not the case, current shareholders will be entitled to subscribe newly issued shares in an amount equal to their ownership percentage on the date the new issuance is approved.
- The right to challenge the decisions of the general shareholders' meeting and the board of directors in the event of breach of the law or by-laws, as further explained in **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors**.
- The right to withdraw from the company following a company transformation, merger, or spin-off that increases shareholders' liability or is detrimental to their equity rights. This right belongs exclusively to absent or dissenting shareholders and will also be triggered in the event of voluntary cancellation of the company's registration in the National Registry of Securities and Issuers or in the

Colombian Stock Exchange. This right cannot be diminished or derogated from. Its scope and effects are further explained in **3.2 Legal Remedies against the Company**.

In SAS, by-laws may set forth additional rights or restrictions, such as the following.

- Different voting rights for different types of shares and multiple voting rights for certain shares, as explained in **1.2 Types or Classes of Shares**.
- The right to request that shareholding companies report any change of control in their shareholding structures to the SAS's legal representative. In these cases, the general shareholders' meeting will be entitled to exclude those shareholders from the company after becoming aware of a change of control.
- The need to obtain prior authorisation from the shareholders' meeting for the transfer of any type of shares. By-laws may also ban the transfer of the company's shares, or of a specific subset of shares, for up to ten years following their issuance. This ten-year restriction may be extended for additional ten-year periods with the unanimous vote of all shareholders.
- The right to divide votes to elect members of the board or other collegiate corporate bodies.
- A minimum or maximum percentage of shares that can be controlled by one or more shareholders.

1.5 Shareholders' Agreements/Joint-Venture Agreements

Shareholders' Agreements

Shareholders' agreements are enforceable by and among the parties thereto. It is common in Colombia for shareholders to enter into these agreements.

In Corporations, shareholders' agreements can be enforced against the company and other shareholders only if they refer to voting rights (eg: pooling agreements). In both Corporations and SAS, these agreements may provide that the right to vote be delegated to a third party, such as a trust.

As a rule, shareholders' agreements must be in writing. To be enforceable against the company, they must be delivered to the legal representative and deposited with company management.

In Corporations, shareholders that are also company managers cannot enter into these agreements. In publicly traded Corporations, shareholders' agreements must be further filed with the National Registry of Securities and Issuers.

In SAS, shareholders' agreements may refer to any licit matter. These agreements may not be in force for more than ten years, but they can be renewed with the unanimous vote of all parties for successive ten-year periods.

Joint-venture Agreements

Joint-venture agreements are also enforceable in Colombia. These are collaboration contracts in which two or more parties join efforts to develop a specific project or business and to share in the profits jointly. Parties combine their assets, capital, skills, efforts, and knowledge, but no new company or legal entity is created.

Colombian commercial laws do not contain special provisions governing these agreements, except for a specific subtype of joint venture called *cuentas en participación*. Therefore, joint-venture agreements are generally executed, interpreted, and performed in accordance with the general rules governing commercial contracts.

In Colombia, these agreements are common in the context of public procurement (ie, contracts in which at least one party is a state entity). Law 80 of 1993 (Public Procurement Statute) sets forth two specific types of joint-venture agreements: (i) consortiums (*consorcios*) and (ii) temporary unions (*uniones temporales*). Parties to both types of agreements are jointly and severally liable for all obligations arising from the specific project or business. However, in temporary unions, penalties arising from breach of contract will be imposed in proportion to each member's participation in the joint venture.

1.6 Rights Dependent upon Percentage of Shares

Some shareholders' rights are only exercisable by shareholders holding a certain percentage of shares, such as the following.

- Shareholders who hold 10% or more of the company's shares can request company managers, the statutory auditor, or the competent government regulator to summon a shareholders' meeting. This request must be upheld (Article 6, Law 2069 of 2020).
- Shareholders holding 5% or more of a listed company's issued and outstanding shares may submit specific proposals to the board of directors, which, in turn, is bound to respond to them in writing with a reasoned decision (Article 40, Law 964 of 2005). These proposals cannot touch upon industrial secrets or strategic company information.
- Shareholders holding 20% or more of the company's shares can summon a shareholders' meeting to discuss the filing of a corporate liability suit (*acción social de responsabilidad*) against company managers (Article 25, Law 222 of 1995).
- Shareholders of publicly traded Corporations who hold no more than 10% of the company's shares and have no representation in company management can bring a claim before the Superintendence of Finance if they consider that their rights have been violated by the decisions of other shareholders, directors, or managers (Article 141, Law 446 of 1998).
- In companies that are not subject to the Superintendence of Finance's surveillance and whose assets or income exceed certain amounts, one or more shareholders holding at least 10% of the company's shares can request that the Superintendence of Companies:
  - (a) summon a shareholders' meeting if that meeting has not taken place in due course according to the law or by-laws;
  - (b) order the amendment of specific provisions in the company's by-laws that stand against the law; or
  - (c) initiate administrative investigations if the law or by-laws have been breached (Article 87, Law 222 of 1995).

1.7 Access to Documents and Information

In Corporations and SAS, shareholders have a right of inspection. However, this right is limited in time and scope. In Corporations, shareholders can only examine the company's books, financial statements, and corporate records during the 15-business-day period immediately preceding the ordinary shareholders' meeting that will examine and approve the company's financial statements. In SAS, shareholders' right of inspection may be exercised during the five business days immediately preceding this meeting, unless a longer term is set forth in the by-laws.

This right does not include inspection of industrial secrets or information that could be used to damage the company, should it become public. According to the Superintendence of Companies, this right only extends to documents pertaining to the last fiscal year.

1.8 Shareholder Approval

In Corporations, shareholders shall approve the following non-exhaustive list of matters, usually by a simple majority of votes (50% of the shares represented at the meeting + one share), unless the law or by-laws establish a special majority.

- Amendments to the company's by-laws.
- Financial statements and board of directors' reports on economic matters.
- Distribution of profits/dividends, which must be of no less than 50% of the company's net profits, unless 78% or more of the shares represented at the meeting vote otherwise. In some instances, Corporations must distribute no less than 70% of their profits.
- Designation, ratification, or removal of directors and managers in accordance with the company's by-laws.
- Management reports prepared by the board of directors and the legal representative on the occasion of the ordinary shareholders' meeting.
- The statutory auditor's report, if applicable.
- Any issuance of common shares that will not be subject to the right of first refusal (pre-emptive subscription). This decision must be approved by a special majority of at least 70% of the shares represented at the meeting.
- Constitution of accounting reserves not required by law.
- Voluntary dissolution/liquidation events (not required by law or the company's by-laws).
- Payment of dividends in shares, provided that any such decision is approved by at least 80% of the shares represented at the meeting.

In SAS, shareholders shall also approve the above-mentioned matters. However, unless otherwise provided in the company's by-laws, none of the special voting majorities previously described for Corporations will apply to the decisions of an SAS's shareholders' meeting.

Conversely, if the following matters are included in an SAS's by-laws, their amendment must be approved unanimously by all shareholders. If these were not initially addressed in the company's by-laws, their subsequent incorporation must also be approved unanimously by all shareholders:

- bans or restrictions on the transfer of shares;
- authorisation from the shareholders' meeting for the transfer of shares;
- exclusion of shareholders from the company;
- the decision to submit corporate and shareholder disputes to arbitration or *amigable composición* (an alternative dispute resolution method).

In publicly traded Corporations, shareholders must be notified in advance if a meeting will discuss an increase of the company's authorised capital or a decrease of its subscribed capital. Failure to provide this notice will render the corresponding decision ineffective. In these cases, company managers shall prepare a report that must be made available to shareholders during the entire notice period preceding the relevant shareholders' meeting.

1.9 Calling Shareholders' Meetings

Right to Call Shareholders' Meetings

In Corporations, shareholders are not entitled to call general shareholders' meetings, except if they intend for the meeting to discuss the filing of a corporate liability suit against company managers, in the terms explained in **1.6 Rights Dependent upon Percentage of Shares**.

In SAS, by-laws may grant shareholders the right to call such meetings.

Meeting Summons

In Corporations and SAS, ordinary and extraordinary shareholders' meetings must be summoned. However, meetings can be held at any time if all shareholders are represented. Ordinary meetings must be summoned at least once a year, while extraordinary meetings can be called whenever there is an urgent or unexpected need.

A meeting summons can be sent by any means of communication, including email. For extraordinary meetings, the summons must include the meeting's agenda.

In Corporations, a meeting must be summoned 15 business days in advance of the proposed date if financial statements are to be approved. Otherwise, the notice must be sent five calendar days before the meeting.

In SAS, all meetings (including those in which financial statements will be approved) must be called five business days in advance of the proposed date.

Virtual/Remote Meetings

In Colombia, virtual shareholders' meetings are allowed. For these purposes, any means of communication by which shareholders can deliberate and decide, whether simultaneously or successively, will suffice. Successive communications must occur immediately, as permitted by the means employed. Shareholders must be able to provide proof of virtual meetings in accordance with the technical means used. Meeting minutes are also required.

Written Votes

Under Colombian law, decisions of the general shareholders' meeting will be valid whenever all shareholders cast their votes in writing. Written votes may be submitted separately, or in a single document signed by all shareholders. All such documents must be received by the legal representative.

1.10 Voting Requirements and Proposal of Resolutions

Voting Requirements

In Corporations, shareholders are entitled to one vote per share. In both Corporations and SAS, shareholders are also entitled to vote by proxy. Proxies must be in writing and must indicate the name of the proxy-holder and the meeting(s) that the proxy-holder is authorised to attend in that capacity.

In SAS, by-laws can grant different voting rights – single or plural – to different types of shares. Shareholders may also divide their votes to elect directors (see **1.2 Types or Classes of Shares** and **1.4 Main Shareholders' Rights**).

Unless otherwise provided in the company's by-laws, the general shareholders' meeting cannot deliberate if the majority of the company's subscribed shares are not represented at the meeting. Subject to this initial quorum, shareholders' decisions will be taken by an absolute majority (50% + one) of the shares attending the meeting, unless a greater number is required by the law or by-laws.

Electronic Vote

Shareholders of both Corporations and SAS can vote electronically, whether at in-person or virtual meetings. Written votes may be also submitted through electronic means, such as emails and text messages (see **1.9 Calling Shareholders' Meetings**).

Additional Proposals by Shareholders

As a rule, all shareholders have the right to request that a specific issue be considered, or a resolution put forward, at a shareholders' meeting. In ordinary meetings, any shareholder can propose that specific matters not included in the agenda be discussed and decided. Nevertheless, shareholders cannot deliberate or decide on matters not included in the agenda of extraordinary meetings, unless the majority of shares represented at the meeting votes to include an additional item in the agenda. An exception to this rule refers to the removal of directors and officers, on which the shareholders' meeting may always cast a vote.

1.11 Shareholder Participation in Company Management

Shareholders can participate in company management and even sit on its board.

In Corporations, shareholders who seek appointment as directors or legal representatives can submit their candidacies to the shareholders' meeting. Directors are designated through a special voting system called *cuociente electoral*.

SAS, however, are not legally bound to have a board of directors unless their by-laws require it. If a board is not created, the legal representative will be in charge of company management. Any shareholder can be appointed as legal representative. Should a board exist, the company's by-laws may provide that directors be appointed by any mechanism, including *cuociente electoral* or specific voting majorities.

1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors

Shareholders of both Corporations and SAS are entitled to appoint, ratify, or remove directors from the board. Shareholders can also challenge a board decision in courts, arbitral tribunals, or before the Superintendence of Companies if that decision is contrary to the law or by-laws. This suit must be brought within the two months following the date of the relevant decision.

If the decision of the board of directors was subject to mandatory registration before the chamber of commerce, it must be challenged within two months following the date of registration. In these lawsuits, shareholder-plaintiffs can also request a temporary injunction. The competent authority will uphold this request if it is deemed necessary to avoid serious damages and if the plaintiff provides security for costs. Injunctions are subject to appeal.

Should these lawsuits succeed on the merits, challenged decisions may be declared null and void, without legal effects, or unenforceable against the shareholder-plaintiffs and third parties, as applicable.

1.13 Shareholders' Right to Appoint/Remove Auditors

In both Corporations and SAS, shareholders have the right to appoint and remove the company's statutory auditor. Article 204 of the Code of Commerce requires that any such appointment or removal be approved by an absolute majority (50% + one) of the shares of those shareholders attending a general shareholders' meeting. Statutory auditors of foreign company branches, however, must be appointed by the foreign company's competent corporate body in accordance with its by-laws.

1.14 Disclosure of Shareholders' Interests in the Company

As a rule, shareholders of Corporations and SAS are not required to disclose their interests in the company. In fact, they are entitled to remain anonymous vis-à-vis third parties. Therefore, certificates of incorporation and good standing issued in Colombia for these two types of companies do not identify their shareholders. While public deeds of incorporation and amendments to a Corporation's by-laws may be accessed by the public, Corporations may still preserve the anonymity of shareholders by registering only relevant excerpts of these documents that do not disclose their identity.

In addition, Article 61 of the Code of Commerce grants special protection to company documents. It provides that corporate books and records may be examined only by the company's owners, third parties who have been duly authorised by the company's owners, or as a result of an order issued by a competent authority. Accordingly, books and records may be accessed by the company's auditors, shareholders exercising their right of inspection (see **1.7 Access to Documents and Information**), and government regulators exercising surveillance over the relevant company (eg, the Superintendence of Companies, the Superintendence of Finance).

Publicly Traded Companies

Law 964 of 2005 (Securities Exchange Law) and Decree 2555 of 2010 (Unified Decree for the Financial, Insurance, and Capital Markets sectors) impose a set of disclosure and reporting duties on companies whose securities are listed on the Colombian Stock Exchange. Among others, publicly traded companies are required to report to the public, at the end of each accounting period, "information regarding participation in the issuer's stock and other material matters relating to its shareholding structure" (Decree 2555 of 2010, Article 5.2.4.2.2). Further, External Letter 018 of 2018 issued by the Superintendence of Finance requires listed companies to deploy their best efforts to identify their shareholders up to the third degree of ownership and report that information to the Superintendence. As evidenced, these obligations (i) are merely best-efforts obligations and (ii) are only binding on listed companies (not on their shareholders).

Finally, issuers are required to disclose any change of control in their shareholding structure or that of their parent company/majority shareholder, subsidiaries, or affiliates.

Controlling Shareholders and Business Groups

Law 222 of 1995 requires controlling shareholders to register their controlling position before the chamber of commerce of the controlled company's corporate domicile. For these purposes, a situation of control exists whenever a company's decision-making power is subject to the will of another person or company (deemed the controlling shareholder). To do so, the controlling shareholder must prepare a private document describing the conditions that give rise to the situation of control, and indicating the names, corporate domiciles, nationalities, and economic activities of both the controlling shareholder and the controlled companies. This document must be registered before the competent chamber of commerce no later than 30 days following the date on which the situation of control arose.

However, a business group will exist if, in addition to a situation of control, there is unity of purpose and direction between a parent company/controlling shareholder and its affiliates or subsidiaries. Business groups must also be registered by controlling shareholders/parent companies before the competent chamber of commerce. Registration of a business group exempts the controlling shareholder from filing a separate document to register its situation of control.

Financial Conglomerates

Law 1870 of 2017 introduced the concept of "financial conglomerates" (*conglomerados financieros*) and "financial holdings" (*holdings financieros*) in Colombia. It defined a financial conglomerate as a group of at least two domestic or foreign entities with a common controller, in which at least one group member carries out business activities in Colombia that would normally be subject to the Superintendence of Finance's oversight and control (usually financial, insurance, or capital markets activities). It further defined a financial holding as any entity/company or investment vehicle with separate legal personality exercising the first level of control or significant influence over the members of a financial conglomerate.

Colombian financial holdings are subject to the Superintendence of Finance's oversight and control. Foreign financial holdings, however, will be subject to the provisions of Law 1870 of 2017 unless they can prove that they are supervised by a foreign regulator in their home jurisdictions and that this supervision is substantially equivalent to the one the Financial Superintendence performs in Colombia.

Most importantly, Law 1870 of 2017 authorised the Superintendence of Finance, among other measures, to request changes in a financial conglomerate's structure if its current composition does not allow the adequate disclosure of information, a comprehensive supervision of the relevant conglomerate, and/or proper identification of the conglomerates' members and beneficial owner. The Superintendence may also request specific information to ensure adequate supervision of any conglomerate member that is domiciled in Colombia. If the Superintendence considers that the information provided by the financial conglomerate does not allow for the proper supervision of the Colombian group member, it may revoke that member's authorisation to do business in Colombia.

Anti-money Laundering and Counter-terrorist Financing

The Basic Legal Circular issued by the Superintendence of Companies (*Circular Básica Jurídica*) incorporates a set of anti-money laundering and counter-terrorist financing policies that require certain companies to perform due diligence processes and risk-assessment procedures in connection with their counterparties in business. Companies that are bound by these policies must undertake and document their best efforts to identify their counterparties' beneficial owners. Compliance with this duty, however, does not impose an obligation on counterparties to disclose their shareholding structure, as they may invoke the confidentiality provision set forth in Article 61 of the Code of Commerce.

1.15 Shareholders' Rights to Grant Security over/Dispose of Shares

Shareholders are entitled to grant security interests over their shares, provided that they register any such liens in the company's stock ledger (*libro de registro de accionistas*). In the absence of a specific agreement to the contrary, pledged shares do not confer typical shareholders' rights to the pledgee (eg, voting rights, rights to receive dividends, etc). In addition, under Law 1676 of 2013 (*Ley de Garantías Mobiliarias*), a pledge over a company's shares may be registered before the Special Registry for Security Interests over Movable Property to ensure greater transparency before third parties. Pledged shares may also be transferred by a shareholder if the creditor allows it.

In both Corporations and SAS, shareholders may dispose freely of their shares in the absence of specific provisions in the company's by-laws restricting their transfer or disposal (see **1.4 Main Shareholders' Rights** and **1.8 Shareholder Approval**). These provisions may also be included in shareholders' agreements, which must comply with the requirements explained in **1.5 Shareholders' Agreements/Joint-Venture Agreements** to be enforceable.

1.16 Shareholders' Rights in the Event of Liquidation/Insolvency

Law 1116 of 2006 sets forth two types of insolvency proceedings: (i) corporate reorganisations and (ii) judicial liquidations. While corporate reorganisations pursue debt restructuring to ensure company survival and business continuity, judicial liquidations seek to liquidate and wind up the company, after paying its outstanding debts and liquidating its assets.

In corporate reorganisations, the general shareholders' meeting continues to operate, albeit with certain restrictions (eg, it may not approve any amendments to the company's by-laws or engage in operations outside the company's ordinary course of business without the competent judge's approval). Conversely, judicial liquidations require that the company's corporate bodies (including the general shareholders' meeting) cease to perform their duties.

The fact that corporate reorganisations allow for the company's corporate bodies to continue to discharge their duties means that shareholders will retain their rights to challenge the validity, legal effects, and enforceability of corporate decisions, and to pursue derivative actions, as applicable, in the events explained in **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors**, **3.2 Legal Remedies against the Company**, and **3.6 Derivative Actions**. Further, reorganisation agents (*promotores*) and liquidators (*liquidadores*) in insolvency proceedings are bound by the duties of managers under Colombian law. Therefore, while shareholders are not entitled to challenge the validity, legal effects, or enforceability of their decisions in the context of reorganisation or liquidation proceedings, they may exercise derivative actions against them.

However, in the absence of specific provisions to the contrary in the company's by-laws, insolvency proceedings do not pose any restrictions on shareholders' rights to transfer or dispose of their shares.

Finally, shareholders who are also creditors of the insolvent company will be entitled to the same rights as all other creditors in insolvency proceedings (eg, the right to submit objections to the promoter's proposed credit ranking in reorganisation proceedings, or the right to access and examine the proceedings' case file).

Voluntary and Mandatory Dissolution Events

Outside the context of insolvency proceedings, the Code of Commerce and Law 1258 allow for Corporations and SAS, respectively, to be voluntarily dissolved and liquidated whenever their shareholders decide to do so. Unless otherwise provided by the company's by-laws, no special voting majorities are required in either type of company for shareholders to approve this decision. Additionally, shareholders are free to include special dissolution events in their bylaws, as well as special voting majorities for both mandatory and voluntary dissolution events.

However, Colombian laws also set forth a series of mandatory dissolution and subsequent liquidation events. In the case of Corporations, these include:

- expiry of the Corporation's term;
- inability to discharge the company's corporate purpose;
- bankruptcy;
- an order issued by a competent authority requiring that the company be dissolved and liquidated;
- having fewer than five shareholders; and
- whenever a single shareholder owns 95% or more of the company's issued and outstanding shares.

The first four of these mandatory events will also apply to SAS.

COVID-19 Reforms to Insolvency Proceedings

Shareholders' rights in liquidation events and insolvency proceedings have not changed as a result of the COVID-19 pandemic. However, several laws and regulations have been enacted, with important effects on liquidation and insolvency matters.

By way of example, Legislative Decree 772 of 2020 temporarily suspended the application of a specific dissolution event shared by all types of companies and partnerships. Prior to its enactment, shareholders and partners were required to declare the company's dissolution if the latter incurred losses that reduced its net worth below 50% of its subscribed capital. This measure sought to preserve the country's economic stability and corporate landscape, as well as to avoid increasing levels of unemployment.

Later, however, this mandatory dissolution event was completely abolished by Law 2069 of 2020 and was instead replaced by a broader reference to the non-compliance with a company's ongoing business hypothesis (*no cumplimiento de la hipótesis de negocio en marcha*). The occurrence of this new dissolution event is not determined by the existence of a specific financial or accounting indicator, but rather by the managers' reasonable assessment of the company's financial statements and growth projections, as well as their impact on the company's net worth and risk of insolvency. While shareholders and managers are required to analyse thoroughly and document the existence of this dissolution event, its acknowledgement does not necessarily entail the company's mandatory liquidation.

Finally, Decree 560 of 2020 enacted a relative overhaul of insolvency provisions to make reorganisation proceedings simpler and more flexible (eg, through the introduction of emergency and out-of-court negotiation and mediation procedures, tax benefits, an expedited review mechanism for reorganisation requests, and a broader range of financial relief measures in reorganisation agreements, among other measures).

2. SHAREHOLDER ACTIVISM

2.1 Legal and Regulatory Provisions

Shareholder activism generally refers to the process by which minority shareholders of publicly traded companies exercise their shareholders' rights to pursue a specific agenda within the company and influence or produce changes in company management, corporate governance, and/or business practice. Activist shareholders' agendas may include a wide range of pursuits, from management strategies and profitability goals to broader concerns about the company's business (eg, corporate social responsibility, environmental impact, diversity and inclusion, and labour rights).

Notwithstanding the foregoing, shareholder activism can also be deemed to include the broader range of cases in which any shareholder (regardless of its ownership stake) of any company (whether publicly traded or not) exercises its rights to bring about change within the company or, perhaps more broadly, to pursue or protect its own interests. In Colombia, this second understanding of shareholder activism prevails.

Regulation of Shareholder Activism

1.3 Primary Sources of Law and Regulation lists the primary sources of law and regulation governing activist shareholders' behaviour. Other than through the obvious limitations imposed by majority voting requirements, Colombian laws and regulations do not restrict shareholder activism in any of its forms. Instead, the legal system provides a solid framework for shareholders to exercise their rights – whether they hold a majority or a minority interest, whether they do so in closed or publicly traded companies, and whether they intend to pursue a political/social agenda or merely their individual interests.

Activist shareholders who want to fulfil their specific agendas within a company can apply, among others, laws and regulations that:

- set forth quorums for deliberation and special voting majorities for the approval of certain corporate decisions (see **1.8 Shareholder Approval**);
- allow shareholders to enter into shareholders' agreements (see **1.5 Shareholders' Agreements/Joint-Venture Agreements**);
- provide for inspection rights (see **1.7 Access to Documents and Information**) and special notice and summon requirements (see **1.9 Calling Shareholders' Meetings**);
- allow shareholders to call shareholders' meetings and submit proposals to the board (see **1.6 Rights Dependent upon Percentage of Shares**);
- entitle shareholders to appoint and remove directors and statutory auditors (see **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors** and **1.13 Shareholders' Right to Appoint/Remove Auditors**); and
- allow shareholders to sit on the board (see **1.10 Voting Requirements and Proposal of Resolutions**).

Likewise, the fact that shareholders can:

- challenge the validity, legal effects, and enforceability of corporate decisions (see **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors** and **3.2 Legal Remedies against the Company**);
- seek compensation for damages suffered as a result of managers' or company conduct (see **3.2 Legal Remedies against the Company** and **3.3 Legal Remedies against the Company's Directors**);
- exercise derivative actions on behalf of the company (see **3.6 Derivative Actions**);
- bring claims and request specific measures before administrative authorities (see **1.6 Rights Dependent upon Percentage of Shares**); and even
- initiate lawsuits against other shareholders for claims of "abuse of rights" (see **3.4 Legal Remedies against Other Shareholders**), further proves that Colombian laws and regulations have equipped shareholders for activism.

Special Provisions for Listed Companies

As explained in **1.6 Rights Dependent upon Percentage of Shares**, shareholders holding 5% or more of a listed company's stock may submit specific proposals to the board, which must provide a reasoned written response to those proposals.

Nevertheless, listed companies' by-laws may include special mechanisms for the designation of board members other than the *cuociente electoral* set forth in Article 197 of the Code of Commerce, provided, however, that those mechanisms allow minority shareholders to increase the number of board members they would be entitled to appoint under the *cuociente electoral* system (Article 40, Law 964 of 2005).

Finally, at least 25% of a listed company's board must be comprised of independent directors (ie, not controlling shareholders) (Article 44, Law 964 of 2005).

All these provisions are meant to safeguard minority shareholders' rights and ensure their effective participation in company management and decision-making.

2.2 Level of Shareholder Activism

Despite the country's solid legal and regulatory framework governing shareholders' rights and publicly traded companies, shareholder activism, as defined in paragraph one of **2.1 Legal and Regulatory Provisions** above, is not prevalent in Colombia. To date, there has been only a limited number of companies whose shares are listed on the Colombian Stock Exchange (65 as of August 2021). In addition, listed securities usually represent the issued and outstanding stock of only a minority of listed companies.

As previously explained, a more common form of shareholder activism can be seen in closed companies. In the past decade, the country has experienced an increasing flow of foreign direct investment and the incorporation of private equity funds (PEFs) that have, in multiple ways, engaged in activist-shareholder behaviours within the non-listed companies they target. Many of these funds have acquired majority stakes in key market players of strategic industries, designating C-level executives and/or adopting specific business strategies aimed at growing their target companies and increasing profitability.

Likewise, there is a growing body of case law issued by the Superintendence of Companies in the context of shareholders' disputes. Vested with judicial powers for almost a decade now, the Superintendence frequently adjudicates disputes regarding abuse of voting rights, piercing of the corporate veil, specific performance of shareholders' agreements, managers' liability, and annulment of corporate decisions, among others. According to the Superintendence, approximately 50% of these suits are initiated by minority shareholders. Activist shareholders have thus found in the Superintendence an important mechanism to enforce their rights.

Finally, an increasing number of inspected companies have submitted information to the Superintendence of Companies regarding the adoption of Corporate Social Responsibility policies. Whether these policies have been approved as a result of shareholder activism is unknown, but they serve as evidence of companies' growing commitments to pursue social impact agendas that coincide with those promoted by activist shareholders of listed companies in other jurisdictions.

2.3 Shareholder Activist Strategies

There is no specific set of strategies or fixed agendas commonly pursued by activist shareholders, whether of publicly listed or non-listed companies. Generally, however, these tend to be pursued through agreed-upon mechanisms (eg, shareholders' agreements) rather than hostile or confrontational tactics (eg, threatened litigation or disclosures to media outlets). Broadly speaking, the most widely used strategies to bring about changes in company management, corporate governance, or business conduct include (i) shareholders' agreements and amendments to companies' by-laws, (ii) submission of proposals to the general shareholders' meeting and/or managers, and (iii) designation of C-level executives and/or board members with expertise in strategic industries and specialised academic backgrounds.

In the absence of shared activist agendas, the COVID-19 pandemic has sparked investors' interest in environmentally sustainable businesses that promote diversity and inclusion, as well as respect for workers' rights.

Conversely, in its prevailing interpretation as a defensive mechanism to enforce shareholders' rights, the most commonly employed activist strategies will include those described in the legal remedies section of this guide.

2.4 Targeted Industries/Sectors/Sizes of Companies

There is no known publicly available information indicating a preference of activist groups for specific industries or sectors. There are, however, prominent interest groups and industry associations that are particularly active in promoting legislative and regulatory changes, as well as the pursuit of certain political and economic agendas at the corporate level.

2.5 Most Active Shareholder Groups

In the Colombian corporate landscape, private equity funds (PEFs) have been a particularly active group of shareholders. According to the Colombian Private Equity Association (COLCAPITAL), trending industries targeted by PEFs include real estate, retail, healthcare, and infrastructure.

2.6 Proportion of Activist Demands Met in Full/Part

There is no known publicly available information that clearly identifies what proportion of public activist demands were met in full or in part during recent years.

2.7 Company Response to Activist Shareholders

In responding to activist shareholders' demands, companies must make sure they have adequate corporate governance standards. These may include specific provisions in a company's bylaws or in shareholders' agreements, but also the adoption of corporate governance manuals and best practices (eg, regarding disclosure of information to shareholders, procedures to exercise inspection rights or to address proposals submitted by shareholders, among others). It is also advisable for managers to keep written records of their interactions with shareholders.

In listed companies, audit committees (required by Law 964 of 2005) may indirectly contribute to the safeguarding of shareholders' rights and respond to activist demands by supervising company management. The same can be said of compliance officers in companies that are required by law to appoint them. Finally, the Superintendence of Companies and the Superintendence of Finance have each issued useful guides and recommendations on a wide array of corporate governance standards (eg, regarding virtual shareholders' meetings and transparency standards, among others), most of which are either non-binding or only mandatory for listed companies (such as the "*Código País*"), but which may prove useful to any company in responding to shareholder activism.

3. REMEDIES AVAILABLE TO SHAREHOLDERS

3.1 Separate Legal Personality of a Company

As a rule, Colombian law recognises the separate legal personality of a company as distinct from its shareholders. Nevertheless, from the middle of the 20th century on, Colombian judges initially, some laws thereafter, and the Code of General Judicial Procedure (*Código General del Proceso*) currently, allow the "piercing of the corporate veil". As a result, a company's separate legal personality may be disregarded in exceptional circumstances.

Accordingly, piercing of the corporate veil will only proceed when the latter is used to distort the meaning and purpose of the law or to wrong third parties. Should the competent authority decide to pierce a company's corporate veil, this measure will entail annulment of the wrongful acts and the duty to indemnify injured parties for all damages caused. Shareholders and managers who committed, aided, or abetted the deceitful acts will be jointly and severally liable for the obligations and damages arising therefrom.

Though rarely found in formal business, Colombian law also recognises the existence of "ex facto companies" (*sociedades de hecho*). To the extent these so-called companies have not been incorporated by public deeds or otherwise registered before a chamber of commerce, they will not be deemed to have a separate legal personality. Thus, their members will be jointly and severally liable for all "company" conduct.

3.2 Legal Remedies against the Company

For purposes of this guide, the term "remedies" will refer to any form of relief available to a party seeking to enforce its rights under the Code of Commerce and complementary legislation (such as declaratory relief, injunctive relief, damages, and specific performance). Remedies are generally awarded after the interested party brings an action or claim before a competent court, arbitral tribunal, or, exceptionally, an administrative agency vested with judicial functions.

All shareholders, without distinction, have legal remedies against the company whenever it contravenes the law or by-laws. Among others, these remedies include annulment of corporate decisions (*nulidad*), a declaration that they will be deprived of all legal effects (*ineficacia*), their non-enforceability against the claimant and third parties (*inoponibilidad*), and liability for damages. The following paragraphs will highlight the most important remedies available to shareholders in our jurisdiction.

Challenging the Validity, Legal Effects, and Enforceability of Corporate Decisions

All shareholders are entitled to bring a suit against the company to challenge the validity, legal effects, or enforceability of decisions taken by the general shareholders' meeting, the board of directors, or any other corporate body if they deem such decisions to be against the law or bylaws. If the decision has been taken by the general shareholders' meeting, it may only be challenged by absent or dissenting shareholders. **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors** explains these lawsuits in further detail.

Decisions of the general shareholders' meeting or board of directors (i) taken without the required quorums to deliberate or decide, or (ii) approved at a meeting that was not summoned in accordance with the law or by-laws, will be deprived of all legal effects (Article 190, Code of Commerce). The Superintendence of Companies or the Superintendence of Finance, as applicable, may declare, on its own initiative or at the request of a party, the existence of the aforementioned circumstances and the subsequent deprivation of a decision's legal effects (Article 326, Decree 663 of 1993).

Similarly, decisions (i) adopted without the requisite number of votes set forth in the law or by-laws, (ii) exceeding the scope of the company's by-laws, or (iii) otherwise obtained through abuse of shareholders' rights, will be declared null and void (Article 190, Code of Commerce, and Article 43, Law 1258).

Finally, decisions of the general shareholders' meeting that do not have a general scope or that are not meant to bind all shareholders alike will be unenforceable against absent or dissenting shareholders (Article 190, Code of Commerce).

Liability for Damages

As a rule, companies will be liable for the damages caused to third parties (including their own shareholders) that arise from breach of contract or torts. In particular, should a decision of the general shareholders' meeting or the board of directors be declared null and void, shareholders may be compensated for any damages suffered as a result of that decision.

However, Article 193 of the Code of Commerce further provides that if the company itself suffered damages arising from that decision (such as those that stem from the company's prima facie obligation to compensate the damages initially suffered by shareholders), it may, in turn, seek compensation from managers who executed, applied, or enforced the relevant decision. Accordingly, those managers will be jointly and severally liable for the damages inflicted upon the company.

Likewise, if the annulled decision was adopted by the general shareholders' meeting, managers may also seek indemnification from the shareholders who approved it.

Withdrawal and Appraisal Rights

As explained in **1.4 Main Shareholders' Rights**, shareholders will have the right to withdraw from the company upon the occurrence of certain events.

Once a shareholder notifies the company of the decision to withdraw, his or her shares will be offered to other shareholders, who may decide to purchase them. If they decline to do so, the company must buy those shares, provided that it has liquid profits or reserves created for that purpose. If the company does not meet the legal requirements to acquire these shares, the withdrawing shareholder will have a right to demand reimbursement of his or her capital contribution. If the withdrawing shareholder and the company cannot agree on the value of that reimbursement, independent experts appointed by the chamber of commerce will be in charge of the appraisal (Articles 12, 15, and 16, Law 222 of 1995).

3.3 Legal Remedies against the Company's Directors

All shareholders, without distinction, have legal remedies against the company's directors and officers. Depending on the situation, these remedies include removal of directors/officers, annulment (*nulidad*), deprivation of legal effects (*ineficacia*), or unenforceability of board of directors' decisions against the claimant and third parties (*inoponibilidad*), and liability for damages.

Liability for Damages

Directors and officers will be jointly and severally liable for damages they inflict upon the company, shareholders, or third parties if they acted with negligence (*culpa*) or intent (*dolo*). Negligence is presumed when directors/officers acted ultra viresor against the law or by-laws. However, they can always prove there was no wrongful act or breach of duty.

As explained in **3.2 Legal Remedies against the Company**, directors and officers who:

- voted against board decisions that were later declared null and void, ineffective, or unenforceable;
- did not participate in the meetings in which those decisions were approved; or
- did not execute, apply, or enforce those decisions,

will not be subject to any such liability.

Corporate Liability Suits and Removal of Directors/Officers

In Colombia, any shareholder may request that the company file a "corporate liability suit" (*acción social de responsabilidad*) to remove directors/officers and hold them liable for damages caused to the company. As explained in **3.6 Derivative Actions**, shareholders are also entitled to bring this suit as a derivative action on behalf of the company.

Individual Liability Suits

Shareholders and third parties can also bring an "individual liability suit" (*acción individual de responsabilidad*) against directors/officers if their wrongful conduct caused direct damages to those shareholders or third parties (in addition to, or even in the absence of, damages to the company itself). Under this action, directors or officers, as applicable, are vis-à-vis liable to shareholders or third parties, who may bring this suit to protect or restore their individual rights. In addition, claimants must be able to prove all damages suffered to obtain compensation from directors/officers.

3.4 Legal Remedies against Other Shareholders

All shareholders, without distinction, have legal remedies against other shareholders in the events of breach of contract and torts. Moreover, Colombian laws set forth specific causes of action that entitle shareholders to obtain legal remedies, such as when other shareholders:

- breach the provisions of a shareholders' agreement;
- use the company's corporate veil to harm them;
- obtain decisions in shareholders' meetings by abusing the so-called "majority", "minority" or "parity" rights;
- vote against the interests of the company or to the detriment of other shareholders;
- use their votes to obtain unjustified advantages for themselves or third parties; and
- use their votes in a manner that could harm the company or other shareholders.

These causes of action are enshrined in Articles 20 and 24 of the General Code of Judicial Procedure. Many of them are rooted in the prohibition of abuse of rights set forth in Article 43 of Law 1258, according to which shareholders who take part in the events described in points three to six above will be liable for the damages they inflict upon third parties, including other shareholders. In these cases, they may also seek annulment of the relevant decisions of the shareholders' meeting.

3.5 Legal Remedies against Auditors

All shareholders, without distinction, have legal remedies against the company's auditors, who may be declared liable for damages inflicted by negligence or intent in discharging their duties. These remedies are also available to the company and third parties (Article 211, Code of Commerce).

No shareholder has a right against the company's external advisers, should they discharge their duties with negligence or the intent to inflict harm upon others. However, the company itself will be entitled to sue them and seek compensation for damages.

3.6 Derivative Actions

While the right to file a corporate-liability suit belongs prima facie to the company, shareholders can bring a derivative action if the claim is not pursued promptly by the company itself. Through this suit, plaintiffs may seek a declaration of directors' or officers' liability and compensation for damages. Derivative actions are brought on behalf of the company and for its exclusive benefit.

Approval of this suit by the general shareholders' meeting requires a simple majority (50% + one) of the shares attending the meeting and will automatically entail removal of directors or officers, as applicable. However, if the suit is not filed within three months following its approval, then any shareholder will be entitled to bring this action on behalf of the company (Article 25, Law 222 of 1995).

In addition to shareholders, any other manager, the company's statutory auditor, and, in some circumstances, creditors can bring a derivative suit in the company's interest.

3.7 Strategic Factors in Shareholder Litigation

The most important factor shareholders typically consider before litigating in the jurisdiction is whether an arbitration agreement exists. Despite being more costly, arbitration would allow the parties to obtain an award within six months to about two years following submission of their claim. In the absence of a prior arbitration agreement (such as an arbitration clause within a contract, including the company's by-laws or shareholders' agreements), the parties may still agree to submit their disputes to arbitration. However, if they are unable to do so, the case must be brought before State courts, where a final decision could take several years. Some corporate and shareholders' disputes may also be decided by the Superintendence of Companies.

Palacios Lleras is a boutique firm with over 35 years' experience, which advises and represents State entities and private parties throughout Colombia, and corporate clients in Latin America, the US, and Europe. Based in Bogotá, its small but expert team of lawyers – most of whom hold LLM degrees from world-class universities – combines decades of experience in litigation, arbitration, and legal advice. The firm is recognised for its business, constitutional, and administrative law practices, with cases and transactions that span multiple industry sectors (eg, mining, energy, finance, public utilities, infrastructure, and insurance). Palacios Lleras advises clients in the corporate structures that best fit their business models, and in the drafting of by-laws and shareholders' agreements that minimise risks of conflict. It frequently provides legal opinions on corporate matters and represents clients in judicial, arbitral, and administrative proceedings dealing with managers' liability and shareholder disputes (eg, abusive capitalisations, minority-shareholders' rights, and company control).

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Trends and Developments

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Introduction

The search for new dimensions of traditional shareholders' rights – most notably, minority shareholders' rights – merits great attention under Colombian law; so does the notion of shareholder activism.

In other jurisdictions, shareholder activism generally refers to activities undertaken by one or more shareholders of publicly traded companies with the purpose of triggering changes in the corporation's behaviour. In Colombia, however, shareholder activism has been commonly understood as the possibility for shareholders to protect and enforce their rights within the company and before courts, arbitral tribunals, and administrative authorities.

In this context, this essay will provide a brief overview of several trends and developments in the Colombian legal landscape regarding shareholders' rights and shareholder activism, as the latter is currently understood in Colombia. The focus will be on the two most often used types of Colombian companies whose equity is divided into shares of stock: (i) stock corporations (*sociedades anónimas*) (hereinafter, Corporations) and (ii) simplified stock corporations (*sociedades por acciones simplificadas*) (hereinafter, SAS).

Accordingly, this essay will:

- address the importance of protecting shareholders' rights and explain recent trends in this direction in Colombian law and practice;
- focus on managers' duties of loyalty and good faith, and on shareholders' duty to refrain from abusing their rights;
- discuss several mechanisms by which companies and shareholders can protect their rights and interests from the abuse or negligence of managers;
- examine the ways in which Colombian legislation and competent authorities are protecting shareholders from abusive capitalisations; and
- briefly explain some recent developments on, and attempted legal reforms to, managers' liability regime.

Trends: The Importance of Protecting Shareholders' Rights

In addition to the law, companies' by-laws are the most important instrument through which shareholders regulate their relations with each other, the company, and company managers. Executed and delivered by parties (shareholders) seeking to incorporate a separate legal entity, by-laws are as binding and enforceable as any other civil or commercial contract under Colombian law. Through by-laws, shareholders delegate management of the company's interests and, indirectly, of their own interests, to other shareholders or third parties.

As a rule, managers are usually better informed than shareholders to conduct the company's business. Several studies suggest that the company must be structured in such a way that managers have incentives and controls to act in the interest of the company and shareholders, rather than in their own interest. In the absence of an adequate corporate structure and incentives, managers are more likely to act for their own benefit. This is commonly referred to as the agency problem of corporate life.

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Further, Colombian companies are usually closely held companies. This means that, more often than not, majority shareholders own sufficient equity to have practical control over the company. In the past, such high ownership concentrations allowed majority shareholders to neglect the interests of the company and of minority shareholders. Among others, they were able to distribute or retain profits at will, dispose of companies' cash resources in their own interests, direct investments to prevent the company from competing with their individual interests, appoint managers and auditors, and deprive minority shareholders of their right to hold majority shareholders or managers accountable.

Today, however, both Colombian legislation and judicial/arbitral decisions, are increasingly mindful of the need to ensure that majority shareholders are able to exercise their rights in a way that makes the best interest of the company their paramount concern, while simultaneously allowing for independent controls to operate and for the protection of minority shareholders' rights. The legal doctrine of "abuse of rights" has played a key role in this evolution.

Similarly, judges, arbitral tribunals, and the Superintendence of Companies (the Colombian administrative agency overseeing corporate matters) have all contributed, to shape, develop, and strengthen the aforementioned trends through their decisions.

The following paragraphs will explore the most common conflicts affecting shareholders' rights, namely, those arising from the abuse of voting rights, breach of managers' duties, and abusive capitalisations.

Good Faith and the Abuse of Rights

In Colombia, all individuals, legal entities and authorities are expected to act in good faith. This duty is enshrined in the Political Constitution, the Civil Code, and the Code of Commerce. This good-faith principle also became a cornerstone of managers' duties in Law 222 of 1995. Accordingly, Law 222 contains practical guidelines on "conflicts of interest" for company managers. In the same vein, the prohibition to abuse of one's rights, initially enshrined in the Civil Code, was developed by Colombian courts throughout the 20th century and is currently incorporated in commercial legislation.

Law 1258 of 2008, governing SAS, set forth a specific prohibition of abuse of rights binding upon shareholders, thereby strengthening the principle of good faith. This Law gives founders of SAS ample powers to decide on the specific rules that will govern company operation and corporate governance. Further, it substantially reduces requirements and formalities to incorporate these specific companies, making them more flexible and dynamic than traditional Corporations. This high level of flexibility underscores the importance of having all shareholders act in good faith.

Rules governing SAS depart in multiple ways from rules governing the more traditional Corporations. An SAS structure is therefore better suited to companies that are not interested in seeking additional funds or liquidity through the securities market.

Law 1258 provides that shareholders who abuse their rights will be liable for any damages arising therefrom. In turn, the Colombian Code of General Procedure (*Código General del Proceso*) allows judges, arbitrators, and the Superintendence of Companies to annul decisions of the general shareholders' meeting that derive from votes cast as a result of abuse of rights. The so-called "abuse of parity" is also forbidden. These fairly recent legal provisions have allowed judges, arbitrators, and the Superintendence of

Companies to apply the abuse of rights' prohibition effectively to all types of companies.

Likewise, this law firm has witnessed the way in which several arbitral tribunals have protected minority shareholders' rights. One of the most relevant awards dates from 2017, when, at this firm's request, the tribunal found that the majority shareholder, in his dual capacity as company manager, competed against the Corporation. In so doing, the manager incurred a conflict of interests and caused a significant loss of profits. Consequently, the tribunal ordered the manager to indemnify the client for the share of the Corporation's profits she would have obtained had the manager not breached his obligation to refrain from competing with the company.

In another landmark case dating from 2018, an arbitral tribunal, at this firm's request, annulled a transfer of shares obtained by a majority shareholder, acting as a manager, from one of the heirs of a deceased shareholder. The manager disguised an actual acquisition of shares as an assignment of "inheritance rights". His frustrated manoeuvre was intended to circumvent his obligation as a manager to obtain prior authorisation from the general shareholders' meeting to buy shares. Moreover, it sought to prevent other shareholders from exercising their pre-emptive right (also known as right of first refusal) to acquire those shares.

In addition, the Superintendence of Companies has also ruled on these matters of good faith, conflicts of interest, and abuse of rights, thus enforcing a trend towards a more effective protection of minority shareholders' rights.

Managers' Duties and Derivative Actions

As previously explained, Law 222 of 1995 provided that company managers would be bound by the duties of good faith and loyalty. It also set forth a duty of care, according to which managers must behave with the diligence of good businessmen and women. Above all, it provided that managers must act in the interest of the company.

Accordingly, one of the most important duties of managers is to refrain from acting in situations in which they might be involved in a "conflict of interests" or in "competition" with the company. In such cases, managers must disclose all relevant information to the general shareholders' meeting and seek its authorisation to continue to engage in any activity or to pursue any endeavours that could involve a conflict of interests. If the manager happens to be a shareholder, his or her vote shall be excluded from the meeting that will grant or deny the authorisation. In any event, this authorisation may only be granted if the manager's purported conduct or activity does not hinder company interests.

In addition, managers' negligence (*culpa*) is presumed whenever they incur in ultra vires conduct or breach the law or by-laws. It is also presumed when managers propose or execute a decision regarding the distribution of profits that contravenes the rules governing such distribution. To escape liability, managers must prove that they did not participate in any such breaches or ultra vires conduct, or that, despite acting with the required level of diligence, they could not avoid any such wrongful action.

Against this backdrop one must also highlight the Superintendence of Companies' and arbitral tribunals' efforts to apply foreign legal figures, such as the business judgement rule, which could clarify the scope of managers' duty of care under Colombian law (the "standard of diligence of a good businessperson"). According to this rule, when analysing managers' decisions, judges must consider party autonomy, managers' discretion, and the reasonability of those decisions in light of the information available to

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managers at the time. These factors must be assessed, even if a manager's final decision is deemed to be mistaken and its result is unwelcome.

There are two types of actions in Colombian legislation that allow plaintiffs to seek a declaration of managers' liability and obtain compensation for damages: (i) a "corporate liability suit" (*acción social de responsabilidad*) that companies can bring against managers, and (ii) an "individual liability suit", by which a shareholder may seek compensation for individual damages caused by managers (*acción individual de responsabilidad*). The company's filing of a corporate liability suit does not prevent shareholders from filing individual liability suits, and vice versa.

Through a corporate liability suit, a company may remove managers from office, obtain a declaration of liability, and seek compensation for damages. Any shareholder attending a general shareholders' meeting may propose that the company initiate this lawsuit. If the proposal is approved but the suit is not filed within three months following the meeting, any shareholder, manager, or auditor will be entitled to bring this suit on behalf of the company. In some instances, if the proposal has been approved but the suit has not been filed, harmed creditors can submit this claim. Whenever a corporate liability suit is not brought directly by the company, but rather by a third party (eg, shareholder, creditor) on behalf of the company, it will be referred to as a derivative action.

This law firm obtained an award in which the arbitral tribunal ruled that a manager who was also a shareholder was not entitled to vote in the general shareholders' meeting in which the filing of a corporate liability suit against him was being discussed.

Through an individual suit, however, any shareholder may seek a declaration of liability against managers and compensation for damages inflicted upon the shareholder. Individual damages to the shareholder must be proven. In addition, any such damages must be separate and distinct from the damages suffered by the company itself. Thus, an individual liability suit may not be brought in the interest, or for the benefit, of the company. Instead, the purpose of this action is to obtain specific compensation for the shareholder-plaintiff, which may be calculated in an amount equal to the shareholder's portion of the company's value or profits if damages had not been inflicted.

The Rights of Shareholders to Earn Monetary Profits: Abusive Capitalisations

As is well known, the right to share in the company's profits, should these exist, is among shareholders' most important economic rights. As a rule, dividends must be paid in cash. However, relying on an unclear exception in Colombian law, majority shareholders have sometimes prevented or limited distribution of profits, hindering the interests of minority shareholders. A common practice to this effect has been the use of so-called "abusive capitalisations", whereby shareholders are asked to choose between receiving their cash dividends or receiving the same amount in additional shares of the company at their nominal value. Shareholders who take their dividends in cash see their voting rights diluted from that day on.

In this context, in an arbitral award issued in 2016 in favour of the firm's clients, the tribunal reminded the parties that the general shareholders' meeting of a Corporation had ample discretion to decide whether dividends would be distributed, and to specify the amounts, date, and manner in which these would be paid. However, it explained that the general shareholders' meeting may not distribute less than 50% of the

Corporation's net profits, unless 78% or more of the shares represented at the meeting vote otherwise. If the general shareholders' meeting does not specify how such dividends will be paid, they must be paid in cash. If it does not specify when they will be paid, they must be paid immediately.

At that time, the tribunal reminded the parties that the decision itself to allow distribution of dividends in shares is initially subject to the 78% majority previously described. However, it also explained that, unless this majority exceeds 80% of the shares attending the meeting, it will not be up to each shareholder to receive dividends in cash or in shares. Thus, if this 80% majority is not achieved, all dividends must be paid in cash.

These decisions effectively protect minority shareholders from the abusive capitalisation of dividends. This way, Colombian legislation has sought to protect the right of shareholders to receive dividends promptly and in cash. Retention of profits is allowed, as is the payment of dividends in shares, but only when a substantial plurality of shareholders agrees to it.

Developments

Reform initiatives on general corporate matters and managers' liability

Following the COVID-19 pandemic, certain initiatives and reforms have focused on rules governing virtual meetings, with a view to ensuring transparency and effective shareholder participation. Prominent recent examples include (i) Decree 398 of 2020, which clarified a longstanding provision on the requisite quorums for virtual meetings, and (ii) a non-binding Guide on Best Practices for Virtual Shareholders' Meetings of Publicly Traded Companies issued by the Superintendence of Finance in February 2021.

However, despite legal advances on virtual meetings and the protection of shareholders' rights, other corporate matters are still subject to significant improvement. For example, rules governing the incorporation and operation of most company types (eg, Corporations and other partnerships) are still quite rigid. Ideally, many of the simpler rules and procedures governing SAS should be extended to these other companies.

Accordingly, there has been a persistent interest in Congress to approve a comprehensive reform of corporate matters, including rules on company establishment and amendments to by-laws. There is also a growing interest in enacting legislation that explicitly extends the application of certain SAS-specific protections to other company types (such as those dealing with abuse of rights, piercing of the corporate veil, and annulment of share transfers in breach of a company's by-laws).

Likewise, several legislative initiatives have touched upon managers' duties and their liability regime. Some have sought to incorporate the common law-inspired "business judgement rule" into Colombian laws, and to repeal current legal provisions according to which a manager's negligence is presumed when acting ultra vires or against the law or by-laws. Other initiatives have advocated for the establishment of contractual limits to managers' liability, with a view to protecting them from excessive claims by shareholders or third parties. To this end, certain proposals have focused on allowing a company's by-laws to cap the amounts for which managers can be held liable, and to limit their liability towards shareholders to the events in which bad faith or breach of the duty of loyalty is proven.

There have been other initiatives to establish a standalone derivative action for any shareholder to seek, on behalf of the company, a declaration of liability for managers' breach of duties and compensation for damages. Unlike the existing corporate liability suit, these initiatives advance the view that a shareholder's right of action should not be subject to any voting mechanism within the general shareholders' meeting or to the company's prior exercise of its own right of action.

Corporate matters in arbitration

In Colombia, there is a view that relies on the legal doctrine of separability – which states that arbitration agreements are entirely separate from the underlying contract in which they are found – to conclude that the arbitration agreement contained in a company's by-laws may not be enforced against shareholders who, like the heirs of a deceased founding partner, did not join the company at its incorporation. This opinion is highly controversial, and many lawyers and judges affirm that the arbitration agreement binds all shareholders, regardless of when or how they joined the company. This second interpretation is the preferred option.

Since the Colombian Arbitration Statute (Law 1563 of 2012) does not shed light on this issue, there is currently a section in a bill recently filed in Congress by the Ministry of Justice that addresses this matter. This initiative states that, if the arbitration agreement is included in a company's by-laws, it is enforceable against all shareholders, including those who joined the company after the initial execution of those by-laws.

Implementing OECD recommendations

Colombia is the 37th country in the world to have adhered to the Convention on the Organisation for Economic Co-operation and Development (OECD). To be admitted, the country had to implement the recommendations issued by each of the 23 OECD committees, including the Corporate Governance Committee. It did so by means of several changes in legislation and regulations. Among others, in 2014, the Colombian Superintendence of Finance (*Superintendencia Financiera de Colombia*) updated its Code of Best Corporate Practices, or "Country Code" (*Codigo País*), which had been initially issued in 2007. The Development Bank of Latin America (*Banco de Desarrollo de América Latina* – CAF) and other members of the corporate and business sector in Colombia also participated in this initiative.

This comprehensive overhaul of the Country Code considered the evolving nature of corporate governance standards and the specific recommendations made by OECD committees. While its provisions were specifically designed for publicly traded Corporations (regardless of their size and percentage of public equity), this does not prevent closed companies from taking advantage of the Country Code's guidelines to strengthen their governance systems. Ultimately, the Country Code's main goal is to build a solid culture of corporate governance in Colombia.

It must be noted, however, that in 2009 the Superintendence of Companies also issued a Guide on Corporate Governance for Closed and Family Companies, the provisions of which may be better suited for many companies that still dominate the Colombian corporate landscape.

Nevertheless, and although the Country Code is not legally binding, it has become an important reference for the implementation of the best corporate practices in Colombia. Every year, publicly traded Corporations are required to report to the Superintendence of Finance the extent to which they have complied with the Country Code's provisions, and the manner in which those provisions have been implemented. In doing so, Corporations must also explain the reasons why they have departed from any specific provisions of the Country Code.

Specifically with respect to shareholders' rights, the Country Code contains several guidelines to ensure that companies give equal treatment to similarly situated shareholders (eg, shareholders holding the same type or percentage of shares). It also provides that companies may not grant access to privileged information to certain shareholders above others. It further requires that boards of directors approve actual procedures to determine the methods of communication with different types of shareholders, as well as with the public, whenever necessary (including by electronic means).

Additional provisions refer, among others, to shareholders' rights to approve the compensation schemes of directors, as well as certain operations involving strategic company assets. The Country Code also suggests larger notice periods to summon ordinary shareholders' meetings and ensure shareholders exercise their inspection rights.

In addition, the Country Code protects minority shareholders from abusive equity dilution. To this end, it provides that whenever transactions that may cause the dilution of equity must be approved, they should be explained to minority shareholders in detail through a prior report from the board of directors.

Conclusions

As previously explained, shareholder activism in Colombia has been generally understood as the possibility for shareholders to protect and enforce their rights before judges, arbitrators, and public authorities.

Thus, especially in the last 30 years, Colombia has taken important steps to empower shareholders and ensure respect for their rights. However, there is still significant room for improvement, as evidenced by multiple attempts to approve comprehensive reforms on corporate matters and managers' liability.

While future developments must continue to adapt to the changing needs of companies in the ongoing pandemic, the current legal framework ensures a solid protection of shareholders' rights and good corporate governance standards.

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Palacios Lleras is a boutique firm with over 35 years' experience, which advises and represents State entities and private parties throughout Colombia, and corporate clients in Latin America, the US, and Europe. Based in Bogotá, its small but expert team of lawyers – most of whom hold LLM degrees from world-class universities – combines decades of experience in litigation, arbitration, and legal advice. The firm is recognised for its business, constitutional, and administrative law practices, with cases and transactions that span multiple industry sectors (eg, mining, energy, finance, public utilities, infrastructure, and insurance). Palacios Lleras advises clients in the corporate structures that best fit their business models, and in the drafting of by-laws and shareholders' agreements that minimise risks of conflict. It frequently provides legal opinions on corporate matters and represents clients in judicial, arbitral, and administrative proceedings dealing with managers' liability and shareholder disputes (eg, abusive capitalisations, minority-shareholders' rights, and company control).

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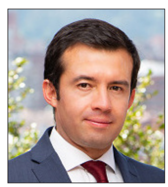

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