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Latin America Strategy

Argentina: Protecting Minority Shareholders

In this report, we analyze the Argentine capital markets reform, which was decreed into law and became effective on 1 June 2001. The new Law improves corporate governance and increases transparency, favoring the development of the Argentine capital market. Some issues include:

Tender Offers: The Law imposes mandatory tender offers for the acquisition of control once 35% has been acquired.

Residual Shareholdings and De-Listings: Minority shareholders can force controlling shareholders who own 95% or more of the company to acquire the residual shares at a 'fair price' (see Table 1).

Establishing a 'Fair Price' for De-Listings: The tender price for de-listing may not be lower than the average market price of the last six months and a predetermined technique for establishing the tender price must be used and approved by the CNV (National Securities Commission).

Share Exchange Offers: The CNV must regulate on the issue within 180 business days from the enactment of the Law.

Audit Committee: Public companies are now required to have an Audit Committee, with at least three members and an independent majority.

Arbitration Courts: Arbitration Courts for the resolution of conflicts become mandatory for issuers and optional for investors.

Shareholders Rights: The Law protects minorities by facilitating their participation in shareholders meetings, easing their access to information for these meetings and extending the array of topics treated.

Table 1: Argentine Companies With Residual Float of Less Than 5%

Company	Sector	DB Rec	Price US\$ 6/27/01	Free Float %	Mkt Cap US\$m
Astra	Oil&Gas	No Rec	NA	0.7	NA
YPF	Oil&Gas	No Rec	24.50	0.6	9,244
Banco Galicia	Banks	No Rec	2.95	1.1	1,383
Banco Rio	Banks	No Rec	4.25	1.2	1,474
Pecom Energy (former Perez Companc)	Oil&Gas	No Rec	3.50	1.8	2,728
Telefonica Argentina	Telecom	No Rec	18.61	2.0	3,854
Massalin Particulares	Tobacco	No Rec	8.00	< 5.0	650

Source: Deutsche Banc Alex. Brown estimates and company information

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Contents

Argentina: Protecting Minority Shareholders	3
Mandatory Tender Offers	4
Residual Shareholdings and De-Listings.....	5
Establishing a 'Fair Price' for De-listings	5
Share Exchange Offers	6
Audit Committee	6
Mandatory Arbitration for Issuers and Optional Arbitration for Investors...	7
Enforcement of Book Entry Securities Rights	7
Shareholders' Rights.....	7
Enhancing Adjustments to Corporate Capital Structure.....	8
Major Regulations on Transparency.....	9
Defining New Forms of Prohibited Practices That Contravene Transparency	10
Powers of the CNV	10



Argentina: Protecting Minority Shareholders

In this report, we analyze the capital markets reform passed into law by decree on 23 May 2001, becoming effective on 1 June 2001. The capital markets or 'Transparency Law', as it has come to be known, was adopted thanks to the special powers granted by Congress to the Executive Branch, which empower it to enact legislation aimed at improving the competitiveness of the Argentine economy. In our view, the new law establishes better corporate governance practices, and increases transparency, favoring the development of the Argentine capital market.

Argentina, Chile, Mexico and Brazil are acting to improve corporate governance

The Argentine government's efforts to improve Corporate Governance are in line with recent legislation in other Latin American countries. Among the recent initiatives worth mentioning are the 2001 Capital Markets Reform in Mexico, the 2000 new Chilean 'OPA' law (dealing with tender offers), the Brazilian Corporate Law reform currently in Congress, and the 2001 Bovespa's 'Novo Mercado' initiative to classify companies according to their corporate governance practices.

The main objectives of the Argentine Transparency Law include:

- Adapt basic capital markets concepts to international practices
- Increase transparency of tender offers
- Incorporate modern management tools for listed companies
- Guarantee equal treatment for minority shareholders
- Strengthen minority shareholders' rights
- Make flexible the capital structure of listed companies
- Remove potential legal uncertainties regarding capital markets transactions
- Define in order to avoid, additional forms of non-transparent practices
- Create new control tools in order to improve investor's confidence in the Argentine market

Many of the issues addressed by the new Law differ from those in either Mexico or Brazil

It is worth mentioning that in Argentina, many of the issues addressed by the Law differ from those in either Mexico or Brazil, given Argentina's different corporate legal structure and its formal Corporate Law, which already addresses some of the concerns that are present in other countries. The Argentine reform draws on experiences and legislation in the UK, Europe and the US, following the guidelines of some of the best corporate governance practice codes. Problems such as the existence of different share classes, relevant in Mexico or Brazil, are less of an issue in Argentina. Rather, investors' concerns in Argentina are concentrated on other questions, which we discuss below.

The Argentine reform increases the power of the CNV

One of the first aspects that we notice in the Argentine reform is that it increases the power of the CNV (National Securities Commission). However, the CNV has traditionally lacked the resources to operate efficiently. A decree enacted in April of this year created a specific duty, which will be added to the resources that the CNV already receives from the National Budget. This duty does not guarantee the economic independence of the CNV, as part of

its financing still comes from the National Budget. However, in terms of decision-making, the CNV is an independent institution, which reports only at the administrative level to the Economy Ministry.

Mandatory Tender Offers

A tender offer must be launched prior to the acquisition of control

The Argentine Law imposes mandatory tender offers to assure all shareholders fair and equal treatment in connection with corporate takeovers. However, an 'opting out' clause will be available for companies, through the amendment to their corporate by-laws at a shareholders' meeting. The tender offer mechanism introduced by the Law includes the following features:

- **The offer must be made prior to the acquisition of control.** This tender offer mechanism encourages the emergence of 'competitive tender offers', which may contribute to maximizing the control premium.
- **The acquisition level to trigger a tender offer is 35%.**
- **The CNV will determine whether a tender offer will be partial or total,** depending on the company's financing capacity.

Most aspects related to tender offers are treated at the level of the law, not regulations

While in the case of the Mexican reform, the regulator (CNBV) is requested to regulate on tender offers, the Argentine Law incorporates most aspects related to tender offers, leaving little room for additional regulation by the CNV. Yet, the following topics are to be further regulated by the CNV:

- **Equal treatment of shareholders** with regards to economic, financial and any other conditions arising from an acquisition
- Reasonable and sufficient **terms** to make a decision
- Provide **sufficient information** to the investor
- Information to be included in the offering's **prospectus**
- **Conditions that make an offer revocable** and the stated reasons shall be delineated in a clear and highlighted way in the prospectus
- Regulations of the **Board's** obligation to give their **opinion pertaining to the terms and conditions of the offer**
- The **system** of all possible competing offerings
- Rules regarding the **withdrawal or revision of the offer**
- Rules with respect to the **publicity of the offering**
- In the case of **share exchange offers**, rules for including the financial and accounting information of the issuer of the offered securities in the prospectus
- The **exceptions** applicable to these procedures

Residual Shareholdings and De-Listings

The new Argentine Law regulates the acquisition of residual shares. The objective is to improve the structure of companies, defend minority shareholders of companies that are no longer public and avoid the abuse of minorities.

Shareholders are granted the right to buy or be bought at a fair price

According to the Law, both controlling shareholders and minority shareholders are granted the right to buy or be bought at a 'fair price' (as determined by law). This fair price is determined in the same manner as in the case of tender offers (see section below). This has been a source of concern for investors, who fear that stocks may be de-listed at their book value.

Minorities may force tender when controlling group owns 95% or more of company

The regime is applied whenever a controlling shareholder has almost **total control, which implies ownership (directly or indirectly) of 95% or more of the company's subscribed capital. In such cases, according to the Law, controlling shareholders may acquire the remainder shares, and investors may force the controlling shareholder to acquire the remainder shares. In Table 2, we list the Argentine companies with a free float of less than 5%.** This is probably the only country in Latin America to address this issue, which is widely recognized in Europe, and is even incorporated into the guidelines of the European Economic Community.

The Law also details the following procedures:

- **Any minority shareholder may request that the controlling shareholder tender.** If after 60 days the controlling shareholder does not respond, the shareholder may request that the controlling shareholder acquire his shares at a price to be determined by the courts or arbitration.
- The controlling shareholder has six months since the date it acquires almost total control to issue an "*unilateral manifestation of consent*" to acquire the remaining shares.

Table 2: Argentine Companies With Residual Float of 5% and less

Company	Sector	DB Rec	Price US\$ 6/27/01	Free Float %	Price % Change US\$			P/E 00E	P/BV	Mkt Cap US\$m
					1 Wk	YTD	52 Wks			
Astra	Oil&Gas	No Rec	NA	0.7	NA	NA	NA	NA	NA	NA
YPF	Oil&Gas	No Rec	24.5	0.6	-3.2%	-16.8%	-35.5%	7.4	1.0	9,244
Banco Galicia	Banks	No Rec	3.0	1.1	0.0%	18.8%	-19.6%	8.2	1.0	1,383
Banco Rio	Banks	No Rec	4.3	1.2	-5.6%	1.0%	-39.5%	8.4	1.1	1,474
Pecom Energy (former Perez Companc)	Oil&Gas	No Rec	3.5	1.8	-6.7%	-6.8%	-7.9%	8.9	1.0	2,728
Telefonica Argentina	Telecom	No Rec	18.6	2.0	-0.1%	-35.7%	-43.4%	10.1	1.4	3,854
Massalin Particulares	Tobacco	No Rec	8.0	Less than 5	0.0%	29.3%	14.3%	8.5	NA	650

Source: Bloomberg, Deutsche Banc Alex. Brown estimates and company information

Note: Massalin Particulares is completing a tender offer by the end of June for the 5% float remaining

Establishing a 'Fair Price' for De-listings

The new Law addresses the establishment of a 'fair price' for de-listings. This has been a recurring problem in the past when the only requirement was that

the price paid could not be lower than the P/BV. According to the new law, the controlling group must justify the 'fair price' to the CNV by using one or more of the following criteria:

- Special de-listing balance sheet
- Company's value according to discounted cash flows
- Company's liquidation value
- Average price of the security from the previous quarter
- Price offered in prior tender offers.

The minimum price cannot be lower than the average market price of the last six months

In all cases, the minimum price may not be lower than the average market price of the last six months. The CNV may veto the price, and must control the process by which it is determined (opinion of independent experts, opinion of independent board members, etc.).

Share Exchange Offers

The CNV will regulate share exchange offers

The CNV has to regulate share exchange offers within 180 business days from the date the Law became effective. It is unclear whether the CNV will have the capacity to block an operation, as the regulations are still being processed, although the new Law allows the CNV to veto the price if it is considered unfair.

Audit Committee

Audit committees need a minimum of 3 members and a majority of independent members

The Law mandates the creation of an audit committee for any publicly traded company. The CNV will implement and enforce the regulations concerning the audit committees within three years, and will set out the timelines for companies to adhere to such regulations. The committee must be formed by at least three members, the majority of which must be qualified as 'independent directors' according to criteria defined by the CNV. The audit committee will have the following rights and duties:

- Give an opinion about the **selection of external auditors**
- Give an opinion in cases of **conflicts of interest**
- Give an opinion about **underwriting fees and expenses**
- Give an opinion about **operations with related parties**
- Evaluate the company's **risk management**
- Supervise the **internal control system** and the administrative-accounting system relative to the **company's public information**
- Verify the compliance of **conduct rules**, in case they exist



Mandatory Arbitration for Issuers and Optional Arbitration for Investors

Creation of Arbitration Courts for the resolution of conflicts

As in other Latin American countries, the question of enforcement is a major source of concern for investors in Argentina. The Law addresses this problem by imposing the installation of Arbitration Courts for the resolution of conflicts. These courts are mandatory in the case of issuers, but optional in the case of investors. We were told that the Arbitration Court of the Exchange, which is currently not mandatory, has earned a positive reputation among investors and issuers. Therefore, it is highly probable that the existing Arbitration Court will be the one that will be used.

Enforcement of Book Entry Securities Rights

The Law allows legal actions to be brought in recognition of global certificates as valid, legal documents. The holder of a security may request an account balance certificate. This certificate allows the holder to file legal claims or file arbitration proceedings, including summary proceedings. The Law also allows the holder of an account balance certificate to submit credit verification applications and/or participate in universal actions, in which case, the certificate will satisfy any shareholder authentication requirement. As a result, trustees will be able to represent any holders who do not wish to exercise the rights individually.

Shareholders' Rights

The new law increases protection of minority shareholders

In order to protect minority shareholders, the new Law facilitates the participation of minorities in shareholders meetings, their access to information, and extends the array of topics treated at shareholders' meetings, giving more power to minorities. Some of the major issues include:

Meetings without member attendance: Shareholders' meetings may take place without the physical presence of its members, whenever it is stipulated by the corporate by-laws. This directive recognizes a favorably accepted practice in Board of Directors meetings, extending it to the case of shareholders' meetings, in order to facilitate voting, especially for international shareholders.

Exercise of voting rights in favor of third parties by custodian banks and other entities: The CNV may regulate on voting rights in order to protect shareholders. This intends to solve the current problem of divergent votes of custodian banks that act on behalf of shareholders (ADRs).

Facilitating the participation of minority shareholders in Shareholders' Meetings: The public solicitation of proxies is regulated in order to motivate the active participation of minority shareholders, allowing them to present their proposals at Shareholders' Meetings. According to the new Law, those shareholders who represent 2% of the company's capital and who have been shareholders for at least one year may require the public granting of proxies in their favor and elevate proposals to the Shareholders' Meeting.

Terms for summoning Shareholders' Meetings: The new Law establishes a minimum of 20 days and a maximum of 45 days to summon shareholders meetings (previously, it was 10 and 30 days, respectively). This extension allows shareholders to study in greater detail the topics to be treated at the meeting.

Derivative Action: The new Law allows investors to initiate shareholders' derivative suits for pecuniary damages indirectly suffered, creates liability for malfeasance on the part of the issuers and promotes proper professional decision-making.

Treatment of special topics at Shareholders' Meetings: Operations that involve the partial or total disposal of the company's assets, or administration or management contracts paid with the company's revenues or profits must be approved at General Shareholders' meetings.

Contracts with related parties: Operations with related parties that involve relevant amounts (1% of shareholders' equity or P\$100,000) must have an opinion from the audit committee and/or independent appraisers. However, in the absence of proper market conditions, these operations must be approved at the Shareholders' Meeting, with the abstention of the related party involved.

Right to appoint an external auditor: Shareholders that represent at least 5% of the company's capital may request an external audit of the company. The CNV, after obtaining the opinion of the supervisory council and audit committee of the company, may order the company to appoint an external audit.

Enhancing Adjustments to Corporate Capital Structure

Argentina incorporated in its Law a number of modern market tools, aimed at enhancing flexibility to adjustments in the corporate capital structure. Some of the major tools include:

Green-Shoe: The new Law introduces the concept of Green-Shoe in order to make the regime more flexible for capital subscription. Whenever a Shareholders' Meeting approves a capital increase, it can delegate on the Board of Directors the decision to increase the size of the issue within a limit established by the CNV, if there is excess demand for the stock in the market.

Stock Options: The new Law allows companies to issue options, whenever it is stipulated by the corporate by-laws. The Board of Directors will determine the conditions of the issue.

Share Buy-Backs: Share buy-backs are permitted according to the new Law. The maximum limit is established at 10% of the company's capital stock and the shares must be disposed of no later than three years after they are purchased.



Major Regulations on Transparency

Most of the CNV rules on transparency are given the force of Law

Chapters II, III and IV of the Law include reforms that are aimed at improving transparency. Previous CNV regulations are now given the force of law. Most of the rules on transparency, which already existed as CNV regulations, are given legal status, adding new information and responsibility requirements.

Providing Information to the CNV: All existent CNV regulations on information disclosure receive legal status. Important additions include:

- Companies must designate a person responsible for providing information to the market in order to satisfy investors' needs (an 'investor relations' person).
- Companies must inform the CNV about 'shareholders agreements' whenever these are relevant to investors.

Inside Information: The new Law explicitly instructs that inside information must be kept in reserve, and defines the extent to which this must be done.

Negotiation Systems: The Law establishes that negotiation systems shall be directed by principles such as investors' protection, equity treatment, efficiency, transparency, no segmentation of the market and systemic risk reduction. Accordingly, self-regulated entities must issue regulations furthering these principles, to be approved by the CNV.

Greater transparency of external auditors: The new Law promotes the independence of external auditors and establishes as a requirement for their designation by the General Shareholders' Meeting, the prior opinion of the Audit Committee.

Limitations and sanctions to participants in the placement of marketable securities: The CNV will regulate those persons who participate in the placement of marketable securities in order to avoid artificial pricing or manipulation practices.

Market stabilization tools: Market stabilization is allowed according to regulations to be enacted by the CNV.

Greater transparency in the marketing of operations: Regulations already issued by the CNV on the following matters are given the power of the law:

- Obligation of proving to the public all information about an issue
- Penalties for the distribution of false information

Greater information requirements for financial statements and annual reports: The new Law adds the following requirements for issuers:

- The Notes to the Financial Statements must include information about stock or convertible marketable securities issued or pending issuance; agreements that commit assets and information about risk hedging policies (derivatives).

- The annual report must include the issuer's commercial policy, internal control and decision-making system (corporate governance), dividends and board of directors and management compensation policies

Defining New Forms of Prohibited Practices That Contravene Transparency

The new Law explicitly prohibits: insiders trading, short-swing profits and market manipulation

The Transparency Law proscribes certain practices that are deemed to be in contravention of corporate transparency principles. In addition, CNV is empowered to rule over the acts of those participating in underwriting processes in order to avoid the artificial determination of prices or manipulation practices. Related to this is a main innovation of the law that establishes a new regime of liability for the information presented in the prospectus. The new Law explicitly defines and prohibits new forms of non-transparent practices, such as:

Inside information and insiders trading: All regulations related to the use of inside information are elevated to legal status, increasing the spectrum of persons who are required to maintain inside information in reserve.

Short-swing profits: The new Law stipulates that companies have the right to recover within a period of six months any profits obtained by management from the purchase or sale of stock using inside information. If the companies do not initiate actions against management within 60 days, any shareholder is allowed to do so.

Market manipulation: This is explicitly established as a fraudulent activity.

Entities acting without authorization by the CNV: The Law penalizes those entities participating in the public offering with no authorization by the CNV and/or the self-regulated entity.

Responsibility regarding the information contained in prospectuses: Companies and brokers are responsible for erroneous information contained in prospectuses, thus forcing them to diligently review this information.

Powers of the CNV

The CNV may supervise the securities markets and regulate on sanctions and fines

The Law grants new tools to the CNV to better supervise the securities markets, and allows it to regulate on sanctions and fines. Some specific issues include:

- Duty to disclose information to the CNV in an investigation process
- Power to supervise control procedures and systems established by self-regulated entities for persons under their control
- Power to declare acts irregular or void
- Powers to the CNV to preventively suspend the public offering or the negotiation of securities

- Power to rule and assess penalties established with grounded resolution. However, this power is limited in a manner that prescribes a right of defense to the alleged offender and alternative legal recourse.
- Power to rule on distinct levels of information disclosure
- Allows and facilitates the exchange of information between the CNV and the Financial Information Unit.
- Allows financing of legal expenses of CNV's Staff
- Clarifies the scope of the fees collected by the CNV

Notes

Notes

Regularly Published Latin America Strategy Reports

Weekly	Weekly Fund Flow Monitor
Weekly	Money Flow Stocks of the Week
Weekly	Weekly Stock Screen
Monthly	Monthly Fund Allocation Monitor
Quarterly	Quarterly Earnings Surprises
Quarterly	Regional Fair Value and Country-Sector Analysis

Recently Published Latin America Strategy Reports

		<u>Micro</u>	<u>Macro</u>	
28-June-01	Latin America Strategy Weekly Stock Screen		X	Renato Grandmont
28-June-01	Latin America Strategy Brazil: Welcoming Bovespa's First Level I Companies		X	Renato Grandmont
11-Jun-01	Latin America Strategy Brazil Earnings Surprises: Very Disappointing 1Q01	X		Renato Grandmont
11-Jun-01	Latin America Strategy Money Flow Stocks Of The Week	X		Renato Grandmont
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1-Jun-01	Latin America Strategy — Monthly Fund Allocation Monitor Cash is King As No Region Is Overweight		X	Renato Grandmont
29-May-01	Latin America Strategy Money Flow Stocks Of The Week	X		Renato Grandmont
25-May-01	Latin America Strategy — Weekly Fund Flow Monitor Latin Investors Sell Into The Rally		X	Renato Grandmont
24-May-01	Latin America Strategy Further Demystifying The MSCI Indices	X		Renato Grandmont
23-May-01	Latin America Strategy Mexico 1Q01 Earnings Surprises: Underperforming Expectations	X		Renato Grandmont
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