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## Politics in the Origins: The Making of Corporate Law in Nineteenth-Century Brazil†

*The growing recognition of the role of law in financial and economic development has generated significant disagreement about what determines the structure and content of legal institutions in the first place. Legal traditions and local politics have emerged in the literature as the most likely sources of legal development, but the relationship between these two forces remains largely unexplored. This Article investigates the determinants of legal evolution by examining the development of corporate laws in Brazil since the early nineteenth century. Contrary to standard views, foreign commercial law models were neither forcefully imposed by Portuguese colonizers nor followed automatically due to language or cultural affinity with the French legal tradition. Brazilian lawmakers deliberately picked and chose among the laws of different civil and common law jurisdictions, and substantially altered their essence in order to best fit the interests of incumbent elites. Politics mattered from the outset, while legal family considerations were not a significant constraint to early transplant decisions. This Article also suggests that selective legal transplants and local adaptations were one of the channels through which elites periodically recreated inefficient institutions over time.*

### I. INTRODUCTION

There is a growing consensus among economists that financial development matters for economic growth and that law, in turn, matters for financial development.<sup>1</sup> As economists have increasingly

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1. See, e.g., for studies suggesting a causal relationship between financial and economic development, Robert G. King & Ross Levine, *Finance and Growth: Schumpeter Might Be Right*, 108 QUART. J. ECON. 717 (1993); Ross Levine & Sara

come to recognize that markets are not natural entities that always function well independently of legal and social institutions, the question of what determines the structure of legal institutions in the first place did not take long to surface. This inquiry into the sources of legal evolution is of course not new among legal scholars. Comparative lawyers, in particular, had a simple and ready answer; they had long acknowledged that “societies largely invent their constitutions, their political and administrative systems, even in these days their economies, but their private law is nearly always taken from others.”<sup>2</sup>

Since Alan Watson published his seminal book declaring “legal transplants” as “the most fertile source of [legal] development,” both the term and the underlying concept have played a central role in comparative law scholarship.<sup>3</sup> But even as the success, failure, and mutation of foreign models have attracted significant scholarly attention, comparatists have largely overlooked the decision-making process leading to the adoption of legal transplants.<sup>4</sup> The very author who turned legal transplants into a central theme of comparative law scholarship had a notoriously hermetic view of the law as an autonomous system which is a product of “purely legal history,” rather than a result of social, political, and economic considerations.<sup>5</sup>

These basic lessons of comparative law scholarship attracted the attention of economists Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, who broke new ground by undertaking to measure the causal effects of investor and creditor rights on financial development—a longstanding assumption which, however, lacked empirical verification.<sup>6</sup> Their pioneering article begins by cit-

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Zervos, *Stock Markets, Banks, and Economic Growth*, 88 AM. ECON. REV. 537 (1998); Raghuram G. Rajan & Luigi Zingales, *Financial Dependence and Growth*, 88 AM. ECON. REV. 559 (1998). See also, for a review of the relationship between law and economic development, Kevin E. Davis & Michael J. Trebilcock, *The Relationship between Law and Development: Optimists versus Skeptics*, 56 AM. J. COMP. L. 895, 945 (2008) (concluding that the empirical evidence generally supports the strong consensus that law matters for economic development, but precisely what types of legal institutions matter remains an open question).

2. S.F.C. MILSON, *HISTORICAL FOUNDATIONS OF THE COMMON LAW* ix (1969).

3. ALAN WATSON, *LEGAL TRANSPLANTS* 95 (1974). The concept of legal transplants is, of course, much older. The very term was used repeatedly by Brazilian lawmakers in nineteenth-century legislative debates. See *infra* note 222 and accompanying text.

4. In the few existing narratives about the background of legal transplants, the story often goes that public-spirited reformers sought to modernize the law of a backward society by importing “the best possible law” then governing a more developed nation. *Id.* at 92 (noting that law reform processes reflect “a conscious attempt to achieve the best possible rule”).

5. ALAN WATSON, *THE MAKING OF THE CIVIL LAW* 38 (1981). See also William Ewald, *Comparative Jurisprudence (II): The Logic of Legal Transplants*, 43 AM. J. COMP. L. 489 (1995) (evaluating Watson’s theory of legal transplants and evolution).

6. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998) [hereinafter La Porta et al.].

ing Alan Watson and taking as its starting point “the recognition that laws in different countries are not written from scratch, but rather transplanted.”<sup>7</sup> La Porta et al. then resort to another longstanding tenet of comparative lawyers—the notion that “*commercial laws* come from two broad traditions—common law, which is English in origin, and civil law, which derives from Roman law.”<sup>8</sup>

In their attempt to draw causal inferences from observational data, La Porta et al. took the approach of comparative law scholars one step further by rejecting the possibility of meaningful choice among different foreign regimes.<sup>9</sup> In their words, “[c]ountries typically adopted their legal systems involuntarily (through conquest or colonization), and even when they chose a legal system freely, as in the case of former Spanish colonies, the crucial consideration was language and the broad political stance of the law rather than the treatment of investor protections.”<sup>10</sup> Conveniently, La Porta et al. could then use legal origins as an instrumental variable to overcome a potential endogeneity problem, and show that investor protection laws cause financial development, and not the other way around.<sup>11</sup> Specifically, these authors famously and controversially argued that common law countries have the highest and French-derived civil law countries the lowest levels of investor protection and financial development, with countries of the Scandinavian and German legal families falling in between.<sup>12</sup> Subsequent studies have expanded the

7. *Id.* at 115.

8. *Id.* La Porta et al.’s reliance on legal families is based on a steady stream of works within the comparative law literature. As James Whitman put it, they “cannot be blamed for believing what they read.” James A. Whitman, *Consumerism Versus Producerism: A Study in Comparative Law*, 117 *YALE L. J.* 340 (2007).

9. Comparatists generally use the term “transplants,” an expression implying passivity on the part of the recipient country, interchangeably with “borrowing,” a verb denoting an active stance on the part of the importing jurisdiction. See WATSON, *supra* note 3.

10. La Porta et al., *supra* note 6, at 1126.

11. The very power of La Porta et al.’s empirical findings about the causal relationship between investor protection and financial development rests on the premise that legal origins are exogenous. Even though these authors no longer regard legal origins as a good instrument to assess the quality of different legal regimes, they still insist that legal origins are exogenous. Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 *J. ECON. LIT.* 285 (2008) (arguing that “even if instrumental variable techniques are inappropriate because legal origin influences finance through channels other than rules protecting investors, legal origins are still exogenous, and to the extent that they shape legal rules protecting investors, these rules cannot be just responding to market development”).

12. La Porta et al., *supra* note 6. Admittedly, the strength of these empirical findings has been questioned. See Holger Spamann, *The “Antidirector Rights Index” Revisited*, 23 *REV. FIN. STUD.* 467 (2009). See also Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 *J. FIN. ECON.* 430 (2008), for a revised index correcting coding errors and conceptual ambiguities present in the original works of the law-and-finance literature.

use of legal families to explain cross-country variation in labor markets regulation, entry restrictions, government ownership of banks and the media, and military conscription.<sup>13</sup>

Yet, this view of private law as a “politically neutral endowment”<sup>14</sup> is clearly at odds with both the basic intuition that modern law is the result of the will of the people (or the will of the King, or something in between), and the substantial body of literature that vindicates the role of local politics as a more powerful determinant of legal and financial development.<sup>15</sup> While some works have suggested that different legal origins might impact or constrain the operation of political forces,<sup>16</sup> both comparatists and economists are largely silent on the influence of local politics on legal transplants. However, just as the existing scholarship on legal transplants downplays the role of politics, existing works on the political economy of corporate governance all but ignore transplants as a source of legal development.<sup>17</sup>

In addressing the complexity of a single case not visible at a stratospheric level of generality, this study will begin to explore the “black box” of foreign model selection in finance. The apparent disconnect between legal origins and politics is at least partially attributable to the too narrow focus and high level of generality at which most of the existing literature operates. Both the law-and-finance literature and its competitors consist primarily of broad cross-country comparisons. Case studies are the exception, and even

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13. See La Porta et al., *supra* note 11 (for a review of the contributions of what they call the “Legal Origins Theory”). But see Holger Spamann, *Contemporary Legal Transplants: Legal Families and the Diffusion of (Corporate) Law*, 2009 B.Y.U. L. REV. 1813, 1813 (arguing that the correlations between legal families and regulatory outcomes are “the result of separate diffusion processes rather than of intrinsic differences between common and civil law”).

14. The expression comes from CURTIS J. MILHAUPT & KATHARINA PISTOR, *LAW AND CAPITALISM* 22 (2008).

15. See, e.g., Mark J. Roe, *Political Preconditions from Separating Ownership from Control*, 53 STAN. L. REV. 539 (2000); Marco Pagano & Paolo F. Volpin, *The Political Economy of Corporate Governance*, 85 AM. ECON. REV. 1005 (2005); Raghuram Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 J. FIN. ECON. 5 (2003); Marco Pagano & Paolo F. Volpin, *Shareholder Protection, Stock Market Development, and Politics*, 4 J. EUR. ECON. ASSOC. 315 (2006); Enrico C. Perotti & Ernst-Ludwig Von Thadden, *The Political Economy of Corporate Control and Labor Rents*, 114 J. POL. ECON. 145 (2006); Mark J. Roe, *Legal Origins, Politics and Modern Stock Markets*, 120 HARV. L. REV. 460 (2006).

16. Rajan & Zingales, *supra* note 15, at 43 (suggesting that civil law jurisdictions may be more susceptible to the influence of interest groups); John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L. J. 1, 65 (2001) (positing that the common law is more welcoming to private law-making than the civil law).

17. The view of the law as a-political stands in sharp conflict with another key proposition of the law-and-finance literature, which attributes the differences between common and civil law to the varying political conditions and degrees of centralization of power in England and France in the Middle Ages. See Andrei Shleifer & Edward Glaeser, *Legal Origins*, 117 QUART. J. ECON. 1193 (2002). See also MILHAUPT & PISTOR, *supra* note 14, at 22.

scarcer with respect to developing countries. Political economy works, in particular, rarely go beyond the social democracies of the “Wealthy West.”<sup>18</sup> Similarly, mainstream comparative law—an inherently superficial enterprise—has traditionally focused on a handful of “parent” jurisdictions, and provided at best a synopsis of legal developments elsewhere.<sup>19</sup> Legal scholarship around the world, still mostly doctrinal in nature, has also generally failed to fill in this gap.

This Article investigates the driving forces of legal evolution by looking at the early development of corporate laws in Brazil. Brazil presents a particularly important and understudied context, since both corporate laws and capital market development levels underwent significant changes throughout the country’s history. Brazil enacted no less than five major corporate law reforms between 1850 and 1900, and at least five more in the following century. Capital market activity also fluctuated wildly. There were very few business corporations operating in the country until the mid-nineteenth century, but by the turn of the century Brazil had already witnessed a major stock market boom and bust. Brazil faced declining capital markets and boasted one of the highest levels of private benefits of control worldwide in the 1990s,<sup>20</sup> only to become one of the most impressive instances of governance reform and rapid capital market growth in the last decade.<sup>21</sup> Unlike previous works, which focused primarily on the law-on-the-books and on corporate practice, this study also examines the debates, both in Parliament and in the Council of State (*Conselho de Estado*), preceding the adoption and the

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18. La Porta et al., *supra* note 11, at 311. For a recent exception to this trend, see Nicholas Calcina Howson & Vikramaditya S. Khanna, *The Development of Modern Corporate Governance in China and India*, in CHINA, INDIA AND THE INTERNATIONAL ECONOMIC ORDER 514 (M. Sornarajah & J. Wang eds., 2010) (for recent case studies concluding that the “politics” account best explains stock market developments over time in India and China).

19. F.H. Lawson, *The Field of Comparative Law*, 61 JURID. REV. 16, 36 (1949) (claiming that “a comparative lawyer is bound to be superficial”). See also the influential comparative law treatise of KONRAD ZWEIFERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 39 (1992). In providing guidance about the choice of which legal systems to compare, Zweigert & Kötz expressly urge comparatists to “ignore the affiliate [legal system] and concentrate on the parent system.” In this vein, they suggest that scholars interested in the Romanistic tradition focus exclusively on France and Italy, as “[t]he legal systems of Spain and Portugal (. . .) do not often call for or justify very intensive investigation.” *Id.*

20. Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 49 J. FIN. 538 (2004) (estimating that Brazil had the highest level of private benefits of control among a sample of 393 control transactions in 39 countries between 1990 and 2000).

21. For a description of recent developments in Brazil’s capital markets, see Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU*, 63 STAN. L. REV. 475 (2011) (describing the rapid development of Brazil’s capital markets since 2004).

official interpretation of commercial laws—an obvious and valuable, but so far underutilized, source for this type of analysis.<sup>22</sup>

This effort reveals that the generalizations about Brazil in the existing literature are not only superficial and imprecise, as is expected, but at times diametrically opposed to actual developments. Following the comparative law works in which its taxonomy is based, the law and finance literature classifies Brazil, like its Latin American peers, as a French-style civil-law jurisdiction<sup>23</sup>—an assumption that is taken for granted even in sophisticated case studies of Brazilian corporate history.<sup>24</sup> In their influential work on modes of legal transplantation, Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard coded Brazil as an “unreceptive” jurisdiction, meaning that the transplanted laws were unknown in the country prior to their import and were not further adapted to fit local circumstances.<sup>25</sup> As a Latin American country receiving the French legal system without an instructions manual, Brazil is expected to have misinterpreted the functioning of the French legal system as being

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22. *But see* José Reinaldo de Lima Lopes, *A Formação do Direito Comercial Brasileiro: A Criação dos Tribunais de Comércio do Império*, 6 *CADERNOS DIREITO GV* (2007) (for an excellent study of the creation of Brazil’s merchant courts relying on primary historical sources, including legislative debates); JOSÉ REINALDO DE LIMA LOPES, *O ORÁCULO DE DELFOS* (2010) (for an in-depth study of the general jurisprudence of Brazil’s Council of State). Neither of Lima Lopes’s works, however, focuses particularly on business organizations.

23. To be sure, legal scholars have appropriately noted that Brazil’s civil code was also influenced by Germany as well as other civil-law jurisdictions. *See* KENNETH W. DAM, *THE LAW-GROWTH NEXUS* 43 (2006) (citing Zweigert and Kötz for the proposition that “[i]n addition to the Code civil [of France] it [Brazil] was able to draw on the Portuguese and Italian codes, as well as those of Germany and Switzerland. The structure of the Code, especially its ‘General Part,’ is largely traceable to German influence.” Other comparativists remain confident that the classification of Latin American countries as French-civil law jurisdictions is “less problematic.” *See* Mathias M. Siems, *Legal Origins: Reconciling Law & Finance and Comparative Law*, 52 *MCGILL L.J.* 55, 69 (2007). Nevertheless, this Article argues that even these critical assessments of the law-and-finance literature have significantly underestimated the diversity of Brazil’s legal origins.

24. *See* Aldo Musacchio, *Can Civil Law Countries Get Good Institutions? Lessons from the History of Creditor Rights and Bonds Markets*, 68 *J. ECON. HIST.* 80 (2008) (justifying the choice of Brazil for a case study for “it is currently a French civil law country with a profile of inadequate creditor protection and contract enforcement”); ALDO MUSACCHIO, *EXPERIMENTS IN FINANCIAL DEMOCRACY* 2 (2009) (exploring how Brazil was able to develop fairly developed capital markets in spite of its “relatively ‘adverse’ institutional heritage,” which included the “French civil law system inherited from the Portuguese”). As we will see throughout this Article, French law was but one of the multiple influences on Brazil’s legal system, and the influence of French law on Brazilian law took place by and large after independence and was therefore not inherited from Portuguese colonizers.

25. Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *Economic Development, Legality, and the Transplant Effect*, 47 *EUR. ECON. REV.* 165 (2003) [hereinafter *Economic Development*]; Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *The Transplant Effect*, 51 *AM. J. COMP. L.* 163 (2003).

overtly rigid and formalistic,<sup>26</sup> with presumably detrimental consequences to its development.<sup>27</sup> Nevertheless, a careful examination of Brazil's legislative debates in the nineteenth century reveals that each of these assumptions is unwarranted.

I argue that the development of early corporate laws in Brazil is marked by three distinctive features: (i) politicized lawmaking, (ii) diverse origins, and (iii) selective transplants. First, in Brazil, as elsewhere, the design and enactment of early corporate laws was not only conscious, but also highly salient and politically contentious. Second, the foreign law models considered for adoption were also much more diverse than one would expect given the ingrained assumption that "Anglo-American law was totally neglected in the civil law world."<sup>28</sup> The cultivated members of the Brazilian elite who served as legislators in the nineteenth century carefully considered the content and effects of legal rules not only of civil law jurisdictions such as France, Portugal and Spain, but also of England, before enacting local laws.<sup>29</sup> In fact, English law's influence on Brazilian lawmakers arguably rivaled that of French law throughout the nineteenth century.<sup>30</sup> Third, this deliberate and complex lawmaking process gave rise to selective legal transplants from foreign jurisdictions, thus resulting in an idiosyncratic regime that, while suitable to the interests of incumbent elites, was often less conducive to financial development than that of any of the foreign models taken in isolation.

These three key features of early corporate law developments in Brazil call for a reevaluation of conventional understandings about the relevance of legal families in explaining legal evolution. The very notion that Brazil belonged to the French legal tradition, and that its legal rules were somehow bound to follow those of its parent jurisdic-

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26. John Henry Merryman, *The French Deviation*, 44 AM. J. COMP. L. 109, 116 (1996), posited that France's strong rhetoric about a judge-proof law was misunderstood in developing countries, with dire consequences to their judicial systems ("[i]n France, where everyone knows how to do what needs to be done behind the separation of powers façade, misrepresentation of the judicial function does not have severe consequences. But when the French exported their system they did not include the information that it really does not work that way, and they failed to include a blueprint of how it actually does work.")

27. Thorsten Beck, Asli Demirgüç-Kunt & Ross Levine, *Law and Finance: Why Does Legal Origin Matter?*, 31 J. COMP. ECON. 653, 655 (2003).

28. Ugo Mattei, *Why the Wind Changed: Intellectual Leadership in Western Law*, 42 AM. J. COMP. L. 195, 202 (1994) (citing the works of Joseph Story on conflicts of law as the only exception to the general neglect of Anglo-American law in civil law countries).

29. Clóvis Bevilacqua, *Evolução Jurídica do Brasil no Segundo Reinado*, 46 REVISTA FORENSE 5, 9 (1926). Bevilacqua, the draftsman of Brazil's Civil Code of 1916, noted that while in the first years of independence Portuguese law was the main source of inspiration, Brazilian lawmakers soon turned to other sources, especially France, Belgium and England.

30. This was true not only in commercial law matters, but also with respect to more general features of the legal system, such as the structure of the judiciary and the availability of remedies against State oppression. See Part VI *infra*.

tion, seems to have escaped notice by Brazilian lawmakers. Indeed, the embryonic classifications of legal systems employed by Brazilian authors in the nineteenth century recognized the patchwork nature of legal systems in Latin America and viewed them as belonging to a category separate from other Anglo-European groupings. It is anachronistic to expect this later academic label of “French civil law jurisdictions” to have had a binding effect in the evolution of early Brazilian law.

An initial puzzle stemming from the law-and-finance literature is why French law had such deleterious effects in the periphery, while France itself seems to have fared quite well. Building on the lessons of comparative law scholars, Thorsten Beck, Asli Demirgüç-Kunt and Ross Levine have advanced the French Deviation hypothesis, according to which legal practice in France did not live up to French law’s highly formalistic rhetoric, while foreign jurisdictions fully incorporated France’s purported emphasis on separation of powers.<sup>31</sup> This study supports the view that Brazilian law did indeed depart from French law in material ways, but challenges the reasons given to explain such deviation.

I argue that Brazilian elites did not misunderstand the French legal system, but rather consciously opted to depart from it (and from other foreign models) when it was in their interest to do so. For example, slaves did not even exist in the land of *égalité*, but they made it into the text of the Brazilian Commercial Code, which expressly ruled them out as a valid form of commercial collateral.<sup>32</sup> Brazilian lawmakers were well aware that the French resorted to tradable limited partnerships (*sociétés en commandite par actions*) as a surrogate for existing restrictions to incorporations, but nevertheless opted to outlaw these business entities in Brazil.<sup>33</sup> Local politics, not ignorance, explain the Brazilian deviation.

Brazil’s case also speaks to the literature addressing how the transplant process—rather than the identity of the exported legal system alone—determines legality and, consequently, economic development. Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard have posited that the manner in which the foreign law is transplanted and received is more important than the identity of its supplier in predicting the effectiveness of the resulting legal system.<sup>34</sup> They find that countries which were already familiar with foreign laws or which further adapted them to local circumstances had results superior to those which blindly copied unknown legal orders.<sup>35</sup> This line of reasoning sounds plausible, but the Brazilian case

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31. Beck et al., *supra* note 27, at 655.

32. Código Comercial Brasileiro, art. 273.

33. See Part IV *infra*.

34. Berkowitz et al., *Economic Development*, *supra* note 25.

35. *Id.*



suggests that adaptation of foreign models, without more, cannot be considered unambiguously positive. Because recipient countries are generally more unequal than exporting jurisdictions, there is in fact reason to fear that the political economy in the periphery may be less conducive to economic growth than that of parent jurisdictions.

This account of legal evolution in Brazil is consistent with the large economic literature underscoring the enduring consequences of early colonization strategies that create highly unequal social structures and entrench small elites to the detriment of the remainder of the population.<sup>36</sup> Daron Acemoglu, Simon Johnson and James A. Robinson credit economic underdevelopment to the long-lasting character of extractive institutions imposed by European settlers facing high mortality rates in a given region.<sup>37</sup> Calixto Salomão Filho attributes underdevelopment to the persistence of certain structures of concentrated economic power in ex-colonies.<sup>38</sup>

The Brazilian experience, however, suggests that the relevant variable is not whether initial colonial arrangements persist, but whether the expropriatory nature of institutions can be self-perpetuating despite apparent institutional change. Corporate laws, in particular, underwent considerable transformation over time, but such changes often reflected more the rent-seeking ambitions of the country's small elite at any point in time than social welfare considerations. I argue that selective transplantation and conscious transmutation of foreign models were in fact one of the channels through which local elites recreated socially inefficient institutions over time.

In addition to setting Brazil's record straight, these findings have potentially broader normative implications. The legal origins thesis has been widely influential in policy circles, especially in the World Bank.<sup>39</sup> However, if politics matter and certain legal origins are not better or worse, much less decisive, the ongoing fight against

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36. See, e.g., Daron Acemoglu, Simon Johnson & James A. Robinson, *The Colonial Origins of Comparative Development: An Empirical Investigation*, 91 AM. ECON. REV. 1369 (2001) [hereinafter *Colonial Origins*]; Daron Acemoglu, Simon Johnson & James A. Robinson, *Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution*, 117 QUART. J. ECON. 1231 (2002); Stanley L. Engerman & Kenneth L. Sokoloff, *Factor Endowments, Inequality, and Paths of Development Among New World Economies*, NBER Working Paper 9259 (2002); William Easterly & Ross Levine, *Tropics, Germs and Crops: How Endowments Influence Economic Development*, 50 J. MON. ECON. 3 (2003).

37. Acemoglu et al., *Colonial Origins*, supra note 36.

38. CALIXTO SALOMÃO FILHO, *HISTOIRE CRITIQUE DES MONOPOLES* (2010).

39. For critiques of the World Bank's Doing Business Reports, see Benito Aruñada, *Pitfalls to Avoid When Measuring Institutions: Is Doing Business Damaging Business?*, 35 J. COMP. ECON. 729, 734-35 (2007) (convincingly arguing that the Doing Business Reports adopt a Manichean view of economic reality by measuring only the initial costs of business formalization while ignoring its subsequent benefits); Benedicte Fauvarque-Cosson & Anne-Julie Kerhuel, *Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of*

the French civil law tradition has been wrong. In fact, overstating the importance of legal origins is not only inaccurate, but also self-defeating. Urging countries to repudiate their very “origins”—or their legal families, or traditions—is unlikely to be popular and is, in any case, ineffective. If special interest groups have successfully blocked legal reforms enabling financial and economic development, their opposition should be met head on.<sup>40</sup>

This Article now proceeds as follows. Part II investigates the sources of Brazilian commercial law from the beginning of the nineteenth century until its codification in 1850. Part III describes the driving forces behind the adoption of the Brazilian Commercial Code and the decision-making process leading to its enactment. Part IV examines how local politicians resorted to selective legal transplants and local innovations to repress corporate and bank formation in nineteenth-century Brazil. Part V explains how changes in underlying local and political conditions led to a reversal in corporate law rules and financial policies, which brought about the greatest stock market boom and bust in Brazilian history. Part VI evaluates the comparative importance of origins and politics in the making of early corporate laws in Brazil as well as the implications for the law-and-finance literature. Part VII concludes.

## II. ORIGINS OF BRAZILIAN COMMERCIAL LAW (1808-1850)

Like many other developing countries, for most of its colonial history Brazil was an agricultural and, according to some commentators, quasi-feudal society.<sup>41</sup> Brazil exported agricultural commodities produced by slave labor in local plantations to Portugal, and imported all requisite industrial goods from the metropolis. In typical colonial fashion, the establishment of local industries was expressly outlawed.<sup>42</sup>

It was not until Napoleon’s impending invasion of Portugal, and the flight of the Portuguese royal family from Lisbon to seek refuge in Rio de Janeiro in 1808, aided by the British navy, that the colonial pact effectively came to an end. In what was the first and only time in history in which a colony became the headquarters of a European royalty, legal and institutional change became a practical imperative to accommodate the needs of the thousands of members of Portugal’s

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*the Law*, 57 AM. J. COMP. L. 811 (2009) (describing the strong negative reaction to the Doing Business Reports in France).

40. For the description and analysis of “regulatory dualism” as a strategy to overcome political economy hurdles to growth-inducing legal reforms, see Gilson, Hansmann & Pargendler, *supra* note 21.

41. See, e.g., SÉRGIO BUARQUE DE HOLANDA, *RAÍZES DO BRASIL* 234 (1956).

42. Alvará (Royal Decree) (Jan. 5, 1875).

monarchy and bureaucracy that had moved to colonial Brazil.<sup>43</sup> Only eight days after arriving in Brazil, the regent prince of Portugal put an end to its previous monopoly to Brazil's international trade, hence opening Brazil's ports and permitting it to directly trade with "friendly nations"—which meant, for most practical purposes, England.<sup>44</sup> Just a few months later, Portugal abolished colonial prohibition on indigenous industries and manufactures in Brazil.<sup>45</sup> The year of 1808 also saw the creation of the very first Brazilian corporations—the first Bank of Brazil and an insurance company—by royal decree.<sup>46</sup>

Brazil's independence took place soon after the return of the Portuguese royal family to Lisbon in 1821, which ignited local fears of recolonization. In sharp contrast to its Latin American neighbors, which endured bloody independence wars, Brazil's emancipation process could hardly have occurred in a more conciliatory manner. The very prince of Portugal declared Brazil's independence and became the country's new emperor, in a move that combined the interests of the rural aristocracies and the absolutist aspirations of the prince.

Unlike other countries in Latin America, Brazil retained territorial unity and adopted a constitutional monarchy, rather than a republican government, after independence. The local elite promoting independence had no interest in changing the institutions of the colonial period.<sup>47</sup> In this vein, an 1823 statute made clear that Brazil's legal system remained otherwise entirely in place until the enactment of local legislation.<sup>48</sup>

Throughout most of the colonial period, the laws of Portugal and Brazil alike were those of the Philippine Ordinances of 1603, based on Roman and Canon law. In 1769, however, the sources of Portuguese commercial law—and, accordingly, Brazilian law—became much more diverse. In that year, Portugal, under the influence of the Enlightenment, enacted what would be later called the "Law of Good Reason" (*Lei da Boa Razão*). Among other things, it ruled out Roman law's authority as a subsidiary source of law in commercial matters.<sup>49</sup> In its place, the Law of Good Reason directed courts to apply the laws

43. Historians estimate that between 10,000 and 15,000 members of Portugal's royalty and bureaucracy immigrated to Brazil around late 1807. See BORIS FAUSTO, *HISTÓRIA CONCISA DO BRASIL* 66-67 (2d ed. 2008).

44. Alvará (Jan. 28, 1808), usually known as the royal charter for the "opening of Brazilian ports to friendly nations."

45. Alvará (Apr. 1, 1808).

46. Decreto (Feb. 24, 1808) (chartering the Companhia de Seguros Boa-Fé, an insurance company); Alvará (Oct. 12, 1808) (chartering the Banco do Brasil).

47. FAUSTO, *supra* note 43, at 79.

48. Law of October 20, 1823. The statute made clear that all Portuguese laws as of April 25, 1821, which included the Philippines Ordinances and the Law of Good Reason, would continue to apply in Brazil until the enactment of national codes.

49. Law of August 18, 1869. See José Carlos Moreira Alves, *A Panorama of Brazilian Law from its Origins to the Present*, in *A PANORAMA OF BRAZILIAN LAW* 89 (Jacob

of other “enlightened and polished Christian nations” to resolve commercial disputes in the absence of local rules. This habitual use of foreign legal sources, whether or not authoritative, to resolve domestic legal disputes would become a feature of Brazilian civil and commercial law for years to come.

The Law of Good Reason provided no guidance for judges in choosing among the different laws of “civilized” nations, therefore granting local courts significant leeway in picking their favorite solution depending on the interests at stake.<sup>50</sup> An influential commentator classified as civilized “all European nations, except for Turkey.”<sup>51</sup> Consequently, the laws of all such jurisdictions could, in principle, become immediately eligible for import.<sup>52</sup> The result is that, from the Law of Good Reason onward, foreign legal transplants in commercial law matters were not only explicitly welcome, but their sources were also multiple, as well as potentially conflicting. Whether by accident or design, the existence of a large array of foreign law menus, and the ensuing possibility of arbitrary transplant choice, would subsist as a distinctive feature of Brazilian business law for years to come.

Under the Law of Good Reason regime, Brazilian judges picked and chose among the laws of different nations as they saw fit. France and England were the most influential foreign sources,<sup>53</sup> but the laws of Spain, Portugal, and other European jurisdictions were also applied at times. Because the laws of different “cultivated” jurisdictions varied substantially, the resulting uncertainty was a key motive behind the subsequent enactment of Brazil’s Commercial Code. Legislators cited the “shocking amount of contradictory decisions” under the Law of Good Reason as “the worst evil that a nation could suffer from.”<sup>54</sup>

The notion that Brazilian jurists were inclined to resort to English as well as French law defies deep-seated assumptions of comparative lawyers, but it should not be all that surprising considering England’s economic clout in the region throughout the nineteenth century. England’s economic influence in post-independence Latin America dwarfed that of other European countries.

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Dolinger & Keith S. Rosenn eds., 1992) (attributing the enactment of the Law of Good Reason to the Enlightenment’s criticism of the excessive reliance on Roman Law).

50. JOSÉ HOMEM CORREA TELLES, *COMMENTARIO CRÍTICO À LEI DA BOA RAZÃO* (1865). Telles, an influential commentator of the statute defined civilized nations as any European country other than Turkey, and resented the potential for arbitrary court decisions. *Id.* at 64.

51. *Id.*

52. *Id.*

53. BERNARDO DE SOUZA FRANCO, *OS BANCOS DO BRASIL* 69 (2d ed. 1984) (first edition published in 1848); *Anais do Senado* [hereinafter Senate Records], speech of Ministro da Fazenda (Feb. 4, 1850), at 46.

54. Senate Records, speech of Senator Clemente Pereira (May 27, 1848), at 276.

Between 1860 and 1875, Britain accounted for more than ninety percent of investments by foreign enterprise in the region.<sup>55</sup> Historians have long argued that the main consequence of Brazil's independence was to make it a *de facto* British colony, rather than a Portuguese one—a view which was widely shared among contemporary observers.<sup>56</sup>

English predominance in Brazil, in particular, was also a function of its historically close relationship with Portugal, which afforded it preferential tariff and legal treatment. At least since the late seventeenth and early eighteenth centuries Portugal granted legal privileges to England, which included special courts conferring extraterritorial rights for its citizens in Portuguese territory—an institution that was extended to Brazilian territory in 1808. As a result of the close relationship between both countries, Portuguese law was itself heavily influenced by English law.<sup>57</sup>

English presence in Brazil increasingly became a major rival of France in terms of cultural influence.<sup>58</sup> Brazil's first economist and commercial law scholar, José da Silva Lisboa (later Viscount Cairú), was an Anglophile and a self-declared disciple of Adam Smith, although his reading of the Scottish author's lessons was tainted by his own worldview.<sup>59</sup> Brazil's first law schools, which supplied most of Brazil's politicians during the nineteenth century, provided both French and English lessons, and taught French authors together with Jeremy Bentham and John Stuart Mill.<sup>60</sup> When the sixth edition of "Brazil and the Brazilians" came to press in 1866, the growing British influence among Brazilian politicians was clear. "Formerly their political theories were greatly influenced by French writers,"

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55. See ANA CÉLIA CASTRO, *EMPRESAS ESTRANGEIRAS NO BRASIL, 1860-1913* (1979).

56. See, e.g., GILBERTO FREYRE, *INGLESES NO BRASIL* 77 (1948) (arguing that "the abolition of the apparent colonial system was no more than a mere change in the identity of the metropolis; Brazil ceased to depend on Portugal to become an English colony"). See also Senate Records, speech of Senator Vasconcellos (Jan. 18, 1850), at 249 (arguing that, following independence, "we passed a jury statute, as we understood that, from Portuguese colonies, we turned from one day to another into English ones").

57. See FRANCISCO JOSE DA ROCHA, *SOCIEDADES EM COMANDITA SEGUNDO O CODIGO COMMERCIAL DO IMPERIO DO BRAZIL* 40-42 (1884) (noting that, "in commercial matters, Portugal had become used to take as a model its best friend, England, the sovereign of the seas and commerce, as she was dubbed"). See also *infra* notes 79 and 80 and accompanying text.

58. *Id.*

59. See JOSÉ DA SILVA LISBOA (VISCONDE DE CAIRÚ), *PRINCÍPIOS DE ECONOMIA POLÍTICA* (1804) (eulogizing Adam Smith and claiming to follow its lessons, while asserting that "[t]he principle of political economy is that the nation's sovereign must consider itself as the head or chief of a vast family, and consequently support all of those in it as its children and collaborators to total happiness") (cited by Caldeira). See also JORGE CALDEIRA, *MAUÁ* 120 (30th ed. 1993), for a detailed analysis of Cairú's peculiar misinterpretation of Smith's theories.

60. FREYRE, *supra* note 56, at 63.

the authors noted, “but at the present time no foreigner so influences the minds of the younger and middle-aged Brazilian statesmen as John Stuart Mill.”<sup>61</sup>

Brazilians increasingly studied English theories and embraced their customs. In addition to adopting tea, steak and potatoes, and water closets, a few Brazilians also emulated English business practices with considerable success.<sup>62</sup> Historians attribute much of the success of Brazil’s legendary entrepreneur, Irineu Evangelista da Silva (later Baron and Count Mauá)—a self-made businessman who at some point controlled seventeen firms and had amassed one of the greatest fortunes of the nineteenth century—to his experience as an apprentice in British firms from a very tender age. Mauá himself was astounded by the major differences between the Brazilian and the British impersonal way of doing business, and profited handsomely in following the latter.<sup>63</sup>

Britain was by no means indifferent to the propagation of political and economic ideas to Brazil. Free trade ideals, including the Law of Comparative Advantage,<sup>64</sup> were an integral part of its strategy to ensure captive demand and avoid future competition for industrialized products by convincing peripheral countries that commodity export was their “natural” vocation. Still, English influence on Brazilian law was arguably more a product of voluntary imitation than of external imposition. The Brazilian elite seemed eager, at least in principle, to emulate the nineteenth-century superpower, in the hope to eventually achieve a similar status. By 1846, Brazilian legislators viewed contemporary France as no more than a “satellite of England.”<sup>65</sup>

It is not clear whether England had an interest in exporting its legal system in general, and its commercial laws in particular, to Latin America. In fact, to the extent that the deficiencies in Brazilian law hindered the development of local financial markets, they did not constitute a commercial handicap for the English, but rather a competitive advantage. Access to cheap financing through London’s capital markets gave English merchants operating in Brazil a significant competitive edge compared to their local counterparts, who lacked impersonal financing sources of any kind at least through the

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61. JAMES C. FLETCHER & DANIEL P. KIDDER, *BRAZIL AND THE BRAZILIANS PORTRAYED IN HISTORICAL AND DESCRIPTIVE SKETCHES* 586 (6th ed. 1866).

62. FREYRE, *supra* note 56.

63. CALDEIRA, *supra* note 59.

64. According to this theory, as articulated by David Ricardo in the early nineteenth century, free trade benefits all parties in forcing them to specialize in products and services in which they have comparatively lower costs of production. See DAVID RICARDO, *ON THE PRINCIPLES OF POLITICAL ECONOMY, AND TAXATION* (3d ed. 1821). The Law of Comparative Advantage helped justify the vocation of peripheral countries as exporters of agricultural commodities and buyers of industrialized products.

65. Senate Records, speech of Senator Paula Souza (Aug. 12, 1846), at 414.

mid-nineteenth century.<sup>66</sup> The restrictive stance towards incorporations in Brazil discussed in Part IV likely benefited England, as it widened the financing gap even further. When the Companies Acts of 1855 and 1862 liberalized the incorporation process in England and offered limited liability to joint-stock banks, many entrepreneurs rushed to form corporations in England and operate them abroad.<sup>67</sup>

### III. ADOPTING A COMMERCIAL CODE (1850)

Brazil's first Constitution of 1824 prescribed the elaboration of civil and criminal codes "as soon as possible."<sup>68</sup> The nation's first Criminal Code was enacted in 1830. Nevertheless, unlike France (where the *Code Napoléon* of 1804 paved the way for the *Code de commerce* of 1807), Brazil's commercial codification preceded its civil counterpart by a staggering sixty-six years.<sup>69</sup>

The early impetus for the adoption of a Brazilian Commercial Code came from the chaotic state of affairs under the Law of Good Reason and the uncertainties it generated among merchants, an argument consistently made in the legislative debates preceding the Code's adoption. In rebutting critics, an advocate of the Commercial Code argued that "the lack of a civil code should not lead us to refrain from adopting a commercial one, which is so highly requested."<sup>70</sup> Indeed, the first initiative for the enactment of a Commercial Code in Brazil dated back to as early as 1809, when commercialist José da Silva Lisboa was commissioned to draft such a codification, which however, did not come into being.<sup>71</sup>

Berkowitz et al. have coded the adoption of the Brazilian Commercial Code as an instance of automatic and wholesale borrowing of French law without regard to local needs and circumstances.<sup>72</sup> But the backdrop of the enactment of Brazil's Commercial Code—which followed numerous parliamentary debates, copious amendments,<sup>73</sup>

66. CALDEIRA, *supra* note 59, at 131-32.

67. See RORY MILLER, *BRITAIN AND LATIN AMERICA IN THE NINETEENTH AND TWENTIETH CENTURIES* 130 (1993) (noting that soon after the Companies Act of 1862 permitted the formation of joint-stock banks of limited liability, several British banks were incorporated to operate abroad). See also *supra* note 55 and accompanying text.

68. *Constituição Política do Império do Brazil* (1824), art. 179, XVIII. Brazil's Civil Code would not be enacted until 1916, that is, ninety-two years after the constitutional command.

69. Brazil's Commercial Code was enacted in 1850. By contrast, a first draft of a Civil Code was submitted to the legislature in 1854, but Brazil's first Civil Code was not enacted into law until 1916.

70. Senate Records, speech of Senator Clemente Pereira (session of May 15, 1846), at 66.

71. See *supra* note 59 and accompanying text on Viscount Cairú.

72. Berkowitz et al., *Economic Development*, *supra* note 25, at 175.

73. W.R. Swartz, *Codification in Latin America: The Brazilian Commercial Code of 1850*, 10 *TEX. INT'L L. J.* 347, 353 (1975) (quoting a remark by a House representative to the effect that "there are so many amendments to this Code that they are the Code").

and a “blizzard of petitions” from commercial associations<sup>74</sup>—could hardly have differed more from this stereotype. After lingering in Parliament for nearly two decades, the Commercial Code was finally enacted in 1850, not coincidentally, the year of Brazil’s first minimally effectual statute prohibiting transatlantic slave trade. The abolition of slave trade was bound to release massive amounts of capital from its prior use, which entrepreneurs then sought to redirect towards financial and industrial ventures.<sup>75</sup>

The Brazilian parliament received its first draft of the Commercial Code in 1833. The stated objective of its draftsmen was to produce a Code that at the same time reflected both the benefits of international legal convergence and the importance of attending to particular local circumstances. In their words, “the Commercial Code shall be drafted under the legal principles adopted by merchant nations, in harmony with commercial uses and styles that gather under the same flag the peoples of the new and old world.”<sup>76</sup> They argued, however, that “at the same time a Code should be suited to the special circumstances of the peoples for which it is designed.”<sup>77</sup>

Brazil is said to have borrowed heavily from the Commercial Code of France (1808), Spain (1829), Portugal (1833) and the Netherlands (1838) to produce what local commentators praised as the “first truly original commercial code in the Americas.”<sup>78</sup> Rhetoric notwithstanding, this first draft was a close copy of the Portuguese code. Had it been adopted without modification, Brazil might well have fit the existing stereotypes of careless borrowing of foreign law. Yet, not even a wholesale import of Portugal’s Commercial Code would have made Brazil’s commercial laws unambiguously French in origin or inspiration.

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74. EUGENE RIDINGS, *BUSINESS INTEREST GROUPS IN NINETEENTH-CENTURY BRAZIL* 286 (1994) (describing the significant involvement of commercial associations of Rio de Janeiro, Bahia, and Pernambuco in the legislative process preceding the Code’s adoption, with the latter petitioning six different times in seven years). The Senate’s legislative records contain multiple references to the significant pressure that various commercial associations then exerted for the adoption of a Commercial Code. *See, e.g.*, Senate Records, speech of Senator Clemente Pereira (session of Aug. 9, 1848), at 185.

75. *See, e.g.*, IRINEU EVANGELISTA DE SOUZA MAUÁ, *AUTOBIOGRAFIA* 126 (Zelio Valverde 1942) (1878) (for a description of how Brazil’s leading entrepreneur of the time saw in the abolition of slavery the opportunity to channel old capital to industrial goals).

76. J.X. CARVALHO DE MENDONÇA, *1 TRATADO DE DIREITO COMERCIAL BRASILEIRO* 92 (1937).

77. *Id.*

78. *See also* SPENCER VAMPRE, *1 TRATADO ELEMENTAR DE DIREITO COMERCIAL* 34 (1922) (noting that the earlier South American Codes of Haiti (1829), Bolivia (1834), Paraguay (1844), Republica de S. Domingos (1845) and Costa Rica (1850) were literal copies of either the French or the Spanish Commercial Codes). The commission in charge of drafting the Code presented an opinion in 1835 noting that Brazil would have “no reason to envy the laws of France, England, Portugal and Spain,” as its Code had “incorporated the best from all such codes and adapted them to Brazil’s circumstances.” *Id.* 34.



It is revealing that the Portuguese Commercial Code of 1833 was itself drafted in England. The cover letter to the Code by draftsman José Ferreira Borges, dated “London, June 8, 1833,” explicitly mentions his time in “exile.” As described in this document, the Code was influenced by the laws of Prussia, Flandres, France, Spain, England, Scotland, Russia, and Germany, as well as by Italy’s draft code. The English influence on the Portuguese Commercial Code was particularly conspicuous. For example, the Portuguese Code followed English law in not recognizing the limited partnership (*comandita*) as a business entity, even though this business organizational form was prevalent in France at the time.<sup>79</sup> Additional borrowings from England included the very institution of the commercial jury, which Borges deemed to be “compatible with the current stage of Portugal.”<sup>80</sup>

After many years, debates and amendments, not a single article of Brazil’s Commercial Code was a literal copy of the Portuguese model.<sup>81</sup> The enactment of a Commercial Code was not considered a technical matter, but a highly political one. The initial draft of the legislation moved around Senate and House committees for years,<sup>82</sup> and since 1845 the parliamentary records contain numerous and lengthy debates about the relative merits of the Code’s adoption and the specifics of its provisions. The Code’s proponents had initially suggested a “global” vote on the draft, without detailed discussions about individual provisions, but this proposal was defeated. Some senators went as far as to advocate a separate discussion of individual provisions of the draft Code—a clearly impractical proposition given its more than 1,000 articles. The compromise solution was to put the different titles of the Code to separate processes of discussion, amendments, and votes.

Despite the chaotic status quo, legislators did not take the need for commercial codification for granted.<sup>83</sup> One representative of rural interests and fierce opponent of the proposed Code criticized the effort to override Brazil’s existing commercial jurisprudence. England, he argued, had the world’s “most industrious merchants,” but lacked

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79. See Part IV *infra* for an overview of the controversy surrounding the legality of limited partnerships in Brazil.

80. *Código Commercial Portuguez* (1833).

81. Swartz, *supra* note 73, at 353 (also noting that, as enacted, Brazil’s Commercial Code contained 903 articles, less than half of the 1,860 articles of the Portugal’s Commercial Code).

82. *Id.* (noting that drafts of the legislation circulated in Senate and Chamber committees in 1835, 1836, 1837, 1839, 1843 and 1845).

83. The same was true with respect to civil codification, the constitutional mandate notwithstanding. As late as 1899, Inglez de Souza, a prominent scholar and draftsman of a project of Commercial Code (whose version however was never enacted), strongly resisted the enactment of a Civil Code. See Inglez de Souza, *Convém Fazer um Código Civil?*, 17 *REVISTA BRASILEIRA* 257 (1899) (arguing against the enactment of a Civil Code in Brazil).

such codification.<sup>84</sup> He also repeatedly cautioned that his conservative party (the same as the Code's proponents) would be to blame if the Commercial Code backfired, with detrimental consequences to future elections.<sup>85</sup>

Like its foreign counterparts, Brazil's draft Commercial Code contained a specific section devoted to business corporations. Still, the country apparently could no longer wait for the adoption of the Code, and the emperor enacted Brazil's first corporations law by decree in January 1849.<sup>86</sup> The minister's message preceding the enactment of the decree is illustrative of the continued force of the Law of Good Reason—and, consequently, of foreign laws—in shaping Brazil's commercial law. He notes that:

our legislation is silent in important respects as to economic and commercial matters: but given par. 9 of the Law of August 18, 1769 [the Law of Good Reason], which provides that in these cases there shall be resort to the laws of civilized nations; and given that the legislation of the former is uniform in requiring authorization for incorporations, there is no question that this doctrine is, in the absence of local rules, the law of the land.<sup>87</sup>

The Council of State argued that incorporations without governmental approval were unlawful as well as unsound policy, considering what it saw as their inherent susceptibility to fraudulent and speculative ventures. In its opinion preceding the enactment of the decree, the Council of State cited the laws of several different jurisdictions, reasoning that the existence of limited liability and concerns about creditor protection, among other things,

have induced the legislators of modern nations not to permit incorporations without previous governmental approval, and to respect freedom in the organization of other business associations.

England tolerates incorporations without governmental approval, but the members of such companies are jointly and severally liable in the absence of a chartering act by Parliament—an act which is usually so costly that there are companies who have spent more than 2 million *cruzados* to

84. Senate Records, speech of Senator Vasconcellos, at 234 (Aug. 11, 1848).

85. *Id.*

86. Decree 545 (Jan. 10, 1849). The authority of the Emperor to enact a corporations statute by decree was questionable—and was indeed explicitly questioned by Conselheiro Manoel Alves Branco in his dissenting vote in the Council of State, which argued that the matter required legislative action. See Resolution n.172 (Jan. 3, 1849), in 2 IMPÉRIAS RESOLUÇÕES DO CONSELHO DE ESTADO NA SECÇÃO DE FAZENDA, 1845-1849, 371 (1870).

87. *Id.* at 375.

obtain one, as in the case of the railway company from Manchester to Liverpool.

The codes and statutes of commercial nations of the entire civilized world require prior authorization to incorporations: there can be no business corporations by private agreement alone in France, Holland, Spain, Portugal, Sardinia, Napoli, Pontificate States, Russia and in the entire Germany.<sup>88</sup>

Decree 545 of 1849 explicitly aimed at “establishing the rules for the incorporation of any *sociedade anônima*.” It imposed prior governmental authorization requirements for all incorporation and required firms seeking special privileges to obtain legislative charters. Under the decree, which was largely inspired by regulations issued by the French ministry of the interior in 1807 and 1817, the government had broad discretion in adjudicating charter petitions.<sup>89</sup> The relevant factors for incorporation decisions included the likelihood that the firm will succeed, “the qualities and morality of its subscribers,” and the “interests of industry in general.”<sup>90</sup> Corporate activity prior to obtaining the requisite governmental authorization resulted in joint and several liability of the firm’s directors and managers.<sup>91</sup> Banking corporations were subject to additional governmental supervision as well as to forced dissolution for failure to comply with legal requirements.<sup>92</sup>

The background of the 1849 decree was the recent upsurge in incorporations of state banks of emission, which the Imperial government sought to curtail by explicitly imposing governmental approval requirements.<sup>93</sup> Brazil’s new incorporation statute, which on the surface looked like a liberalizing and business-friendly move, was in reality less clearly so. To the dismay of some politicians, promoters had been organizing business corporations “spontaneously”—that is, with the approval of the executive alone and, in some cases, with no

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88. *Id.* at 368.

89. IV IMPERIAES RESOLUÇÕES DO CONSELHO DE ESTADO NA SECÇÃO DE FAZENDA, *supra* note 86, at 423 (noting that “the Decree of January 10, 1849 was copied from the decision of France’s minister of interior dated as of Dec. 31, 1807”). *But see* III IMPERIAES RESOLUÇÕES DO CONSELHO DE ESTADO NA SECÇÃO DE FAZENDA, *supra* note 86, at 117 (arguing that the French regime differs from that adopted in Brazil).

90. Decree 545 (Jan. 10, 1849), art. 5.

91. *Id.* art. 8.

92. *Id.* art. 10.

93. The background behind this decree were consultations to the Council of State in 1847 and 1849 with respect to the legal status of state banks recently incorporated without governmental approval. *See* Consultation of May 28, 1847 (discussing the case of Banco da Bahia) and Resolution of Jan. 3, 1849 (discussing the case of Banco do Maranhão and proposing a decree establishing rules for the establishment of *sociedades anonyms*), both in II IMPERIAES RESOLUÇÕES DO CONSELHO DE ESTADO NA SECÇÃO DE FAZENDA, *supra* note 86, at 218 and 366, respectively.

governmental approval at all.<sup>94</sup> Few corporations existed in Brazil before 1849, but the instances of informal business formation and the surge in incorporations after the Code's enactment suggests that their scarcity was due to legal hurdles, rather than to a lack of demand alone.<sup>95</sup>

The attempt to deter the formation of local corporations and banks was likely detrimental to the country's development. Bernardo de Souza Franco observed at the time that, despite the recent creation of Banco Commercial of Rio de Janeiro, Brazil's economic center remained strikingly underserved by banking institutions. Before 1850, Rio de Janeiro had a population of 200,000, but only one bank with a capital of 2500 *contos de réis* as restricted by its corporate charter. By contrast, New York City, with a population of approximately 312,000, had twenty-four banks with a capital of over 50,000 *contos de réis*.<sup>96</sup> Commenting on Souza Franco's findings, Carlos Manuel Pelaez and Wilson Suzigan have noted that "Brazil's financial structure and economic activity were extremely backward both in relative and in absolute terms," and that "one could hardly expect progress based on such limited financial and capital market."<sup>97</sup>

The Commercial Code, which came into effect in June 1850, maintained the State approval requirements for incorporations set forth by the 1849 decree. Mauá had pushed for free incorporation in his commission's discussions, but to no avail.<sup>98</sup> It was a hard sell at the time, since none of the other common foreign models, such as France, England, Spain, Portugal and Belgium, permitted full-fledged incorporations without prior governmental approval.<sup>99</sup> England had since 1844 permitted the formation of joint-stock companies without specific authorization, but it still deprived them of the privilege of limited liability.<sup>100</sup> Only the United States had a

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94. MARIA BÁRBARA LEVY, *A INDÚSTRIA DO RIO DE JANEIRO ATRAVÉS DE SUAS SOCIEDADES ANÔNIMAS* 36 (1994) (noting that, "while the legislature did not act, corporations were formed in an arbitrary fashion and in a regime of almost complete irresponsibility").

95. According to official records, only ten corporations had received governmental authorization to function in Brazil in the more than four decades since 1808. Ministério do Trabalho, Indústria e Comércio, *Sociedades Mercantis Autorizadas a Funcionar no Brasil* (1808 – 1946) (1946) [hereinafter *Business Associations Authorized to Operate in Brazil*]. Due to the difficulty in locating all governmental acts authorizing incorporations, the actual number of business corporations formed during this period is likely to be higher than the figures implied by this document.

96. SOUZA FRANCO, *supra* note 53, at 30.

97. CARLOS MANUEL PELAEZ & WILSON SUZIGAN, *HISTÓRIA MONETÁRIA DO BRASIL* 59 (1976).

98. CALDEIRA, *supra* note 59, at 229.

99. See *supra* note 88 and accompanying text for references to foreign jurisdictions prohibiting incorporation without governmental approval.

100. England would not allow general incorporation with limited liability for most firms until the Companies Act of 1855-56.

large number of business corporations at the time,<sup>101</sup> but even there general incorporation did not become the norm in most states until the late nineteenth century.<sup>102</sup>

Brazil's Commercial Code devoted only five articles to business corporations, which regulated their most basic features: (i) requisite governmental approvals, (ii) transferable shares, (ii) limited shareholder liability, (iii) publicity of constitutional documents, (iv) causes for dissolution, and (v) unlimited management and director liability prior to the company's registration.<sup>103</sup> Scholars subsequently asserted that these provisions were an almost literal translation of the French Commercial Code.<sup>104</sup> For example, Alfredo Lamy Filho and José Luiz Bulhões Pedreira, prominent Brazilian jurists and draftsmen of Brazil's Corporations Law of 1976, stated that Brazil's Commercial Code followed the French *Code de commerce* in dedicating five provisions to business corporations.<sup>105</sup> Apart from the fact that the French Code in fact contained eleven articles on *sociétés anonymes* alone, the differences between the laws of business organizations of both countries would prove to run far deeper.

The apparent similarities in statutory language should not imply that Brazil's newly adopted regime was a mirror image of legal developments in France or elsewhere in continental Europe. Brazil's ruling elites were generally skeptical of incorporations, banks, and industrial ventures, and often found even France's relatively hostile approach to business organizations too permissive. As discussed in greater detail in Part IV below, to the extent that the French-inspired legal regime still left margins for financial development, Brazilian officials quickly acted to shut them down. Specifically, Brazil deliberately chose to withdraw the availability of tradable limited partnerships, an organizational substitute for incorporations provided and widely employed under French law.

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101. Richard Sylla & Robert E. Wright, *Corporate Governance and Stockholder/ Stakeholder Activism in the United States, 1790-1860: New Data and Perspectives 2*, available at [http://millstein.som.yale.edu/sites/millstein.som.yale.edu/files/Corporate%20Governance%20and%20Stockholder-Stakeholder%20Activism%20in%20the%20United%20States\\_0.pdf](http://millstein.som.yale.edu/sites/millstein.som.yale.edu/files/Corporate%20Governance%20and%20Stockholder-Stakeholder%20Activism%20in%20the%20United%20States_0.pdf) (providing evidence that approximately 8000 corporations had been chartered in the United States by 1830 and nearly 22,000 by 1860). France, by contrast, had incorporated only about 700 firms by 1860. Prussia had just about 300 by 1871, a figure that the United States surpassed around 1800. *Id.* at 3.

102. General incorporation in the United States dates back to a New York statute of 1811. By 1845, only Connecticut, New York, and New Jersey had general incorporation statutes of wide applicability. See Henry Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEG. STUD. 129, 143 (1985).

103. Law 556 (June 25, 1850) (Código Comercial Brasileiro), arts. 295-99.

104. CANDIDO LUIZ MARIA DE OLIVEIRA, CURSO DE LEGISLAÇÃO COMPARADA 37 (1903).

105. ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, A LEI DAS S.A. 115 (1992).

## IV. NEW HURDLES TO FINANCIAL DEVELOPMENT (1851-1881)

At least in relative terms, incorporations soared following the enactment of the Commercial Code. Between 1850 and 1852, thirteen new firms were incorporated in Brazil, which was more than in the previous forty years combined.<sup>106</sup> Established by the government in 1845 mainly to trade in public bonds, the Rio de Janeiro Stock Exchange saw a 460% increase in its trading volume in the two years following the enactment of the Code.<sup>107</sup>

The first signs of financial development did not go unnoticed by conservative politicians. The backlash against incorporations and banks did not reflect populist resistance against big business, monopoly, or high interest rates, as was the case in the United States, but targeted instead competition and cheap financing. By 1853, politicians argued that high interest rates, a sign of “public prosperity,” stood for “industrial development, the country’s progress, and the people’s faith in the government.”<sup>108</sup> Financial monopoly and high cost of capital were, in this view, not the problem, but the solution.

Brazil was of course not alone in displaying deep suspicions of corporations and banks in its earlier (and, to some extent, also later) history. Most countries faced significant anti-corporate sentiment in one form or another, although the precise nature of the objections raised against the corporate form varied widely.

Hostility against corporations was particularly pronounced in the United States prior to the Civil War. Anti-corporate sentiment in the United States was a product of the direct association between corporations and monopoly, since the grant of a corporate charter was construed during most of this early period to imply monopoly rights with respect to the underlying activity.<sup>109</sup> This type of criticism, however, dissipated as states liberalized their chartering policies and eliminated monopoly rights.<sup>110</sup> The upshot is that business corporations flourished in the United States like nowhere else during the nineteenth century.<sup>111</sup>

In other countries, notably France and England, suspicion of business corporations had deeper historical roots, tracing back to the eighteenth-century debacle of John Law’s Mississippi Company in

106. See *Business Associations Authorized to Operate in Brazil*, *supra* note 95.

107. *Id.* See also MARIA BÁRBARA LEVY, *HISTÓRIA DA BOLSA DE VALORES DO RIO DE JANEIRO 75* (1977) (describing the rise in the number of traded companies from three in 1850 to eight in 1852).

108. Records of the Chamber of Deputies, speech of Sr. Viriati (session of June 11, 1853), at 158.

109. See, e.g., the U.S. Supreme Court’s discussion of the reasons for the opposition to business corporations in the early U.S. republic in *Citizens United v. Federal Election Commission*, 130 S. Ct. 876, 925-26 (2010) (Scalia J., *concurring*).

110. HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW 1836-1937*, 36-37 (1991).

111. Sylla & Wright, *supra* note 101.

France and of the South Sea Company in England.<sup>112</sup> In this light, the main problem associated with business corporations was their propensity for crisis and the risk of fraudulent ventures. Monopoly was less of a concern, especially because under the French post-Revolutionary model (in which respect Brazil followed) the grant of a corporate charter did not automatically confer any monopoly rights. Nevertheless, while concerns with monopoly could be overcome by easing entry through a greater supply of corporate charters, concerns about crises required governmental restrictions to incorporations. It was precisely the latter approach—inspired by English and especially French anti-corporate rhetoric—that ultimately prevailed in Brazil for the most part of the nineteenth century, despite the contrary opinions of corporate defenders.<sup>113</sup>

Moreover, the controversy surrounding business incorporations in Brazil was also intertwined with the lively and enduring political debate about monetary policy and the role of banks of emission. In the 1850s, in particular, Brazilian politicians once again resurrected the traditional British nineteenth-century debates about the desirability of adopting the gold standard. In the tropics, the two sides of the debate were represented by *metalistas*, who sought to restrict the money supply through a strict adherence to the gold standard, and *papelistas*, who favored credit expansion.<sup>114</sup> Both camps had read extensively about the English debate, and habitually quoted their English counterparts.<sup>115</sup>

The first assault on Brazil's embryonic financial system by orthodox *metalistas* came in 1853 with the nationalization and merger of Brazil's major banks—Banco Commercial and the second Banco do Brasil—to form yet another, state-controlled, Bank of Brazil. Commercial associations of Rio de Janeiro had formed Banco Comercial in 1838. Mauá enthusiastically established the Banco do Brasil in 1851.

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112. Randall K. Morck & Lloyd Steier, *The Global History of Corporate Governance: An Introduction*, in *A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD* 11-13 (Randall Morck ed., 2005) (acknowledging that the anti-corporate reaction in France was even more severe than in England). For a description of the classic speculative episodes involving the Mississippi Company and the South Sea Company, see JOHN KENNETH GALBRAITH, *A SHORT HISTORY OF FINANCIAL EUPHORIA* 26-53 (1993).

113. For prominent works defending the benefits of incorporations to economic development and condemning the government's restrictive policies, see MAUÁ, *supra* note 75; JOSÉ ANTONIO PIMENTA BUENO, *DIREITO PÚBLICO BRAZILEIRO E ANÁLISE DA CONSTITUIÇÃO DO IMPÉRIO* 408 (1857) (describing the existing procedures to obtain a corporate charter as “long and humiliating,” resulting in “the subordination of all national development” to the government).

114. See André Villela, *The Quest for Gold: Monetary Debates in Nineteenth-century Brazil*, 21 *BRAZILIAN J. POL. ECON.* 79, 79 (2001). See also Winston Fritsch & Gustavo H.B. Franco, *Aspects of the Brazilian Experience under the Gold Standard* 4 (1992) (unpublished manuscript) (on file with author).

115. Villela, *supra* note 114, at 86 (noting that “some of the major tenets of the Currency school vs. Banking school controversy—such as the currency principle and the needs of trade doctrine—were repeated as undisputed truths”).

In a speech extolling the virtues of his new enterprise, Mauá cited the recent experience of the United States and Great Britain, and claimed that the “spirit of association” epitomized by the bank’s incorporation was “one of the strongest elements of prosperity in any country” and “the soul of progress.”<sup>116</sup>

The establishment of the second Banco do Brasil was meant to institute a monopoly of issue under a national bank following the model of the Bank of England.<sup>117</sup> This new state-run but privately-owned monopoly attracted significant investor interest. Buyer orders exceeded the number of shares offered by more than three times, but the shares placed according to political connections, not market forces.<sup>118</sup> The new list of shareholders was a “who’s who” of Brazil’s political elite; members of the Brazilian and Portuguese royalty received the largest lots of 100 shares each. Generous compensation made directorships in the new bank highly attractive, and an open battle for board appointments ensued.<sup>119</sup> Following the merger, Banco do Brasil’s credit was primarily directed to rural oligarchs.<sup>120</sup>

Mauá had been elected as a director of the new bank, but refused to serve. Dissatisfied with the new monopoly, he was determined to find ways around it. A new banking enterprise would require numerous investors, but he feared, quite naturally, that governmental approval for another bank charter would not be forthcoming after the recent State takeover. Indeed, a number of requests for incorporation of new banks following the establishment of the new Banco do Brasil were rapidly dismissed by the Council of State, which reasoned that, given the numerous administrative burdens imposed on the Banco do Brasil, “the creation of new competitors, which will limit its profits, shall not be authorized in the absence of widely recognized need.”<sup>121</sup> In denying a petition for the chartering of a bank to be established in Porto Alegre, the Council argued that it would be more fruitful to

establish a branch of the Banco do Brasil in the city of Porto Alegre than an independent bank . . . not only because such a branch would provide greater resources and guarantees to the commerce of that location, but also because it is not in the State’s interest to limit the sphere of operations of the Banco do Brasil.<sup>122</sup>

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116. CALDEIRA, *supra* note 59, at 226.

117. PELAEZ & SUZIGAN, *supra* note 97, at 78.

118. CALDEIRA, *supra* note 59, at 281.

119. *Id.* at 281.

120. JOHN SCHULZ, *THE FINANCIAL CRISIS OF ABOLITION* 5 (2008).

121. Resolution n.353 of July 1, 1854 (denial of authorization to the chartering of Banco Urbano to be established in the city of Rio de Janeiro), in III IMPERIAES RESOLUÇÕES DO CONSELHO DE ESTADO NA SECÇÃO DE FAZENDA, *supra* note 86, at 283.

122. Consultation n.359 of Aug. 24, 1854, in III IMPERIAES RESOLUÇÕES DO CONSELHO DE ESTADO NA SECÇÃO DE FAZENDA, *supra* note 86, vol. III, at 320.



Given the difficulty in obtaining a corporate charter, France provided an obvious model for inspiration, as its entrepreneurs had long resorted to tradable limited partnerships (*sociétés en commandite par actions*) to raise capital from the broader public while avoiding the burdensome governmental approval process required for incorporations.<sup>123</sup> In 1854, Mauá attempted a similar strategy by forming the tradable limited partnership (*sociedade em comandita por ações*) of Mauá, MacGregor & Cia. In his words, he was “moved by the desire to place at the service of our progress a new instrument which, released from governmental guardianship, could develop independently of any government interference.”<sup>124</sup> The potential for unlimited personal liability on his part as a general partner under this business form did not seem to be a sufficient deterrent.

The creation of Mauá, MacGregor & Cia., however, outraged the powers that be, which soon called into question the legality of limited partnerships divided in shares under Brazilian law. Unlike the French Commercial Code, which expressly authorized limited partnerships to divide their capital in shares,<sup>125</sup> the Brazilian codification omitted such a provision. Following various filing requests by local merchants, Brazil’s commercial registries interpreted the Code’s silence as permitting limited partnership by shares and authorized their constitution. The issue, however, proved to be controversial and generated heated debates in Brazil’s Council of State.

The Council of State, many of whose members had served as legislators years earlier when the Commercial Code was enacted, ruled that share limited partnerships were prohibited in Brazil. The Council’s decision noted that “it was still fresh in the memories of those who took part in the discussion of the Code the fact that the adoption of the provision of the French Commercial Code [permitting limited partnership by shares] was contemplated and deliberately rejected.”<sup>126</sup> There was, to be sure, one forceful dissent to this decision, which questioned the soundness of the majority’s opinion by arguing that share limited partnerships were permissible under the Commercial Code and that a ban on such entities was unsound “in a new

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123. See Naomi R. Lamoreaux & Jean-Laurent Rosenthal, *Legal Regime and Contractual Flexibility: A Comparison of Business’s Organizational Choices in France and the United States during the Era of Industrialization*, 7 AM. L. & ECON. REV. 28 (2005); Timothy Guinnane, Ron Harris, Naomi R. Lamoreaux & Jean-Laurent Rosenthal, *Putting the Corporation in Its Place*, 8 ENTERPRISE & SOC’Y 708 (2007) (arguing that, before 1857, the attractiveness of the share *commandite* in France was such that it in fact muted demand for free incorporation).

124. MAUÁ, *supra* note 75, at 236.

125. Code de commerce (1807), art. 38 (providing that the capital of limited partnerships could be divided in shares, without prejudice to the legal rules applicable to this form of organization).

126. Conselho de Estado, Resolution of Dec. 13, 1854, in I IMPERIAES RESOLUÇÕES TOMADAS SOBRE CONSULTAS DA SECÇÃO DE JUSTIÇA DO CONSELHO DE ESTADO 523 (José Próspero Jeová da Silva Caratá ed., 1884).

country, in which it is necessary to promote commercial and industrial associations."<sup>127</sup> This opinion culminated in the issuance of an "interpretive" decree declaring share limited partnerships illegal under Brazilian law and ordering the retroactive dissolution or conversion of all such companies then in existence.<sup>128</sup>

From a legal standpoint, Brazilian lawmakers attributed the ban on tradable limited partnerships to the differences in statutory language between the commercial codes of France and Brazil,<sup>129</sup> thus showing that seemingly minor deviations from foreign models could have teeth. It is doubtful, however, that the main reason for prohibiting tradable limited partnerships in Brazil was a highly formalistic, French-inspired, approach to statutory interpretation. France itself had interpreted its statutory provisions on limited partnerships broadly,<sup>130</sup> and the very author of the Brazilian decree seemed eager to explain why this restrictive approach made good policy. Nabuco de Araújo, a prominent Brazilian senator, insisted that the decree was sound in light of France's negative experience with share *commandites*, which he saw as replete with abuses to public confidence and creditors' rights.<sup>131</sup>

This incident showed that French legal solutions were well known, but by no means binding in Brazil. Brazilian politicians felt comfortable embracing French laws when they liked them, and then switching to a selective focus on France's negative experiences when French legal solutions seemed too liberal for their taste. In 1857, a group of legislators (including Mauá himself, who was then a member of the Chamber of Deputies) introduced a bill to revert the 1854 decree and permit the formation of tradable limited partnerships in Brazil, but their attempt again met with resistance and was ultimately unsuccessful.<sup>132</sup>

The 1854 decree had forced Mauá to convert the bank into a regular limited partnership (*sociedade em comandita simples*). Unlike in a share limited partnership, limited partners of a regular limited partnership could not be subject to later capital calls—a very useful

127. *Id.* at 524 (opinion of Conselheiro Visconde de Olinda).

128. Decree 1,487 of 1854.

129. See Roderick J. Barman, *Business and Government in Imperial Brazil: The Experience of Viscount Mauá*, 13 J. LAT. AMER. STUD. 239, 253-55 (1981); Anyda Marchant, *A New Portrait of Mauá the Banker: A Man of Business in Nineteenth-Century Brazil*, 30 HISP. AM. HIST. REV. 411 (1950).

130. See Lamoureaux & Rosenthal, *supra* note 123, at 34 (noting that, when disgruntled shareholders in 1830 challenged in court the issuance of bearer shares by *commandites*, on the ground that the practice was not specifically permitted by the French Commercial Code, French courts upheld their legality).

131. JOAQUIM NABUCO, *UM ESTADISTA DO IMPÉRIO* (1936) (citing Nabuco's speech of June 21, 1856).

132. For the lively legislative debates on this theme, see Annaes do Parlamento Brasileiro: Câmara dos Srs. Deputados [Records of the Chamber of Deputies], (sessions of July 28, 1857 and Aug. 5, 1857).

and popular feature of corporations and tradable limited partnerships in the nineteenth century—and could easily exit by redeeming their partnership interests to the detriment of the firm’s capital. Still, few of the initial 182 limited partners defected upon the conversion, and the Bank initially enjoyed considerable success.<sup>133</sup> At its peak, it boasted branches in various locations in Latin America, as well as in London, Manchester, Paris, and New York.<sup>134</sup> A regular limited partnership, however, had its shortcomings from a legal and economic standpoint. When the bank ultimately collapsed years later, the 1854 decree forcing the bank’s conversion into a regular limited partnership headed Mauá’s blame list—which listed deficiencies of Brazilian law as three out of the top six causes for the bank’s debacle.<sup>135</sup>

Brazil’s patchwork approach to the law of business organizations provides a clear example of selective transplants and local tailoring foreign models, not necessarily for the better. Economists have recently debated the relative merits of the laws of civil and common law jurisdictions on business organizations in the nineteenth century. While a number of studies emphasize the pioneering role of common law countries (and the United States in particular) in the propagation of the corporate form,<sup>136</sup> other scholars have argued that French and German law offered a greater variety of business entities and more organizational flexibility than Anglo-Saxon jurisdictions. Tradable limited partnerships, in particular, allowed entrepreneurs to raise capital from the investing public, and effectively operated as functional, though imperfect, substitutes to incorporations.<sup>137</sup>

On account of their comparative ease of formation, *commandites par actions* dwarfed the number of *sociétés anonymes* in France.<sup>138</sup> Comparative lawyers of the time recognized that the functional equivalent of joint-stock companies in France were *commandites par actions*, not *sociétés anonymes*—the latter being “due to their very rarity, only of secondary importance to the country.”<sup>139</sup> Between 1823

133. MAUÁ, *supra* note 75, at 237. Mauá, however, resented the fact that, through the conversion, the entity had lost its very foundation, the free transferability of its shares. *Id.* at 40.

134. Paulo Roberto de Almeida, *Os Investimentos Estrangeiros e a Legislação Comercial Brasileira no Século XIX: Retrospecto Histórico* 15, [http://www.tj.rs.gov.br/institu/memorial/RevistaJH/vol3n5/03-Paulo\\_Almeida.pdf](http://www.tj.rs.gov.br/institu/memorial/RevistaJH/vol3n5/03-Paulo_Almeida.pdf) (2003).

135. See MAUÁ, *supra* note 75, at 287.

136. Sylla & Wright, *supra* note 101.

137. Guinnane et al., *supra* note 123, at 687 (arguing that the wider selection of business entity forms in French and German law since the nineteenth century discredits the notion that Anglo-Saxon legal institutions are inherently superior to civil law ones).

138. Obtaining a corporate charter from France’s *Conseil d’Etat* was a difficult, expensive, protracted and risky proposition. Corporations were subject to constant governmental supervision, and their authorization could be revoked at any time. See JEAN STREICHENBERGER, *SOCIÉTÉS ANONYMES DE FRANCE ET D’ANGLETERRE* 41 (1933).

139. Ch. Coquelin, *Des sociétés commerciales en France et en Angleterre*, in *REVUE DES DEUX MONDES* 415-16 (1843).

and 1838 France saw the creation of 1340 tradable limited partnerships but only 157 business corporations.<sup>140</sup> To be sure, French contemporaries frequently resented the phenomenon known as the “limited partnership fever” (*fièvre des commandites*), which was associated with the proliferation of fraudulent ventures. In 1838 a draft bill aimed at regulating and restricting the use of tradable limited partnerships was introduced in the French parliament, but the strength of the liberal lobby prevented the proposal from obtaining the necessary political support. It was not until 1856 that France finally enacted a statute to regulate *commandites par actions* more closely.<sup>141</sup> Even though contemporaries viewed France’s limited partnerships as inextricably linked to fraudulent ventures with deleterious effects on public savings, a more moderate revisionist view now suggests that many such firms engaged in honest practices and played an important role in France’s industrialization.<sup>142</sup> Brazil’s willingness to imitate parts of the French system, but not others, might have deterred the formation of local capital markets to support its development.

A second attack on financial activity came in 1860, after a brief experimental period with financial liberalization during the one-year tenure of Bernardo de Souza Franco as Treasury Secretary. Franco was the author of a book on banking that was highly complimentary of New York’s Free Banking Act of 1837.<sup>143</sup> During his brief tenure between 1858 and 1859, Souza Franco authorized the creation of six additional banks of emission in Brazil.<sup>144</sup>

Nevertheless, one year later, and exactly ten years after the enactment of the Commercial Code, conservative politicians pushed for the adoption of a new statute unambiguously aimed at deterring the formation of banks and business corporations. Banco do Brasil and its well-connected shareholders had a keen interest in regaining a monopoly of emission and in restricting competition from other banking institutions. Moreover, the government itself feared the industrial and commercial expansion that the availability of financ-

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140. Pierre Allinne, *Le développement du Droit commercial en dehors du Code et l'influence des droits étrangers 1807-1925*, in *QU'EN EST-IL DU CODE DE COMMERCE 200 ANS APRÈS?* 85 (Corinne Saint-Alary-Houin ed., 2009).

141. *Id.* at 83-86.

142. See Jean Hilaire, *Le règne et la spéculation: Les sociétés en commandite depuis le Code de commerce*, in *LA SOCIÉTÉ EN COMMANDITE ENTRE SON PASSÉ ET SON AVENIR* 42 (1983).

143. See FRANCO, *supra* note 53. In his words, he decided to publish a book on banking because “in a young and capital deprived like Brazil, it is a very important service to seek to . . . adopt credit institutions as the most powerful way to take advantage of existing capital, put it into the service of industry and duplicate its benefits.” *Id.* at 9.

144. Constitutional Congress Records, speech of Senator Amaro Cavalcanti 206 (Dec. 16, 1890).

ing was beginning to generate.<sup>145</sup> The new statute had the support of Brazil's emperor, who believed that the financial system should serve international trade transactions, not investments in Brazil's domestic industrial production.<sup>146</sup> Decades later, Brazilian congressmen would resent the enactment of the 1860 statute as a manifestation of the notion that in Brazil "vital questions were almost never decided by taking into consideration the practical standpoint from which they should be approached; politics was involved in everything."<sup>147</sup>

The new Brazilian statute was so hostile to financial activity that it came to be known in Europe as "*loi d'entraves*" ("*Lei dos Entraves*," in Portuguese, or "Law of Impediments").<sup>148</sup> Even though the primary objective of the new law was to prevent the creation of new banks of emission, the statute's wording and chilling effects were much broader in scope. Under the new regime, banks, railroads and navigation companies could no longer be formed without first obtaining special legislative charters.<sup>149</sup> Executive authorization remained sufficient for the incorporation of firms in other industries, but the new statute strengthened the existing sanctions for failure to obtain the requisite approval. Business corporations formed without governmental authorization were subject not only to unlimited shareholder and director liability, but also to hefty fines and mandatory dissolution.<sup>150</sup> Moreover, the statute also disenfranchised investors in banking firms by prohibiting proxy voting in director elections.<sup>151</sup>

The intense parliamentary debates preceding the enactment of the statute also contained numerous references to foreign law and practice. The disagreement had to do with the interpretation of the effects of the Anglo-American experience with financial liberalization. Detractors of the proposed statute argued that the easy availability of financing was an integral part of the U.S. recipe for economic success.<sup>152</sup> Advocates of the new restrictions, in turn, stressed that both Britain and the United States required legislative approval of bank charters and had in any case witnessed numerous

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145. *Id.* at 207.

146. Law 1,083 of 1860. In the words of a contemporary commentator, the new statute "would be a crime if it were not a law." See TAVARES BASTOS, *CARTAS DO SOLITÁRIO* 19 (1863).

147. Constitutional Congress Records, speech of Senator Amaro Cavalcanti 207 (Dec. 16, 1890).

148. French finance scholar Garnier seems to have been the first to coin this expression. See M. JOSEPH GARNIER, *TRAITÉ DE FINANCES* 403 (1862).

149. Law 1,083 of 1860, art. 2, § 2.

150. Law 1,083 of 1860, art. 2, § 1.

151. *Id.* art. 2, § 12.

152. Senate records, speech of Senator Visconde de Maranguape, at 521 (July 21, 1860) (arguing that the "ample, almost unlimited freedom of credit" in the U.S. was a key ingredient in its recipe for industrial and economic development, an example which Brazil, as a new nation, should follow).

financial crises and fraudulent ventures.<sup>153</sup> The latter view prevailed and the statute came into effect in August of 1860.

Neither the laws of foreign jurisdictions, nor a local misunderstanding of their meaning and operation, are sufficient to explain Brazil's early policies of financial deterrence. Looking at the political economy of financial development is more illuminating.<sup>154</sup> If plantation owners saw an interest in resisting any departure from Brazil's role as an exporter of agricultural commodities, so did the incumbent merchant class, which was predominantly foreign.<sup>155</sup> Portuguese merchants prevailed in numbers, while the English had by far the most capital.<sup>156</sup> Foreign businessmen in the import-export business held a significant majority of board seats in Brazil's most influential commercial associations.<sup>157</sup>

Interestingly, the same commercial associations that so vehemently pushed for the adoption of a Commercial Code adopted a much more hesitant attitude with respect to the creation of business corporations and banks. It is noteworthy that most commercial associations, also known for resisting industrialization policies, did not oppose the enactment of the Law of Impediments.<sup>158</sup> Moreover, the few politically-connected banks and business corporations that succeeded in obtaining charters also had a vested interest in maintaining the existing legal hurdles and the barriers to entry that they had erected.<sup>159</sup>

The small size of Brazil's economic and political elite allowed its members to profit handsomely from their privileged access to State officials, a benefit that the development of impersonal market forces and economic growth could put in jeopardy. Financial development threatened their economic power and could lead, ultimately, to what Daron Acemoglu and James Robinson call a "political replacement

153. Senate records, speech of Council's President, at 43 (July 4, 1860).

154. See Mark J. Roe & Jordan I. Siegel, *Finance and Politics: A Review Essay Based on Kenneth Dam's Analysis of Legal Traditions in 'The Law-Growth Nexus,'* 47 J. ECON. LIT. 781, 788 (2009) (suggesting that "when you don't see finance developing, look for the polity's dominant interest").

155. See LEVY, *supra* note 94, at 78 (noting that exporters of agricultural commodities disfavored urban enterprises and the instability they were deemed to cause); Eugene W. Ridings, *Business, Nationality and Dependency in Nineteenth Century Brazil*, 14 J. LAT. AM. STUD. 55 (1982) (arguing that Brazil's business elite was not Brazilian).

156. See RIDINGS, *supra* note 74, at 32.

157. *Id.* at 32. The most extreme cases were the commercial associations of Rio de Janeiro (Brazil's largest) and Porto Alegre, in which, by statute, Brazilians were to occupy only three out of seventeen, and three out of fifteen board seats, respectively.

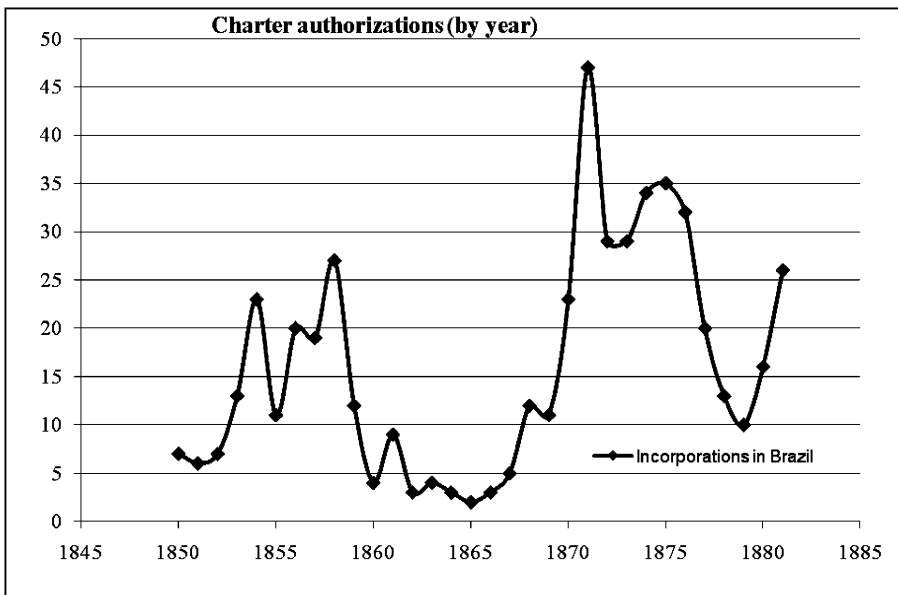
158. *Id.* at 205 (asserting that "Brazil's major business interest groups, the commercial associations of Rio de Janeiro, Bahia and Pernambuco, did not oppose the 1860 law").

159. See William H. Summerhill, *Sovereign Commitment and Financial Underdevelopment in Imperial Brazil*, [http://www.international.ucla.edu/economic/history/eh\\_papers/sovereign.pdf](http://www.international.ucla.edu/economic/history/eh_papers/sovereign.pdf) (2006).

effect”—a risk which is especially acute in places like Brazil, where upward and downward social mobility was not only possible, but common.<sup>160</sup> All in all, incumbents erected institutions that would allow them to maintain their comfortable status quo, even if at the cost of general economic growth.

The restrictive policies of the 1860 statute had a noticeable effect on incorporations, at least initially. Figure 1 below shows a clear blip in the number of new corporate authorizations following the law’s enactment compared to previous periods. At the same time, the formation of regular limited partnerships rose significantly during this period, thus signaling some degree of substitution away from the corporate form.<sup>161</sup>

FIGURE 1. NUMBER OF INCORPORATIONS IN BRAZIL (1850-1882)



Total: approximately 516

Source: Author’s formulation based on data by the Ministério do Trabalho, Indústria e Comércio (1946)

160. Daron Acemoglu & James A. Robinson, *Economic Backwardness in Political Perspective*, 100 AM. POL. SCI. REV. 1 (2006) (for a model suggesting that elites that are not highly entrenched are more likely to block institutional reform that poses risk to their incumbency advantage). See also SCHULZ, *supra* note 120, at 3 (2008) (positing that “both upward and downward social mobility were extremely common in nineteenth-century Brazil”).

161. Summerhill, *supra* note 159, at 21.

## V. BOOM, BUST AND THE DAY AFTER (1882 – 1900)

Brazil's increasingly restrictive stance towards incorporations was on the wrong side of history—and Brazilians knew it. News about foreign legal developments traveled fast even in the nineteenth century.

In adopting the Companies Acts of 1855 and 1856, England was the first country in Europe to permit the formation of business corporations with limited liability without the need for governmental approval. Its pioneering role was, at least in part, due to a lack of functional substitutes for the corporate form under English law. While France and Germany permitted the proliferation of tradable limited partnerships,<sup>162</sup> England successfully resisted the introduction of *commandites* for many years despite strong demand.<sup>163</sup> In 1862 England consolidated the previous statutes under a new Companies Act that further expanded the scope of general incorporation.

Only one year after the enactment of the Companies Act of 1862, French corporate law rapidly converged towards the English model. Competitive pressures were behind this particular instance of legal diffusion. In 1862, England and France entered into a Free Trade Agreement that expressly authorized English corporations to operate in French territory. Because England had already liberalized its incorporation process, French entrepreneurs judged that their national laws effectively put local firms at a disadvantage.<sup>164</sup> The result was the enactment of a new French statute in 1863 authorizing the creation of *sociétés limitées*, a literal translation of the English term employed in the Companies Act, which served as a model for the French law. The French statute was more restrictive than the English Act, however, in that it limited the exemption from governmental authorization to corporations whose capitalization did not exceed twenty million francs. Unrestricted general incorporation in France would have to wait until 1867.

Brazilian politicians monitored these foreign developments closely. In 1865, legendary Brazilian statesman Nabuco de Araújo proposed a new corporations law based on the English and French statutes of 1862 and 1863. The primary goal of his proposed bill on *sociedades limitadas*, also a literal translation of the term employed in the English and French statutes, was to permit incorporations

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162. See *supra* note 137 and accompanying text.

163. Despite creative attempts by English entrepreneurs to import continental European legal entity forms, English courts refused to accept limited partnerships under the common law. Limited partnerships were not permitted in England until the enactment of a 1907 statute. See RON HARRIS, *INDUSTRIALIZING ENGLISH LAW* (2000). See also ROB McQUEEN, *A SOCIAL HISTORY OF COMPANY LAW, GREAT BRITAIN AND AUSTRALIAN COLONIES* 73 (2009) (describing attempts to introduce *commandites* into English law in the early 1850s).

164. STREICHENBERGER, *supra* note 138, at 43.



without governmental approval. In most instances, Nabuco favored the more liberal approach of the English statute over the more restrictive stance of its French counterpart.<sup>165</sup>

The proposal met with resistance in the Council of State, where ministers argued that Brazil's lack of credit and "spirit of association" was not caused by legal restrictions, but by a lack of public confidence in view of prior abuses.<sup>166</sup> The Council blocked the project, which it viewed as "in keeping with the conditions of the English people, with its *self government*, with the sober character of the British citizen, the cautious, pensive man who respects his own dignity and knows how to maintain untouched his political liberty and will therefore not abuse this commercial freedom."<sup>167</sup> The fact that, by then, France had already begun to allow firms to incorporate without obtaining governmental approval did not seem to move Brazilian lawmakers either. The Council contended "that there was no parallel between Brazil's situation and France's," since France already permitted the organization of tradable limited partnerships (liberal incorporation being the logical next step), while Brazil did not.<sup>168</sup> Refusing to follow its usual foreign models in liberalizing the incorporation process, the Council concluded, in a sober note, that "[i]t is our painful but necessary duty to note the condition of Brazil, which is truly deplorable."<sup>169</sup>

The conservative forces were highly successful in deterring business formation after the enactment of the 1860 statute, but less so in avoiding the looming shift in the balance of economic and political power. Even in the absence of legal change, incorporations picked up again in 1870 (see Figure 1 *supra*), the year marking the end of the Paraguayan war. This means that, despite the existing bureaucratic and political hurdles to incorporation, a very large number of companies—more than 500, according to a conservative estimate—were chartered in the more than three decades following the enactment of the Commercial Code.<sup>170</sup> Thus, the conventional view among economists that incorporations were exceedingly rare in Brazil prior to 1882 is simply incorrect.<sup>171</sup> There is good reason to believe that the number of business corporations—and, consequently, the vigor of eco-

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165. NABUCO, *supra* note 131, at 557; INGLEZ DE SOUZA, DIREITO COMERCIAL 131 (4th ed. 1926) (noting the English law origins of Nabuco's legislative proposal).

166. Resolution of April 24, 1867, in IMPERIAES RESOLUÇÕES TOMADAS SOBRE CONSULTAS DA SECÇÃO DE JUSTIÇA DO CONSELHO DE ESTADO, *supra* note 126, vol. 2, at 1339.

167. *Id.* at 1338.

168. *Id.* at 1339.

169. *Id.*

170. Author's calculation based on *Business Associations Authorized to Operate in Brazil*, *supra* note 95.

171. For a recent exposition of this understanding, see Ran Ambramitzky, Zephyr Frank & Aprajit Mahajan, *Risk, Incentives and Contracts: Partnerships in Rio De Janeiro, 1870-1891*, 70 J. ECON. HIST. 686, 689 (2010) (noting that prior to the advent

conomic activity—would have been even greater had Brazil adopted free incorporation laws earlier.

In 1882 Congress finally overturned the Law of Impediments by enacting a new and more liberal corporate statute, which commentators celebrated as “releasing business corporations from State guardianship.”<sup>172</sup> Legal scholars credited the structure of the 1882 Corporation Law to the French tripod freedom of association, publicity and liability.<sup>173</sup> The statute’s main contribution was the elimination of the requirement of governmental approval for most business corporations. Companies in the foodstuff business, religious organizations, mutual insurance companies, and foreign firms remained subject to governmental approval. The incorporation of banks, in turn, continued to require special legislative authorization.<sup>174</sup> In exchange for the most liberal incorporation regime, the statute imposed stricter requirements in terms of disclosure and management responsibility. Liability-related provisions included shareholder rights to sue management directly for violations of law or charter provisions; the obligation of members of management to offer stock (as set forth in the charter) as security for their administration; and the imposition of criminal liability in cases of fraud, improper dividend payments, and irregular liquidation.<sup>175</sup>

The new law had the support of commercial associations, including the powerful unit of Rio de Janeiro, which now attributed the repressive regime of 1860 to “abnormal circumstances.”<sup>176</sup> Opponents of free incorporation appealed once again to various instances of corporate fraud and abuses in foreign experience as grounds for maintaining governmental intervention.<sup>177</sup> Nonetheless, this time the prevailing stance was that it was illogical to “destroy a powerful instrument of progress because it may originate abuses.” Legislators argued that the statute should instead provide for “protective formu-

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of free incorporation laws in Brazil, chartering “depended on imperial government authority, and very few joint-stock companies were formed before the 1880s”).

172. VAMPRE, *supra* note 78, at 40.

173. Senate Records, speech of Senator Lafayette (Apr. 24, 1882) (stating that “the mission of the law is limited to the trilogy of liberty, publicity and responsibility; beyond that all there is are unjustifiable restrictions to individual rights”); DÍDIMO AGAPITO DA VEIGA, *AS SOCIEDADES ANONYMAS* 9 (1888).

174. Law 3,150 (Nov. 4, 1882), art. 1.

175. *Id.* art. 10 (provision of shares as security); art. 11 (civil liability of directors for damages caused by negligence or intentional wrongdoing); art. 26 (fines for founders’ and managers’ failure to comply with various statutory provisions), arts. 27-30 (criminal penalties for managerial misconduct).

176. RIDINGS, *supra* note 74, at 287.

177. See Senate Records, speech of Senator Afonso Celso, at 65 (Aug. 22, 1882) (arguing that “the State is not indifferent to losses suffered by corporations, which frustrate and weaken the useful and fertile spirit of enterprise” and citing inconveniences in France and the Black Friday of England as a cautionary note).

las whose objective is to alert the investing public and stimulate shareholder supervision."<sup>178</sup>

The 1882 statute provided for continuing seller liability for subscribed but not yet paid-in capital for up to five years after the share transfer.<sup>179</sup> In nineteenth-century Brazil, as elsewhere, stock subscriptions were often paid in installments. As argued by Sylla and Wright, the installment mechanism was effectively an investor protection device, which allowed shareholders to observe the initial management and performance of the firm before committing the totality of their funds to their enterprise.<sup>180</sup> Mid-way investor defection from businesses that turned out to be unattractive was common both in Brazil and in the United States.<sup>181</sup> Unlimited liability for unpaid subscriptions, which applied to any transferor of the shares for up to five years after the sale, provided additional protection for creditors at the expense of shareholders.

A shift towards fully liberal corporate and financial policies did not come until the final abolition of slavery in 1888. The end of slavery without compensation to slaveholders had a profound impact on Brazil's economic and political environment. Almost instantly after abolition, Brazil's rural oligarchs felt a deep need for additional credit and currency to enable a transition to a system of wage labor by immigrants and freemen.<sup>182</sup> The incumbent economic and political forces were changing rapidly, and in November of 1889, the military deposed Brazil's Emperor and declared the country a Republic with the support of the new financial *bourgeoisie*.

The effects of the liberal corporate and banking policies beginning in 1882 and culminating in the 1890 reforms were substantial. The main change to the Corporations Law of 1882 was the effective elimination of shareholder reserve liability for subscribed but not yet paid-in capital following a transfer. Combined with favorable changes in monetary policy, these legal reforms resulted in an exponential growth in the number of corporations operating in Brazil.<sup>183</sup>

Only six months after the legal reforms of 1890, São Paulo saw the creation of at least 222 companies and banks, which stands in sharp contrast to the only 30 such firms in operation as late as

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178. VEIGA, *supra* note 173, at 28; Senate Records, speech of Senator Lafayette (Apr. 25, 1882), at 1798.

179. Law 3,150, art. 7, § 1°.

180. Sylla & Wright, *supra* note 101, at 7.

181. *Id.* at 7; SCHULZ, *supra* note 120, at 82.

182. *See, e.g.*, SCHULZ, *supra* note 120.

183. For a discussion of the effects of the 1890 reforms, see Stephen Haber, *The Efficiency Consequences of Institutional Change: Financial Market Regulation and Industrial Productivity Growth in Brazil 1866-1934*, 28 EST. ECON. 379 (1998) (arguing that the reforms resulted in an increased rate of investment and productivity and a decline in industrial concentration).

1897.<sup>184</sup> Transactions in the Rio de Janeiro Stock Exchange, then Brazil's primary listing venue, increased by eighty-four percent in 1889, ninety-eight percent in 1890 and forty-five percent in 1891.<sup>185</sup> By 1890, 114 firms traded on the Rio de Janeiro Exchange,<sup>186</sup> and many more in the brand new São Paulo Stock Exchange.<sup>187</sup> These events culminated in a speculative bubble which historians refer to as the *Encilhamento* (literally, "saddling up").

The trading fever of *Encilhamento* attracted investors of the most varied segments of society, and proved that no inherent cultural repugnance existed among Brazilians to stock investment and speculation. In the critic words of a contemporary newspaper:

[E]veryone gambled—the merchant, the physician, the lawyer, the public servant, the broker, the *zangão*; with little of their own money, with much of other' people's money (. . .). Each citizen became an incorporator and a manager of banks and business firms; those who yesterday were not capable of running a small tavern had become managers of great finances; each citizen neglected his own profession to gamble, and Rio de Janeiro converted itself into a Monte Carlo casino . . . .<sup>188</sup>

The legal reforms enabling a major stock market bubble in Brazil were not a reflection of foreign developments, but rather a response to special political and economic conditions following the abolition of slavery and changes in the political regime.<sup>189</sup> John Schulz explains the trend toward financial liberalization by the end of the Empire and beginning of the Republic as an attempt to create "easy money" in order to appease disgruntled planters, who could no longer rely on slave labor and therefore had to pay wages in order to ensure production.<sup>190</sup>

The ultimate burst of *Encilhamento* in 1892 drove the national economy into a severe recession. From a corporate governance perspective, the stock market collapse of the early 1890s exposed numerous fraudulent ventures involving fictitious firms, which earned the period a bad reputation that would shape corporate law policy for years to come. More recently, however, scholars have provided evidence that the initial bubble had longer-lasting positive effects on Brazil's economic and industrial development. A significant

184. See ANNE G. HANLEY, *NATIVE CAPITAL* 87 (2005).

185. Eulalia Maria Lahmeyer Lobo, *O Encilhamento*, 5 *REVISTA BRASILEIRA DE MERCADO DE CAPITAIS* 261, 269 (1976).

186. *Id.*

187. See HANLEY, *supra* note 184, at 88.

188. VISCONDE DE TAUNAY, *O ENCILHAMENTO* 12 (Itatiaia 1971) (1893).

189. SCHULZ, *supra* note 120, at xii.

190. *Id.* at 8.

number of the firms incorporated during the *Encilhamento* remained listed on the Rio de Janeiro Stock Exchange in the following years, and played a major role in the development of Brazilian industry until the State-run import-substitution industrialization process after World War II.<sup>191</sup> For Albert Fishlow, Brazil's first incursion into import-substitution industrialization took place during the inflationary finances of the *Encilhamento* period, which, in his view, represented "something much more substantial and enduring than a South Sea bubble."<sup>192</sup>

Stephen Haber finds that the 1890 legal reforms elicited an expansion of local capital markets, which in turn transformed the structure of Brazil's textile industry vis-à-vis its counterpart in Mexico. While the rise of more competitive capital markets in Brazil allowed firms to access impersonal sources of financing and growth, the financial elite in Mexico successfully used its political clout to build legal barriers to entry in the banking industry, thus giving established and well-connected cotton mills an advantage over newcomers. As a result, Brazil's cotton industry experienced a higher rate of growth, a lesser degree of concentration, and greater productivity levels than that of Mexico.<sup>193</sup> Similarly, Aldo Musacchio and Ian Read studied the networks of interlocking boards of directors in Brazilian and Mexican companies in 1909 and found that kinship and network connections were significantly less important in Brazilian than in Mexican firms.<sup>194</sup> Indeed, before World War I, Brazil had active stock markets that were the second-largest in Latin America as well as second to none in the number of listed companies. Rajan and Zingales estimate that Brazil's stock market capitalization at the time reached twenty-five percent of the GDP,<sup>195</sup> a record level that would not be surpassed until the 1990s.<sup>196</sup>

Although a significant number of *Encilhamento* firms withstood the crash reasonably well and contributed to the country's economic modernization thereafter, the trauma from the bubble burst would

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191. Lobo, *supra* note 185, at 269.

192. Albert Fishlow, *Origins and Consequences of Import Substitution in Brazil*, in *INTERNATIONAL ECONOMICS AND DEVELOPMENT* 315 (Luis Eugenio di Marco ed., 1972) (disputing the conventional wisdom as to the detrimental effects of *Encilhamento* as ignoring "the permanent consequences of this temporary stimulus to national entrepreneurial initiative").

193. Stephen Haber, *Financial Markets and Industrial Development: A Comparative Study of Governmental Regulation, Financial Innovation, and Industrial Structure in Brazil and Mexico, 1840-1930*, in *HOW LATIN AMERICA FELL BEHIND* 147-48 (Stephen Haber ed., 1997).

194. Aldo Musacchio & Ian Read, *Bankers, Industrialists and Their Cliques: Elite Networks in Mexico and Brazil during Early Industrialization*, 8 *ENTERPRISE & SOC'Y* 842 (2007).

195. Rajan & Zingales, *supra* note 15, at 15.

196. Aldo Musacchio, *Laws versus Contracts: Shareholder Protections and Ownership Concentration in Brazil, 1890-1950*, 82 *BUS. HIST. REV.* 445, 449 (2008).

later serve to justify the new system of increasingly concentrated corporate ownership and suspicion of outside financing.<sup>197</sup> While Brazil spent a good part of the nineteenth century importing foreign disillusionment with finance, it had now experienced a big debacle of its own. Scholars have suggested that severe financial distress may be at the roots of repressive attitudes towards finance, but an adequate knowledge about the impact of economic trauma on institutional development is still lacking.<sup>198</sup> There is little question that financial trauma can be real and consequential, but the Brazilian experience suggests that negative opinions can also be imported, or even fabricated, by those who can benefit from the absence of capital markets.

## VI. EVALUATING EARLY TRANSPLANTS

As described above, Brazil has historically borrowed legal rules and institutions from a far more diverse array of jurisdictions than is usually assumed. The Portuguese did not forcefully impose French law in Brazil, nor were nineteenth-century Brazilians so immersed in French culture that their choice of legal systems was severely constrained. Brazil's nineteenth century lawyers—who were famous for being politicians rather than scholars<sup>199</sup>—felt comfortable navigating and importing laws and institutions from different civil and common law jurisdictions.

To be sure, the law-and-finance literature has increasingly shifted focus from cross-country differences in specific commercial law rules to variations in more general features of the legal system, such as the structure of the judiciary.<sup>200</sup> But even when one takes a broader perspective, the origins of Brazil's legal system look quite diverse and the resulting legal transplants just as selective. Brazilian lawmakers in the nineteenth century were willing to consider England as a model not only for commercial laws, but also for other more fundamental features of its legal system. Brazil's first Constitution of 1824 simultaneously adopted a "Frencher-than-the-French" system of quadripartite separation of powers<sup>201</sup> but followed the En-

197. As Galbraith put it, "[t]he financial memory is brief, but subjective public attitudes can be more durable." GALBRAITH, *supra* note 112, at 53.

198. Morck & Steier, *supra* note 112, at 13.

199. See Miguel Reale, *Prefácio*, in A.L. MACHADO NETO, *HISTÓRIA DAS IDÉIAS JURÍDICAS NO BRASIL* (1969) (noting that Portuguese and Brazilian jurists were not traditionally inclined to general theorizing).

200. See La Porta et al., *supra* note 11.

201. Brazil's Constitution of 1824 followed the work of French author Benjamin Constant in inaugurating a system which included the Moderating Power (*Poder Moderador*), represented by the Emperor, in addition to the legislative, executive, and judicial branches. This quadripartite system was never adopted in France, and scholars have noted that the Brazilian conception of the Moderating Power made it even more powerful than originally envisioned by Constant. See, e.g., NELSON SALDANHA, A

glish model in contemplating both civil and criminal juries. Classic English remedies such as *habeas corpus* were adopted soon thereafter.<sup>202</sup>

On several occasions, Brazilian senators eulogized the degree of judicial independence in England, referred to England as the “model country,” and described U.S. and English judges as “the first in the world.”<sup>203</sup> They believed that a proposed project’s attempt to formalize a judicial career and create a judicial hierarchy would further erode the guarantee of an independent judiciary provided by the Brazilian constitution.<sup>204</sup> The law-and-finance literature pays a great deal of attention to the lower status of judges in the French civil law tradition,<sup>205</sup> but Brazilian judges in the nineteenth century “benefited from a degree of social and political prestige that was only comparable to those enjoyed by judges in England and North America.”<sup>206</sup> Up to this day judges in Brazil are among the highest paid in the world.<sup>207</sup>

There is little question that French law was highly influential in nineteenth-century Brazil, but its influence was by no means undisputed or inevitable. Overt criticism of France and its legal culture were commonplace,<sup>208</sup> and Brazil repeatedly chose to depart from French legal solutions both with respect to business organizations and the general structure of its legal system. After a careful study reviewing all available decisions by Brazil’s Council of State, legal historian José Reinaldo Lima Lopes concludes that “our debt to foreign law was not limited to the continental, civilian, Romanist family. England was always remembered by Brazilian monarchists as the ideal of a modern, liberal, conservative monarchy to be imitated. The

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TEORIA DO “PODER MODERADOR” E AS ORIGENS DO DIREITO POLÍTICO BRASILEIRO 6 (1988).

202. See Criminal Code of 1830 and Criminal Procedure Code of 1832. See also Senate Records, session of May 14, 1832, for a discussion of the adoption of the *habeas corpus* remedy and its English origins.

203. Senate Records, speech of Sr. Saturnino (session of June 3, 1850), at 31; Senate Records, 1850, speech of Sr. Alves Branco (session of June 3, 1850) at 37. Indeed, greater judicial independence is said to be one of the distinguishing features of common law jurisdictions according to the law-and-finance literature. See, e.g., Beck et al., *supra* note 27.

204. Senate Records, speech of Senator Alves Branco (session of May 25, 1850), at 97.

205. Beck et al., *supra* note 27, at 659 (noting that in the French civil law tradition, forms of recruiting, salary and prestige reflect the role of the judge as serving a mainly clerical function).

206. Pedro Calmon, *Organização Judiciária*, in *LIVRO DO CENTENÁRIO DOS CURSOS JURÍDICOS (1827-1927)* 95 (1928).

207. Eduardo Graeff, *Luta de Classes no Brasil*, Folha de São Paulo, July 3, 2008.

208. Senate Records [Anais do Senado], speech of Senator Alves Branco (June 4, 1850), at 56 (“God save us from the French system!”—exclaimed Senator Alves Branco in discussing potential models for reform of Brazil’s judiciary).

United States also deserved attention and became the object of admiration."<sup>209</sup>

Brazil in fact lacked the quintessential element of a French-style civil law jurisdiction—a Civil Code—for the entire nineteenth century. Brazil's Parliament did not commission a first draft of the Civil Code until 1858—eight years after the enactment of the Commercial Code and thirty-four years after the constitutional requirement for such a code.<sup>210</sup> Moreover, this initial attempt ultimately broke down when its draftsman, Augusto Teixeira de Freitas, questioned the soundness of the separation adopted in French codifications between civil and commercial law, and refused to proceed with a civil codification that would be separate from a commercial one.<sup>211</sup>

The codification scheme advanced by Freitas was markedly distinct from France's *Code civil* and its progeny. His proposed framework would involve two distinct codifications: (i) a General Code (*Código Geral*) that defined the legal terms and concepts common to all areas of law and (ii) a Civil Code (*Código Civil*) that overcame the separation between civil and commercial law, which Freitas regarded as "arbitrary" and unnecessary, and whose persistence elsewhere he attributed to the "inertia of legislations."<sup>212</sup> In his letter to the Imperial government defending his proposal, Freitas explained that his idea of producing a General Code was not novel, but rather had its seeds in sources as varied as (i) Pothier's *Pandectas*, (ii) Bacon's *legum legis*, that is, laws that have as their object all other laws, and (iii) the Civil Code of Louisiana, which devoted its last section to general definitions of terms.<sup>213</sup> In a different writing, Freitas himself articulated the prevailing view of the time in stating that "[w]e do not have a law of a pure nationality."<sup>214</sup>

Lawmakers in the nineteenth century seemed utterly unaware that Brazil was a "French civil law jurisdiction," and, as such, was bound to follow French legal solutions.<sup>215</sup> In his lessons on "compara-

209. LOPES, *supra* note 22, at 347.

210. See *supra* note 68 and accompanying text.

211. Teixeira de Freitas, the Code's first draftsman, elaborated an entire Rough Draft of a Civil Code (*Esboço*). The Rough Draft was never enacted into law in Brazil, but it served as a model for other Civil Codes in Latin America, notably the Argentinian one. Teixeira de Freitas's overt repudiation of the division of private law in civil and commercial law, which would later become popular among Italian authors, was original at the time. For a thorough discussion of the process leading to the Civil Code's enactment, see Moreira Alves, *supra* note 49.

212. Letter of Teixeira de Freitas, *supra* note 211.

213. *Id.*

214. F.P. Lacerda de Almeida, *O Direito Civil e sua Codificação*, in *LIVRO DO CENTENÁRIO DOS CURSOS JURÍDICOS (1827-1927)* 169 (1928) (quoting Freitas).

215. Indeed, Brazil was not unique in this regard. The emerging taxonomies of legal systems in the nineteenth century looked significantly different from the classificatory schemes popularized by twentieth-century comparative law scholarship. See Mariana Pargendler, *The Rise and Decline of Legal Families*, 60 *AM. J. COMP. L.* (forthcoming 2012).



tive legislation on private law,” Clóvis Bevilacqua, a prominent Brazilian scholar and later draftsman of Brazil’s Civil Code of 1916, relied heavily on the classificatory scheme advanced by French author Ernest Glasson. According to this categorization, the laws of European countries could be divided into three different groups: (i) legal systems that are largely exempt from the influence of Roman and canon law, which included England, the Scandinavian countries, the United States, and Russia; (ii) laws of strong Roman law heritage, which are exemplified by those of Spain, Portugal, Italy, and Romania; and (iii) legal systems combining Roman, Germanic, and national influence, which included France, Germany, Belgium, Holland, and Switzerland.<sup>216</sup> To Glasson’s tripartite division Bevilacqua adds a fourth group to encompass the laws of Latin American countries, which, he claimed, “could not logically be included in any of the three aforementioned categories.”<sup>217</sup> In his view, the laws of these groups were *sui generis* because they not only combined their Spanish and Portuguese heritage with European (and notably French) legal influence but also displayed a “strong boldness” typical of young nations.<sup>218</sup>

Most of the academic debate about the import of legal origins for financial development is framed in terms of how the effects of early legal transplants implemented during colonial times could persist for well over a century.<sup>219</sup> This Article suggests, however, that the persistence puzzle puts us on the wrong track. Indeed, the focus on legal families—and their consequences towards choice of legal imports—seems to be largely a twentieth-century phenomenon. Reference to English commercial law and U.S. public law seemed natural in the nineteenth century—to the point that a statute directed federal courts to employ cases of the U.S. common law and equity as subsidiary sources of procedure in Brazil.<sup>220</sup>

The import of Anglo-American models, although common, eventually began to be perceived as more “foreign” over the course of the twentieth century. France’s influence on Brazil’s commercial law has always been lesser than in other fields, but in the 1960s and 1970s the seeming Americanization of Brazilian commercial and corporate law then began to be seen as an “exception” to legal family lines.<sup>221</sup>

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216. CLÓVIS BEVILAQUA, RESUMO DAS LICÇÕES DE LEGISLAÇÃO COMPARADA SOBRE O DIREITO PRIVADO 72-73 (1897).

217. *Id.* at 74.

218. *Id.*

219. See, e.g., Aldo Musacchio, *Law and Finance c. 1900*, (Nat’l Bureau of Econ. Research, Working Paper No. 16,216, (2010)), available at <http://papers.nber.org/papers/w16216> (seeking to ascertain “how persistent are the effects of legal institutions adopted or inherited in the distant past” are).

220. Decree 848 (Oct. 11, 1890), art. 386.

221. Arnaldo Wald, *Brésil*, in LA CIRCULATION DU MODÈLE JURIDIQUE FRANÇAIS 126 and 131 (Travaux de l’Association Henri Capitant 1993).

If legal family considerations seemed immaterial to early Brazilian lawmakers, the opposite was true for their attitude toward legal transplants in general. Brazilian lawmakers reflected not only on the relative merits and implications of different foreign legal regimes, but also on the very wisdom of borrowing other countries' laws as a development strategy. References to the very term legal "transplants" (*transplantes* or, in its verb form, *transplantar*) were commonplace in legislative debates of the time, as were allusions to the underlying metaphor of a transferred plant that struggles to survive in unfamiliar soil.<sup>222</sup> As one senator put it, "we are not here to discuss if French legislation is good for that country, if Portuguese legislation produces such effects in Portugal etc.; our question is if the legislation of these countries can be adopted in Brazil without inconvenience, and if it will be here as fruitful as it perhaps might be in those countries."<sup>223</sup>

In addition to considering the suitability of alien models to local conditions, parliamentary debates also addressed the institutional implications of copying the laws of other countries. One senator warned that the parliament of England, a "great country" having "much illustration and national pride," does not spend all of its time "citing the laws of France, Bavaria or Spain."<sup>224</sup> Representatives warned that the endless references to foreign laws should be taken with caution as "our own country should be the principal object of our meditation."<sup>225</sup> In the words of one Brazilian senator,

[i]f our role is limited to translating some provisions of the French or the Bavaria code etc., then we do not need to think about the circumstances of this country; (. . .) if one illustrated nation can provide laws for the entire world, why then do we have this House, this deliberative body, why should we kill ourselves studying, thinking, debating for long days about any legislative matter?<sup>226</sup>

Then, as now, efficiency pressures towards legal convergence also played an important role in legal reform. While Brazilian lawmakers felt comfortable picking, choosing and distorting foreign models, it was harder to explicitly avoid legal solutions that had reached universal acceptance among "cultivated" nations. When

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222. Senate Records, speech of Senator D. Manoel (July 26, 1850), at 483 (arguing that the transplant of banking institutions to Brazil and the issuance of paper money should only be admissible once "the terrain is prepared to receive this still exotic plant in our country"); Senate Records, speech of Senator D. Manoel (July 26, 1850), at 483 (criticizing the import of the French national guard system as an "exotic plant which could not adapt to Brazilian soil"). The etymological image of legal transplants as transplanted plants has since become familiar in the comparative law literature.

223. Senate Records, speech of Senator D. Manoel (June 1, 1860), at 13.

224. *Id.*

225. *Id.*

226. *Id.*

lawmakers did so, these departures often came in the form of inconspicuous decrees rather than in the more salient and prestigious provisions of codes and major statutes.

One must be cautious, however, about drawing generalizations from the Brazilian experience. The case of Brazil does not—indeed cannot—provide a precise roadmap for the evolution of corporate laws elsewhere in the developing world or even across Latin America. A previous study of commercial law history in Colombia revealed a radically different experience in nineteenth-century Latin America—one in which a lack of human and material resources led to thoughtless import of foreign laws without regard to local circumstances, or even social or economic demand.<sup>227</sup>

As described in Part IV above, Brazil endured a major political struggle before permitting business firms to incorporate without obtaining governmental approval. Conversely, Robert Means tells us that Colombia's pioneering role as the first country in the region to adopt free incorporation did not reflect a conscious policy choice, but was rather the product of inadvertent changes by local draftsmen who were entirely unfamiliar with the corporate form.<sup>228</sup> Previous inferences from Colombia's experience to understand developments in Brazil were more misleading than informative; there is no reason why hasty generalizations from the Brazilian case to other countries would be immune from this risk either.

Still, the role of politics in the origins of corporate laws may not have been unique to Brazil. Other Latin American countries have also been conspicuous latecomers in the free incorporation process.<sup>229</sup> Given the speed in which legal ideas traveled even in the nineteenth century, mere local ignorance of foreign legal developments is an improbable explanation. The case of Argentina seems particularly telling. Similarly to Brazil, private law institutions in Argentina generally had a Latin origin, but the strong commercial presence of Britain in the region made Argentinean commercial law eclectic and

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227. See ROBERT CHARLES MEANS, *UNDERDEVELOPMENT AND THE DEVELOPMENT OF LAW: CORPORATIONS AND CORPORATION LAW IN NINETEENTH-CENTURY COLOMBIA* xiv (1980) (arguing that “[t]he codes’ corporate law provisions were only tenuously related to Colombian reality during most of the nineteenth century” and “[t]he very existence of the corporate law provisions of the codes owed little or nothing to any Colombian demand for a statutory law of business corporations”).

228. *Id.* at xv (arguing that Colombia's “heterodoxy” in permitting free incorporations reflected “not an autonomous national legal development but an incapacity for such development. The changes permitting freedom of incorporation apparently were made by a draftsman with little understanding of the significance of the issues and approved by a legislature probably not even aware of their existence.”). These changes were later reversed when Colombia copied the Chilean Code years later.

229. M.C. MIROW, *LATIN AMERICAN LAW* 162 (2004) (describing that “just as these European commercial codes were liberating corporations from the administrative control of the state, Gabriel Ocampo’s 1860 commercial code was being enacted in Chile in 1865. This influential code repeated the earlier ideas of state supervision”).

subject to a strong English influence.<sup>230</sup> The draftsmen of the Argentinean Commercial Code of 1889 allegedly sought inspiration from the laws of Portugal, Italy, England, Belgium, Spain, and Germany.<sup>231</sup> Nevertheless, Argentina deviated from every single one of these foreign models in retaining the requirement of governmental approval for incorporations well into the twentieth century.<sup>232</sup>

## VII. CONCLUSION

The high degree of selectivity inherent to foreign legal transplants adopted in Brazil did not go unnoticed by nineteenth-century Brazilian observers. Corporate lawmaking, in particular, entailed a conscious and deliberate process which, following the examination of various foreign law models, often produced patchwork legal outcomes that did not exactly mirror any foreign legal solutions. The process leading to corporate law reforms was a highly political one—and consciously so. In the debates preceding the adoption of Brazil's 1882 corporation statute, one senator warned that, despite efforts to frame the discussion in legal terms, the theme "has had for a long time a political connotation."<sup>233</sup>

Alan Watson's view echoed by La Porta et al., that legal systems evolve largely independently of political forces, is predicated on the assumption that "for most of the time rulers and governments in the Western world as a whole were little interested in making private law."<sup>234</sup> Whatever wisdom this view may hold with respect to developments in contracts, torts, or property law, its utility in explaining the law of corporations is much more dubious. One reason is that private law regimes have existed for over two millennia, while general business corporation statutes are only about two centuries old. Perhaps more importantly, the effects that corporate law can have on financial development and, consequently, on the degree of economic competition, growth, stability, and mobility have made it almost impossible for governments to ignore this area of law—in the present, as in the past.

In conventional descriptions of the background of legal transplants, the story invariably goes that public-spirited reformers seek to modernize the law of a more backward society by importing "the

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230. See, e.g., ANDRÉ FÉASSE, *LES SOCIÉTÉS ANONYMES DANS LA RÉPUBLIQUE ARGENTINE* (1928) 13 (emphasizing the eclectic character of Argentine commercial law, which mixed very different legal sources).

231. *Id.* at 14.

232. *Id.* at 39 (noting that by 1928, other than Argentina, only Chile, Paraguay, Uruguay, Holland, Russia and Turkey maintained the requirement of governmental approval for incorporations).

233. Senate Records, speech of Senator Visconde de Jaguaru (May 2, 1882), at 1.

234. Alan Watson, *From Legal Transplants to Legal Formants*, 43 *AM. J. COMP. L.* 469, 469 (1995).

best possible law” then governing a more developed nation.<sup>235</sup> Just as the view of the law as politically neutral is misleading,<sup>236</sup> so is the purported political neutrality of legal transplants. Legal outcomes have been intertwined with political power not only in the Middle Ages, as argued by Shleifer and Glaeser,<sup>237</sup> or in contemporary Western social democracies, as suggested by most of the political economy literature,<sup>238</sup> but across the board.

In Brazil, the content of legal rules—and their perceived impact on ruling elites—was a far more relevant consideration in their adoption than the issue whether the available legal menus were “made in France,” “made in the USA,” or made at home. Until the 1880s, Brazil not only mimicked, but independently magnified France’s restrictions towards business formation; in 1882, however, it also resorted to French law to liberalize the incorporation process, with positive consequences for financial development. In the twentieth century, Anglo-American law served as inspiration for a statute authorizing the issuance of non-voting preferred shares, which came to be widely blamed for minority shareholder expropriation in Brazil.

Legal developments in Brazil were not mere copies, or inadvertent mutations, of foreign models. While many examples exist of foreign concepts that were simply lost in translation,<sup>239</sup> intentional deviations from foreign legal solutions were commonplace throughout Brazilian history. One Brazilian congressman in the nineteenth century sarcastically suggested that Brazil’s jury model—which differed markedly from its counterparts in England and France—deserved a patent for legal innovation.<sup>240</sup> To be sure, while many instances of local ingenuity were very fruitful, others were less so. The selective transplantation of foreign models, and their transmutations into versions more advantageous to local elites, was arguably one of the channels through which Brazilian oligarchies periodically recreated inefficient institutions to best fit their changing needs over time.

If legal families were not outcome determinative, and if political considerations seemed to be driving the results, one could wonder whether legal transplants mattered at all. The Brazilian experience suggests that foreign models, as a whole, did carry significant weight. Brazilian lawmakers adopted a “cafeteria” approach to legal transplants. There was not a single country whose legal solution was

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235. WATSON, *supra* note 3, at 92 (noting that law reform processes reflect “a conscious attempt to achieve the best possible rule”).

236. See MILHAUPT & PISTOR, *supra* note 14.

237. Shleifer & Glaeser, *supra* note 17.

238. See *supra* note 15 and accompanying text.

239. Judith Martins-Costa & Mariana Pargendler, *Us et abus de la fonctionne punitive: Dommages-intérêts punitifs et le Droit Brésilien*, 4 REVUE INTERNATIONALE DE DROIT COMPARÉ 1145 (2006) (describing the misreadings of Anglo-Saxon punitive damages doctrine in Brazil).

240. Senate Records, speech of Senator Costa Ferreira, at 198 (1850).

binding in Brazil, but the legal outcomes of various “prestigious” jurisdictions served, in the aggregate, as a menu based on which local lawmakers made their choices. Brazilian legislators felt more comfortable picking the bits they liked from different foreign models and altering original combinations, than designing new rules and institutions from scratch.

In recent years, Rafael La Porta and his co-authors have expanded their concept of legal origins to encompass not only specific rules but also the “infrastructure” of the legal system, the “style of social control of economic life,” and the “human capital and beliefs of its participants.”<sup>241</sup> This move towards a broader and more fluid definition of legal origins not only renders their claims increasingly unfalsifiable; it also dissociates it from the comparative law findings that form the basis for their models and categorizations. But notwithstanding the recent developments in the law-and-finance project, the assumption that legal origins are exogenous remains the cornerstone of the project.<sup>242</sup> This case study of corporate law developments in Brazil cast serious doubts on the plausibility of this assumption.

Both the defenders of Legal Origins Theory and their followers at the World Bank have proclaimed that legal origin is not “destiny.”<sup>243</sup> The point of this Article is to demonstrate that, at least in Brazil’s case, it never was. Fighting undesirable legal results alone, without regard to underlying political forces, deflects attention from the underlying causes of financial and economic underperformance. Because politics is such a key driver of corporate governance outcomes—now, as before—policymakers should turn their attention to the design of strategies to overcome the elites’ continuing resistance to financial and economic development.

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241. La Porta et al., *supra* note 11.

242. *Id.*

243. Simeon Djankov et al., *Doing Business in 2004: Understanding Regulation* (World Bank, 2004) (declaring that “heritage is not destiny”); La Porta et al., *supra* note 11, at 325 (denying that “origin is destiny”).