INVIGORATING MICRO AND SMALL BUSINESSES THROUGH SECURED COMMERCIAL CREDIT IN LATIN AMERICA: THE NEED FOR LEGAL AND INSTITUTIONAL REFORM

Boris Kozolchyk & Cristinia Castañeda*

I. INTRODUCTION: SCOPE AND PURPOSE

This article deals with micro- and small business associations in the Western Hemisphere and in European jurisdictions that have influenced the development of Latin America's business associations' law. The economic importance of these business associations cannot be overemphasized; they are by far the most numerous and potentially significant sources of employment and economic development. Yet a legal regime that makes it possible for them, their creditors, and employees to thrive continues to elude the efforts of legislators, courts, administrators, and doctrinal writers. This article analyzes the major causes of this failure and offers possible solutions. Accordingly, it first describes key features of micro- and small businesses, including their number; volume of business; presence in the commercial, industrial and services sectors; typical participants; the connection between their services and selling goods; and difficulties in accessing credit at reasonable interest rates. Subsequently, it analyzes their regulation and resulting effects on their profitability and ability to obtain commercial credit. It identifies regulatory systems compatible with the goal of facilitating their access to secured commercial credit at reasonable interest rates and incompatible ones such as the laws of "reciprocal guarantees." Finally, it suggests adjustments to the legal status of micro- and small businesses and to their methods of doing business in response to their need for secured credit. While suggesting these adjustments or changes, this study does not take a position on the various proposals for protective tax regimes. Such proposals entail an evaluation of tax and revenue policies, which are outside the scope of this article.[1]

II. ECONOMIC AND LEGAL LABELS: OVERVIEW OF REGULATORY SYSTEMS

The labels "micro" and "small" are relatively new to the Latin American law and practice of business associations (*micro*, *pequeñas y medianas empresas*,

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* Dr. Kozolchyk, Evo DeConcini Professor of Law at the James E. Rogers College of Law, University of Arizona, and President and Executive Director of the National Law Center for Inter-American Free Trade. Ms. Castañeda, LL.M. and Project Manager of the National Law Center for Inter-American Free Trade [hereinafter NLCIFT].

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referred to in this article as *MiPymes*).[2] Statistically, Central and South American microbusinesses employ fewer than ten and typically only one or two employees, while small (*pequeñas*) businesses employ on average between eleven and fifty employees. By contrast, the number of employees of medium-sized and larger businesses (*medianas y grandes empresas*) fluctuates sharply from country to country. Economic development agencies, such as the United States Agency for International Development (USAID), attempt to provide greater precision to the meaning of microbusinesses by pointing to their archetypal, as well as to their quantitative features:

> A very small enterprise owned and operated by poor people, usually in the informal sector. . . . [T]he term is restricted to enterprises with 10 or fewer workers . . . . Crop production activities, previously excluded from the scope of the definition, are now included as long as they otherwise qualify on the basis of enterprise size and the economic status of the owner operator and employees.[3]

The annual sales figures of Latin American small businesses stand in sharp contrast to those of their United States and Canadian counterparts. For example, a Canadian banker recently summarized the features of a creditworthy Canadian small business association as having audited annual sales of at least one half million Canadian dollars for three consecutive years.[4] More strikingly, United States bankers who participated in a recent National Law Center for Inter-American Free Trade (NLCIFT) seminar with Central American and Caribbean government officials[5] referred to one million U.S. dollars as the volume of annual sales of a United States small company that would qualify it for an "asset-based" loan.[6] The comparatively large amount of annual sales required of small businesses in the United States has redefined the meaning of microbusinesses by

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2. *See* BORIS KOZOLCHYK, THE LAW OF COMMERCIAL CONTRACTS IN A COMPARATIVE AND ECONOMIC DEVELOPMENT PERSPECTIVE, ch. XIV (forthcoming fall 2012) [hereinafter KOZOLCHYK, COMMERCIAL CONTRACTS] (discussing the various types of commercial codes and their policies).

3. *See* U.S. AGENCY FOR INT'L DEV., MICROENTERPRISE DEVELOPMENT, ADS 219, at 12 (July 8, 2011), http://www.usaid.gov/policy/ads/200/219.pdf. Kindly made available to us by Michael Dennis, Esq., from the Office of the Legal Adviser for Private International Law at the United States Department of State.

4. Jeremy Pallant, Vice-President, Emerging Retail, Micro-Finance & Small Business Int'l Banking, Scotiabank; Remarks as a panelist at the Centre for Trade Policy and Law Workshop, Putting the G20 Global Framework on SME Finance into Practice: Prospects for Canada-Caribbean Collaboration (Dec. 6, 2010).

5. Secured Transactions Study Tour (Costa Rica, Dominican Republic, El Salvador, Guatemala, and Panama), NLCIFT, Tucson, Ariz. (Oct. 6–9, 2010).

6. To see an advertisement of U.S. lenders willing to extend unsecured loans for amounts between $20,000 and $500,000, go to http://www.unsecuredloansource.com/ (last visited Dec. 21, 2011).

lumping them into the large category of businesses with sales of less than a million U.S. dollars per year. Thus, the secured lenders to microbusinesses in the United States now consist of credit unions and a variety of other lenders that rely on the borrower's "household" assets (often doubling as "equipment") and on other personal assets, with only the most viable microbusinesses occasionally being able to access credit on an unsecured basis.[7]

The contrast between the assets required from micro- and small businesses in North, Central, and South America also is significant from the standpoint of upward commercial mobility. In 2009, a Phoenix, Arizona, banker told visiting Central American judges and legislators that fifteen years earlier, his bank lent commercially to at least 50% of the companies that now can borrow only from credit unions and household finance companies. However, the same banker estimated that the remaining half, now considered microbusinesses, moved up to the category of creditworthy small- and medium-sized businesses during those fifteen years as a result of lines of credit extended to them by his bank. The Central American visitors inquired about the percentage of business loans that required the businesses' real estate as collateral, and much to their surprise, the banker's reply was that his bank preferred "accounts receivable as collateral because they were much more liquid than real estate."[8]

In contrast to dynamic shifts in the labels inspired by the economic characteristics of micro-, small, and medium-sized business associations in the United States, the "legal" labels worn by most Latin American business associations, as inspired by the French and Spanish nineteenth century commercial codes, have remained firmly fixed and in a closed-number (*numerus clausus*) fashion under Latin American codes.[9] They are:

> 1) Regular general partnerships (*sociedades en nombre colectivo*);
> 2) Limited partnerships (*sociedades en comandita*), where some partners contribute capital, and the others contribute their work and management skills;
> 3) Joint stock companies or corporations (*sociedades anónimas*), whether of a fixed or variable capital; and
> 4) Limited liability companies (*sociedades de responsabilidad limitada*), which followed the German GmbH of 1892 and French *société à responsabilité limitée* of 1925 equivalents,[10] and are often used as substitutes for family or closely-held corporations.[11]

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7. *Id.*

8. Secured Transactions Honduran Delegation, NLCIFT, in Tucson & Phoenix, Ariz. (July 20–23, 2008).

9. The French *Code de Commerce* was the earliest and most influential; it was enacted in 1807. The Spanish *Código de Comercio* was enacted in 1885.

10. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, chs. X, XII.

11. *See* Raúl Aníbal Etcheverry, *Company Law in Argentina*, *in* LATIN AMERICAN COMPANY LAW FROM A COMPARATIVE AND ECONOMIC PERSPECTIVE, ch. 2 (Boris Kozolchyk & Francisco Reyes eds., forthcoming 2012) (a comprehensive review of their main

Some of the more adventurous twentieth century commercial codes added variants such as the "associations in participation" (*asociación en participación* or joint ventures)[12] or the "individual enterprises with limited liability" (*empresas individuales de responsabilidad limitada*).[13] While this nomenclature reflects the form or manner in which their partners, joint venturers, and shareholders invested in them, it does not reflect their size or the value of their assets.

The economically and legally inspired labels of business associations reflect different normative and transactional worlds. The legally inspired labels are usually associated with manifold administrative and legal proceedings (often referred to by the populace as *trámites*) required to supply missing formalities (including numerous licenses)[14] and to fend off objections from government officials and competitors. The economically inspired regulations, in turn, attempt to encourage operations and thereby combat unremitting unemployment and uncontrolled urban crime.[15] The encouragement comes from providing economic incentives such as easier credit and lower taxes and, in some instances, lower purchase prices for raw materials, equipment, or inventory through membership in buying or selling cooperatives. Accordingly, governmental activities on behalf of *MiPymes* have mushroomed to the point that many, if not most, Latin American countries now have ministries or vice-ministries devoted to them.[16]

Unfortunately, many of the credit facilitation laws that have been enacted have failed to attain their goals. Among these are the "Laws of Reciprocal Guarantees" (*Ley de Garantías Recíprocas*), whose mutual or reciprocal personal (unsecured) guarantees or suretyships are provided by commercial associations or

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features). *See generally* LATIN AMERICAN COMPANY LAW FROM A COMPARATIVE AND ECONOMIC PERSPECTIVE (Boris Kozolchyk & Francisco Reyes eds., forthcoming 2012) (discussing all of these types of "legal" labels).

12. *See, e.g.*, Ley General de Sociedades Mercantiles [General Law for Commercial Corporations], arts. 252–59, Diario Oficial de la Federación [DO], 28 de Agosto de 1934 [hereinafter Mexico LSM]; Ley General de Sociedades N° 26887 [General Law of Companies], 5 de Diciembre de 1997 (Peru). *See generally* ANÍBAL SIERRALTA RÍOS, JOINT VENTURE INTERNACIONAL (1st ed. 1996).

13. *See, e.g.*, Law No. 19.857, Febrero 11, 2003, DIARIO OFICIAL [D.O.] (Chile); *see also* Carmen Sfeir Jacir, *Limited Liability Individual Enterprise*, LEX UNIVERSAL (Jan. 1, 2003), http://www.lexuniversal.com/en/articles/938 ("This law authorizes the incorporation of limited liability individual enterprises."); L. 222/95, arts. 71–81, diciembre 20, 1995, DIARIO OFICIAL [D.O.] (Colom.); CÓDIGO DE COMERCIO [C. COM.] [Commercial Code] art. 10 (Costa Rica).

14. Formalities include the company's formation document granted in a public deed, permits, and licenses, among others. *See infra* Part IV (on formalities).

15. *See, e.g.*, 2 FRANCISCO REYES VILLAMIZAR, LATIN AMERICAN COMPANY LAW FROM A COMPARATIVE AND ECONOMIC DEVELOPMENT PERSPECTIVE – A NEW POLICY AGENDA FOR LATIN AMERICAN COMPANY LAW: RESHAPING THE CLOSELY-HELD ENTITY LANDSCAPE (forthcoming 2012) [hereinafter REYES VILLAMIZAR, A NEW POLICY AGENDA].

16. *See, e.g.*, SECRETARÍA DE ECONOMÍA – CONTACTO PYME, http://www.economia.gob.mx/swb/es/economia/p_Contacto_PyME (last visited Oct. 23, 2011).

groups of "senior" merchants to secure loans granted by financial institutions.[17] As will be discussed in a later section, most of them entail high transactional costs and only marginal access to commercial credit at reasonable interest rates. Recently, more realistic and effective legislative and administrative efforts have been undertaken by entities such as the Organization of American States (OAS), the NLCIFT, the Millennium Challenge Corporation (MCC), the USAID, the World Bank-IFC, and the Inter-American Development Bank (IADB) relying on asset-based or secured loans, about which there also will be more later.

Unfortunately, the drafters of business association laws and of the economic measures destined to encourage the growth of *MiPymes* have not paid much attention to the common purposes and functions of their respective legal institutions. Thus, many Latin American countries still require the execution of formal and expensive documents before notary publics (*escrituras públicas*) or less expensive but still burdensome "private deeds" to create, modify, sell, or liquidate any of the authorized business associations. As stated by Article 21 of the Salvadoran Commercial Code: "All business associations are created, modified, transformed, merged and liquidated by means of a public deed."[18] To these requirements, Article 25 adds that "[a] business association's [separate] legal personality is perfected and terminated by registration of the relevant documents before the Registry of Commerce."[19]

Additional formalities faced by these business associations include obtaining business licenses, permits, and registrations, and trade name, trademark, or other forms of intellectual property. Once formed, they are supposed to keep accounting books and records—some of which are of nineteenth century vintage and at odds with contemporary methods of accounting.[20] These *trámites* consume much of the micro- and small business people's time and money.

In response to the high number of *trámites* required for a business to start operating, a growing number of Latin American governments have enacted laws creating "one-stop shops" (*ventanillas únicas*).[21] By and large, however, the burdens (including costly bribes) remain lodged in obscure commercial code provisions or in administrative or judicial decisions that decree the voidness or voidability of *MiPymes*. Hence, the number of micro- and small businesses continues to populate what economists refer to as the "informal" sector.[22] In particular, the disregard for formalities is responsible for categories of informal business associations, such as:

> a) De facto individual proprietorships (*empresas o comerciantes individuales de facto*), where an individual merchant does business

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17. *See, e.g.*, *infra* note 376.
18. CÓDIGO DE COMERCIO [C. COM.] [Commercial Code] art. 21 (El Sal.).
19. *Id.* art. 25.
20. REYES VILLAMIZAR, A NEW POLICY AGENDA, *supra* note 15, at 124, 158–59.
21. *See, e.g.*, CENTRO NACIONAL DE REGISTROS, VENTANILLA ÚNICA VIRTUAL, https://www.e.cnr.gob.sv/portal/ (last visited Dec. 30, 2011).
22. *See infra* Part VI.A.

regularly under her own name but does not comply with contractual, licensing, registration, or bookkeeping requirements;
b) De facto partnerships, which do the same types of business done by the de jure or duly incorporated partnerships but fail to comply with all of the above-mentioned formal requirements; and
c) Irregular business associations, which comply with some of the above requirements, such as the administrative licensing to do business, but fail to comply with other requirements, such as registration in the business associations registry, keeping proper accounting books and records, or paying taxes.

In addition, a large number of informal business associations are formed by farmers, big and small, to conduct business transactions as an individual or on behalf of their nuclear or extended families, or of informal cooperatives.[23]

In sharp contrast with Latin America's wholly formalistic and closed-number business associations (with rigid rules for creation, amendment, transformation, dissolution, or liquidation), German and U.S. laws are much less formal and more flexible. As will be discussed in later sections,[24] the individual merchant or the "sole proprietorship," by far the largest form of business association in both countries (as well as in Latin America), can engage in business in the United States and Germany without having to register as a business entity or association. Such a merchant also can keep simple accounting books and records (including the use of software) and can sue and be sued, without having to comply with cumbersome administrative, accounting, and notarial requirements. Consequently, the legal issues pertaining to the avoidance, nullities, or "inefficaciousness" of business associations and their irregular or de facto status are much less common in these countries than in Latin America.[25] Clearly, the policy of German and U.S. business association law has been to encourage the healthy "physiology" of micro- and small business associations rather than to focus on their "pathology" (or the causes for their seemingly endless types of nullities and "nonexistences").

The following sections will draw an economic and operational profile of irregular and de facto business associations in selected Latin American countries. This will be followed by an examination of the most influential and representative regulatory regimes of micro- and small business associations in Europe and the Western Hemisphere, and a discussion of how to facilitate their access to commercial secured credit.

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23. *See infra* Part VI.A.
24. *See infra* Part IV.B.–C.
25. *See* Catherine Kuchta-Helbling, *Background Paper-Barriers to Participation: The Informal Sector in Emerging Democracies*, CTR. FOR INT'L PRIVATE ENTER. (Braz.), Nov. 13, 2000, at 7–9, *available at* http://www.relooney.info/SI_Expeditionary/CIPE_4.pdf.

III. AN ECONOMIC AND BUSINESS PROFILE OF LATIN AMERICA'S MICRO AND SMALL BUSINESSES

A. Interchangeability of Major Sources of Earnings and Employment Potential

Even by Latin American standards, Central American nations are among the least economically developed.[26] And some that seemed poised for significant development during their recent history saw their economic fortunes reversed and are now struggling to regain economic stability. This is the case, for example, of El Salvador, geographically the smallest country in Central America (with a total land area of 20,720 square kilometers). During the mid-1970s, its population was 4,232,876.[27] Its significant industrial assembly or *maquila* industries of the late 1970s[28] promised significant sustained economic growth. Presently, its population is 6,071,774 (July 2011 estimate), of which 58% are employed in services, 23% are employed in industries, and 19% are employed in agricultural work.[29] Although the official unemployment rate is a low 7.2%,[30] there is much underemployment (44.3% in 2009).[31]

Nonetheless, positive indicators of economic growth can be found in the region. As will be apparent in the following country surveys and statistical analyses, many micro- and small businesses are both providers of services and sellers of goods. This flexibility increases their ability to diversify not only their products and services but also their clientele and suggests that if their businesses were appropriately supported by commercial credit at reasonable interest rates, many could become prosperous small businesses.

Historically, the ability of providers of services to become sellers of goods that they or their families or business partners produced was no doubt a key factor in the transition from medieval feudal and guild-like economies to fully-fledged capitalist economies.[32] This transition was closely connected with the

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26. *See, e.g.*, *The World Factbook*, CIA, at Honduras, El Salvador, https://www.cia.gov/library/publications/the-world-factbook/ (last updated Dec. 13, 2011).

27. DIRECCIÓN GENERAL DE ESTADÍSTICA Y CENSO, ESTIMACIONES Y PROYECCIONES DE LA POBLACIÓN 1950-2050 [POPULATION ESTIMATES & PROJECTIONS] 45 (July 2009), http://www.censos.gob.sv/util/datos/Proyecciones_doc.pdf (El Sal.).

28. Sandra Margarita Quintana et al., *La Industria Maquiladora en El Salvador* [*The Maquila Industry in El Salvador*], BCR BOLETÍN ECONÓMICO [BCR ECON. NEWSL.] (Banco Central de Reserva de El Salvador) (March–April 2002, http://www.bcr.gob.sv/uploaded/content/category/771312474.pdf (last visited Dec. 30, 2011).

29. *World Factbook*, *supra* note 26, at El Salvador.

30. *Id.*

31. PROGRAMA DE LAS NACIONES UNIDAS PARA EL DESARROLLO [PNUD], INFORME SOBRE DESARROLLO HUMANO EL SALVADOR 2010: DE LA POBREZA Y EL CONSUMISMO AL BIENESTAR DE LA GENTE – PROPUESTAS PARA UN NUEVO MODELO DE DESARROLLO 382, *available at* http://www.pnud.org.sv/2007/idh/content/view/35/109/.

32. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. VII (on guilds and the capitalist system).

emergence of intermediaries known in Germanic countries as *verlegers.*[33] Many of them were former laborers, craftsmen, or guild members who amassed a sufficient amount of capital (in money or in kind) to enable piece workers, such as seamstresses or artisans, to finish the goods that the *verlegers* (as intermediaries) would sell to other intermediaries or to the consuming public.[34]

1. Central America's *MiPymes*

El Salvador's *MiPymes* in 2005 accounted for 99.6% of all of its businesses.[35] Of these, 90.52% were microenterprises[36] located in urban areas and especially in the capital city of San Salvador.[37] As common with microenterprises, most Salvadoran microbusinesses are conducted by a single individual or with the assistance of one or two employees.[38] They are generally ambulatory, except for those located in the homes of the microbusiness person.[39] Yet, despite their small and ambulatory nature, many microenterprises seem able to both sell goods and provide services, as is apparent among the most common types of micro- and small businesses:

> i) Street vendors selling popsicles or other snacks, such as mango and cucumber, often prepared by themselves or family members;
> ii) Neighborhood stores (*tiendas*) selling sodas, milk, bread, snacks, etc.; these stores are known in other countries of the region, such as Costa Rica, as *pulperías*;
> iii) *Pupuserías*, which are traditional local diners that specialize in selling *pupusas*, El Salvador's most traditional food; they can be micro-, small, and even medium-sized businesses; and
> iv) Performers of personal services such as plumbers and electricians (for nonbusinesses as well as for business establishments, including the above (ii) and (iii)), as well as performers of consumer services such as hairdressers and manicurists. Not infrequently, members of this group also sell

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33. *Id.* § (B)(1).
34. *Id.*
35. *La MIPYME en El Salvador*, CÁMARA DE COMERCIO E INDUSTRIA DE EL SALVADOR, http://www.camarasal.com/index.php?option=com_content&view=article&id=22&Itemid=32 (last visited Dec. 30, 2011).
36. *Id.*
37. MINISTERIO DE ECONOMÍA, EL SALVADOR, GENERANDO RIQUEZA DESDE LA BASE: POLÍTICAS Y ESTRATEGIAS PARA LA COMPETITIVIDAD SOSTENIBLE DE LAS *MIPYMES* 94 (Feb. 2008) [hereinafter EL SALVADOR, GENERANDO RIQUEZA].
38. *Id.* at 65.
39. *Id.*

finished products, equipment, parts, or consumer goods related to their services.

Similar features are found in other Central American countries, although percentages differ from country to country and sector to sector. For example, 93% of Guatemala's businesses are micro- and small businesses;[40] in addition, however, the importance of the agricultural sector is highlighted by the fact that 50% of the labor force is engaged in agricultural endeavors.[41] By contrast, in Honduras, 98% of the total number of businesses are microenterprises,[42] and 39.8% of its labor force is engaged in providing services[43] to all of the economic sectors.

The economic importance of informal businesses in Central America (both urban and rural) and their ability to interchange or complement their sources of earnings were evidenced in Costa Rica during the late 1960s.[44] An official census of manufacturing entities in Costa Rica, especially in its capital of San José, reported that the number of manufacturers who did business as de facto business associations (individuals and partnerships) was officially 256 in San José, a city whose entire population was then approximately 200,000.[45] An interview with the director of this census revealed that the actual number was likely double that amount.[46] Moreover, of the total number of reported manufacturers doing business in Costa Rica (5,808), approximately 80% (4,873) were small individual proprietorships (mostly de facto business associations) and the rest were divided among de jure partnerships (19, or 0.3%), registered limited liability companies (557, or approximately 10%), and joint stock corporations (95, or approximately 2%).[47] Such numbers were striking considering Costa Rican commentators of business association law paid very little attention to individual

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40. Carlos Guaipatín, *Observatorio MIPYME: Compilación Estadística para 12 Países de la Región*, INFORME DE TRABAJO, BANCO INTERAMERICANO DE DESARROLLO 20 (April 2003), http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=381255 [hereinafter *Observatorio MIPYME*] (citing INSTITUTO NACIONAL DE ESTADÍSTICA, CENSO INDUSTRIAL (1999)).

41. *World Factbook*, *supra* note 26, at Guatemala.

42. *Observatorio MIPYME*, *supra* note 40, at 22 (citing Consultoría Interdisciplinaria en Desarrollo, *Estudio de Micro y Pequeña Empresa No Agrícola en Honduras* (2000); Liliana Guerrero, *Diagnóstico de la Micro, Pequeña y Mediana Empresa en Honduras*, COMISIÓN NACIONAL DE LA MICRO PEQUEÑA Y MEDIANA EMPRESA (2001)).

43. *World Factbook*, *supra* note 26, at Honduras.

44. *See* 1 BORIS KOZOLCHYK & OCTAVIO TORREALBA, CURSO DE DERECHO MERCANTIL, TEXTO Y MATERIAL DE ESTUDIO (1969) [hereinafter KOZOLCHYK & TORREALBA 1].

45. *See Tercer Censo de Industrias Manufactureras de Costa Rica de 1964*, MINISTRY OF INDUSTRY AND COMMERCE, DIVISION OF GENERAL STATISTICS AND CENSUS 1–7 (April 1967), *transcribed in* KOZOLCHYK & TORREALBA 1, *supra* note 44, ch. 1, at 13–15.

46. Interviews by Boris Kozolchyk & David A. Gantz, San José, Costa Rica (Jan. 18, 1968).

47. KOZOLCHYK & TORREALBA 1, *supra* note 44, ch. 1, at 13.

proprietorships and de facto partnerships as popular forms of business associations.[48]

In contrast to the disregard of de facto associations by legal scholars, the Costa Rican tax collectors paid close attention to them. Regardless of whether they operated as de jure, de facto, regular or registered, irregular or improperly licensed, the tax collector accorded them a fiscal status. Passive legitimization or standing awarded them the legal capacity to make lawful payments of taxes or fees and to appear in court or before administrative tribunals to contest the collection of the claimed taxes, but no other capacity.[49]

All of the other rights and duties derived from their business and nonbusiness activities, including the enforceability of their contracts and their effect upon third parties' rights, remained ill-defined, as will be apparent in a later section.[50] A review of the case law involving de facto and irregular business associations revealed that their sources of reliable earnings were varied and interchangeable.

Consider, for example, the facts of an unreported decision by the Costa Rican Supreme Court, somewhat related to those found in *Montero Gómez v. Nigro Borbón et al*.[51] The main assets of the informal business involved were sales from a pharmacy it operated in San José under the management of an unlicensed "practitioner" pharmacist who had been a long-time employee.[52] The family that founded the pharmacy contributed the founder's degree in pharmaceutical sciences, which enabled the pharmacy to obtain the license required to sell pharmaceuticals.[53] In exchange for this contribution, the family of the founding pharmacist received a percentage of the proceeds of the sales.[54] A related source of income was the interest paid on products sold on credit.[55] The clientele trusted with credit sales often paid their invoices on a monthly or bi-monthly basis.[56] This enabled the operator of the pharmacy to earn interest that fluctuated between 20% and 30% per annum.[57] As will be discussed in a later section, the ability of the provider of goods or services to collect payments of obligations on a regular and reliable basis is of major significance when lenders consider providing secured credit to merchants such as this informally operated *MiPyme*.

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48. *See e.g.*, ROBERTO L. MANTILLA MOLINA, DERECHO MERCANTIL ch. XII (1966).

49. Boris Kozolchyk, *Toward a Theory of Law in Economic Development, the Costa Rican USAID-ROCAP Law Reform Project*, LAW & SOC. ORDER 681, 707 (1971).

50. *See also* Kozolchyk & Castañeda, *supra* note 2, app. § I.

51. *Id.* app. § I, Decision 2 (case summary, questions, and comments, citing 2 BORIS KOZOLCHYK & OCTAVIO TORREALBA, CURSO DE DERECHO MERCANTIL, LAS SOCIEDADES MERCANTILES ch. IV, at 88–97 (1969) [hereinafter KOZOLCHYK & TORREALBA 2] (citing Ángel Montero Gómez v. Juan Bautista Nigro Borbón y Anita Ortiz Ortiz)).

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. KOZOLCHYK & TORREALBA 2, ch. IV, at 88–97.

57. *Id.*

2. Brazil[58]

Brazil is the largest country in South America and one of its most vital and growing economies.[59] It has a total land area of 8,456,417 square kilometers, a total population of 201,103,330, and a labor force of 103,600,000.[60] The majority of Brazil's labor force works in services (66%).[61] Another 20% works in agriculture, and the remaining 14% in the industrial sector.[62] Nonetheless, and despite its significant growth during the last decade, approximately 26% of Brazil's population lives below the poverty line.[63] It is this segment that could profit the most from the employment potential of the *MiPymes* to hire beyond the members of the proprietors' immediate family. According to a report from the *Serviço Brasileiro de Apoio às Micro e Pequenas Empresas* (Brazilian Service for the Support of Micro and Small Businesses), the number of microenterprises grew 9.1% from 1997 to 2003, from 9,477,973 to 10,335,962, and employed more than 13 million people.[64]

Statistical surveys, phone interviews, and questionnaires conducted in 2008 by Erica Batalha[65] revealed that the following are among the most typical micro- and small businesses in Brazil:

1. LAN Houses, cyber cafes that offer internet and video games;
2. Tutors and private teachers who instruct on everything from English to computers to martial arts, and who also supply related goods to their students;
3. Food carts/stands selling tapioca, *churrasco*, hot dogs, *acarajé* (regional food), as prepared by themselves, members of their families, or close associates;
4. Drink carts selling coconuts, and/or alcoholic beverages, prepared by themselves, members of their families, or close associates;

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58. This section is based primarily on research assistance provided by Erica Batalha, Boris Kozolchyk's former student in the course of Comparative Commercial Law during the spring semester of 2008 at the University of Arizona James E. Rogers College of Law. The authors are very grateful for her contribution to the preparation of this section. Batalha conducted a desk study on this topic, and her research included the use of preformatted questionnaires prepared for the purpose of obtaining information on businesses in Rio de Janeiro, Brazil, as well as phone interviews with micro- and small business owners in the same location (research documents on file with author). This same type of research was used to obtain data from other Central American countries.

59. *World Factbook*, *supra* note 26, at Brazil.

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *See* Observatório Sebrae, *Economía Informal Urbana*, July 2005, at 14, *available at* http://www.biblioteca.sebrae.com.br/bds/BDS.nsf/23E6A56185EB0C9F0325703C007F1478/$File/NT000A985E.pdf.

65. *See supra* text accompanying note 58.

5. Beach salespeople offering art, sunglasses, bikinis, cheese, coconuts, sunscreen, cigarettes, etc.;
6. *Mercados*, or small shops, selling items such as fresh produce, clothing, or knick-knacks;
7. Neighborhood stores that sell on credit;
8. *Lanchonetes*, sandwich or snack shops;
9. Handymen;
10. Seamstresses and tailors;
11. Automobile repair shops; and
12. Appliance repair shops (participants in categories 6 through 12 often prepare or help prepare the products they provide to clients).

3. Colombia

By Latin American standards, Colombia has a medium-sized economy.[66] Colombia has a total land area of 1,038,700 square kilometers.[67] Its population is 44,205,293, with a labor force of 21.27 million.[68] Its official unemployment rate is 11.2%.[69] More than half of Colombia's labor force work in the services industry (68%), 18% work in agriculture, and the remaining 13% are employed in the industrial sector.[70] However, as late as 2008, nearly half of the country's population (46.8%) lived below the poverty line.[71]

According to Law 905 for the Development of Micro, Small and Medium Enterprise,[72] the Colombian *MiPymes* include:

1. Microenterprises, defined by a workforce of not more than ten employees, or whose total capital does not exceed 500 times the amount of the minimum monthly wage.
2. Small enterprises, defined by a workforce that ranges between eleven and fifty employees, or whose total assets range between the equivalent of 501 and 5,000 times the amount of the minimum monthly wage.
3. Medium Enterprises, defined by a workforce that ranges between 51 and 200 employees, or whose total capital ranges between the

66. *World Factbook*, *supra* note 26, at Colombia.
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.*
71. *World Factbook*, *supra* note 26, at Colombia.
72. L. 905, agosto 2, 2004, D.O. (Colom.) (amending art. 2 of Law 590); s*ee also* L. 590, julio 12, 2000, D.O. (Colom.).

> equivalent of 5,001 and 30,000 times the amount of the minimum monthly wage.[73]

An annual survey of Colombian manufacturers showed that the *MiPymes* were responsible for 96.4% of Colombia's business establishments, approximately 63% of its workforce, 45% of its manufacturing sector, 40% of its wages, and 37% of the value-added of its products.[74] In excess of 650,000 micro-, small, and medium-sized entrepreneurs contribute to its social security system.[75] In 2001, the number of small businesses was five times as large (43,242) as that of medium-sized businesses (8,041), while the number of microbusinesses in 2000 dwarfed that of small and medium-sized businesses (967,315 microbusinesses, compared to 51,283 small and medium-sized businesses).[76] Of these, 58% were engaged in commerce, 30% in providing services, and 12.5% in industry.[77] Microenterprises generated 1,094,755 jobs—or the equivalent of 1.1 jobs per establishment.[78]

In 2009, when a Colombian banking regulator was apprised of some of the asset-based lending transactions that had helped United States and Canadian micro- and small businesses migrate from a personal to an asset-based form of lending, the regulator pointed to an ice cream vending family business that supplied ice cream to a number of the offices in the neighborhood.[79] Customarily, the vendor presented his invoice for the amount of ice cream the various offices had purchased on a weekly or bi-weekly basis, and the offices paid for it within thirty days.[80] The regulator asked if these obligations could not become the same "accounts receivable" collateral that facilitated small business credit in Canada and the United States.[81] He asked further whether the use of invoices by the ice cream vendors for each sale could not help qualify this collateral for a line of credit that would enable the hiring of more employees beyond the immediate family.[82] If these questions could be answered in the affirmative, as we believe they can, the migration of the ice cream family business from a microbusiness to a small business, with access to commercial credit at reasonable interest rates, could do much to help Colombia's economy grow, and from the bottom up.[83] The following chart, prepared by the National Department of Statistics for Colombia (DANE, *Departamento Administrativo Nacional de Estadísticas*) after it surveyed

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73. *See* Kozolchyk & Castañeda, *supra* note 2, ch. 1, app. § II (defining *MiPymes* in other Latin American countries).

74. Sección Pymes, BUSINESSCOL.COM, http://www.businesscol.com/empresarial/pymes/index.htm#Calificacion (last visited Dec. 22, 2011).

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

79. Boris Kozolchyk, meeting with Colombia's Superintendent of Finance in Bogota, Colom. (Sept. 10, 2009).

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

microenterprises, shows the present job-generation potential of Colombia's microbusinesses per economic sector at a time when they still lacked access to commercial secured credit at reasonable rates.

Microbusinesses and Employment in Colombia[84]

Sector	Number of Businesses	Workers
Commerce	719,000	1,209,000
Services	366,000	756,000
Industry	87,000	194,000
Total	**1,172,000**	**2,159,000**

Note that the number of workers employed in the services sector is second only to the number employed in the commercial sector. When attendees at a meeting sponsored by the Colombian Superintendence of Companies were asked about the distinction between these two sectors vis-à-vis microbusinesses, most had difficulty pointing to clear differences between them.[85] It is our understanding that, for regulatory purposes, services in Colombia are regarded as part of the commercial sector. A lender would not differentiate between accounts receivable generated by commerce or by the provision of services, hence expanding the collateral pool.

4. Mexico

Mexico and Brazil are the largest Latin American economies.[86] Mexico's statistics on *MiPymes* are equally indicative of employment potential as those of Brazil and Colombia. Ninety-nine percent of all Mexican businesses fall under the rubric of micro-, small, or medium-sized enterprises;[87] they employ approximately 60% of the population (out of which microenterprises employ

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84. Press Release, Departamento Administrativo Nacional de Estadísticas, Microestablecimientos – Evolución I Trimestre (Nov. 6, 2009) (Colom.), *available at* http://www.dane.gov.co/files/investigaciones/boletines/microestablec/Bolet_micro_Itrim09.pdf.

85. Boris Kozolchyk, Lecture, The Financial Crisis – The Lack of Liquidity that Spread Through the Banking and Investment Banking and Brokerage Sectors of the United States, Europe, and Asia, in Bogota, Colom. (Sept. 11, 2009).

86. *World Factbook*, *supra* note 26, at Brazil and Mexico.

87. INSTITUTO NACIONAL DE ESTADÍSTICA Y GEOGRAFÍA (INEGI), RESUMEN DE LOS RESULTADOS DE LOS CENSOS ECONÓMICOS 2009, at 21 (2010) [hereinafter INEGI SUMMARY CENSO 2009], *available at* http://www.inegi.org.mx/est/contenidos/espanol/proyectos/censos/ce2009/pdf/RD09-resumen.pdf.

41.8%),[88] and *MiPymes* are responsible for more than 20% of Mexico's gross domestic product.[89] Mexico, of all Latin American countries, seems to have one of the richest databases on the features of *MiPymes*. According to a study by Mexico's National Institute of Statistics and Geography (INEGI, *Instituto Nacional de Estadística y Geografía*), the growth rate of microbusinesses that employed up to ten employees from 1993 to 2003 was, on average, 74%. By comparison, the growth rate for small businesses (eleven to fifty employees) during the same period was on average only 62%.[90] Thus, while the absolute number of microbusiness had grown as microbusinesses, that growth was not reflected in the percentage of growth of small business; no migration from micro- to small business was apparent.

The following charts from INEGI show the distribution of business by size (micro, small, medium, large) and by economic sector, as well as the importance of these types of businesses on job generation in Mexico.

Number of Businesses per Size and Economic Sector in Mexico

Business	Commerce	Services	Manufacture	Total
Micro	1,803,799	1,291,080	404,156	3,499,035
Small	38,779	64,310	22,349	125,438
Medium	11,619	6,555	7,113	25,287
Large	4,353	5,342	3,233	12,928
Total	1,858,550	1,367,287	436,851	**3,662,688**

88. *Id*. at 22; *see also Observatorio MIPYME*, *supra* note 40, at 23.

89. INEGI SUMMARY CENSO 2009, *supra* note 87, at 22; *see also* Rocío Georgina Fernández Zurita, *Las Pymes en México*, ES MÁS, http://www.esmas.com/emprendedores/pymesint/pymechangarro/493439.html (last visited Dec. 22, 2011).

90. INEGI, MICRO, PEQUEÑA, MEDIANA Y GRAN EMPRESA: ESTRATIFICACIÓN DE LOS ESTABLECIMIENTOS (CENSOS ECONÓMICOS 2004) at 16 (2006), http://www.inegi.gob.mx/prod_serv/contenidos/espanol/bvinegi/productos/censos/economicos/2004/industrial/estratifica2004.pdf [hereinafter ESTRATIFICACIÓN DE LOS ESTABLECIMIENTOS].

***MiPymes* and Employment in Mexico**

Business	No. of Establishments	No. of Employees
Micro	3,499,035	8,285,290
Small	125,438	2,404,023
Medium	25,287	1,860,335
Large	12,928	5,586,388

As the data indicate, microbusinesses are heavily concentrated in commerce and services. The majority of microbusinesses—approximately 60%—are ambulatory.[91] Top subsectors for microbusinesses in commerce are retail activities involving food; apparel, and related goods; hardware; and metal and glass. These activities present a number of possibilities for a firm to seek to increase volume by manufacturing or providing services related to the goods being commercialized, even while the firm's principal activity is commerce. Selling of food can include bread or other baked goods or jams prepared by the selling firm—often by a family member in the case of microbusinesses. Thus, the good sold incorporates a manufacturing activity (e.g., transforming materials or assembling components to acquire new products). For commerce in apparel, alterations can be added. A seller of hardware may make keys or cut blinds to size. These are all activities that go beyond the basic selling of goods.

B. Unsecured Lending and *MiPymes*

1. *Tandas*

During the 1960s, there was a wide variety of unsecured small or microloans made to individuals and families for consumption or business purposes.[92] Consumption loans were often managed by informal associations in which participants contributed small amounts of money to weekly or monthly pools known as *tandas* or *tandinas.*[93] In return, they were able to borrow small

91. INEGI, MICRONEGOCIOS SIN LOCAL (CENSOS ECONÓMICOS 2009) (2009), http://www.inegi.org.mx/est/contenidos/espanol/proyectos/censos/ce2009/pdf/M_Micronegocios.pdf.

92. *See* Boris Kozolchyk, *The Commercialization of Civil Law and the Civilization of Commercial Law*, 40 LA. L. REV. 3, 45 (1979) (referencing *tandas* in Central America and Mexico).

93. *Id.* at 45–46; *see also* CARLOS VELEZ-IBANEZ, BONDS OF MUTUAL TRUST: THE CULTURAL SYSTEM OF ROTATING ASSOCIATIONS AMONG URBAN MEXICANS AND CHICANOS (1983) (describing comparable lending methods in the United States among poor Mexicans).

amounts for an unexpected event, such as a birth, a death, a wedding, and, very occasionally, for an emergency in their own microbusinesses. The weekly or monthly contributions were made to an administrator who also determined distributions. Often, the administrator was a highly respected community person, such as a widow who had managed to support her family despite her husband's early death.[94] Interest rates were not always charged, but when charged, they were considerably below the very high or usurious rates that *tanda* borrowers referred to as "high market" rates. The most common method of documentation of these loans was the administrator's entry in a notebook (*libreta*), where she wrote down the amount of the loan, its date, and the date or dates of repayment(s). Because of the quasi-familial nature of this association, debt repayment was often the victim of the borrowers' precarious budgets. As stated by an administrator, "If [the debtors] can repay, they will do it quickly because they know that their family or friends depend on it to borrow themselves, but if they can't, they can't."[95] *Tanda* administrators complained that police or administrative officials often threatened legal actions against them because they lacked a legal status (*personalidad jurídica*) to both take deposits and manage their *tandas*.[96]

2. Individual and Joint Liability in Microfinance

As noted by Economists Dean Karlan and Jonathan Morduch, one of the earliest attempts to institutionalize microfinance was by means of group lending contracts or extensions of credit.[97] Referring to his experience with microlending while in Bangladesh, Mike Dennis, a lawyer with the Office of the Legal Adviser of the U.S. Department of State, indicates that "the group lending model is more prevalent for smaller loans at the lowest tier of the market, where joint liability generates social pressure . . . while the individual lending model is typically utilized for higher loans at the upper tier of the microfinance market."[98] These observations were confirmed by one of the authors in Central America during the 1960s. Accordingly, borrowers assumed loans either on a joint or joint and several liability basis. In addition, as the number of the participants in the joint

94. Research conducted by Boris Kozolchyk in Costa Rica (1968) (on file with author); *see also* Kozolchyk, *Commercialization*, *supra* note 92, at 45.

95. Kozolchyk & Gantz interviews, *supra* note 46.

96. *Id.*

97. Dean Karlan & Jonathan Morduch, *Access to Finance*, *in* 5 HANDBOOK OF DEVELOPMENT ECONOMICS 4703, 4707 (Dani Rodrik & Mark Rosenzweig eds., 2010), *available at* http://karlan.yale.edu/p/HDE_June_11_2009_Access_to_Finance.pdf.

98. E-mail from Michael Dennis, Esq., Office of the Legal Adviser for Private Int'l Law, U.S. Dep't of State (June 12, 2011, 13:40 MST) (on file with author) (citing KARLAN & MORDUCH, *supra* note 97; Xavier Giné & Dean Karlan, *Group Versus Individual Liability: Long Term Evidence from Philippine Microcredit Lending Groups*, FIN. ACCESS INITIATIVE, May 2009, at 6–7, *available at* http://financialaccess.org/sites/default/files/GroupversusIndividual Lending-May2009_0.pdf).

liability groups grew, lenders required that their borrowers periodically deposit a certain amount of their repayment with banks or credit cooperatives. It also became apparent that certain lenders started requiring collateral, such as recently acquired consumer goods or equipment, and registered their security interests in rudimentary and dysfunctional registries, where the registry was finally entered many months, if not years, after the loan had been granted.[99]

C. Collateral and Central and South American *MiPymes*

The preceding as well as other statistical sources show that *MiPymes* represent well over 90% of the total number of business establishments in the Latin American region and contribute approximately 60% of its GDP.[100]

However, when judged by the same statistical measures, the present revenues of *MiPymes* do not qualify as collateral sufficient to support the grant of secured or unsecured loans. For example, in Honduras, the annual sales of its microbusinesses are an average of $37,500, while those of small companies are $112,500 (contrast these figures with the respective $500,000 and $1,000,000 qualifying annual sales of small and medium enterprises in Canada and the United States).[101] Assuming the annual sales of a Honduran small business with at least eleven employees, part of the small business's gross revenues of $112,500 will need to be used to pay for wages as well as other fixed and variable costs of operation. This does not leave much profit for the small Honduran business owner.

On the other hand, progress based on the collateralization of the assets of *MiPymes* is quite possible. In fact, as noted in 2009 by Karlan and Morduch: "'[A]ccess to finance' is shifting to embrace the idea of providing banking services (credit, savings, and insurance) rather than primarily delivering microcredit for small-scale business."[102]

Interviews in Brazil,[103] Costa Rica,[104] and El Salvador[105] revealed that many of the *MiPymes* were not only providers of goods and services but also tended to have long-standing relationships with their customers. These factors suggest that secured credit may enable the *MiPymes* to extend similarly secured credit to their customers and thereby increase their sales and diversify their

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99. 3 BORIS KOZOLCHYK & OCTAVIO TORREALBA, CURSO DE DERECHO MERCANTIL, TEXTO Y MATERIAL DE ESTUDIO 1–57 (1971).

100. *See* INT'L FIN. CORP. [IFC], THE SME BANKING KNOWLEDGE GUIDE 12 (2009), *available at* http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/SMEBankingGuidebook/$FILE/SMEBankingGuide2009.pdf.

101. Kozolchyk & Castañeda, *supra* note 2, app. § II; *see also* Secured Transactions Study Tour, *supra* note 5.

102. Karlan & Morduch, *supra* note 97, at 3.

103. Batalha research, *supra* note 58, at 65.

104. Kozolchyk research, *supra* note 94.

105. Desk study conducted by Cristina Castañeda (2009) (on file with authors).

sources of reliable and regular income. As will be discussed shortly, these are among the basic banking requirements for the migration of *MiPymes* to the status of small businesses with access to secured credit.

D. Accounts Receivable and the Migration of *MiPymes* to Secured or Asset-Based Lending

As just noted, the main source of repayment of the microloans of the Grameen Bank variety is the borrower's ability and willingness to repay her debt, at times guaranteed or aided by family members and friends acting as sureties, and occasionally secured by consumer goods and equipment. In contrast, secured or asset-based commercial lending depends not only upon the borrower's ability and willingness to repay the loan but also, and most importantly, upon the collateral in the form of valuable business assets she can provide. Commercial assets collateral (such as inventory, equipment, intellectual or industrial property rights, accounts receivable, or proceeds from the sale of goods or services) generally have a shorter lifespan than real property collateral. Some, such as foodstuffs or seasonal crops, are highly perishable, and others, such as accounts receivable, sharply diminish in value after their date of maturity expires. These features make it necessary for business assets such as inventory, accounts, and equipment to have a self-liquidating quality, i.e., they must be capable of repaying the loans that enabled their acquisition quickly, efficiently, and profitably.

In the case of inventory (e.g., a retailer's or wholesaler's merchandise, raw materials, and finished or unfinished goods ready for sale), it must be convertible into cash quickly. This self-liquidation is accomplished by the inventory's sale and repayment of the loan. Thus, while the repayment of the microloan depends upon the borrower's flow of income (from whatever source), the repayment of the asset-based secured commercial loan depends both upon the debtor's reliable flow of income and self-liquidating collateral. The self-liquidating features of *MiPymes*' collateral depend upon the business sector in which they operate. For example, a farmer's crop may become self-liquidating once it is harvested and can be picked up farm-side by its purchaser or broker, or once it is stored with a reliable warehouse and subject to a negotiable warehouse receipt. In contrast, an account receivable may become self-liquidating once the underlying contract has been performed and payment on it is due by a solvent party, regardless of who is in possession of the goods or who has benefitted from the services rendered by the debtor. Further, this type of financing is, in addition to accounts receivable, usually secured by the secured debtor's inventory as well as the proceeds. The proceeds of the sale of such inventory may include any goods or money that can be traced to the sale of the financed inventory.

Thus, accounts-receivable financing greatly facilitates the migration from micro to secured or asset-based lending and the transformation of a microbusiness into a small business. The microvendor or provider of services can produce a tangible record of it by billing his customer for the amount owed. This billing can

be documented with a bill of sale or an invoice. At times, the microvendor creates only a rudimentary record of the transaction that produced his account by entering details in her *libreta*. If properly verified and recast as statements of actual or projected cash flow statements, this documentation facilitates the secured or asset-based credit to micro- and small businesses.[106]

The collectability of accounts receivable as collateral is a function of the soundness of their sources of repayment. How honest and solvent is the account debtor? How liquid is her business? How many other like-debtors does she have? Do they, in the aggregate, generate enough proceeds with which to pay the accounts receivable pledged by the micro- or small business debtor to her institutional or private creditor? In addition, as just noted, the market value of the accounts receivable collateral depends on its average age, among other factors.[107] The age and eligibility of a borrower's accounts receivable in turn depend on the type of business, the sector or industry in which the borrower operates, and its credit policies.

Not infrequently, a microborrower's ability to provide eligible accounts receivable to a secured creditor can cause an immediate migration to the status of a creditworthy small business. Such is the case of certain microagribusinesses in Mexico, where *A*, a microbusinessperson who regularly supplies a number of farmers in his area with the insecticides needed to protect their crops, grants the farmers a thirty-day credit period to pay for such insecticide. Most of the farmers supplied with the insecticide have lines of credit with private bank *B*. The farmers are aware that microbusiness *A* is in need of commercial credit and indicate to their bank *B* that microbusiness *A* has accounts receivable generated from the regular purchases of insecticide by such farmers. Subsequently, and following bank *B*'s due diligence, *B* grants a loan to *A*, secured with *A*'s eligible accounts receivable. Up until that time, *A* had not been successful in terms of obtaining such a secured loan.

Some time after the Mexico field work uncovered the above scenario, one of the authors (Boris Kozolchyk) participated in a Santiago de Chile International Seminar on Access to Credit for Smaller-sized Businesses hosted by NLCIFT's sister center in Chile (*Centro Jurídico de Implementación del Libre Comercio*), the Faculty of Law at the Universidad Mayor, the American Chamber of Commerce of Chile (AMCHAM), as well as the NLCIFT.[108] During his presentation, Lic. Germán Acevedo Campos, the president of the Factoring

106. *See* NLCIFT Roadmap Honduras (Dec. 2007) (on file with author); *see also* Boris Kozolchyk, *Law and the Credit Structure in Latin America*, 7 VA J. INT'L L. 1 (1967).

107. *See, e.g.*, *Average Age of Accounts Receivable*, ACCOUNTING INFO., http://accounting-information.net/accounting_information/financial_ratios/average_age_of_accounts_receivable.shtml (last visited Dec. 22, 2011).

108. Facultad de Derecho de la Universidad Mayor, Centro Jurídico de Implementación del Libre Comercio, Cámara Chileno Norteamericana de Comercio & NLCIFT, Seminario Internacional: Acceso al Crédito para Empresas de Menor Tamaño [International Seminar: Access to Credit for Smaller-sized Businesses] in Santiago, Chile (April 6, 2011).

Association of Chile, stressed the importance of factoring to the Chilean economy. Acevedo noted that in 2010, the Chilean peso volume of factoring amounted to approximately 13% of Chile's GDP.[109] He added that a growing portion of this financing (available during the same year to 18,000 borrowers) was provided to Chilean small and medium-sized businesses (*Pymes*). Dr. Kozolchyk asked whether the financing to *Pymes* was on a nonrecourse basis, meaning that the factor assumed the risk of collecting the *Pymes*' accounts receivable sold or assigned to the factor, as opposed to a recourse basis, in which the *Pyme* assumed the risk of collection. Acevedo answered that Chilean factors financed *Pymes* on a recourse basis (*con responsabilidad de la Pyme*).[110]

Dr. Kozolchyk then asked if Acevedo was aware that the OAS Model Inter-American Law on Secured Transactions (OAS Model Law),[111] as adopted by a number of Latin American countries, provided the factor with a security interest not only in the *Pymes*' accounts receivable but also in their inventory and proceeds attributable to the original collateral. Acevedo indicated that he was very pleasantly surprised to learn this. Dr. Kozolchyk asked whether having such an additional collateral and security interest available would persuade Chilean factors to finance *Pymes* on a nonrecourse basis. Acevedo's response was that it would, and that it also would encourage many more *Pymes* to apply for such a credit.

Thus, it seems that having an enforceable security interest in the *Pymes*' inventory, accounts receivable, and proceeds would significantly increase the financing of *Pymes* in Chile and elsewhere in Latin America. Acevedo's opinion confirmed what we learned from the Mexican field work: the liquidity of inventory and accounts receivable collateral not only enables a bank or credit cooperative to act as a primary lender to micro- and small businesses but also enables such a primary lender to acquire secondary financing from second-tier financial institutions willing to purchase or discount accounts receivable with a young enough age and an attractive enough yield.

It is now time to turn to the law that regulates business associations in Latin America (large, medium, small, and presumably microbusinesses) and to identify the most serious obstacles this law poses to the growth of asset-based secured credit. This will require an examination of the legislative models that influenced Latin American law, as well as some that might be used as models for a more effective regulatory regime.

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109. *See id.* Presentation by Germán Acevedo Campos, Factoring: An Efficient Tool to Finance Working Capital (on file with the author).

110. *Id.*

111. ORG. OF AM. STATES (OAS), MODEL INTER-AM. LAW ON SECURED TRANSACTIONS (2002), *available at* http://www.oas.org/dil/esp/cidip-vi-garantiasmobiliarias.htm [hereinafter OAS MODEL LAW].

IV. REGULATORY MODELS OF LATIN AMERICA'S BUSINESS ASSOCIATIONS LAW

A. The French *Code de Commerce* of 1807 and Related Case Law: Typification, Formality, and Nullity

The French *Code de Commerce* of 1807[112] and the German *Handelsgesetzbuch* of 1897 (HGB)[113] were the two predominant models followed (directly or indirectly) by the Latin American drafters of their respective commercial codes.[114] Even though the *Code de Commerce* was the "ugly duckling" of the Napoleonic codification, it still attempted to follow the drafting style of Napoleon's favorite, the *Code Civil*.[115] One of the most important features of the latter's method of drafting was the manner in which contracts were "typified."[116] The *Code Civil* enumerated the key or "essential" Aristotelian features[117] of each listed contract and defined them in a specific manner. Although in theory there was room for other contracts, in practice judges and lawyers invariably attempted to subsume new types of agreements under the existing types.[118] Those that could not be subsumed were "atypical," and their interpretation was guided by the closest analogy to the existing types.[119]

The *Code de Commerce*, in a less precise and elegant manner than the *Code Civil*, attempted to do the same thing with its contracts and forms of business associations.[120] Even though in theory business associations other than those listed could be created under the *Code Civil*'s principle of freedom of contract or autonomy of the will, in reality only those business associations whose formalities and normative content had been prescribed by the *Code de Commerce* could exist as lawful business associations.[121] The *Code de Commerce* also governed only those transactions it described as "acts of commerce."[122] Thus, its characterization of merchants, big and small, depended on whether they engaged in these transactions. As stated by Article 1 of the *Code de Commerce*:

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112. CODE DE COMMERCE [C. COM.] (Fr.) (promulgated Sept. 15, 1807; it and the up-to-date version are available at http://www.legifrance.gouv.fr/) [hereinafter, respectively, C. COM. 1807 (Fr.), C. COM. (Fr.)].

113. Handelsgesetzbuch [HGB] [Commercial Code] 1897 (Ger.) [hereinafter HGB, 1897].

114. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. XI(D).

115. CODE CIVIL [C. CIV] (Fr.) *available at* http://www.legifrance.gouv.fr/home.jsp (promulgated Mar. 15, 1803, published Mar. 21, 1804).

116. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. VIII(D)(1)(g).

117. These are features without which the described object would be a totally different one. See *id.* for a discussion of the influence of the Aristotelian method of definitions and his essences upon the codification of the French Code Civil.

118. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. VIII(D)(3).

119. *Id.*

120. *Id*. ch. X(B).

121. *Id.*

122. *Id.*

"Merchants are those who exercise the acts of commerce as part of their habitual profession."[123]

The *Code de Commerce* conferred the status of merchants hesitantly, always fearing the accusation that it was ignoring the equality of treatment all French citizens (merchants or not) expected from the Revolution, which preceded codification.[124] On the other hand, because Napoleon, a direct participant in the drafting process of the *Code Civil* and an influential overseer of the drafting of the *Code de Commerce*, distrusted merchants and their "trickery,"[125] the *Code de Commerce* was supposed to be applied as little as possible to the ingenuous nonmerchants.[126] Referring to the formalities required of French business associations (prior to the Decree no. 84-406 of May 30, 1984, on the Commercial and Business Associations Registry), Professor Georges Ripert summarized the state of French decisional law as follows:

> A business association that was not created by means of a written deed is null because of a defect in the form. *The required document is for both the validity of the act as well as for its notice to third parties.* [*Its absence*] *therefore calls for an absolute nullity* (Decision by the Civil Appellate Court of the District of the Seine, March 14, 1934, D.P., 1936, 2, 103) *and, contrary to the nullity that results from the deficiency in the notice to third parties, it may be opposed against third parties.* Yet, case law applies, not without a certain amount of resistance, a rule that tends to ignore the intent of the parties and insists that the contract produce certain legal effects.[127]

However, aware of the obvious uncommercial consequences of the above judicial doctrines, Ripert pointed out:

> [A] contract that has not been entered into in writing could well be valid as an atypical contract. It can be regarded as containing a promise to enter into a business association . . . even though such an entity is not yet a business association it binds each party to proceed to the creation of such an association lest they be responsible for consequential damages.[128]

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123 C. COM. 1807 art. 1 (current art. L121-1) (Fr.).

124. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. X(A).

125. Among the various forms of trickery attributed to merchants by many in Napoleonic France were their use of bills of exchange to hide usury and other "illicit causes" of contracts, and their attempts to evade liability through fraudulent bankruptcies. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. X(A)(1).

126. *Id*. ch. X(B)(1).

127. KOZOLCHYK & TORREALBA 2, *supra* note 51, ch. IV, at 2 n.1 (emphasis added).

128. *Id.*

Further, he stated: "The validity of such a promise has been discussed by a number of judicial decisions . . . was admitted a long time ago by the Court of Appeals of Paris and is now recognized in case law . . . ."[129]

1. Recent Amendments to the *Code de Commerce*

Title II of Book I of the present version of the *Code de Commerce* lists the requirements for the status of a merchant, including that of foreign merchants doing business in France.[130] The concern with protecting nonmerchants and consumers from the risks and evils of commerce is still apparent in this 2008 version of the *Code de Commerce*; for instance, minors, even when declared as having full capacity to enter into contracts, may not be traders.[131] The current *Code de Commerce* also forbids foreign merchants to carry out a commercial or industrial enterprise or craft that requires registration of the company or trade on French soil without the consent of the prefect of the department where the foreigner will initially carry out the activity.[132] Implicit in this provision is the encouragement of an automatic class of de facto and irregular merchants—foreign merchants. However, this provision does not apply to nationals of the European Union member states.[133]

Chapter III of Title II sets forth the statutory and administrative obligations of a merchant, including the duty to register as a legal person in the Companies' Register.[134] A failure to comply with this duty is punishable with the hefty fine of 3,750 Euros. In addition, the noncompliant merchant is deprived of the right "to vote in, and to stand in, elections to the commercial courts, the chambers of commerce and industry and the industrial tribunals for a period of up to five years."[135] By replacing a fine for the nullity of the status of a nonregistering merchant, this provision lifts some of the uncertainties of dealing with de facto and irregular companies.

Another important obligation is that of keeping accurate books and accounts. Merchants are directed to record their transactions "chronologically" and to take stock at least once every twelve months of the "existence and value of the assets and liabilities of the undertaking."[136] In addition, they are required to prepare annual accounts at the end of the financial year in view of the entries made in the accounts and the stock-taking: "These annual accounts shall consist of

129. *Id.*
130. C. COM. art. L121-1 (Fr.).
131. *Id.* art. L121-2.
132. *Id*. art. L122-1.
133. *Id.* art. L122-3.
134. *Id*. art. L123-1.
135. C. COM. art. L123-4 (Fr.).
136. *Id.* art. L123-12.

the balance sheet, profit and loss account [statement] and an annex which shall form an inseparable whole."[137]

A helpful development in the French law of business associations is the facilitation of the status of an individual merchant (*entrepreneur individuel*), who could be a physical person and who, by his registration of a simple declaration, could carry on professional, commercial, artisan, or agricultural business activities. Such an *entrepreneur individuel* is subject to a set of minimal accounting requirements.[138]

These provisions still reflect a preference for formalism and an unwillingness to rely on less formal but more up-to-date accounting methods for disclosing the actual state of revolving commercial assets such as inventory or accounts receivable. This unwillingness may be a result of France's failure, until quite recently, to adopt a developed law of secured commercial assets such as described in the preceding section, in which lenders rely on different types of collateral such as inventory, equipment, accounts receivable, intellectual property, etc., and require timely "snapshots" of the state of their collateral.[139]

Title II governs the activities by nontraditional types of business associations and was drafted to support the activities of small businesspersons and business associations.[140] Among these are: Cooperative Associations of Retailers,[141] Collective Shops of Independent Traders,[142] and Mutual Guarantee Schemes.[143] The last of these associations was designed to facilitate credit, especially for small and medium-sized "traders, industrialists, manufacturers, craftspeople, commercial companies, members of the professions and owners of property or property rights"[144] by means of suretyships and other assumptions of secondary liability. These include the mutual or reciprocal guarantee associations that will be discussed in greater detail in a later section.[145]

In sum, the French regulatory model remains formalistic and limits the business associations to those expressly listed in the *Code de Commerce.*[146] Formality under the French system is *constitutive* of rights: business associations that lack the prescribed written deed of constitution are not capable of creating

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137. *Id.*

138. *Id.* arts. L526-6 et seq.; *see also, e.g.*, Acte Uniforme Portant sur le Droit Commercial Général [OHADA] [Uniform Act on General Commercial Law] (Dec. 15, 2010).

139. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. X(D)(1)(b) (describing France's recent adoption of a still-flawed commercial credit system).

140. C. COM. bk. I, tit. II (Fr.).

141. *Id.* art. L124-1 et seq.

142. *Id.* art. L125-1 et seq.

143. *Id.* art. L126-1.

144. C. COM. 1807 art. L126-1 (Fr.).

145. *See infra* Part VII.

146. The *Code de Commerce* has introduced regulation with regard to simplified business forms with features that resemble those of modern company laws in the United States. *See* C. COM. 1807 art. L227-1 et seq (Fr.).

rights or duties between or among the associates or with respect to third parties.[147] The recent amendments attenuate this rigor by imposing a severe fine (instead of nullities) on those associations who fail to record their status.[148] At the same time, the French legislature evidenced a concern for the lack of commercial credit traditionally experienced by micro-, small, and medium-sized business associations and created mutual guarantee schemes, among others, to ameliorate this need.[149]

B. The German *Handelsgesetzbuch* (Commercial Code) of 1897

In contrast to the *Code de Commerce* and its formalistic and nullity-plagued regime, Germany's HGB prescribed formalities that were not constitutive of rights and duties except when providing notice to third parties.[150] In addition, unlike the *Code de Commerce*, the HGB enabled sole proprietorships—whether merchants, artisans, craftsmen, or farmers—to do business without fear of nullities or fines even though they were not constituted as lawful business associations.[151]

The original version of Section 1 of the HGB defined a merchant as follows: "(1) A merchant within the meaning of this Code is a person who carries on a commercial enterprise. (2) Every business enterprise, which has as its objective one of the kinds of business indicated below, is deemed a commercial enterprise . . . ."[152]

Someone who conducted one of the businesses not listed by the HGB, say, an artisan-printer, could still enjoy the important protection of, for example, exclusive use of his firm's name by filing the name with the Commercial Register.[153] This would be true even though he did not execute a formal deed creating his business association. Up until the time of registering his name, his rights to the firm's name were unprotected and could be used by a third party because, having failed to qualify for an ipso facto status as a merchant, he was not deemed a merchant. After he filed "according to the provisions in effect for the registration of commercial firms,"[154] he was deemed a merchant, and his commercial firm's name (*firma*) was protected.

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147. *See* C. CIV. art. 1873 (Fr.) (regulating *sociétés créées de fait* (French de facto businesses) and creating rights and duties between partners and third parties). For judicial decisions on this matter, see KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. X.

148. C. COM. art. L123-4 (Fr.).

149. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. XII(E)(1) (citing THE GERMAN COMMERCIAL CODE § 50(1) (Simon L. Goren trans.,Wm. S. Hein Publishing 2d ed. 1998) [hereinafter HGB (Goren, 1998)]).

150. HGB, 1897 § 1 (Ger.).

151. *Id.*

152. *Id.*

153. *Id.* § 2.

154. *Id.* (stating, "An artisan or like business enterprise, the carrying on of which is not deemed a commercial enterprise under § 1(2), but which according to its nature and scope requires a business establishment organized in a commercial manner, is deemed a

Having a registered firm name is important under German law not only because of the business's ability to prevent competitors from using its established and valuable name, but also because it increases a merchant's credibility in court and among actual and potential lenders or investors. Those typified as original Section 1 merchants because they habitually practice commerce are "automatically" deemed so by virtue of their type of business—no registration was necessary, and consequently no legal regime for de facto associations was necessary.[155] Their registration of business entities is "declarative"; i.e., they had the preexisting right to be protected as merchants, and the registration merely recognized the existence of special commercial rights.[156]

It is worth emphasizing how sharply the HGB differs from the *Code de Commerce* and its Latin American progeny on the effects of lack of formalities. Recall that the *Code de Commerce* subjects their informal business entities and their contracts or negotiations to a regime of nullities, including a possible absolute nullity,[157] thereby creating considerable insecurity among those who do business or contemplate doing business with de facto or irregular business associations. The HGB not only does not disable transactions retroactively entered into by what would be de facto or irregular associations under French law, it also validates many of these transactions by a simple registration in the commercial registry.[158] The HGB's treatment of "silent" or "dormant" partnerships (s*tille Gesellshaft*) illustrates the informality of certain partnership arrangements that in some respects resembles the treatment of joint venturers in U.S. law.

As described by Professors Heinz-Dieter Assmann, Barbara Lange, and Rolf Sethe,[159] under Section 230 of the HGB, a dormant partnership is an informal partnership between a commercial enterprise (be it a corporation, partnership, or sole trader) and an outside party who contributes money to that enterprise.[160] Unlike a limited partnership, a dormant partnership does not affect the enterprise's legal relations with third parties; it has only internal effects (e.g., between the dormant partner and the enterprise).[161] Third parties may not even know of the existence of this partnership because it is not registered in the commercial registry, and the assets contributed by the dormant partner come under the

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commercial enterprise within the meaning of this Code, insofar as the firm name of the enterprise has been entered in the Commercial Register. The proprietor is obliged to effect the registration according to the provisions in effect for the registration of commercial firms.").

155. *See* MARTIN PELTZER & ELIZABETH A. VOIGHT, HANDELSGESETZBUCH/GERMAN COMMERCIAL CODE 4 (5th rev. ed. 2003).

156. *Id.*

157. *See, e.g.*, C. COM. arts. 343–57 (El Sal.) (on irregular and null forms of business).

158. *See* HGB (Goren, 1998), *supra* note 149, § 3.

159. *See* Heinz-Dieter Assmann et al., *The Law of Business Associations*, *in* INTRODUCTION TO GERMAN LAW 143, 174–75 (Mathias Reimann & Joachim Zekoll eds., Kluwer Int'l 2d ed. 2005).

160. *Id.*

161. *Id.*

immediate ownership of the enterprise.[162] In this respect: "[T]he dormant partnership resembles a loan with participation in the profit, because the dominant partner's remuneration is paid out of the enterprise's profits. The dormant partner bears losses only if explicitly provided in the dormant partnership contract."[163]

One of the constitutive rights granted by the HGB to non-Section 1 merchants by their registration as merchants is the ability to convey powers of attorney and commercial representation to agents (*Prokurists*). As stated by original Section 49 of the HGB, when a commercial establishment conferred the power to sign in its name (*Prokura*), it "authorize[d] juridical and extra-juridical acts and legal transactions, of all kinds, which are involved in the conduct of a commercial enterprise."[164] And, as the original Section 50(1) made clear: "A limitation in the scope of the signing power is ineffective as against third parties."[165]

With respect to small merchants, however, Section 4(1) of the original HGB provided that "[t]he provisions concerning firms, commercial books and authority to sign shall not apply to persons the nature or scope of whose trade does not require a business enterprise equipped in the manner of a commercial business."[166]

This provision further confirmed the HGB's validating approach to the informal method of doing business, which is characteristic of micro- and small business associations.

1. Recent Amendments to the HGB

Since its enactment, the HGB has undergone a number of amendments. The most substantial of these took place in 1998[167] and was especially significant with respect to the HGB's scope.[168] HGB Section 1 of the 1998 amendment retains an open-ended approach to the definition of a merchant: "A merchant within the meaning of this Code is [*any*]*one who conducts a business* [*activity*]."[169] Note that it does not require that he who conducts such an activity be registered as a merchant or be responsible for keeping certain books or records. As noted by Johannes Köndgen and Georg Borges, what is generally understood to be a business activity (*Gewerbebetrieb*) is, for purposes of the HGB, as vague

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162. *Id.*

163. *Id.* at 175 (citation omitted).

164. HGB (Goren, 1998), *supra* note 149, § 49.

165. *Id.* § 50(1).

166. *Id.* § 4(1).

167. *See* PELTZER & VOIGHT, *supra* note 155, at 1.

168. *Id.* at 3–6.

169. *Id.* at 35 (emphasis added); *see also* Johannes Köndgen & Georg Borges, *Commercial Law*, *in* INTRODUCTION TO GERMAN LAW, *supra* note 159, at 130–34 (a historical and contextual analysis of the original and amended provisions).

as "a commercial business activity."[170] Further, only business people (*Gewerbebetreibende*) can be merchants, thus excluding "the learned professions" (*freie berufe*) such as physicians, architects, lawyers, accountants, and so on, unless they choose to do business as one of the recognized types of business associations, in which case their activities would be governed by the HGB.[171]

This amendment also takes into account the differences between micro- and small businesses and fully fledged business enterprises (*Erfordernis Kaufmännischer Einrichtungen*), such as the size of inventory turnover, number of employees, reliance on professional bookkeepers or accountants, ability to act through agents or representatives, access to bank financing, and so on.[172] Where, taking into account the above factors, a business is so small that it need not be organized in a formal manner, the person or persons involved are not deemed merchants and are not subjected to any of the licensing or administrative requirements imposed upon regular merchants.[173] Nonetheless, these micro- or small merchants are allowed to apply for registration in the commercial register and, upon registration, become registered merchants with all of the rights, duties, and privileges attendant to that status.[174] Martin Peltzer and Elizabeth A. Voight summarized the amended scope provisions as follows:

> Now anyone conducting a business is a merchant, be he registered or not. The revised Commercial Code applies to him. The merchant has a duty to register and can be compelled to file for registration by a coercive fine (§ 14 Commercial Code). Members of the [liberal] professions do not carry on a commercial business, and, therefore, the Commercial Code does not apply to them.
>
> The very small business is exempted from the application of the Commercial Code, but it can file for registration and thereby become a merchant (§ 2 Commercial Code) . . . .
>
> Agriculture and forestry are also exempted, but can likewise file for registration in the commercial register where a commercially organized business operation is required . . . .[175]

Small merchants or members of civil law associations often file for registration as merchants, even though this regime imposes harsher obligations and stricter duties of diligence on merchants than those applicable to

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170. *Id.* at 131 (citation omitted).
171. *Id.*
172. *Id.*
173. *Id.*
174. PELTZER & VOIGHT, *supra* note 155, at 3, 5.
175. *Id.* at 4–5.

nonmerchants.[176] For example, oral guarantees and other informal promises are more likely to be enforced against merchants than nonmerchants.[177] Similarly, buyer-merchants, unlike nonmerchants, have the duty to examine purchased goods for defects immediately upon delivery.[178] Additionally, some types of merchants are deemed to have accepted offers even though they merely remained silent after receipt of the offers.[179]

Choosing commercial status under the HGB brings considerable benefits to those who desire "clearly defined and undisputable limitation of liability for the limited partner of a limited partnership."[180] We would add the assurance to third parties that the partnership's designated commercial intermediary (*Prokurist*) has the legal power to bind the partnership, better access to commercial credit, and greater credibility of books and records, whether in judicial or extrajudicial procedures. As a result of uniform and standard processes within the European Union, there has been an increasing convergence between the French and German models.

2. The Commercial Registry (*Handelsregister*)

Germany's commercial registry plays an important role in making these benefits effective, particularly after the 1998 revisions. First, it identifies the registered merchant or business association and its agents.[181] Prior to the 1998 reform, the merchant's name as registered had to correspond with his registered "civil" family name, with the option to add a short description of his business, e.g., "Marek Dubovec, Bookseller."[182] Presently, "any description in words (not symbols) may be used as long as the description identifies the merchant in such a

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176. *Id.*

177. *Id.* at 5 (citing § 350 of the HGB, which states: "The formal requirements of § 766 sentence 1 and 2, § 780 and § 781 sentence 1 and 2, of the Civil Code do not apply to a guaranty, an admission of liability or a debt acknowledgment to the extent that the guaranty, for the guarantor, or the admission of liability or debt acknowledgment, for the debtor, is a commercial transaction.")

178. *Id.* (citing § 377(1) of the HGB, which in relevant part states: "Where the sale is a commercial transaction for both parties, the buyer must examine the goods promptly following delivery by the seller insofar as this is practicable in the proper course of business . . . .")

179. PELTZER & VOIGHT, *supra* note 155, at 5 (citing § 362(1) of the HBG, which in relevant part states: "Where an offer is made to a merchant whose business includes solicitation or conclusion of business transactions for others; and such offer is from someone with whom the merchant has a business relationship and concerns solicitation or conclusion of such transactions on behalf of the offeror, the merchant is obligated to reply immediately; his silence will be deemed to be acceptance of the offer . . . ."

180. *Id.*

181. *See* HGB (Goren, 1998), *supra* note 149, §§ 8–16.

182. Köndgen & Borges, *supra* note 169, at 132.

manner that he can be unambiguously identified."[183] The trade name also indicates the type of business association, and if none is used by the single merchant who has registered his family name, the recording must also state "registered merchant" (*eingetragener Kaufmann*); in the case of business associations such as partnerships or corporations, they must state the type or form of association and their place of business.[184]

Secondly, the commercial registry plays an important role in assuring third parties who contract with registered merchants that the intermediaries that purport to act on the merchant's behalf are indeed empowered to act on behalf of their principals, whether as its corporate officers, agents, or representatives.[185] Registration is particularly important in Latin American countries where the law of agency allows the defense that although a principal clothed the purported agent with apparent authority to act on his behalf, the authority given was insufficient to bind the principal.[186] Registration is also a particularly important form of notice for small and medium-sized companies because contracting parties frequently inquire about the power of their representatives (including those of sole proprietors) to contract on behalf of the registered company.

As Köndgen and Borges point out, "The commercial register is more than just a database":[187]

> Documenting a relevant fact through the register may have two distinct legal effects. First, in some cases, the register does not merely provide evidence of a legally relevant fact or event; the very act of registration also legally validates an act or event. Thus, the registration of a person doing business "in a commercial manner" is merely evidentiary; but persons engaged in agriculture or small businesses obtain the status of a merchant by the very fact of enrolling in the register . . . [and] for a company to come into existence both as a body corporate and as a merchant, registration is constitutive . . . . Second and even more important, the commercial register creates a basis for reliance . . . . Of course one may rely on publicized information which is true. Furthermore, according to the principle of "negative publicity" . . . facts that must be, but in fact are not registered . . . may be assumed not to exist by those relying on their non-existence in good faith . . . . But how about information that is duly registered yet false? Such information may be relied upon in good faith as well . . . .[188]

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183. *Id.* (citing HGB (Goren, 1998), *supra* note 149, § 18).

184. *Id.*

185. *Id.*

186. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. V, app. § (C) (discussing the effects of this agency upon the law of commercial contracts).

187. Köndgen & Borges, *supra* note 169, at 133.

188. *Id.*

In sum, the amendments of the HGB take into account the presence of microbusinesses as measured by their inventory turnover, number of employees, reliance on professional bookkeepers or accountants, ability to act through agents or representatives, and access to bank financing. Where, according to these factors, a business is so small that it need not be organized in a formal manner, the person or persons involved in such a business are not subjected to any of the licensing or administrative requirements imposed upon regular merchants.

C. U.S. Law

1. Sources of U.S. Business Association Law: "Aggregate" and "Legal Entities"

State law governs the creation, operation, amendment, and dissolution of business associations in the United States. This law offers businesspersons a wide and open-ended variety of business association forms. They range from publicly held joint stock corporations to closely held varieties, including "Subchapter S" and limited liability companies as well as various types of partnerships.[189] Unlike French law, this law is open-ended; it is up to the participating businesspersons to agree on the format and modalities of their business association, even if the adopted form may diverge substantially from statutorily sanctioned forms. It is important to note that, even though the U.S. limited liability company initially resembled the Latin American limited liability company, at present, the U.S. version of this business form offers a much more flexible structure.[190]

Why is there such a variety of statutorily inspired forms of doing business in the United States? One of the reasons suggested by Professors Larry E. Ribstein and Jeffrey M. Lipshaw is the parties' freedom to contract around statutory provisions.[191] In other words, much of the U.S. statutory law on business associations is ius dispositivum (a law that can be changed by the parties). Another reason is that the main function of business association statutes in the United States is to provide standard forms to help the parties "economize on contracting costs."[192] This is particularly true for small businesses. The legal fees for drafting a unique charter or founding contract for the chosen type of

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189. I.R.S., Pub. No. 583, *Starting a Business and Keeping Records* 2-3 (Jan. 2007), *available at* http://www.irs.gov/pub/irs-pdf/p583.pdf; *see also Small Business Planner: Choose a Structure*, U.S. SMALL BUS. ADMIN., http://archive.sba.gov/smallbusinessplanner/start/chooseastructure/START_FORMS_OWNERSHIP.html (last visited Dec. 29, 2011) [hereinafter *Choose a Structure*].

190. FRANCISCO REYES VILLAMIZAR, LA SOCIEDAD POR ACCIONES SIMPLIFICADA 57–58 (2d ed. 2010).

191. LARRY E. RIBSTEIN & JEFFREY M. LIPSHAW, UNINCORPORATED BUSINESS ENTITIES 2 (4th ed. 2009).

192. *Id.* at 2.

association could prove too costly, particularly if "off the rack"[193] standardized provisions for each type of association are available. Standard forms, however, need not be derived from statutes.[194] For example, decisional rules on the law of agency have contributed much to the growth of partnership law in the United States and have found their way into standard partnership forms.[195]

Ribstein and Lipshaw refer to the traditional partnership form of business as an aggregate of the owners[196] or, in civil law terms, an extension of their legal personality. The corporation, in contrast, is traditionally regarded as a separate legal entity with rights, powers, and liabilities separate from those of the owners. Thus, while the corporation, not its owners, is liable for the debts of the business, the partners in a general partnership are personally liable for the debts of the firm. Other consequences of the legal entity nature of the corporation "include the continuation of the firm after the withdrawal or death of an owner, [its] ownership of property and [its] prosecution and defense of litigation in the corporate name, and taxation of income and losses at the firm rather than owner level."[197]

Consistent with the pragmatic-utilitarian nature of Anglo-American legal reasoning (as contrasted with the Aristotelian and Scholastic nature of the reasoning in the French codes discussed earlier), the definition and classification of "aggregate" vs. "legal entity" associations was designed by Anglo-American jurists and commentators as a tool for problem solving and not as a revealer of any permanent and universal truth about the nature of business associations.[198] Thus, "even a traditional general partnership may be an 'aggregate' when it comes to partner liability, but an 'entity' for purposes of holding title to property in partnership name."[199]

Yet, not all of the U.S. law of business associations is ius dispositivum. The law of federal taxation and that which supervises the public sale of investment securities, among other U.S. public laws, are ius cogens. They specify requirements that cannot be varied or ignored by the parties because they are deemed essential for tax collection and market supervision. Thus, the Internal Revenue Service, for example, requires that the sole proprietor obtain an Employer Identification Number (EIN) for tax assessment and sets forth formal reporting requirements for Subchapter S corporations to allow a tax liability reduction.[200] Similarly, the Bankruptcy Code and state statutes provide a cap on

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193. *Id.*
194. *Id.*
195. *Id.* at 3.
196. RIBSTEIN & LIPSHAW, *supra* note 191, at 2.
197. *Id.*
198. *Id.*
199. *Id.*
200. For the definition of a Subchapter S corporation and eligibility requirements, see 26 U.S.C.A. § 1361 (West 2007). Among the formal reporting criteria that this type of business association must meet in order to avail itself of tax benefits are: i) have no more than 100 shareholders; ii) shareholders must be individuals, estates, or certain trusts; and iii) have only one class of stock.

exemptions of assets that may be claimed by sole proprietorships, among others.[201]

2. The Sole Proprietorship: A Gender and Occupational Profile

It is a cliché by now that in the United States, "[t]he vast majority of small businesses start out as sole proprietorships."[202] A study by the Small Business Administration of the United States on the gender of sole proprietors from 1985 to 2000 also shows the growing involvement of women.[203] The percentage of sole proprietorships owned by women during this period grew by 81.54%, and those owned by men grew by 38.86%.[204] Yet, these statistics also reflected marked differences between the respective incomes: "An average 7.7 percent of male sole proprietorships made more than $200,000 in sales annually and accounted for 59.2 percent of their gross receipts each year. These figures for large-receipt female sole proprietorships were just 3.0 percent and 35.0 percent, respectively."[205]

The economic sectors in which males and females participated also differed:

> [T]he average percentages of total receipts for male sole proprietorship by industry sector were: 33.7 percent in services; 30.3 percent in wholesale and retail trade; 7.9 percent in finance, insurance, and real estate; 20.3 percent in mining, construction, and manufacturing; 5.2 percent in transportation, communications, and utilities; and 2.6 percent in agriculture, forestry, and fishing.[206]

By contrast, female sole proprietors were more active in services (46.6%), wholesale and retail trade (30.3%), and finance, insurance, and real estate (11.6%). Women were less active in mining, construction, and manufacturing (6.8%); transportation, communication, and utilities (3.1%); and agriculture, forestry, and fishing (1.6%).[207]

Most of the above percentages fell along traditional occupational lines. Yet the percentage of female ownership in the financial and real estate sectors revealed that female sole proprietors are making significant inroads in the

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201. *See In re* Ehlen, 202 B.R. 742, 743 (Bankr. W.D. Wis. 1996).

202. *Choose a Structure*, *supra* note 189.

203. *See* Ying Lowrey, *U.S. Sole Proprietorships: A Gender Comparison, 1985-2000*, at 121, http://www.irs.gov/pub/irs-soi/00solprop.pdf (2005) (analyzing data tabulated for the U.S. Small Business Administration by the Statistics of Income Division of the IRS).

204. *Id.* at 123.

205. *Id.*

206. *Id.* at 129.

207. *Id.*

traditional male businesses that involve trusted intermediaries such as bankers, and insurance and real estate agencies and brokerages. Further, during the tax year of 2000, female-owned real estate agencies and brokerage sole proprietorships were most competitive in receiving the highest incomes,[208] while the most profitable sole proprietorship for males and females alike was consulting and research.[209]

Further, while women made up an average of 34% of the total sole proprietorships in the United States by 2000, their growth rate of proprietorships was double that of male sole proprietorships during the 1985-2000 period.[210] Similarly, in 2000, there were more than three times the number of single female sole proprietors that were also heads of households than that of men in this same category (14.7% versus 5.5%).[211]

The importance of growth in female ownership of sole proprietorships in the United States shows that women (whether married or single) have fully joined the ranks of merchants, by the traditional French and German code definitions of those who make commerce their habitual occupation.[212] This reality bodes poorly for laws that enable married women to carry on trades only with their husband's authorization, as was the case in French law[213] and is still the case in some Latin American countries.[214]

3. Peculiarities of the Sole Proprietorship

As stated by J. William Callison and Maureen A. Sullivan in their widely read manual on the law and practice of partnerships, the main reason for the popularity of the sole proprietorship is that it is the simplest, least expensive, and most flexible form of conducting a business by an individual: "Unlike partnerships and corporations, there is a complete [legal] identity between the individual proprietor and his or her business."[215] The proprietor of this business does not need to draw up documents that attest to its creation or registration, nor is he saddled with complex and expensive bookkeeping or accounting requirements. Typically, a simple, yearly profit and loss, single-entry statement will do—there is no need for fancy double-entry bookkeeping and balance sheets. The only step needed to regularize operations, as far as federal tax authorities are concerned (this could vary by state), is to contact the Internal Revenue Service via the

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208. Lowrey, *supra* note 203, at 128–29 & fig.L.

209. *Id.*

210. *Id.* at 133.

211. *Id.*

212. *See* C. COM. art. L121-1 (Fr.); *see also* HGB, 1807, § 1(1) (Ger.).

213. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. X, app.

214. *See e.g.*, Código Civil de la República Dominicana [Civil Code of the Dominican Republic], arts. 1535 et seq.

215. *See generally* J. WILLIAM CALLISON & MAUREEN SULLIVAN, PARTNERSHIP LAW AND PRACTICE: GENERAL AND LIMITED PARTNERSHIPS § 2:1 (2010).

Internet or by phone and obtain, free of charge, an EIN for the sole proprietor. From this point on, he can open one or more bank accounts, and issue invoices, and other valid taxation-related receipts or acknowledgments.

Simplicity of doing business is manifested in a legal regime that allows that all contracts and other transactions take place between "the proprietor, in his or her individual capacity, and the contracting third party. There are no statutes governing the formation and operation of a proprietorship. No documents are necessary to form a proprietorship, and no filings are necessary to commence business."[216]

In exchange for this flexibility of format, the sole proprietor has a direct, personal, and unlimited liability for all of the transactions conducted by his business.[217] Another disadvantage of the sole proprietorship is its termination and liquidation upon the death or retirement of the proprietor.[218] As noted earlier, "[t]he proprietor does business in his or her own account, and under his or her own name or an assumed name."[219] However, if the proprietor wishes to do business under an assumed name, "state law usually requires that the proprietor register [the] assumed name. Some states require display of a trade name affidavit to provide notice of the assumed name to persons doing business with the proprietorship."[220]

Clearly, the purpose of such a requirement is to protect third parties against the proprietor's unfair competition, trade name, or trademark infringement.[221] It also protects the proprietor who has registered his original trade name against its use by others, "at least in jurisdictions in which the proprietor conducts business."[222]

Among the chief disadvantages pointed out by Callison and Sullivan, in addition to the unlimited liability of the sole proprietor are: 1) "potential liquidation of the business upon the death or retirement of the proprietor";[223] 2) difficulty in raising equity (as contrasted with debt) capital because there can be only a sole owner, so she will be unable to sell partnership interests or corporate shares of stock;[224] and 3) the complication of transferring an interest in it except by directly selling its assets.[225] However, these very assets can also be pledged to a secured creditor, thereby facilitating the financing of its transactions, as will be discussed shortly.

This form of business association has become a "default" category for all forms adopted by micro- and small business associations in the United States.

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216. *Id.*
217. *Id.*
218. *Id.*
219. *Id.*
220. CALLISON & SULLIVAN, *supra* note 215, § 2:1.
221. *Id.*
222. *Id.*
223. *Id.*
224. *Id.*
225. CALLISON & SULLIVAN, *supra* note 215, § 2:1.

Because of its popularity, there is no need in U.S. law for "default" types of business associations such as de facto or irregular business associations found so frequently in Latin American countries. More importantly for our purposes, access to secured commercial credit has not been impaired by the informal legal status of individual or sole proprietorships in the United States. On the contrary, since what matters from a secured lending standpoint is the ability and willingness of these businesses to repay their secured loans and the presence of self-liquidating (collateral) sources of repayment, lenders are generally unconcerned with the formalities of their constitution. Further, since what matters for the protection of the rights of third parties of secured loans (such as those of other secured creditors and bona fide purchasers of their assets) is the accessibility and accuracy of the data on the secured debtors and their collateral; normative efforts are focused on providing the quickest and most reliable notice to these parties. This requires that the function of a registry of security interests be ministerial; i.e., the registry should not be concerned with whether, say, company debtor *A* was properly created, or whether its bylaws were strictly followed when the secured loan was applied for, or whether *A*'s corporate officer *B* was the appropriate officer to sign the loan agreement or to consent to secured creditor *C*'s authorizing the filed financing statement.

V. LATIN AMERICA'S BUSINESS ASSOCIATIONS LAW: *NUMERUS CLAUSUS*, DE FACTO, IRREGULAR, AND OTHER ASSOCIATIONS AND THEIR NULLITIES[226]

A. Argentina

Professor Raúl A. Etcheverry's survey of registered business associations in Argentina shows that they seldom include the so-called "personal" types of business associations, e.g., the regular partnership (*sociedad colectiva*), the partnership of "capital and industry" (*sociedad de capital e industria*), those of "labor and capital" (*sociedad comandita simple*), or "of labor and capital with issuance of stocks" (*sociedad en comandita por acciones*).[227] In addition, Etcheverry's survey does not list sole proprietorships. Thus, when businesspersons, particularly small businesspersons, conduct their businesses as individual merchants or partners, they usually do it as de facto or irregular business associations. He adds another category of business association to that of de facto or irregular associations: the "hidden or reserved" business association (*sociedades ocultas o reservadas*).[228] These associations are neither formally

226. Kozolchyk & Castañeda, *supra* note 2, app. § III (providing a summary table on the procedures, time, costs, and minimum capital required to start a business in Latin America compared to good-practice economies).

227. Etcheverry, *supra* note 11, at 8–10.

228. *Id.* at 8.

created nor registered, and their participants do not wish them to become independent legal entities.[229] They wish them to remain known only to the members of the association and not to other participants in the marketplace.[230] In principle, these associations resemble the previously described German "dormant" or "silent" partnerships.[231]

De facto companies, known in Argentina as *sociedades de hecho*, are equally referred to in Argentine legal parlance as "spontaneous" (*sociedades espontáneas*).[232] They lack the essential formalities required from any of the types of business associations that they resemble most. Hence, they are regulated in the same manner as a business association that does not fulfill the two essential steps of "regular creation": 1) the execution of an agreement by all of its founding partners, members, or participants; and 2) the registration of the business entity in the Office of General Inspection of Justice of Argentina.[233]

A business association in Argentina that is classified as de facto by an Argentine judge or administrative official faces an "unsupportive legal system."[234] Such an entity is treated as a "precarious legal person" (*personas precarias*) whose liability is unlimited, joint and several, and thus can exceed the contributions made to it by its purported partners or shareholders. Even if those involved had agreed that only managing partners or shareholders would be jointly and severally liable for all the liabilities of the entity, the court would disregard such an agreement and hold all of the partners, participants, and shareholders liable for all of the entity's debts. On the other hand, any partner, participant, or shareholder could leave the entity at any time, as long as she paid what she owed the company and third parties.[235]

Hence, as noted by Professor Etcheverry, most of Argentina's small business associations start out as "small business establishments" under a precarious legal regime.[236] And while the legal costs incurred in operating such associations may be negligible at first, the legal regime is so uncertain or, in Professor Etcheverry's words, "highly unstable,"[237] that the costs of compliance with at least the steps of formal creation and registration may in the long run seem negligible when compared with the liability flowing from a de facto or irregular status.

The uncertainty of these de facto or irregular entities is compounded by a legal culture of nullities. This culture is apparent in the attention and subtlety devoted by legal commentators to the topic of nullities. Commentators seem more focused on the typology and pathology of nullities than on the destructive effects

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229. *Id.*
230. *Id.*
231. *See supra* Part IV.B.
232. Etcheverry, *supra* note 11, at 8.
233. *Id.*
234. *Id.*
235. *Id.*
236. *Id.*
237. Etcheverry, *supra* note 11, at 8.

of this burgeoning area of business association law upon the formation of viable micro- and small business associations. Drs. Efraín Hugo Richard and Orlando Manuel Muiño, authors of one of the most popular commentaries on Argentina's business associations law, discuss a law of nullities that is ostensibly sophisticated and apparently aware of the need of micro- and small business associations for greater certainty of status.[238] Yet in the final analysis, the picture that emerges from this discussion is one of contradictions and unpredictability.[239] According to these authors, the Argentine law of business associations (LSC, *Ley de Sociedades Comerciales*)[240] adopted the Italian Civil Code concept of a "multilateral" contract as its normative basis.[241] This concept allows the partial rescission of the business association contract and its continuing operation when one of the contracting parties breaches its associational obligations.[242] Article 1420 of the Italian Civil Code of 1942 states:

> In contracts among more than two parties in which the performance of each of the parties aims at attaining a common contractual purpose, where one of the association's relationships with one of the parties is annulled this nullity does not bring about the nullity of the entire contract, except where the participation of such a party is considered essential [in attaining the common purpose].[243]

From this major premise, Richard and Muiño, as well as another commentator whom they quote, derive the perplexing conclusion that:

> [T]he problem of the "nullity of a business association" comes into the force at the time the business association is registered because the previous nullities pertain to the act or contract that created the association . . . . In other statutory regimes, nullities are excluded once the association was registered, except when the purpose of the association was illegal . . . .[244]

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238. EFRAÍN HUGO RICHARD & ORLANDO MANUEL MUIÑO, DERECHO SOCIETARIO: SOCIEDADES COMERCIALES, CIVIL Y COOPERATIVA ch. XVII (2005) (a commentary that must be widely read in Argentina because it is now in its sixth reprint).

239. *Id.*

240. Ley de Sociedades Comerciales [LSC], Law No. 19550, Apr. 3, 1972, [XLIV-B] A.D.L.A. 1310 (Arg.).

241. RICHARD & MUIÑO, *supra* note 238, at 861–62.

242. LSC art. 16 (Arg.).

243. Art. 1420 Codice civile [C.c.] (It.) (translation by Boris Kozolchyk); *see also* art. 1446 C.c. (restating the rule of art. 1420).

244. RICHARD & MUIÑO, *supra* note 238, at 861–62 (citation omitted) (referencing arts. 2–3 of the Mexican General Law of Business Associations).

Presumably, the goal of this rule is to protect the third parties who deal with the de facto or irregular association by allowing these parties to assume that the law will impose unlimited liability upon whoever these third parties dealt with until that business entity has been registered. Yet, the consequences of Richard and Muiño's assertions are far from certain. They add, as a clarification, that the Argentine law's treatment of "absolute nullities"[245] rejects the retroactive application of the nullities to contracts entered into by the de facto or irregular business association.[246] Yet they also assert that "[t]he defects that a form of business association may suffer during its existence can lead to the partial rescission [of its association contract] or to the dissolution of the association, but not to its irregularity or nullity."[247]

It is not clear whether this assertion applies to both unregistered and registered business associations. Richard and Muiño acknowledge that at least a part of the problem is the rigid typification of business associations in Argentine and other laws, followed by a *numerus clausus*, or closed-number-of-associations approach, that penalizes irregularities "with the extremely severe sanction of nullity, which in our day is excessively rigorous and dysfunctional."[248]

However, they attribute the problem to the Argentine law's adoption of a system of nullities designed for unilateral and bilateral contracts and not for a multilateral agreement such as that involved in the case of business associations.[249] While we agree with part of their diagnosis, we are puzzled by the suggestion that the cure lies in the formulation of a new conceptual system of remedies inspired by the multilateral contract categorization of business associations.[250] In our opinion, probably not inconsistent with that of Richard and Muiño, the main reason for the uncertainty of the Argentine nullities regime can be traced to the French Aristotelian-Scholastic-influenced method of defining and classifying legal institutions including contracts and business associations in a permanent, universal, unchanging, and thus closed-ended fashion.[251] Yet the cure does not lie in erecting a new conceptual multilateral contract system because many business associations, particularly smaller ones, are not multilateral but rather bilateral or single proprietorships. Further, it does not help to split the nullities into those that affect the act of creation of the business association and those that arise after the business association has been recorded.

Consider, for example, the not-unusual case of a sole proprietor who after much hard work developed a very valuable trade name for her product or service. According to Article 28 of the Argentine Law of Trademarks and Designations,[252]

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245. CÓDIGO CIVIL [CÓD. Civ.] [Civil Code] arts. 1037–58 (Arg.) (on nullities).

246. RICHARD & MUIÑO, *supra* note 238, at 861.

247. *Id.* at 865.

248. *Id.* at 863.

249. *Id.*

250. *Id.* at 872.

251. KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. I.

252. *See* Law No. 22.362, Dec. 26, 1980 [XLI-A] A.D.L.A. 58 (Arg.) (stating Argentina's law on trademarks and designations).

ownership of the trade name (designation) is acquired by its use (although it confines the use to a given commercial sector and requires that the trade name be unmistakably that of the user). Assume that the name had been well-known and used for a considerable period of time prior to the registration of the business association. Would the sole proprietor of the trade name be granted or denied protection during the period prior to the registration of the association? Would she be denied protection of the trade name following registration because of an irregularity in the registration of the business association if it claimed ownership of the name? Such are the issues that emerge from a system or regulation predicated upon unrealistic assumptions as to who (merchants or nonmerchants) creates small business associations, how they conduct their businesses, and what kind of legal protections they require in order to be encouraged to "regularize" their status.

B. Brazil

1. Forms of Organization of Micro and Small Businesses

When a Brazilian micro- or small business is formally created, it is most likely to select one of the following business associations:[253]

a) Individual merchants. *Empresário/Autônomo* (businessperson/self-employed), *Firma Individual* (sole proprietorship).[254]
b) Partnership-like forms, which include the oldest forms of partnership: (i) the *sociedade em nome coletivo*, where partners share in profits and losses with a joint and several type of liability; (ii) the *sociedade em comandita simples* and the *sociedade de capital e indústria*, two types of mixed capital labor partnerships; and (iii) the *sociedade em conta de participação*, the Brazilian version of the U.S. joint venture agreement.[255]
c) *Sociedades limitadas* (LTDA). The Brazilian counterpart to the United States's limited liability company and commonly used in closely or family-held businesses.[256]

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253. CÓDIGO CIVIL [C.C.] art. 10406 (Braz.) (regulating business entities in Brazil); Lei No. 6.404, de 15 de Dezembro de 1976, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.) (same).

254. Danilo Nogueira, *The Language of Business Entities in Brazil*, TRANS. J. BUS. & FIN. (July 1998), http://translationjournal.net/journal/05money.htm.

255. *Id.*

256. PINHEIRO NETO ADVOGADOS, GUIDE TO DOING BUSINESS IN BRAZIL 4 (2003), *available at* www.brazilian-consulate.org/secom/incs/DoingBusinessinBrazil.pdf; *see also* DEMAREST & ALMEIDA ADVOGADOS, LEGAL ASPECTS OF DOING BUSINESS IN BRAZIL 9, *available at* www.demarest.com.br/media/896319/doing%20business.pdf. As previously indicated, the U.S. limited liability company is a much more flexible business form.

d) *Sociedade anônima* (SA). The Brazilian counterpart to the Anglo-American joint stock company or corporation.[257]

2. Formal Legal Requirements to Create a Business Association

Erica Batalha's research focused on Rio de Janeiro's procedures and costs of qualifying to do business as a micro- or small business association.[258] She noted that although the laws that govern legal entities in Brazil are uniform throughout the country, the processing time and the specific steps required for registering a new company vary from state to state.[259] The process also differs depending on the type of entity being established. The steps required to register as an individual merchant (*empresário*) and as a corporation (*sociedade anônima*), however, are similar. In Rio de Janeiro, for example, the steps and costs are:

1. Choose a name.
    a. *Empresários* must choose a *firma* name, which includes the owner's name or some variation thereof.
    b. *Sociedades anônimas* must give their corporation a *denominação* that includes some description of the type of activity in which the business engages.[260]
2. Check with the *Junta Comercial do Estado de Rio de Janeiro* (Commercial Registry for the State of Rio de Janeiro) to see if the name is in use.[261]
3. File the following documents at the *Junta Comercial*:
    a. *Empresários* file a Businessperson's Application,[262] which is an authenticated copy of the owner's ID, and proof of payment of registration fees and taxes;[263]

257. PINHEIRO NETO, *supra* note 256, at 7; DEMAREST & ALMEIDA, *supra* note 256, at 9.

258. *See supra* text accompanying note 58.

259. *See supra* text accompanying note 58.

260. *See Quero abrir um negócio* [*I Want to Start a Business*], SERVIÇO BRASILEIRO DE APOIO ÀS MICRO E PEQUENAS EMPRESAS [SEBRAE] [BRAZ. SERV. OF SUPPORT TO SMALL & MICRO ENTERS.], http://gestaoportal.sebrae.com.br/momento/quero-abrir-um-negocio (last visited Dec. 29, 2011).

261. *See Nome Empresarial* [*Business Name*], SEBRAE, http://www.sebrae.com.br/momento/quero-abrir-um-negocio/vou-abrir/registre-empresa/formalize/integra_bia?ident_unico=1051 (last visited Dec. 29, 2011).

262. *See Formulário de Requerimento de Empresário* [*Business Application Form*], DEPARTAMENTO NACIONAL DE REGISTRO DO COMÉRCIO [DNRC], http://www.dnrc.gov.br/Legislacao/normativa/anexo1_in95.htm (last visited Dec. 29, 2011).

263. *See Documentação Exigida*, DNRC, http://www.dnrc.gov.br/Servicos_dnrc/Empresario/inscricao.htm (last visited Dec. 29, 2011) (listing documents to be filed with an application to register as an *empresário*).

b. *Sociedades anônimas* file Minutes of the Shareholder's Meeting for Incorporation; Articles of Incorporation/Bylaws; a bank deposit receipt for the portion of capital presented in cash (although there is no legal minimum capital requirement for this type of entity, at least 10% of the capital used to form an *SA* must be provided in cash); several other documents proving the establishment of the corporation; authenticated copies of IDs for all partners; and proof of payment of registration fees and taxes.[264]

4. Once the above-mentioned documents have been filed, the business will receive an NIRE (business registration ID number) from the *Junta Comercial*. This number will be needed to complete the rest of the process.[265]

5. Register as a taxpaying business with the CNPJ (*Cadastro Nacional de Pessoas Jurídicas*, Brazilian Ministry of Finance's Corporate Taxpayer Registry).[266]

6. Apply for an *alvará de funcionamento* (license to operate) from the *Prefeitura de Rio de Janeiro* (Rio de Janeiro City Government).[267]

7. Register as a state taxpayer with the *Secretaria de Estado de Fazenda de Rio de Janeiro* (State Secretary of the Treasury of Rio de Janeiro).[268]

8. Register with the *Ministerio de Previdência Social* (Ministry of Social Security and Social Assistance).[269]

9. Apply for permission to print invoices and receipts at the *Secretaria Municipal de Fazenda de Rio de Janeiro* (Municipal Secretary of the Treasury of Rio de Janeiro).[270]

10. Apply for the authentication of account ledgers at the Municipal Secretary of the Treasury of Rio de Janeiro.[271]

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264. *See Documentação Exigida*, DNRC, http://www.dnrc.gov.br/Servicos_dnrc/sa/constituicao.pdf (last visited Dec. 29, 2011) (listing documentation required for registering a *sociedade anônima*).

265. *See Guia prático para o registro de empresas* [*Practical Guide to Business Registration*], SEBRAE, http://www.sebrae.com.br/momento/quero-abrir-um-negocio/vou-abrir/registre-empresa/formalize/integra_bia?ident_unico=14 (last visited Dec. 29, 2011).

266. *See* CADASTRO NACIONAL DE PESSOAS JURÍDICAS, http://www.receita.fazenda.gov.br/TextConcat/Default.asp?Pos=3&Div=Guia Contribuinte/CNPJ/ (last visited Dec. 29, 2011) (Brazil's Ministry of Finance's registry for corporate taxpayers).

267. *See* PREFEITURA DE RIO DE JANEIRO [RIO DE JANEIRO CITY GOV'T], http://www.rio.rj.gov.br/ (last visited Dec. 29, 2011) (on *Alvará Já*).

268. *See Guia prático*, *supra* note 265.

269. *Id.*

270. *Id.*

271. *Id.*

The costs associated with registering a business and preparing it for operations are as follows:[272]

	***Empresário* Regular**	***Empresário* Micro or Small**	***Sociedade Anônima* Regular**	***Sociedade Anônima* Micro or Small**
Registration and Incorporation – Paid to the *Junta Comercial*[273]	R$137.05 (US$83.06)	R$137.05 (US$83.06)	R$340.06 (US$206.09)	R$340.06 (US $206.09)
Business Name Filing Fee – Paid to the *Junta Comercial*[274]	R$183.42 (US$111.16)	R$93.42 (US$56.61)	R$183.42 (US$111.16)	R$93.42 (US$56.61)
Business License Fee – Paid to Rio de Janeiro City Government[275]	R$457.91 (US$277.52)	Micro – Exempt Small – R$457.91 (US$277.52)	R$457.91 (US$277.52)	Micro – Exempt Small – R$457.91 (US $277.52)
Total Fees	R$778.38 (US$471.74)	Micro – R$230.47 (US$139.67) Small – R$688.38 (US$417.20)	R$981.39 (US$594.78)	Micro – R$433.48 (US $262.71) Small – R$891.39 (US $540.23)

Yet neither the micro- nor the small businessperson should assume that the above list of procedures and costs exhausts the qualification procedure. Additional procedures may have to be completed, and additional fees may have to

272. Table prepared by Erica Batalha with information from *Junta Comercial de Rio de Janeiro* [Rio de Janeiro Board of Trade] and *Prefeitura de Rio de Janeiro* [Rio de Janeiro City Government].

273. *Tabela de Preços* [*Table of Prices*], JUNTA COMERCIAL DE RIO DE JANEIRO (2009), http://www.jucerja.rj.gov.br/servicos/tbprecos/.

274. *Id.*

275. PREFEITURA DE RIO DE JANEIRO, *supra* note 267.

be paid.[276] For contrast, compare the preceding discussion with that in Professor Francisco Reyes' book on Colombia's Simplified Corporations Act,[277] of which he was the drafter.

3. Bookkeeping and Accounting Requirements

As a result of their relative modernity, Brazilian laws and regulations on micro- and small businesses have taken into account some contemporary bookkeeping and accounting practices, thereby facilitating their business operations.[278] For example, while every business is obligated to follow standard bookkeeping practices, businesses have discretion to use automated, computerized, or paper-based systems.[279] Small businesses are exempt from following standard bookkeeping procedures, except for the *livro diário*.[280] For purposes of this exemption, small businesses are defined as those with only one establishment, conducted as a family business, with a gross annual income not greater than 100 times the highest monthly minimum wage, and with paid capital that does not exceed twenty times such minimum wage.[281]

All businesses, including small businesses, must keep a journal (*livro diário*) with bound, sequentially numbered pages.[282] In this journal, the daily acts and operations of the mercantile activity are to be recorded, as well as occurrences that modify, or could modify, the financial state of the business.[283] In addition, in order to use business records in court or before administrative agencies, all

276. For example, if an authenticated photocopy is required and it is not provided to the *Junta Comercial*, they will make authenticated photocopies for R$73 (US$44.24) per sheet. While there are not defined lengths of time for processing at each stage of business formation, Brazilian law limits the length of time that commercial registries have to process petitions for registration. As of a 2007 amendment to the legislation, the registries have between two and five days to issue a decision, depending on the type of registration application that was filed. Any petition not answered within that timeframe is deemed registered. The process of establishing a business in Brazil is admittedly complicated. In an effort to inform the public about the process of registering a business, the *Junta Comercial de Rio de Janeiro* has issued a newsletter for it. *See also* JUNTA COMERCIAL DE RIO DE JANEIRO, *supra* note 273.

277. *See* REYES VILLAMIZAR, A NEW POLICY AGENDA, *supra* note 15.

278. There are several laws and regulations that govern business accounting practices in Brazil. *See, e.g.*, Lei de Sociedades Anônimas [Law of Corporations], Lei No. 6.404, de 15 de Dezembro de 1976, D.O.U. de 17.12.1976 (suplemento); Decreto-Lei No. 486, de 3 de Março de 1969, D.O.U. de 4.3.1969 (commercial bookkeeping law); Decreto No. 64.567, de 22 de Maio de 1969, D.O.U. de 26.5.1969 (regulation on commercial bookkeeping); Lei No. 10.406, de 10 de Janeiro de 2002, D.O.U. de 11.1.2002 (establishing the Brazilian Civil Code).

279. Decreto No. 486, de 3 de Março de 1969, D.O.U. de 4.3.1969, art. 1 (Braz.).

280. *Id.*

281. Decreto No. 64.567, de 22 de Maio de 1969, D.O.U. de 26.5.1969, art. 1 (Braz.).

282. Decreto No. 486, de 3 de Março de 1969, D.O.U. de 4.3.1969, art. 5 (Braz.).

283. *Id.*

financial records (books, ledger cards, etc.) must be authenticated by the Public Registry of Mercantile Businesses.[284] It is worth noting that some Central American nations also regulate the use of this type of journal or notebook for micro- and small businesses' bookkeeping.[285]

C. Colombia

As pointed out by Professor Francisco Reyes, an important distinction between the liability of partners in a lawfully created regular partnership and a de facto partnership is the absence, in the latter, of subsidiary liability.[286] Article 294 of Colombia's Commercial Code (Colombian Comm. C.) provides that when a regular partnership (*sociedad colectiva*) is lawfully created, individual partners can also be held liable for company debts but only when it is shown that the claim against the partnership, even if it was made extrajudicially, resulted in no payment by the partnership.[287] This principle does not apply to de facto partners:

> [Claims] can be made effectively, directly (or not in a subsidiary or secondary manner) and personally against all the *de facto* partners, in accordance with Article 501 of the [Colombian Comm. C.]. In addition, in contrast with what happens to *de facto* partners, the partner of regular lawfully created partnership who [sells or assigns] his participation is liberated from liability for obligations prior to such a [sale or] assignment after one year of having recorded it in the commercial registry.[288]

As with Mexico's General Law of Commercial Companies (LSM, *Ley General de Sociedades Mercantiles*), Article 98 of the Colombian Comm. C. sets forth the principle of a legal personality separate and distinct from that of the founders, partners, shareholders, or participants of a properly constituted business association.[289] And, as Reyes also pointed out, major legal consequences flow from the partial or total disregard of the prescribed formalities.[290] For example, according to Article 498 of the Colombian Comm. C., a de facto business association is one that was not constituted by means of a notarial or public deed.[291] In addition, for purposes of its legal existence, a de facto company requires that

284. *Id.* arts. 5(2), 8.

285. *See, e.g.*, *infra* Part V.E.2.

286. 1 FRANCISCO REYES VILLAMIZAR, DERECHO SOCIETARIO 30 (2d ed. 2006) [hereinafter DERECHO SOCIETARIO 1].

287. CÓDIGO DE COMERCIO [C. COM.] art. 294 (Colom.).

288. DERECHO SOCIETARIO 1, *supra* note 286, at 30–31(citation omitted) (translation by Boris Kozolchyk).

289. *Id.* at 33.

290. *Id.* at 33, 34.

291. *Id.* at 35.

there be more than one partner, that the partners make contributions and distributions of profits and losses, and that it have a business purpose.[292] He also stresses the consensual (meaning, basically, "informal" in civil law parlance) nature of the agreement to create a de facto company,[293] a principle also found in Articles 2 and 3 of Mexico's LSM, discussed below.

Accordingly, it is enough that the de facto partners acted in a manner similar to that of partners in a regular partnership (except for compliance with all of the legal requirements) for the law to accept proof of its existence. Thus, Colombian, as well as Mexican law, deems the formal requirements for the validation of the acts and contracts of de facto business associations ad probationem, or for evidentiary purposes, and not ad solemnitatem, or as an indispensable solemnity whose absence leads to an absolute nullity of the act or contract.

Another important consequence of the characterization of a business entity as a de facto business association is that, in the words of Reyes, "it lives in a state of permanent dissolution,"[294] a status that makes possible its unwinding or liquidation at any time. As provided by Article 505 of the Colombian Comm. C., once a partner or associate in a de facto partnership requests liquidation, his partners or co-participants are bound to bring it about.[295]

The current status of "irregular" business associations is quite different from what it was during the life of former Article 500 of the Colombian Comm. C. It defined irregular business associations as those that acted without a governmental license or authorization when such a license was required.[296] Members, partners, associates, or shareholders of such associations were jointly and severally liable, as is the case with de facto companies.[297] This provision was abrogated in 1992, and subsequent statutory law confirmed the presence of a new regulatory system for Colombian business associations without the need for an operational permit.[298] This renders the category of irregular companies mostly academic in Colombia,[299] in contrast with other Latin American jurisdictions, such as Costa Rica (discussed below), where it is still ascribed special features and distinct legal consequences.

Reyes concludes his discussion of de facto business associations in Colombian law by making two important observations.[300] First, the Colombian

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292. *Id.*

293. DERECHO SOCIETARIO 1, *supra* note 286, at 35 (citation omitted) (translation by Boris Kozolchyk).

294. *Id.* at 37.

295. *Id.*; *see also* C. COM. art. 1038 (Colom.) ("The nullity of an act is apparent when the law expressly declares such act null or imposes nullity as a penalty. These acts are considered null even if their nullity has not been declared by a court.").

296. DERECHO SOCIETARIO 1, *supra* note 286, at 37.

297. *Id.*

298. *Id.*

299. *Id.*

300. *Id.* at 236.

Comm. C. does not distinguish, as other civil law jurisdictions do, between associations formed predominantly by indistinct contributions of capital (such as, for example, the publicly held joint stock corporation in U.S. law) and distinct contributions of personal work or capital (as with the regular partnership). Colombia's seminal division is between lawful or regular business associations and their de facto counterparts. In the latter, the liability of the entity is inextricably and unlimitedly linked to that of its de facto participants, whereas in the former, there is always the separate legal personality of the business association to take into account before attempting to reach the liability of its partners, members, or participants.[301] His second observation is that this is far from universal; in his words:

> In truth, the grant of a separate legal personality to regularly constituted partnerships is debatable from a practical standpoint . . . . [A]dvanced legal systems such as Germany's, for example, do not find it necessary to grant a separate legal personality to the regular partnership. . . . The same thing occurs with the North American form of business association known, generically, as the partnership. In this form of business association, the liability assumed by the partners with respect to partnership obligations is a direct one. . . . This approach appears to be wise because a certain balance exists between the joint, several, direct and unlimited liability assumed by the partners of a regular partnership and the possibility of creating such an entity without specific formalities. Perhaps the lack of such an approach has generated among us [in Colombia] the relative desuetude of the regular partnership and its generalized replacement by the *de facto* business association.[302]

We agree with this observation. In a 1958 lecture delivered at the *Faculté Internationale de Droit Comparé* by the highly influential Italian commercial law scholar Professor Tulio Ascarelli, he urged his listeners to rethink the role of a separate legal personality for micro- and small business associations (as distinguished from the legal personality of its participants) in light of what he termed the need for greater transparency required by the larger number of suppliers of capital, goods, and services in Europe and the Americas.[303] In Ascarelli's words: "Truth to tell, [the concept of] a legal personality does not directly constitute a normative datum, it is only an abbreviated expression of [one

301. DERECHO SOCIETARIO 1, *supra* note 286, at 36.

302. *Id.* at 236 (citations omitted).

303. Boris Kozolchyk, class notes of Lecture, New Principles of Business Associations Law in Europe and the Americas, in Luxemburg (1958). Professor Tulio Ascarelli had been not only one of Italy's foremost law scholars prior to the Second World War, but after the formation of the Nazi-Fascist Axis, he fled Italy and settled in Brazil, where he continued his influential scholarship and successful law practice.

among many] normative approaches [*disciplina normati*] to the allocation of rights and duties in business association law."[304]

D. Costa Rica

Unlike the Mexican LSM, Article 19 of the Costa Rican Commercial Code (Costa Rican Comm. C.) requires:

> The incorporation of a business association [*sociedad*] as well as its amendment, dissolution, merger and any other acts which in any manner modify its structure must necessarily be drafted in a public [or notarial] deed, published in summary fashion in the Official Gazette and registered at the Commercial Registry.[305]

The purpose of such a requirement, especially for those business associations that limit the liability of its members, is to provide as much notice as possible to third parties that are likely to deal with such an association or be affected by its dealings with other parties who may be third party purchasers, sellers, lenders, borrowers, or joint venturers. In principle, this type of notice makes sense. Its functionality, however, is questionable, particularly in an increasingly speedy if not volatile commercial world. In addition, the consequences of the failure to comply are not altogether clear.[306]

While de facto and irregular business associations coexist in Costa Rica's statutory, decisional, and doctrinal law, there are certain, not always clearly perceived, differences. As pointed out by the Argentine writer Carlos Malagarriga, in an irregular business association, some formalities are disregarded by the parties either willfully or negligently despite the presence of a written associational contract.[307] In contrast, de facto business associations lack an associational contract and rely for their existence on the acts or contractual conduct of their associates.[308]

Reflecting this view, Article 22 of Costa Rica's Comm. C. states:

> As long as no publication and registry [of the associational contract] has been made, the decisions, agreements and documents of such an entity shall not have any legal effects

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304. Andrea Bortoluzzi, *Sulla natura giuridica delle partecipazioni societarie* (translation by Boris Kozolchyk), http://www.andreabortoluzzi.it/index.php?option=com_docman&task=doc_details&gid=74&Itemid=66 (last visited Dec. 29, 2011) (citing 1 TULIO ASCARELLI, *Personalità giuridica e problemi della societa*, *in* PROBLEMI GIURIDICI 236–42 (1959)).

305. C. COM. art. 19 (Costa Rica).

306. KOZOLCHYK & TORREALBA 2, *supra* note 51, ch. I, 1–13.

307. *Id.* ch. IV, at 7.

308. *Id.*

> against third parties . . . . [Meanwhile,] the founding members [of the *de facto* business association] are liable jointly and severally to such third parties for the obligations contracted by the association.[309]

Nevertheless, Article 23 of the same Code allows those third parties affected by the acts or contracts of the de facto business association to prove the existence of the association by commonly used evidence.[310] Litigation involving small Costa Rican associations has not abated, and much legal uncertainty remains.[311]

E. El Salvador

1. Forms of Organization of Micro and Small Businesses

The Salvadoran Commercial Code provides for several forms under which a business may be incorporated, including *sociedades anónimas*, partnerships, and irregular businesses.[312] As in many countries, there are several steps that must be followed for a business's creation and subsequent operation. Normally, the process includes subscribing a public deed incorporating the business before a notary public and registering such deed at the Registry of Commerce.[313] The company must have at least two shareholders,[314] and they must pay an initial capital stock.[315] Also, the new company must register its initial balance sheet,[316] obtain a business license (*matrícula de empresa*),[317] legalize its corporate books,[318] and register with tax and labor authorities.[319] Currently, all of these requirements may be satisfied by filing the appropriate documentation at an Integral Services Window (*Ventanilla de Servicios Integrales*) at the Registry of Commerce.[320]

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309. C. COM. art. 22 (Costa Rica).

310. *Id.* art. 23.

311. *See* Kozolchyk & Castañeda, *supra* note 2, app. § I (including case law highlighting this point).

312. *See* C. COM. arts. 343, et seq. (El Sal.).

313. *Id.* arts. 21–22, 24.

314. *Id.* art. 17.

315. *Id.* arts. 22(VII–VIII), 33.

316. *Id.* art. 282.

317. *See* C. COM. art. 411(I) (El Sal.).

318. *Id.* art. 40.

319. CÓDIGO TRIBUTARIO [TAX CODE] art. 86 (El. Sal.); Decreto 682, Ley de Organizacion y Funciones sel Sector Trabajo y Prevision [Social Law on the Organization and Operation of the Labor and Social Division], art. 55, Apr. 11, 1996 (El. Sal.).

320. *See* CENTRO NACIONAL DE REGISTROS, http://www.cnr.gob.sv/index.php?option=com_content&view=article&id=87&Itemid=152 (last visited Dec. 29, 2011).

It is clear from the economic and social profile of microenterprises and small businesses in El Salvador that these types of businesses are mostly informal or de facto. However, Salvadoran laws also provide for a simpler way of formalizing a business that does not require the merchant to incorporate as a separate legal entity. It is possible for a merchant to register as an "individual merchant" (*comerciante individual*);[321] upon registering as such, the merchant would receive her business license (*matrícula de empresa*).[322] It is worth noting that agricultural businesses and artisans who do not have a fixed place of business are not considered merchants.[323]

Furthermore, if such an individual merchant has assets under US$12,000, the Code does not even require her to register at the Registry of Commerce as a *comerciante individual*.[324] Article 15 of the Commercial Code[325] states that these small commercial or industrial merchants are required to comply only with the obligation stipulated under Article 411(IV), which states: "Independent Merchants and Legal Entities must comply with the following obligations: . . . Conduct their activities within the limits of free competition established by law, commercial usages and good customs, [and] refraining from any anticompetitive actions."[326]

2. Bookkeeping and Accounting Requirements

As was previously mentioned, Salvadoran laws are more lenient on individual merchants with assets under US$12,000;[327] they provide for fewer formalities and requirements. For instance, all types of businesses must comply with accounting and bookkeeping obligations, in either electronic or paper-based form;[328] and, more specifically, an individual merchant whose assets exceed US$12,000 must keep accounting records with a certified accountant.[329] However, an individual merchant with assets under US$12,000 may keep her accounting records in a journal or notebook (*libreta*).[330]

In practice, many micro- and small businesses throughout Central America do not keep formal accounting records. Therefore, to require anything above a simple journal or notebook ledger would be inconsistent with the bookkeeping practices of these businesses. However, if the data contained in these *libretas* could be relied upon by financial intermediaries as reliable records

321. C. COM. art. 411(I) (El Sal.).
322. *Id.* art. 415.
323. *Id.* art. 14.
324. *Id.* art. 15.
325. *Id.*
326. C. COM. art. 411(IV) (El Sal.).
327. *Id.* art. 15.
328. *Id.* art. 435.
329. *Id.* art. 437.
330. *Id.* arts. 437, 452.

of accounts owed to the *MiPymes* by their regular and creditworthy customers, migration to the status of small business could conceivably be facilitated.

F. Mexico

Drs. Richard and Muiño contrast the highly uncertain Argentine regime for de facto and irregular business associations with that of Mexico's LSM.[331] According to these authors, Articles 2 and 3 of the LSM, among other laws, "exclude the nullities when the business association has been recorded, except when their business purpose is illegal."[332]

In relevant part, Article 2 of the LSM states:

> Commercial companies registered in the Public Registry of Commerce, have a legal personality different from that of their partners.
>
> Except for what is provided in the following Article [3], companies that have been registered in the Public Registry of Commerce cannot be declared null.
>
> Companies not recorded in the Public Registry of Commerce that have exteriorized their status to third parties, whether or not they have formalized it with a notarial deed [*escritura pública*] shall enjoy a legal personality.
>
> The internal relations of irregular companies shall be governed by the contract that created the business entity [*contrato social respectivo*] and in the absence of such a contract by the general and special provisions of this law, in a manner consistent with the type of business association.
>
> Those who carry out juristic acts as representatives or agents of an irregular company, shall be responsible to third parties for their performance in a subsidiary, joint, several and unlimited manner, aside from the criminal liability in which they may have incurred if third parties were injured.
>
> Those partners who are not culpable of the irregularity can claim damages from those who are culpable as well as from

331. Mexico LSM art. 2.
332. RICHARD & MUIÑO, *supra* note 238, at 861–62.

those who act as representatives or agents of the irregular business association.[333]

Note that the detrimental reliance considerations in the third paragraph of Article 2 impose legal consequences to acts or contracts of unregistered business associations "that have exteriorized their status to third parties . . . ."[334] But also note that these articles do not address the question whether the acts or contracts that resulted from hiding the status of such an entity would not result, *a contrario sensu*, in their absolute nullity or whether actions for damages would be possible involving assets of the partners or the secret association.

It is true that the legal regime set forth by Article 2 when granting a "legal personality" to a de facto or irregular association that has "exteriorized its status" provides greater certainty to those dealing with such an entity than its silent Argentine counterpart. However, as will be discussed shortly, the question is not whether the de facto or irregular association has a legal personality, but of the specific rights and duties it grants or imposes to or upon the association and those who deal with it. In this respect, Article 2, Paragraph 3, differs sharply from the HGB, which binds the principal for the acts of its registered representative or agent (*Prokurist*) even if he or it exceeded its authority. As noted in the discussion of German law, this is a rule that provides much-needed certainty when dealing with small business associations being represented by agents who do business in a similarly de facto, irregular, and informal manner. A simple, timely, and inexpensive registration—a Latin American equivalent of the German *Handelsregister*—could do much to ameliorate uncertainties.

VI. *HOMO HOMINI LUPUS EST* (MAN IS MAN'S WOLF): THE BATTLE FOR A PROTECTED LEGAL STATUS – WORKERS VERSUS MICROBUSINESSES

A. The Cost of a Protected Legal Status

As is apparent from the preceding sections, many *MiPymes* in Latin America cannot meet the required formalities and thus lack an enforceable legal status. Instead, they wind up doing business as irregular or de facto associations or individuals and can lose their licenses or permits to do business at any time. The victims of these uncertainties risk losing their economic survival and include street merchants as poor and ubiquitous as shoeshiners or newspaper vendors. Not surprisingly, many of them wind up as beggars and thus are willing to do whatever they can to acquire a legal status that could protect them against eviction and/or competitive threats.

333. Mexico LSM art. 2.
334. *Id.*

John C. Cross' study of the legal obstacles faced by street vendors in Mexico City[335] illustrated how they compete with one another in attempt to obtain protected privileges, however miniscule. According to a 1951 regulation[336] enacted by the Mexican Federal Congress, street vending was permitted in administratively specified market areas.[337] Yet, this permission was generally ignored by officials who claimed that street vendors violated municipal codes prohibiting individuals from "blocking traffic or causing a public nuisance."[338] Still, Cross notes that during the 1989-1995 period during which his research took place:

> [A]pproximately 200,000 individuals . . . [were] permanently dedicated to this activity throughout the city in a variety of forms. Some have permits, although the city has officially refused to grant any new permits since 1984 and all previously assigned permits are now technically void. Others are "tolerated" by city officials in exchange for some regulatory control. This means that officials have allowed members of a group of vendors to sell in a specific area, but without any formal permit that guarantees their tenancy, a practice that is technically illegal and frequently leads to claims of favoritism and conflicts between groups of vendors or with more established merchants . . . . Indeed, while the city charged a modest floor tax on vendors up to 1985, this tax had to be dropped when officials realized they could not tax an activity that was technically illegal.[339]

Yet, some of the otherwise uncertain administrative authorizations or permits protected some street vendors who, despite their lack of an employment relationship with their suppliers, still qualified for the privileged status of "workers" (*trabajadores*). This was the case with newspaper vendors; the Market Regulation of 1951 stated that "newspaper vendors perform a service in 'the national interest'"[340] and that "[n]ewspaper vendors, musicians, and shoe shiners are regulated under a separate law" (Regulations for the unsalaried workers of the Federal District).[341] Someone familiar with Mexico's twentieth century legal

335. JOHN C. CROSS, INFORMAL POLITICS, STREET VENDORS AND THE STATE IN MEXICO CITY 86 (1998).

336. *Id.*

337. *Id.*

338. *Id.*

339. *Id.* at 86–87.

340. CROSS, *supra* note 335, at 86 n.1.

341. *See* Reglamento para los Trabajadores no Asalariados del Distrito Federal [Regulations for Non-salaried Workers in the Federal District], DO, 2 de Mayo de 1975 (Mex.), *available at* http://www.ordenjuridico.gob.mx/Estatal/DISTRITO%20FEDERAL/Reglamentos/DFREG95.pdf.

history and particularly with the legal effects of its revolution and the socialist overtones of its 1917 Constitution will quickly and rightly conclude that the legal characterization of an "unsalaried worker" is a much safer one in terms of enforceable rights and duties than that of a microbusinessperson. To this day, Mexican jurists (in unison with their great muralists) take pride in the fact that the Mexican Constitution was the first in the world to proclaim the workers' right to strike.[342]

Cross shows that some street vendors were able to collude with "policy implementers" (e.g., municipal bureaucrats, local police) to temporarily lift some of their regulatory or competition burdens.[343] The social costs of such a protection for workers are significant. Regardless of whether these workers earned salaries, their protection was at the expense of other street vendors whose ability to do business in the public square depended upon their making up the loss of public or private revenue with their payments of fines or bribes as part of self-perpetuating costly and corrupt practices. Invariably, however, the protection of certain microbusinesses caused the demise of many unprotected ones with many violent incidents along the way.

B. Some Hopeful Signs of Simplification

Despite the prevailing and counter-productive formalism of much of the law of business associations extant in Latin America, occasional hopeful signs and suggestions of possible cures are apparent in some countries. As has been the case in recent years with commercial legal advances, Colombia has spearheaded promising reforms in its law of business associations. The abrogation of former Article 500 of its Commercial Code in 1992 (which declared "irregular" those associations that acted without a required governmental license or authorization)[344] meant that the absence of these licenses was no longer a cause of nullity or nonexistence; when necessary, the deficiencies can be cured (as in Germany, with regards to a posteriori). This informed Reyes' conclusion that irregular companies are now mostly academic in Colombia.[345] In addition, Colombian Law No. 1258 of simplified corporations[346] shows the way to a much healthier legal environment for small business associations that wish to limit their liability in an inexpensive, albeit transparent, manner.

Another hopeful development for the facilitation of secured commercial credit in Latin America is the widespread use of comprehensive databases of national identification numbers. Often, these databases help verify the names of

342. *See* Constitución Política de los Estados Unidos Mexicanos [C.P.], art. 123, DO, 5 de Febrero de 1917 (Mex.) (one of the few legislative provisions that has a major street named after it in Mexico City).

343. CROSS, *supra* note 335, at 86–87.

344. DERECHO SOCIETARIO 1, *supra* note 286, at 37.

345. *Id.*

346. *See generally id.*

taxpayers, members of social security collection or payment funds, or of the operators of vehicles. These databases make it possible to adopt a German- or U.S.-style system to identify *MiPymes* operating as sole proprietors without the need for them to register as merchants or choose a traditional form of business association and the bookkeeping and accounting duties associated with it. Clearly, this identification practice should be accompanied by the inexpensive registration of simplified business forms for individual merchants, with or without personal liability, or business associations with similar features.

Similarly, Salvadoran legislators have attempted to simplify and modernize bookkeeping and accounting requirements, which aids the assessment of *MiPymes*' creditworthiness in secured commercial loans. As will be discussed shortly, cash flow and accounts receivable information provided by these *libretas* (adjusted to the peculiarities of each sector) could significantly enhance merchants' access to asset-based lending and especially to accounts receivable financing.

VII. THE ROAD TOWARD SECURED LENDING AND THE UNNECESSARY DETOUR OF RECIPROCAL GUARANTEES

At present, Latin American microbusinesses rely for the most part on personal credit given by family members, friends, and neighborhood pools administered by long-time and trusted residents.[347] Bank loans are rare[348] and, depending upon the size of the loan and the type of bank, rely on the borrowers' personal sureties or—even more frequently—on mortgages on the borrowers' homes, land, or places of businesses.[349] In the last two decades, qualified

347. *See generally* Boris Kozolchyk, *Toward a Theory of Law in Economic Development, the Costa Rican USAID ROCAP*, 1971 LAW & SOC. ORDER 681 (1971); *see also* Paul Karon, *Law and Popular Credit in Mexico*, 1 ARIZ. J. INT'L & COMP. L. 88 (1982); CARLOS VELEZ-IBANEZ, BONDS OF MUTUAL TRUST: THE CULTURAL SYSTEMS OF ROTATING CREDIT ASSOCIATIONS AMONG URBAN MEXICANS AND CHICANOS 200 (1983).

348. *See* Boris Kozolchyk, *Secured Lending and Its Poverty Reduction Effect*, 42 TEX. INT'L L.J. 727, 729–31 (2007) (listing some statistics on the financing sources of microenterprises).

349. *See* Odile Hoffmann, *Crédito y Préstamo Hipotecario en una Zona Cafetalera del Estado de Veracruz, durante el Profiriato*, *in* MARIE-NÖELLE CHAMOUX ET AL., PRESTAR Y PEDIR PRESTADO: RELACIONES SOCIALES Y CRÉDITO EN MÉXICO DEL SIGLO XVI AL XX 139 (an insightful description of real property mortgage financing of early republican Mexico, concluding that agricultural mortgage credit resulted in "the cohesion of the dominating minority [of creditors] to the exclusion of the poorest [borrowers] . . . . The grant of mortgage credit [in the Veracruz region] was an adequate channel to intervene in local society and become an indispensable partner . . . . In fact, the majority of present landholders and of people of high social rank, appear in the land archives first as lenders and then as owners of the [mortgaged] land.").

borrowers have also resorted to authorized lines of credit in credit cards.[350] During the same period, multinational development assistance organizations such as the IADB have encouraged the adoption of statutes on "mutual" or "reciprocal" guarantee companies, which promise to pay the loans of *MiPymes* in case of default.[351]

The mutual guarantee system of credit was born in continental Europe as a distant heir of the guild system in which craftsmen supported each other by making credit available to needy members through credit cooperatives or associations.[352] Current mutual guarantee systems assist merchants, regardless of trade, occupation, or type of business association, in obtaining loans and, most importantly, in providing a guarantee of payment for their loans.[353] Usually, they are regulated by special laws or code provisions, and their purpose is apparent in labels such as France's *Societés de Caution Mutuelle*, Spain's *Sociedades de Garantías Recíprocas*, and Chile's *Instituciones de Garantía Recíproca* (collectively referred to here as SGRs).[354]

Although SGRs initially were related to associative or cooperative forms of businesses, nowadays they have features from commercial companies (such as corporations or *sociedades anónimas*), cooperatives, and financial institutions. In sum, SGRs are financial institutions created to assist micro-, small, and medium-sized businesses access credit by guaranteeing their obligations to third parties/lenders, as well as to assist debtors to obtain better terms and conditions for their loans and provide advice on business plans.[355]

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350. *See* Marla Dickerson, *Global Capital – Mexicans Discover How Easy, and Hard, Plastic Is*, L.A. TIMES, Aug. 11, 2007, at C1, *available at* http://articles.latimes.com/2007/aug/11/business/fi-mexcredit11.

351. In 2006, Boris Kozolchyk consulted with Inter-American Development Bank representatives for Guatemala and El Salvador on the advisability of adopting SGRs in these countries, and he expressed a negative opinion. Guatemala has yet to adopt such a guarantee system.

352. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. VI (describing the guild system and its support for members).

353. *See* Law No. 20179, Mayo 10, 2007, D.O. (Chile) [hereinafter Chilean SGR] (creating a legal framework for the incorporation and operation of mutual guarantee corporations).

354. *See* Code Monétaire et Financier [CMF] [Monetary and Financial Code] arts. L515–4-515-12 (Fr.); C. COM. art. L126-1 (Fr.); Régimen Jurídico de las Sociedades de Garantía Recíproca [Legal System of Mutual Guarantee] (B.O.E. 1994, 12) (Spain); *see also* Relativo a las Normas de Autorización Administrativa y Requisitos de Solvencia de las Sociedades de Garantía Recíproca [Administrative Authorization Rules and Solvency Requirements for Mutual Guarantee Societies] (B.O.E. 1996, 281) (Spain); Recursos Propios de las Entidades Financieras [Financial Institutions' Equity] (B.O.E. 2008, 16) (Spain) (discussing the administrative authorization, solvency, and resources of SGRs); Chilean SGR.

355. André Douette, *Small and Medium-Sized European Enterprises and the Way They Are Financed: The Point of View of the Loan Guarantee Schemes*, EUR. MUT. GUAR. ASSOC. (AECM), April 2006, at 20 (including a broader definition of SGRs).

These guarantees are considered "mutual" or "reciprocal" because the SGR guarantees payment on behalf of its member (borrower) in favor of a third party (lender); in exchange, the member has to provide a security or guarantee to the SGR as a counter-guarantee.[356] In a privately owned SGR, its members essentially guarantee each other because all members pay a membership fee or acquire shares in the SGR, thereby acquiring an interest in the SGR's operations and solvency.[357] Publicly held SGRs vary from country to country, and at times, lenders will combine SGR guarantees with other guarantees issued by private parties or other entities (such as government guarantee funds).[358] In theory, the mutual or reciprocal assumption (or sharing) of risks reduces the transactional costs of the loans. We say "in theory" because in practice, as will be discussed shortly, this is not true.

SGR legislation was first enacted in Belgium in 1849,[359] then in Spain in 1915.[360] In Spain, it allowed credit unions to secure their members' obligations to third parties. However, the first law specifically regulating SGRs was enacted in France in 1917.[361] It created the *Societé de Caution Mutuelle* for the exclusive benefit of small and medium-sized businesses, merchants, and craftsmen.[362] The *Societé de Caution Mutuelle* endorsed promissory notes and other negotiable instruments on behalf of its members.[363] Today, French SGRs are governed by provisions found in France's Commercial, and Monetary and Financial Codes.[364]

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356. Eduardo M. Favier-Dubois, *Sociedades de Garantía Recíproca*, LEGALMANIA.COM (June 2001), http://www.legalmania.com/derecho/sociedades_garantia_reciproca.htm; *see also Estatutos Sociales* [*Bylaws*], IBERAVAL, S.G.R., art. 38 (June 21, 2010), http://www.iberaval.es/pdfs/estatutossociales.pdf.

357. *See, e.g.*, IBERAVAL, *supra* note 356, art. 17.

358. Ilhyock Shim, *Corporate Credit Guarantees in Asia*, BIS Q. REV. 85, 91 (Dec. 11, 2006), *available at* http://www.bis.org/publ/qtrpdf/r_qt0612i.pdf?noframes=1.

359. MYRON T. HERRICK & R. INGALLS, RURAL CREDITS: LAND AND COOPERATIVE 380 (D. Appleton & Co., 1915); *see also* Pablo Pombo González, *Las Sociedades de Garantías Recíprocas: una experiencia de financiación de las pymes*, BOLETÍN ECONÓMICO DE ANDALUCÍA, 1995, at 285, 289 (1995) (on file with author).

360. Pombo González, *supra* note 359, at 289 (discussing the decree of July 31, 1915, which established industrial and commercial unions).

361. Loi du 13 Mars 1917 de ayant pour objet l'organisation du crédit au petit et au moyen commerce, à la petite et à la moyenne industrie [Act of March 13, 1917, for the purpose of providing credit to small and medium businesses and industries], *available at* http://www.legifrance.gouv.fr/affichCode.do?cidTexte=LEGITEXT000006072676&dateTexte=19170401 [hereinafter Law of March 13, 1917].

362. *Id.*; *see also*, Pombo González, *supra* note 359, at 289.

363. Law of March 13, 1917 art. 1 (Fr.).

364. CMF arts. L515-4–515-12 (Fr.); C. COM. art. L126-1 (Fr.).

A. Modus Operandi

We will illustrate the method of operation of a privately owned SGR by using the Spanish-law version as an example.[365] It has two types of partners: 1) the protecting partners (*socios protectores*), who invest in the SGR but cannot ask it to guarantee their obligations,[366] and 2) the participating partners (*socios partícipes*). The latter must be merchants who, at the time of becoming partners, are neither bankrupt nor insolvent.[367] Participating partners are the only ones who may ask the SGR to guarantee their obligations. Once a merchant becomes a participating partner, she must file a request form and attach a statement of assets as well as other requested data, including taxes, accounting records, licenses, and so on. Such documentation requirements presuppose that the *MiPyme* has a regular or "regularized" legal status, including being registered with the registry of businesses, which, as noted earlier, is often impossible because numerous *MiPymes* lack such legal status.

Upon review, the guarantee will be granted or denied.[368] If the request for a guarantee is approved, the participating partner must: i) pay in full his share or shares in the SGR; ii) pay a commission to the SGR for the guarantee; iii) pay all administrative expenses incurred by the SGR in granting the guarantee; iv) provide a collateral or security, whether a pledge, mortgage or a personal surety, in favor of the SGR; v) promise to use the loan that the SGR is guaranteeing for the purpose stated in his request; and vi) execute a guarantee contract with the SGR.[369]

Note that the issuance of these guarantees is dependent on the borrower/participating partner's ability to provide collateral or sureties in a manner satisfactory to the SGR, just as it would be required by a secured lender. Therefore, a *MiPyme*'s access to credit is not necessarily improved by its membership in an SGR. The SGR has the same option to reject the request for a guarantee by the *MiPyme*, as would any other secured or unsecured lender. However, the nature of their respective liabilities is different. In the case of the SGR, its promise consists of a secondary liability; its liability is effective only if its member, as the principal obligor, defaults on her debt. In addition, as with all personal types of guarantees, the SGR's liability, even when it issues or endorses a negotiable instrument, such as the member's promissory note or draft, is "causal"; i.e., to a certain extent, it is subject to defenses derived from the underlying transaction.

All of the above makes the guarantee of an SGR a much less liquid and thus, a less valuable obligation than that involved in a secured loan with a lender.

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365. *See generally* Spanish sources cited *supra* note 354 (discussing the administrative authorization, solvency, and resources of SGRs); *see also* IBERAVAL, *supra* note 356.

366. IBERAVAL, *supra* note 356, art. 17.

367. *Id.* art. 17(a–c).

368. *Solicitud de Aval* [Guarantee Request Form], IBERAVAL, http://www.iberaval.es/formularios/IberFM_Mod201_041111.pdf (last visited Dec. 30, 2011).

369. IBERAVAL, *supra* note 356, art. 38(a–f).

For in the latter arrangement, the secured creditor obtains a preferential right in rem in the collateral granted by the debtor and accordingly can foreclose on it or retain it and pay herself from the proceeds of its sale or appropriation. The secured debtor can only object after foreclosure, if she can prove that the realization of the security interest was wrongful or unjustly enriched the secured creditor. This, incidentally, is the reason European nations that rely on SGR guarantees supported efforts of the United Nations Commission on International Trade Laws (UNCITRAL) to promulgate a Convention on Independent Guarantees and Standby Letters of Credit, adopted in 1995.[370]

Even though Spanish SGRs granted €15.759 million to 85,746 small and medium-sized businesses in 2006, such a guarantee model has not been as widely adopted by Latin American countries. One of the few positive examples in Latin America is Argentina, which enacted a law creating and regulating SGRs in 1995.[371] Since then, Argentine SGRs have spread rapidly; there are currently twenty-five authorized SGRs in Argentina, which had granted 16,100 financial guarantees up until the second quarter of 2010.[372] However, if Argentina had enacted a personal property secured transactions law, it would have provided even better access to credit at much lower interest rates than those available through the SGR system. In brief, many Latin American countries do not have an SGR guarantee system, and the few that do[373] have not experienced the expected growth of commercial credit in part because obtaining an SGR guarantee carries high costs.

VIII. SECURED LENDING AND *MIPYMES*

A. Principal Legal Features

Asset-based lending presupposes the borrower/secured debtor's ability to pledge self-liquidating assets, such as inventory, accounts receivable, easily resalable equipment, intellectual property rights, and so on. As noted earlier, secured commercial credit relies for its repayment on the loan's self-liquidation or

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370. United Nations Convention on Independent Guarantees and Stand-By Letters of Credit, Dec. 11, 1995, 2169 U.N.T.S. 163; *see also* Boris Kozolchyk, *Bank Guarantees and Letters of Credit: Time for a Return to the Fold*, 11 U. PA. J. INT'L BUS. L. 1, 7–11 (1989).

371. *See* Law No. 24.467, Mar. 15, 1995, *as amended by* Law No. 26.496, B.O. July 5, 2009 (Arg.).

372. *See* SUBSECRETARÍA DE LA PEQUEÑA Y MEDIANA EMPRESA Y DESARROLLO REGIONAL [MINISTRY OF ECONOMY AND PRODUCTION], http://www.sepyme.gob.ar/wp-content/uploads/ 2009/10/contacto_sgr.pdf (last visited Dec. 29, 2011) (Arg.).

373. *See, e.g.*, Decreto 553, Ley del Sistema de Garantías Recíprocas para la Micro, Pequeña y Mediana Empresa Rural y Urbana [Law Regulating the Reciprocal Guarantee System for Micro, Small and Medium-Sized Rural and Urban Businesses], Oct. 22, 2001 (El Sal.); Chilean SGR; Law Regulating the National Reciprocal Guarantee System for Small and Medium-Sized Businesses, Aug. 11, 1999 (Venez.).

self-repayment and not on the personal and primary (joint) liability of the borrower or his co-signers or on the secondary or accessory liability of an SGR.[374] Thus, the secured loan pays for itself out of the proceeds of the sales, exchanges, or other transactions made possible by the amounts lent. In other words, the commercial secured loan enables the purchase of a merchant's inventory or equipment, which the merchant (including an agribusiness farmer) uses to produce and/or sell goods to generate the proceeds that repay the loan. The legal meaning of proceeds, as discussed earlier in connection with the factoring of accounts receivable,[375] encompasses much more than the "fruits" of trees or animals or the goods that replace others of the same kind as part of an inventory; it encompasses anything of value acquired by the secured debtor that can be traced to money or credit made available to him or her by the secured creditor.

Hence, in the secured, self-liquidating loan, the borrower is allowed to remain in possession of the collateral, to use it (as in the case of equipment), transform it (as in the case of raw materials), and sell or exchange it, thereby producing proceeds or assets traceable to the secured loan. Further, the borrower does not need to prove title to the collateral. All she needs to have are lawful possessory rights in the business assets she uses as collateral. As long as she is a legitimate possessor or has rights to the possession of the collateral, she can create a security interest in the collateral. The fact that the debtor does not have to prove either her, or her legal entity's, ownership of the collateral eliminates the costly formalities associated with attesting to such an ownership. Further, as provided by the Honduran Registry Regulations for the registration of security interests, the secured debtor, regardless of whether she is a physical person or a legal entity, must be identified by the national identification or tax number without providing additional information or satisfying other formalities.[376] Accordingly, a legal entity as informal as a sole proprietorship in the United States or a *MiPyme* can, despite its informal legal status, be a borrower in a commercial secured loan. What matters to the lender is the borrower's ability to generate a sufficient income from the sale, lease, or exchange of assets; and if she does not, the creditor's ability to foreclose on the collateral quickly and inexpensively.

That the debtor in a secured commercial loan need not be the owner of or have title to the collateral was recognized first by Section 9-202 of the U.S. Uniform Commercial Code (UCC),[377] by far the most influential of secured

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374. *See NLCIFT 12 Principles of Secured Transactions Law in the Americas*, princ. 1, NLCIFT (2006), http://www.natlaw.com/bci9.pdf [hereinafter *NLCIFT 12 Principles*].

375. *See supra* Part III.C.

376. Reglamento del Registro de Garantías Mobiliarias, Accord 2074-2010, arts. 2 (a, d, k–l) & 9–13, 14 de marzo del 2011, DIARIO OFICIAL [D.O.] (Hond.). During the Annual Meeting of the World Bank-IFC in October 2010 in Washington, D.C., two registries were showcased: that of the People's Republic of China, mostly for accounts receivable, and that of Honduras, for all types of collateral.

377. U.C.C. § 9-202 (2000) ("Except as otherwise provided . . . the provisions of this Article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.").

lending statutes. It inspired the NLCIFT's Second Principle of Secured Transactions Law in the Americas, which states:

> A security interest *is a preferential right to possession or control of personal property.* As such, it does not require that the debtor who grants the interest have title to the personal property collateral; his right to its possession, even though co-existent with other possessory rights in the same property by other creditors and debtors, will allow the creation of the security interest.[378]

It similarly inspired the OAS Model Law and the laws of Guatemala,[379] Honduras,[380] and Peru.[381] One of the practical implications of this principle is that a *MiPyme* that has an option to buy business assets or that has paid for only a small portion of its inventory can use any inventory to which it has a right of possession as collateral to obtain a loan that will enable it to purchase more inventory, equipment, or advertisements to facilitate the sale of its inventory. For what matters to the secured creditor most is having access to the debtor's liquid assets such as his cash proceeds, accounts receivable, and bank deposits. Moreover, consumers who purchase goods from that inventory in the ordinary course of the secured debtor's business need not fear being deprived of the goods by a secured or unsecured creditor of the merchant who sold them the goods. The secured lender of the merchant is more interested in receiving the proceeds of the sale of these goods than the goods themselves. This is why various creditors' rights can coexist in the same collateral with other security interests, albeit subject to prescribed priorities.

1. The Roots of the Notion of the Security Interest

What the United States's UCC Article 9 refers to as a security interest in personal property is not peculiar to the common law system. Both the common and civil law systems have in common the Roman Law's *iura in re aliena* (rights in the property of others), which confer a *ius ad rem* to their holders. The holders of the Roman law's rights in rem, such as those on the ownership (*dominium*) of things, were given a generic *in rem actio*. This action is defined by the Justinian Digest as "that by which we seek our property which is possessed by another and

378. *NLCIFT 12 Principles*, *supra* note 374, princ. 2 (emphasis added).

379. *See* Ley de Garantía Mobiliaria, Decree 51-2007, 16 de noviembre de 2007, DIARIO OFICIAL (Guat.) [hereinafter Guatemala LGM].

380. *See* Ley de Garantía Mobiliaria, Decreto No. 182-2009, art. 50, 28 de jueves del 2010, D.O. (Hond.) [hereinafter Honduras LGM].

381. *See* Ley de la Garantía Mobiliaria, Law No. 28677, 1 de marzo. de 2006, GACETA OFICIAL (Peru) [hereinafter Peru LGM].

is always against him who possesses the property."[382] The holders of *iura in re aliena* were provided with "interdicts," or interlocutory remedies, to repossess the property to which they had a right of possession.[383] These remedies were ad rem in the sense that they were available to lawful possessors or parties with a lawful claim to the possession of the property and whose rights fell short of those of an absolute owner. This distinction between the rights of the holder of a fee simple absolute and those of a holder of possessory rights to things owned by others provides the conceptual basis for the protection given to the holder of a security interest in Anglo-American law, and especially in the UCC and in Canada's Personal Property Security Act.[384]

The protection of possessory rights in Roman law did not require what the renowned German Roman law scholar Friedrich von Savigny described as the physical control of the property (*factum possessionis*) coupled with the intent to own the thing (*animus dominii*).[385] Instead, the intent it required was identified by the equally renowned German legal historian and philosopher Rudolf von Jhering as an *animus possessionis*—an intent to merely possess in a lawful manner.[386] Accordingly, bailees, tenants, and pledgee-creditors, among other nonowners and nonaspirants to ownership, were protected by Roman possessory actions and interdicts.[387] This is why, as yet another German legal historian pointed out, by the time the opinions of Roman jurists were being collected, possessory rights had been separated from ownership, and both types of rights could coexist in the same asset.[388]

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382. DIG. 44.7.25; BLACK'S LAW DICTIONARY 901 (4th ed. 1951).

383. RODOLFO SOHM, ET AL., INSTITUCIONES DE DERECHO PRIVADO ROMANO 154–56 (Wenceslao Roces Suárez trans., 1951) (1928) (discussing the protection of possessory rights in Roman law and pointing out that the interdicts of the classical period had merged into the same procedures used for ordinary actions during Justinian times).

384. Personal Property Security Act, R.S.B.C., c. 359 (1996) (Can.), *available at* http://www.bclaws.ca/EPLibraries/bclaws_new/document/ID/freeside/00_96359_01.

385. FRIEDRICH KARL VON SAVIGNY, DAS RECHT DES BESITZES § 21 (Erskine Perry trans., 1848, reprt. Sweet, London, 1979) (1803).

386. *See* RUDOLPH VON JHERING, UEBER DEN GRUND DES BESITZESCHUTZES. EINE REVISION DER LEHRE VOM BESITZ (Aalen Scientia 2d ed. 1968) (1869).

387. J.A.C. THOMAS, TEXTBOOK OF ROMAN LAW 140 (1976) (For Friedrich von Savigny, animus was the intention to hold the thing as one's own; i.e., the *animus domini*. In his view, the man who had control of a thing de facto with the intention to exercise that control for himself was in law its possessor and would be granted the interdicts. This theory concededly accords with most cases of possession, but it does not explain the possession of the *precario tenens*, *sequester*, pledge creditor, and *emphyteuta.* Jhering's view was that "corpus was the essence of possession which was itself the outward manifestation of ownership; a man would be possessor of a thing if he was, in relation to it, in the position that an owner would normally be; animus was merely an intelligent awareness of the factual situation.").

388. L.A. Warnkonig, *Analysis of Savigny's Treatise on the Law of Possession*, 19 AM. JURIST & L. MAG., 1838, at 13, 24.

Ad rem rights that could be invoked against contracting and third parties were indispensable in the development of Roman secured transactions.[389] For example, the jurist Javolenus[390] described a situation in which an adverse possessor (*usucaptor*) whose rights fell short of ownership could still lawfully pledge the asset he was adversely possessing.[391] Yet while the *usucaptor*-debtor was deemed an adverse possessor until he completed the requirements of his *usucapio* (which would then provide him with ownership of the property), the secured creditor-pledgee of the *usucaptor* was given actual possession of the thing while the pledge lasted, thereby enabling him to perfect his pledge.[392] This pledgee was thus entitled to possessory remedies against an unlawful interference and deprivation of the asset, but his possession did not entitle him to ultimate ownership through *usucapio*, as was the case with the *usucaptor*-pledgor.[393] Obviously, had classical Roman law insisted on the pledgor's ownership rights as a condition for the creation of the pledge, secured lending would have been hindered.

In sum, the seminal concept of a security interest created by a secured commercial (self-liquidating) loan and defined as a preferential right to the possession or control of personal property that does not require that the secured debtor have title to the collateral is compatible with the conceptual roots of secured transactions law in the world's major legal systems. Hence, its corollaries should, in principle, qualify as effective, uniform, and standardized tools to provide commercial credit to micro- and small-business associations in the Americas and elsewhere where Roman law provided such roots.

2. Effectiveness of the Security Interest: Corollaries of the Principle of Self-liquidation

Among the most important corollaries of the principle of self-liquidation of the secured loan are its methods of: a) creation; b) perfection or the giving of functional notice to other creditors and bona fide purchasers of the collateral of the presence and priority of the security interest or ius ad rem; and c) realization by the quickest and fairest form of repossession and foreclosure of the security interest. *MiPymes* as well as other types of borrowers need to be able to show that the collateral will continue to repay the loan.

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389. *See generally*, R.W.M. Dias, *A Reconsideration of Possessio*, 14 CAMBRIDGE L.J. 235 (1956).

390. *Id.* at 240.

391. *Id.*

392. *Id.*

393. Warnkonig, *supra* note 388, at 29, 30.

a. Creation of the Security Interest

NLCIFT's Fourth Principle of Secured Transactions Law in the Americas states:

> Security interests may be created by contract or by law. The effectiveness of a security interest between the secured creditor and debtor arises from their contract or from a statutory or judicial imposition without any additional formality. Nevertheless, third party rights, including the rights of judgment creditors and trustees in bankruptcy, will not be affected by the security interest unless proper notice of it is provided [perfection] to third parties.[394]

Security interests created by (mostly) statutory law abound in most jurisdictions. It is rare that a country or jurisdiction does not grant the status of an automatic lien to the unpaid work performed, say, by a mechanic on his customer's vehicle or by a maritime and land carrier for unpaid freight. Yet, while these claims can become liens on the debtor's property, for them to be effective against third parties, the contemporary trend is to require that notice of their existence be given to third parties, usually by means of the filing of the lien in the appropriate registry.[395]

Security interests created by the parties' consent require a security agreement—whether simple and private or formal and documented in a public deed—and in some jurisdictions, such as the United States, more than that.[396] Considering the informal manner in which micro- and small businesses do their contracting in Latin America, this principle facilitates access to commercial credit because it does not require more than an informal contract between the secured creditor and debtor. Further, as stated by Article 6 of the OAS Model Law, the security interest becomes effective between the parties from the moment of the execution of the agreement, whether in a traditional or electronic version.[397] Yet, as pointed out by the NLCIFT's Fourth Principle, third party rights, including those of creditors of the secured debtor and purchasers of the collateral, will not be affected unless the security interest is properly publicized.

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394. *NLCIFT 12 Principles*, *supra* note 374, princ. 4.

395. *See, e.g.*, Guatemala LGM arts. 6(b), 15.

396. On this point, the law of the contracts involved in secured transactions in civil law countries does not generally require all of the requisites of attachment presently required by U.C.C. § 9-203.

397. *See* OAS MODEL LAW art. 6. However, a security interest in future or after-acquired property encumbers the secured debtor's rights (personal or real) in such property only from the moment the secured debtor acquires such rights.

b. Perfection and Priority of the Security Interest

Perfection can be accomplished by filing a summary notice in a specially designed registry. The filing of a "financing statement"[398] can be a paper document or an electronic message or record. Perfection can also be accomplished by the creditor's or his agent's possession. A creditor may acquire his possession directly, as it is done to this day with pawn-shop pledges, or indirectly through an agent authorized for that purpose (as with a "field" warehouse created in the debtor's place of business or a "terminal" warehouse, where the collateral is located in a warehouse owned by a third party). In addition, the debtor may confer what is known as "control" over the collateral by instructing a third-party custodian or depositary (such as a bank or other financial institution) to allow the secured creditor to draw on the debtor's account in total or partial payment of the debtor's obligations in the secured loan subject to specified terms and conditions.[399]

Under the OAS Model Law, as well as under the Guatemalan and Honduran laws of secured transactions, the *erga omnes* effects of the contractually created security interest, either in paper or electronic fashion, are postponed until the agreement is publicized or possession or control is given to the creditor.[400] The publicity or notice contemplated by contemporary secured transactions laws is simple and inexpensive. Unlike the notice in the traditional notarial or public deed filed in many land registries, which requires a very detailed description of the real property that secures the loan, the description of an asset in a commercial secured loan suffices if it provides select summary data filed mostly under the secured debtor's name. This data includes, among other items, the personal or business names of the parties and a general description of the collateral, such as "the debtor's inventory," or "accounts receivable corresponding to sales or services provided after . . . date," or "fixtures that consist of wooden counters and display windows located in the debtor's business premises."[401] Some exceptions apply to especially valuable assets; if they are identifiable by serial numbers, their description must contain these numbers. Similarly, when fixtures are used as collateral, the description of the real property to which they are attached should be

398. *See* U.C.C. § 9-502 (2010) (providing the contents of a typical financing statement).

399. *See* Boris Kozolchyk & Marek Dubovec, *Commentary on NLCIFT 12 Principles* (June, 2006) (confidential unpublished report) (on file with author). In the last decade of the twentieth century, it became necessary to upgrade the protection of creditors who relied for their security in incorporeal or intangible things, such as the right to draw proceeds deposited in their debtors' bank accounts, the rights to investment securities credited to account holders or their creditors by means of electronic bookkeeping entries in the accounts kept by investment securities intermediaries, or the rights of holders or their creditors in electronic documents of title.

400. OAS MODEL LAW arts. 10, 34; Guatemala LGM art. 15; Honduras LGM arts. 14–15.

401. OAS MODEL LAW art. 37(IV); Guatemala LGM art. 43(e); Honduras LGM art. 44(II).

provided, and a cross reference should be made to the real property registry that contains the full description of this property.[402]

The law of secured transactions provides corollary principles to determine the priority of the recorded and possessory security interests. With few exceptions, priority is determined not by the type of right recorded but by the principle of first to file or to acquire possession of the collateral. The major exception to this principle is provided for the so-called "purchase money security interest." It enables the secured creditor who provides financing for the acquisition of specified goods that become part of an existing inventory to have priority over other secured creditors who recorded an earlier security interest in the inventory as a whole (i.e., without specifying the goods whose acquisition were financed by their secured loan). The reasons for this priority are twofold. One is to encourage creditors who can contribute assets that will increase the overall value of the inventory to do so without fear of having to subordinate their rights to those of earlier creditors. Secondly, this priority prevents creditors who may wish to rely on omnibus or monopolistic clauses, such as those that specify that their loan is secured by "all of the debtor's present and future assets," from discouraging other loans on assets related to those over which they had tried to acquire monopolistic rights. Therefore, a priority system is of considerable assistance to micro- and small businesses whose inventory may be worth considerably more than the amount being financed by the omnibus creditor and who could, on that basis, have access to additional credit but would be prevented from doing so by the omnibus clause.

c. Realization of the Security Interest

Self-liquidation of the security interest requires that repossession and foreclosure of the collateral be effectuated by the quickest and fairest possible means. Usually, it relies on a contractual clause or subsequent agreement authorizing a procedure of extrajudicial enforcement. This procedure confers upon the creditor, agreed-upon intermediary, or fiduciary agent the power to repossess and publicly or privately sell the collateral, repay the creditor, and return the remainder, if any, to the debtor. The quick pace of this procedure goes hand in hand with the self-liquidating nature of the secured loan.

This procedure can be traced to Roman law that preceded the reign of Emperor Constantine (306-337 A.D.). Indeed, Roman law before his reign not only allowed but encouraged many types of security interests on personal property collateral that relied on the transfer of ownership or quasi-ownership fiduciary rights from debtor to the creditor, such as with the *pactum commissorium* and *constitutum possessorium.*[403] Upon a debtor's default, the transferee creditor was

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402. OAS MODEL LAW art. 51(IV); Guatemala LGM art. 50; Honduras LGM art. 44(IV).

403. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 2, ch. IV (discussing Roman law).

authorized to retain the pledged item and resell it in order to repay himself. The *pactum* was outlawed by Constantine because of "abuse" by creditors, especially to evade his prohibition against usury.[404] Yet his prohibition defined usury as any interest charged for the loaned principal.[405] Even a fraction of a percent would qualify as usurious by the then-prevailing definition of usury. With the emergence of a definition of usury as charging an interest rate above that authorized for the place or market in question, the reason for this prohibition has ceased to exist.

On the other hand, in certain Latin American countries, the constitutional (due process) objections to contractually agreed-upon and peaceful extrajudicial repossession and foreclosure are undermined not only by the debtor's contractual consent to the remedy but also by his or her ability to sue the creditor for any unjust enrichment or abuse of rights that may have occurred as a result of his use of these remedies.[406]

d. The Negative Lending Practices of "Procured" Licenses as Collateral

Business licenses in Latin America "come in bunches."[407] In addition to the generic authorization to do business, where a marketplace is large and popular enough to attract many customers—as with citywide or neighborhood marketplaces—special permits must be obtained by the operators of stalls within the markets' premises or by ambulatory merchants. Many of these licenses are valuable enough so that only those with sufficiently strong political or monetary influence can procure them. As the NLCIFT Roadmap team that did the research on Honduran secured lending practices discovered, those who procured the licenses (usually in their own names or in the names of trusted agents) also often doubled as secured lenders to the licensees.[408] In that capacity, they charged their borrowers exorbitant interest rates (even by Honduran standards) for the loans that enabled the licensees to acquire their inventory. In addition, if their debtors defaulted in their repayment obligations, the usurious lenders quickly withdrew the license or sublicense.

The negative effects of this practice are not only the usurious rates but also the fact that the amounts lent depend strictly on the usurer's perception of

404. *See* Boris Kozolchyk & Dale Furnish, *The OAS Model Law on Secured Transactions: A Comparative Analysis*, 12 SW J. L. & TRADE AM. 235, 256–57 (2006).

405. *Id.*; *see also* OAS MODEL LAW arts. 62–63; Honduras LGM arts. 60, 66; Guatemala LGM arts. 65–66.

406. *See* Kozolchyk & Furnish, *supra* note 404, at 281.

407. *See, e.g.*, *Doing Business 2011: Making a Difference for Entrepreneurs, Costa Rica*, IFC/WORLD BANK, at 8, 10–11, *available at* http://www.doingbusiness.org/~/media/fpdkm/doing%20business/documents/annual-reports/english/db11-fullreport.pdf; *see also supra* Part V.B.2.

408. *See* NLCIFT Roadmap, *supra* note 106.

how much he can safely extract from his borrower. By contrast, nonusurious commercial loans secured by inventory and accounts receivables establish a ratio between the credit made available to the secured debtor and his volume of sales and accounts receivable. Meanwhile, the license "procured" from the usurer unlike the inventory and accounts receivable, remains a static form of collateral ready to be used as an immediate threat to unwind the borrower's business whenever necessary.

e. Bankers' Views on the Migration from Micro to Small Businesses through Secured Lending[409]

All bankers would agree that microentrepreneurs in Latin America described in this study must diversify their customer base and increase their sales volume to regular purchasers (and timely payors) to meet the prevailing banking standards for creditworthy small businesses. Growth of sales and customer diversification go hand in hand. If the *MiPyme* only diversified its customer base and did not increase its volume of sales, it would still be considered too risky a borrower; the same would happen if the *MiPyme* increased its volume of sales but did not diversify its clientele. Depending on the type of secured lending and collateral, bankers also desire accurate and up-to-date bookkeeping and accounting records and liquid accounts receivable, as well as adequate procedures designed to monitor the value of collateral over time, including "blue books" or manuals that establish the market value of commodities or products used as collateral.

On the other hand, and contrary to widespread assumptions, the market for loans to small and medium enterprises, which are a healthy component of Latin America's *MiPymes*, is, in the words of the World Bank's International Financial Corporation (IFC), "a strategic target of banks worldwide . . . SME [small and medium enterprise] banking appears to be growing the fastest in emerging markets (low- and middle-income countries), where this gap has been the widest."[410] This is a market populated by former microenterprises and other firms "whose financial requirements are too large for microfinance, but are too small to be effectively served by corporate banking models."[411] Setting aside unpredictable macroeconomic factors, the bankers interviewed by the IFC cited

409. Interviews with bankers who participated in the implementation of the NLCIFT/Millennium Challenge Account-Honduras Secured Transactions Project (2009–2011): Lirain Urreiztieta, J.P. Morgan Chase; Dennis Bourgeois, Sunrise Bank of Arizona; and Mike Quinn, J.P. Morgan Chase; views expressed by bankers interviewed in IFC ADVISORY SERVICES, THE SME BANKING KNOWLEDGE GUIDE (2009) [hereinafter SME BANKING KNOWLEDGE GUIDE].

410. SME BANKING KNOWLEDGE GUIDE, *supra* note 410, at 5.

411. *Id.* at 10.

"regulatory obstacles"[412] and "weak legal frameworks"[413] as the most common challenges.

In Mexico, for example, the migration from micro- to small business is such a difficult process that once a business employs eleven employees (the minimum required for the designation), the growth rate drops from 89.7% to 66.2%.[414] By these standards of growth, it is clear that only those exceptional microbusinesses that managed to acquire a reliable diversified clientele and an optimum and reliable volume of sales could qualify for the status of small businesses and acquire the ability to access secured credit. The fact that most street vendors sell on a cash basis and do not generate accounts receivable or other self-liquidating collateral disqualifies most of them from accounts receivable or "supply chain" financing. Further, even if they were to sell on credit to some of their customers, street vendors' usual lack of minimal accounting and legal resources would render them high-risk borrowers. In addition, lenders to micro- and small businesses interviewed by the NLCIFT pointed to the very high costs of qualifying microborrowers for secured lending. For example, a lender that specializes in loans to micro- and small enterprises noted that the costs for qualifying a $2,000 secured loan to a microbusiness were as high as those for a $50,000 small business loan. This official indicated that the high costs of qualification stemmed from the need to verify the accuracy of the microbusiness' credit record (if any) as well as her bookkeeping and accounting records, especially as it concerned the source(s) of repayment.

IX. CONCLUSIONS AND RECOMMENDATIONS FOR LEGISLATIVE REFORM AND UNIFORM BEST PRACTICES

Sound substantive and procedural secured transactions laws and registry regulations (excluding the unnecessary and costly laws of reciprocal guarantees) are now in place in some Latin American countries and are fruitfully serving as models for other nations in this hemisphere and beyond.[415] This makes it possible for interested nations to replace their present normative obstacles to a vital commercial credit for their *MiPymes* with laws and registry regulations inspired by the OAS Model Law and fully adopted by countries such as Honduras. As U.S. Secretary of State Hillary Clinton stated in San José, Costa Rica, while remarking on the adoption of the III Ministerial Meeting of Pathways to Prosperity in the Americas:

> [T]he United States is committed to working with our Pathways partners to modernize laws that govern lending so that small and

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412. *Id.* at 21.

413. *Id.*

414. ESTRATIFICACIÓN DE LOS ESTABLECIMIENTOS, *supra* note 90, at 16; *see also supra* Part III.A.4.

415. *See, e.g.*, Mexico LGM.; Guatemala LGM; Honduras LGM; Peru LGM.

> medium-size businesses can use assets other than real estate as collateral for loans. I visited the display that Honduras has, and they showed me the kind of equipment that can now serve as collateral in Honduras because Honduras has changed their laws: sewing machines, tool boxes, farm equipment.
>
> Small businesses are the backbone of our economy and the source of employment for many of our citizens . . . . I commend Honduras for the model programs that they are implementing.[416]

Yet, as is shown in the present article, the regularization of large numbers of de facto and irregular business associations, including sole proprietorships, requires more normative work. Still missing are statutes and regulations that would simplify the creation, registration, and licensing of business associations and sole proprietorships. Fortunately, as discussed earlier, some Central and South American jurisdictions, such as Honduras, now rely on national identification numbers to establish the identities of most of their secured and unsecured debtors and creditors. Some also have adopted simpler, less expensive procedures for the creation, registration, and licensing of business associations and sole proprietorships. The German, Colombian, and U.S. regulatory models can thus be quite helpful in attaining a modicum of simplification in the creation and registration of *MiPymes*.

On the other hand, interviews with micro- and small business borrowers in Honduras showed the necessity of eliminating usurious practices such as those that rely on the collateral of "procured" licenses. It became painfully clear in NLCIFT Roadmap interviews with these borrowers that the usurious loans collateralized with procured licenses need to be replaced by a line-of-credit-type lending that relies on the secured debtor's inventory and accounts receivable as collateral and makes credit available depending upon the debtor's volume of sales and quality of accounts receivable. In addition, the NLCIFT Roadmap study showed that most secured lenders could not reliably establish the value of much of the commercial collateral contemplated by the OAS Model Law and by the Honduran Law of Secured Transactions, among others. The same study and subsequent discussions with local and foreign bankers interested in instituting secured lending throughout Latin America showed that procedures and steps could be taken in the near future to provide such vitally needed information. This is particularly true with respect to inventory and accounts receivable collateral in countries that depend upon their exports of agricultural and fisheries' products for their immediate economic growth. The steps involved in this process would be at least four, although not necessarily in a linear or sequential manner.

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416. Hillary Rodham Clinton, U.S. Sec'y of State, Remarks at III Ministerial Meeting of Pathways to Prosperity in the Americas (Mar. 4, 2010).

Take, for example, Honduras. As reported by Andrew Medlicott,[417] an agricultural scientist who supervised Honduras's Millennium Challenge Account (MCA) agricultural lending project: farmers who were recipients of MCA grants or loans and produced vegetables for export filled out, as a first step in the data-gathering process, pre-printed sheets on which they listed, not only the amounts of vegetables planted per the allotted space but also the other products used to assure the compliance with the health and environmental requirements (among others) of the actual or potential importing countries. These sheets helped verify compliance with the importing nations' requirements. In addition, however, such forms could enable an objective estimation of base costs of the exportable vegetables. During the second step, the final cost figures would be completed by the farmers or farming cooperatives, at first with the technical assistance of entities such as the MCA, but also of local secured lending banks. This step would help the secured lenders objectively evaluate the profitability and market realism of the invoice prices. During the third step, individual farmers, or cooperatives on their behalf, would fill out simple cash flow and income and expenses statements (such as those drafted by NLCIFT staff members and consultants now used by some Honduran banks). These simple statements could enable secured lenders to estimate the ratios between the value of collateral and the prices and volumes of products sold by each loan applicant. During the fourth step, the experience obtained with the objective estimation of the value of collateral by secured lenders and their borrowers in each economic sector would enable the preparation of commodity or product manuals that would classify the collateral according to its quality and market value. As reported by Lirain Urreiztieta of JPMorgan Chase, some such manuals exist and have been used frequently and successfully by some Arizona international bankers in determining the ratio of collateral that secured their loans to Mexican or U.S. exporters of seafood and other fish originating in Western Mexico and shipped to and financed in the United States. Needless to say, the costs of researching and drafting these legislative and uniform best practices texts for each Latin American nation would be reduced considerably if they were undertaken on a multinational or regional basis that would recognize and accommodate geographic, economic, legal, and cultural similarities and differences.

A streamlined process of creating a business will facilitate the transition of informal businesses into the formal sector, with all of its attendant benefits, including enhanced access to commercial credit. Indeed, following a close review and analysis of the Colombian simplified joint-stock corporation, it is clear that the creation of this new business form has generated a significant growth in the number of formal businesses established in that country—and particularly in the

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417. *Entrenamiento y Desarrollo de Agricultores* [*Farmer Training and Development*], CUENTA DEL MILENIO-HONDURAS, http://www.mcahonduras.hn/proyectos.php?o=6 (last visited Dec. 30, 2011).

number of simplified businesses established, as compared to the total number of new businesses (a 25.3% increase from 2009 to 2010).[418]

The ease in establishing and/or formalizing existing businesses has been such that in Colombia, it has resulted in a considerable increase in the number of businesses, it has significantly expedited the migration from micro- to small businesses, and it has facilitated access to credit to all of these businesses. Colombia can thus serve as a model for other countries in the Americas.

At a minimum, the work product of working groups dedicated to the development of legal reforms and transactional best practices as well as the establishment of simplified processes for creating a business should make it possible to expedite the migration of many *MiPymes* to the status of small businesses with access to secured commercial credit at reasonable interest rates and to rely on inventory and accounts receivable collateral at much lower costs than are now possible in the Americas and beyond.

418. *See* Francisco Reyes Villamizar, Presentation, NLCIFT in Tucson, Ariz. (Mar. 11, 2011) (on file with author); *see also* REYES VILLAMIZAR, A NEW POLICY AGENDA, *supra* note 15.