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**VENTURE CAPITAL IN LATIN AMERICA:
THE COSTS OF THE CAYMAN SANDWICH**

Raphael Andrade and Alvaro Pereira

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Raphael Andrade* and Alvaro Pereira**

Abstract

Latin America has become one of the world's most dynamic emerging markets for venture capital (VC). As global investors flock to the region's promising startup ecosystems, VC finance is increasingly reaching companies committed to addressing long-standing social and economic challenges through the development of new technologies and industries. Yet, investments rarely occur directly. Instead, international VCs structure their investments through a multi-jurisdictional architecture known as the "Cayman Sandwich"—a layered holding company arrangement involving entities in the Cayman Islands, Delaware, and the startup's home country. This workaround shields investors from perceived legal risks in Latin America, enabling an unprecedented flow of capital to the region, along with new, underexplored challenges.

This Article presents the first critical analysis of the Cayman Sandwich and its implications for legal and institutional development in Latin America. While the structure has enabled much-needed capital inflows and entrepreneurial growth, it has come at a cost. On the one hand, startups operating through this tri-jurisdictional structure face significant financial and administrative costs that can hamper business development and growth. On the other hand, VC markets and domestic institutions endure opportunity costs, as lawyers, courts, and regulators lose exposure to high-value transactions that could catalyze institutional learning and legal development. Perhaps most consequentially, the use of foreign legal systems limits the ability of domestic policymakers to assess—and improve—their own legal systems.

To evaluate the tradeoffs, this Article examines the legal risks that motivate the use of the Cayman Sandwich, distinguishing perceived from actual risks. Perceptions of inflexible legal systems and weak investor protections in Latin America often reflect outdated assumptions about civil law jurisdictions, amplified by biased global legal indexes. In contrast, actual risks—such as

* Postdoctoral Researcher, University of Copenhagen, and Partner, Andrade Chamas.

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ambiguous doctrines for piercing the corporate veil, rigid rules constraining startup governance, and inefficient dispute resolution systems—merit targeted reform. By disentangling myth from reality, this Article argues that Latin American countries can reduce their dependence on foreign legal structures not only by updating domestic laws, but also by challenging misperceptions and improving legal signaling.

The Cayman Sandwich is not unique to Latin America; it reflects broader patterns in how emerging markets interface with global capital. As such, the framework and findings developed here offer a new lens through which to understand legal outsourcing in international investment—and provide a roadmap for jurisdictions seeking to build VC-ready legal systems from within.

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I. INTRODUCTION

The rise of venture capital (VC) in Latin America marked a significant shift in its entrepreneurial landscape. A region that was historically dominated by state and family-owned enterprises in traditional industries, such as oil and gas,¹ is now the home of leading innovative companies, such as the world's first digital-only bank, *Nubank*.² VC has been critical for the emergence and growth of this and other disruptive businesses, channeling unprecedented amounts of capital and non-financial resources to companies that otherwise would not have been viable.

In recent years, global VC investors have been increasingly drawn to the region's burgeoning startup ecosystem. Major VC firms have established dedicated funds, reflecting confidence in Latin America's economic potential and innovation capabilities.³ Factors such as a sizable population, an expanding middle class, and technological advancements have fueled demand for digital solutions to seemingly unresolvable problems, leading to a surge in startups across sectors like fintech, e-commerce, healthtech, and agtech.⁴ The growth in the flows of VC investments,⁵ the rise of Latin American unicorns,⁶ and its entrepreneurial population's demonstrable ability to achieve significant market success with comparatively minimal resources are a testament to the region's

¹ See, generally, Alberto Chong & Florencio López-de-Silanes, *The Truth About Privatization in Latin America*, in *PRIVATIZATION IN LATIN AMERICA: MYTHS AND REALITY*, 1–66 (Alberto Chong & Florencio López-de-Silanes eds., 2005).

² See Nasdaq, *Fast Company Names Nu Most Innovative Company in the World in Finance and Personal Finance 2025* (Mar. 18, 2025, 9:00 AM), <https://www.nasdaq.com/press-release/fast-company-names-nu-most-innovative-company-world-finance-and-personal-finance-2025> (last visited June 17, 2025) (describing Nubank's rise as a leader in financial services, and reporting that it “was included for the fifth time in Fast Company's prestigious World's Most Innovative Companies list. Nu is #1 in the Finance and Personal Finance category and 3rd place in the overall ranking, gaining 19 positions from last year. The annual list recognizes businesses at the forefront of their industries, driving innovative solutions and shaping the future.”)

³ MCKINSEY, *LATAM DIGITAL REPORT: STARTUP STUDY* (2023) (finding that over 150 new Latin American-based VC funds have been established in the past three years).

⁴ See Sarah Birke, *The Future is Bright for Latin American Startups*, *The Economist* (Nov. 13, 2023).

⁵ THE LAUDER INSTITUTE, *THE SURGE OF VENTURE CAPITAL IN LATIN AMERICA: THE LAUDER GLOBAL BUSINESS INSIGHT REPORT* (2022).

⁶ Since 2019, when Colombian *Rappi* became Latin America's first Unicorn, at least 34 companies have surpassed the \$1 billion valuation. These companies are based in Brazil, Colombia, Mexico, Chile, and Argentina. Crunchbase, *Unicorns from Latin America* (2024), <https://www.crunchbase.com/lists/unicorns-from-latin-america/b5da4ab5-5f86-490b-82b9-109d6c17b9fc/organization.companies>. (last visited June 17, 2025).

potential to breed innovative and impactful companies.⁷

Despite these promising trends, a pressing challenge for developing VC markets in the region is the absence of direct investments, which results from distrust in legal institutions. Instead of acquiring shares and other securities of Latin American startups, international VCs demand the establishment of complex, multi-jurisdictional corporate structures to ensure that investments are not governed by Latin American laws.⁸ Investors' concerns primarily revolve around two sets of legal issues.⁹ The first is the potential liability of VC funds or their partners for portfolio companies' obligations. The perception is that if a startup fails to meet its goals and cannot secure follow-up funding (which is not uncommon), investors could be judicially compelled to make additional investments or even ordered to pay residual claims if the startup is wound up. The second issue concerns differences in corporate laws that can prevent (or make it more costly) to replicate standard VC agreements. The use of stock options and convertible securities, for example, has proven effective in developed VC markets to manage problems derived from information asymmetries between founders and investors and uncertainty over business outcomes, which are inherent to financing innovative companies.¹⁰ Rigid corporate law rules, e.g., on share issuances or board powers, can make it excessively costly to implement those stock-based solutions to common problems,¹¹ and, thus, the perception that such rigidities prevail in the region operates as a deterrent to direct investments.

To contribute to the growth of Latin American startup ecosystems and participate in the benefits without being exposed to these legal risks, international VCs require startups to implement a structure known as the "Cayman Sandwich."¹² Concretely, the Cayman Sandwich is a two-layer holding

⁷ ATLANTICO, LATIN AMERICA DIGITAL TRANSFORMATION REPORT (2023).

⁸ See Section IV.

⁹ *Id.* Also see BRIAN REQUARTH, VIVA THE ENTREPRENEUR: FOUNDING, SCALING, AND RAISING VENTURE CAPITAL IN LATIN AMERICA (2021).

¹⁰ See, generally, Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067 (2002); Also see William W. Bratton, *Venture Capital on the Downside: Preferred Stock and Corporate Control*, 100 MICH. L. REV. 891 (2002); Douglas Cumming & Sofia A. Johan, *Security Design*, in VENTURE CAPITAL AND PRIVATE EQUITY CONTRACTING: AN INTERNATIONAL PERSPECTIVE 319 (2 ed. 2014).

¹¹ Alvaro Pereira, *The Law of Contingent Control in Venture Capital*, 2023 COLUM. BUS. L. REV. 676 (2023).

¹² To be sure, the Cayman Sandwich is one of many different structures, but the one that directly addresses the two identified issues. For commentary on alternative investment structures, see Luciana Jhon Urrunaga

structure: the operational company, incorporated in Latin America, is wholly owned by a Delaware LLC, which in turn is owned by a Cayman Islands holding company.¹³ This arrangement addresses investors' two main concerns.¹⁴ Firstly, it limits investors' exposure to the risks of legal liability for startups' obligations. To be successful, any claim of that nature would require disregarding the legal personality of the Latin American startup company, the Delaware LLC and the Cayman Islands company, each of which has independent doctrines and requirements to pierce the corporate veil.¹⁵ This arrangement, therefore, discourages such claims, concentrating liability at the operational level. Secondly, the Cayman Sandwich subjects governance and financing agreements to the Cayman Islands' corporate and contract law, as it is the Cayman Island holding company that issues the securities that investors purchase and where key decisions are made, such as appointing executives or approving share issuances or mergers. Although tax considerations also play a role, investors prefer Cayman Islands law mainly because it follows the Anglo-American common law tradition with which they are familiar.

The Cayman Sandwich structure has undeniable benefits. It has enabled the entrance of VCs who might not have been able to participate in these markets directly due to strategic or legal restrictions of their own investors (i.e., their limited partners). In doing so, it has increased the capital available, contributing to the expansion of startup ecosystems in Latin America and the emergence of unicorns.¹⁶ These benefits are acknowledged by entrepreneurs and championed by industry organizations, which explains its prevalence.¹⁷ Its costs, however, are generally overlooked, notwithstanding their relevance for a sensible analysis of the tradeoffs for entrepreneurs, VC markets, and institutional development.

and Anibal Manzano, *Corporate Structures for Latin American Startups*, Manzano Law (Jun. 19, 2023)

¹³ See Raphael Andrade and Alvaro Pereira, *Venture Capital in Latin America: A Critical Look at the 'Cayman Sandwich' Structure*, OXFORD BUSINESS LAW BLOG (2023), <https://blogs.law.ox.ac.uk/oblb/blog-post/2023/11/venture-capital-latin-america-critical-look-cayman-sandwich-structure>. (last visited June 17, 2025).

¹⁴ See Section IV.B.

¹⁵ Id.

¹⁶ See, e.g., Hellen Villena, *Cayman Sandwich: What is it and Why Does it Taste so Good?*, Latitud (Aug. 30 2022), <https://www.latitud.com/blog/cayman-sandwich-corporate-structure-startups> (last visited June 17, 2025) (reporting that "47.7% of all Latin American unicorns have a Cayman Holding as part of their corporate structure.")

¹⁷ Id.

In this paper, we present the first critical examination of the Cayman Sandwich. We acknowledge its merits but identify two specific sets of costs. On the one hand, startups that use this structure face increased *operational costs* in the form of financial resources, time, and efforts dedicated to sustaining legal entities in three jurisdictions.¹⁸ These costs can somewhat impair a startup's growth potential since competitors might not need to incur in such costs. On the other hand, domestic legal systems and economies endure *opportunity costs*: by outsourcing the law applicable to VC investments, the Cayman Sandwich deprives local legal operators and service providers of gains that they would otherwise perceive when negotiating, drafting, and enforcing complex financial transactions.¹⁹ Moreover, policymakers' ability to measure the impact of relevant reforms is also curtailed.²⁰ These costs may not be insurmountable, but their acknowledgment is necessary to consider the tradeoffs of this structure—and identify ways to develop cost reductions.

To evaluate the tradeoffs of the Cayman Sandwich, we skeptically reconsider investors' concerns (i.e., the potential liability for portfolio company's obligations and difficulty in replicating VC standard contracts) and distinguish *perceived* from *actual* legal risks.

Perceived legal risks include weak investor protection and inflexible contract laws. These perceptions rest on stereotypical accounts of civil law jurisdictions in Latin America, reinforced by legal indexes that, while providing seemingly objective metrics, are marred by biases favoring common law jurisdictions²¹ and overlooking the nuances of VC transactions.²² Factually, most jurisdictions in the region have continuously updated their legal frameworks over the past two decades,²³ and have traditionally recognized

¹⁸ See Section V.A.

¹⁹ See Section V.B.

²⁰ Id.

²¹ See Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 REV. FIN. STUD. 467 (2010).

²² Pereira, *supra* note 11 (finding that empirical studies in venture finance that use legal indexes "most studies do not distinguish the legal instruments used to distribute control, whether commitments are enforceable, the consequences of breaching such commitments, and how such variations affect incentives").

²³ Relevant examples include the introduction of simplified corporations, specifically tailored to facilitate founder-entrepreneur bargains over startups' cash flow and governance rights. See, e.g., Mexican, Ley del Mercado de Valores (Dec. 2005) (introducing the Sociedad Promotora de Inversión), Chilean Ley 20,190 (2007) (introducing the Sociedad por Acciones), Colombian Ley 1258 (2008) (introducing the Sociedad por Acciones Simplificada or "SAS"), Argentinian Ley 27,349 (2017) (introducing the SAS), Ecuadorian Ley Orgánica de Emprendimiento e Innovación, Registro Oficial No. 151 (2020) (introducing the SAS), and, in El Salvador, Decreto N° 905 (2023) (introducing the SAS). For empirical of the legal evolution of corporate

freedom of contract (or private parties' "autonomy") as a core principle of corporate and contract law.²⁴ By uncovering the shortcomings in these long-standing perceptions, Latin American countries can disincentivize the use of the Cayman Sandwich and minimize its associated costs without legal or regulatory reform.

Actual legal risks, on the other hand, merit further scrutiny and may justify legal changes, as they likely impact not only VC but other types of foreign investments and commercial transactions in general. Although differences across legal systems are relevant, we identify three main risks. The first one is the absence of a consistent approach to lifting the corporate veil, which exposes VC funds and their limited partners to potential liability.²⁵ The second legal risk is found in mandatory rules of corporate law that limit the range of agreements between founders and investors over startups' cash flow and control rights.²⁶ The third is the lack of efficient and reliable dispute resolution mechanisms.²⁷ We discuss recent developments in all three areas, identifying improvements that can inform permanent solutions to encourage direct investments in Latin America by international investors, ultimately reducing the identified costs. To the extent that structures like the Cayman Sandwich are common in many emerging economies, the reported findings can also inform discussions and policies beyond Latin America.

The remainder of the paper is divided into six sections. Section II defines VC and identifies its distinctive characteristics and benefits. Section III presents an overview of the rise of VC in Latin America. Section IV discusses the general risks associated with direct investments in Latin American startups and introduces the Cayman Sandwich structure, designed to minimize those risks. Section V analyzes the costs that the pervasive use of the Cayman Sandwich creates for startups and institutional development. Section VI develops a distinction between perceived and actual legal risks and argues that the latter should be addressed to reduce the costs associated with the Cayman Sandwich.

law in major Latin American countries, *see* Alvaro Pereira, *Selective Flexibility: The Hidden Evolution of Startup Corporate Law* (on file with authors).

²⁴ *See, e.g.,* RAPHAEL ANDRADE, FUNDOS DE VENTURE CAPITAL E PRIVATE EQUITY NO BRASIL (2022), and Brazilian Civil Code, article 421-A, II, providing that "risk allocation defined by the parties must be respected and observed."

²⁵ *See* Section VI.B.1.

²⁶ *See* Section VI.B.2.

²⁷ *See* Section VI.B.3.

Section VII concludes.

II. WHAT IS VENTURE CAPITAL?

Venture Capital (VC) is a form of private equity that focuses on innovative private companies with high-risk and high-return opportunities.²⁸ These companies have the potential to quickly capture, change, or even create markets but require a recurrent influx of capital and preserving information secret from established companies, terms that are inviable for most financiers and business partners.²⁹ VC investors acquire assets that are representative, convertible, or replaceable for equity or equity-linked interests at different stages of the startup lifecycle, thus providing the required capital in exchange for specific rights in the startup company that help them alleviate issues derived from information asymmetries and uncertainty over outcomes.³⁰

VCs act as financial intermediaries between companies with significant growth potential and various investors, such as pension funds, foundations, family offices, insurers, endowment funds, and high-net-worth individuals, who are legally or strategically proscribed and/or disincentivized from directly investing in these companies.³¹ VCs procure returns by developing an expertise in emerging industries and technologies and actively engaging their portfolio companies' governance.³² After a period between seven to ten years, VCs divest by selling their equity stake to another company in a merger or an acquisition, or to retail investors in an initial public offering ("IPO") of securities—what is commonly referred to as an "exit" or "liquidation event."³³ Exits enable VCs to return the invested capital along with a premium to the fund's own investors, so-called limited partners ("LP").³⁴ Exits also allow the VC fund's managers,

²⁸ See generally Josh Lerner & Ramana Nanda, *Venture Capital's Role in Financing Innovation: What We Know and How Much We Still Need to Learn*, 34 J. ECON. PERSP. 237 (2020).

²⁹ See Robert Cooter & Hans Bernd Schäfer, *The Secret of Growth Is Financing Secrets: Corporate Law and Growth Economics*, 54 J.L. & ECON. S105 (2011).

³⁰ Paul Gompers & Josh Lerner, *The Venture Capital Revolution*, 15 J. ECON. PERSP. 145 (2001).

³¹ DOUGLAS CUMMING AND SOFIA JOHAN, *VENTURE CAPITAL AND PRIVATE EQUITY CONTRACTING: AN INTERNATIONAL PERSPECTIVE* 5 (2014).

³² PAUL GOMPERS, VICTORIA IVASHINA, RICHARD S. RUBACK *PRIVATE EQUITY: A CASEBOOK* 3 (2019); GEOFF YATES, MIKE HINCHLIFFE, *A PRACTICAL GUIDE TO PRIVATE EQUITY TRANSACTIONS* 2 (2009).

³³ D. Gordon Smith, *The Exit Structure of Venture Capital*, 53 UCLA L. REV. 315 (2005).

³⁴ Id.

known as general partners (“GP”), to receive direct benefits in the form of returns on their own contributed capital to the VC fund and performance fees (“carried interest” or “carry”).³⁵

VC funds are generally established for a period of 7 to 10 years.³⁶ This temporal constraint, along with the legal and reputational commitments to the LPs, incents VC investors to promote the fast scale-up of their portfolio companies. A positive consequence of it is that VCs are incentivized to timely make financial and non-financial investments that contribute to the company’s success, including managerial expertise, an extensive network of contacts encompassing potential suppliers, consumers, and executives, and a “seal of competence and quality” derived from securing funding from a renowned investor—what is collectively referred to as “smart money.”³⁷ A negative consequence is that, aware that most startups do not succeed and that their overall portfolio can produce returns with just one or two hyper-successful companies, VCs might induce founders to take excessive risks³⁸ or attempt to force the premature sale of the company.³⁹

The startup-VC relationship is, indeed, complex but critical for innovation, growth, and competitiveness. VC has enabled the entry into market and growth of some of the most valuable companies by market capitalization and helped develop new industries such as personal computers, smartphones, and AI, increasing productivity, competitiveness, and employment generation,

³⁵ Ning Jia & Dan Wang, *Skin in the Game: General Partner Capital Commitment, Investment Behavior and Venture Capital Fund Performance*, 47 J. CORP. FIN. 110 (2017).

³⁶ Douglas Cumming, Grant Fleming & Armin Schwienbacher, *The Structure of Venture Capital Funds*, in HANDBOOK OF RESEARCH ON VENTURE CAPITAL 155 (Hans Landström (ed.) ed. 2007).

³⁷ See Elizabeth Pollman, *Startup Governance*, 168 U. PENN. L. REV. 155, 180 (2019). (“VCs are in fact sometimes called ‘smart money’ in reference to the value-adding services they provide, such as serving as a sounding board to the founders and team, helping to recruit management personnel, formulating business strategies, and providing contacts.”) See also STEFANO CASELLI AND GIULIA NEGRI PRIVATE EQUITY AND VENTURE CAPITAL IN EUROPE: MARKETS, TECHNIQUES, AND DEALS 6 (2018) (“In fact, a private equity investment is not limited to simple money provision; the financial support comes from managerial activity consisting of advisory service and full-time assistance for the company’s development. For young venture or new business ideas, cooperation with financiers is very important, because reputation, know-how, networking, relationships, competencies, and skills are the nonfinancial resources provided by private equity and venture capital operators. Although difficult to measure, these resources are the true reason underlying the deal and important for firm growth. They may be defined as benefits or effects embedded within the money injection of the investor.”); and DOUGLAS J. CUMMING & SOFÍA JOHAN, VENTURE CAPITAL AND PRIVATE EQUITY CONTRACTING: AN INTERNATIONAL PERSPECTIVE 4 (2014).

³⁸ Brian J. Broughman & Matthew Wansley, *Risk-Seeking Governance*, VAN. L. REV. 1299 (2023).

³⁹ Brian Broughman & Jesse M. Fried, *Carrots and Sticks: How VCs Induce Entrepreneurial Teams to Sell Startups*, 98 CORNELL L. REV. 41 (2013).

among many other indirect positive outcomes.⁴⁰ VC is, therefore, beneficial not only for innovative entrepreneurs' individual aims but also for economic development.

While VC has experienced a global expansion over the past two decades, investments mainly flow from US funds to startups in different regions of the world,⁴¹ evidencing that the development of local VC markets remains a pressing challenge for most economies—and Latin America's is no exception.

III. THE RISE OF VENTURE CAPITAL IN LATIN AMERICA

It is perhaps telling that, until the 1990s, there was no word in either Portuguese or Spanish for “entrepreneur.” Sure enough, there *were* entrepreneurs in Latin America, but they were usually referred to as “empresários” in Portuguese or “empresarios” in Spanish, which translates into “businessmen,” a word often used to describe suit-and-tie businesspeople leading established companies, not a youngster starting a tech company out of a garage.⁴²

In recent years, however, Latin America has experienced a significant surge in new business formation and VC investments. Global investors increasingly turn their attention to the region, recognizing its immense growth and innovation potential.⁴³ Major VC firms from around the world have established dedicated funds or expanded their presence in Latin America, signaling confidence in the region's startup ecosystem, while local players are accumulating valuable experience.⁴⁴ This surge can be attributed to several key

⁴⁰ See Lerner and Nanda, *supra* note 28 (noting that, despite limitations, venture capital was involved in financing startups that ultimately have become some of the largest and most successful firms, playing a disproportionately relevant role in the US economy). *Also see* Josh Lerner & Ramada Nanda, *Venture Capital and Innovation*, in HANDBOOK OF THE ECONOMICS OF CORPORATE FINANCE: PRIVATE EQUITY AND VENTURE CAPITAL 77 (2023).

⁴¹ KPMG, *Venture Pulse Q3 2024: Global Trends in Venture Capital* (Oct. 16, 2024), <https://kpmg.com/kpmg-us/content/dam/kpmg/pdf/2024/venture-pulse-q3-2024.pdf> (last visited June 17, 2025).

⁴² BRIAN REQUARTH, *VIVA THE ENTREPRENEUR: FOUNDING, SCALING, AND RAISING VENTURE CAPITAL IN LATIN AMERICA* (2021).

⁴³ Economist Impact, *Beyond the Unicorns: Smaller Companies Also Hold Great Promise in Latin America* (2023), <https://impact.economist.com/perspectives/sites/default/files/beyond-the-unicorns-smaller-companies-also-hold-great-promise-in-latin-america.pdf> (last visited June 17, 2025).

⁴⁴ MCKINSEY, *LATAM DIGITAL REPORT: STARTUP STUDY* (2023) <https://latamdigitalreport.mckinsey.com/> (last visited June 17, 2025). (Finding that over 150 new Latin American-based VC funds have been established between 2020 and 2023.)

factors that are reshaping the investment ecosystem and propelling the region onto the global stage as a thriving hub for innovation and entrepreneurship.

First, Latin America has an undeniable economic potential. The region has a combined population of 660 million people (double that of the US), \$6 trillion GDP, and an ever-growing middle class.⁴⁵ In recent years, internet penetration, smartphone usage, banking access, and payment facilitation have all contributed to an uptick in the demand for digital products and services.⁴⁶ Advances in technology and the widespread adoption of digital solutions have created fertile ground for startups to flourish across Latin America.⁴⁷ The region has seen a proliferation of tech-enabled businesses addressing various sectors, including fintech, e-commerce, healthtech, agtech, and edtech.⁴⁸

One of the key drivers behind the surge of VC investments in Latin America is the recognition of the significant real-world problems that exist across the region.⁴⁹ These challenges span various sectors and touch the lives of millions of people, creating ripe opportunities for innovative solutions and impactful ventures. These include socio-economic inequality, financial inclusion, access to healthcare and education, and much-needed improvements in environmental sustainability, urbanization, infrastructure, agricultural productivity, and food security.⁵⁰ The rapid pace of technological progress experienced over the past few decades has reduced the cost of producing technological and marketable solutions to these pervasive problems,⁵¹ and local founders have developed scalable business models, unleashing unprecedented interest from VCs.

The data reflect these developments. Between 2018 and 2021, there was a 6x increase in the volume of funds invested by VC funds, a 1.4x increase in

⁴⁵ See, generally, World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators> (last visited June 17, 2025).

⁴⁶ Bas B. Bakker et al., *The Rise and Impact of Fintech in Latin America*, 2023 FINTECH NOTES (2023), <https://www.elibrary.imf.org/view/journals/063/2023/003/article-A001-en.xml> (last visited June 17, 2025).

⁴⁷ Id.

⁴⁸ ATLANTICO, LATIN AMERICA DIGITAL TRANSFORMATION REPORT (2023); THE LAUDER INSTITUTE, THE SURGE OF VENTURE CAPITAL IN LATIN AMERICA: THE LAUDER GLOBAL BUSINESS INSIGHT REPORT (2022).

⁴⁹ Sarah Birke, *The Future is Bright for Latin American Startups*, The Economist (Nov. 13, 2023) (last visited June 17, 2025).

⁵⁰ Id.

⁵¹ Id.

the number of investment rounds, and a 2.4x increase in the number of active VC investors in the region.⁵² The number of unicorns—startups valued at over \$1 billion—increased 4x, jumping from 9 in 2018 to 34 in 2021.⁵³

Another factor propelling VC investments is Latin American entrepreneurs’ ability to “do more with less.” According to Atlantico, despite VC investments in Latin America representing only 0.1% of the region’s combined GDP in 2022, from 2017 to 2022, there were 12 exits valued at over \$1 billion, totaling a market cap of \$82 billion.⁵⁴ In contrast, in Southeast Asia, where VC investments represented 0.3% of the region’s combined GDP, there were only 7 exits, totaling \$80 billion in market cap.⁵⁵ Moreover, about half of the Latin American students from top universities surveyed in the DTR 2023 Student Survey expressed interest in founding a startup in the future.⁵⁶

The expected growth in the number of new startups solving prevalent problems with scalable business models in economies with a growing middle class will likely sustain or increase the volume of VC investments in Latin America. However, higher flows of investments do not automatically lead to the development of domestic VC markets—and the dominant corporate structure used in VC deals in the region, the Cayman Sandwich, reveals important challenges for local economies.

IV. THE “CAYMAN SANDWICH” STRUCTURE

The Cayman Sandwich is one of many structures international investors use to elude the application of domestic law to their financial interests in Latin American startups, including agreements that define the companies’ governance and capital structure.⁵⁷ Investors’ main concerns are the risk that the fund or its

⁵² MCKINSEY, LATAM DIGITAL REPORT: STARTUP STUDY (2023), <https://latamdigitalreport.mckinsey.com/> (last visited June 17, 2025).

⁵³ Id. Still, according to recent reports, following the recent trends in the venture capital industry throughout the world, the total amount of VC dollars raised in Latin America in 2023 (\$2.2b) and thus far in 2024 (\$1.1b) dropped sharply from historical record levels in 2021 (\$15.3b) and 2022 (\$8b). *See* ENDEAVOR & GLISCO PARTNERS, ECOSISTEMA DE VENTURE CAPITAL Y GROWTH EQUITY EN LATAM (2024).

⁵⁴ ATLANTICO, LATIN AMERICA DIGITAL TRANSFORMATION REPORT (2023); THE LAUDER INSTITUTE, THE SURGE OF VENTURE CAPITAL IN LATIN AMERICA: THE LAUDER GLOBAL BUSINESS INSIGHT REPORT (2022).

⁵⁵ Id.

⁵⁶ Id.

⁵⁷ Structures with only one parent company in Delaware or the Cayman Islands are also common and more

partners could be held liable for the obligations of the portfolio companies and that their interests could not be adequately protected due to differences in corporate law. Hence, in this section, we first discuss the risks and, subsequently, how the Cayman Sandwich structure attempts to control them.

A. Legal Risks for Venture Capital in Latin America

In the standard VC model developed in the US, VC funds are established as limited partnerships between one or more managers (i.e. GPs) and several investors (i.e. LPs).⁵⁸ GPs are responsible for allocating capital, supporting the companies, and procuring returns.⁵⁹ LPs commit to providing funds when they receive capital “calls” from the GPs.⁶⁰ GPs bear full responsibility for all aspects related to fund management, holding a fiduciary duty to act solely in the interest of the partnership, making capital “calls,” and both investment and divestment decisions according to the predefined rules in the limited partnership agreement (the “LPA”).⁶¹ LPs, on the other hand, are “pure financial investors” who cannot be involved in day-to-day operations or in managing the fund or the invested companies.⁶²

The strict limitation of LPs’ liability in this structure enables GPs to access a wider pool of investors to capitalize their funds. For instance, investors with a highly diversified portfolio who self-restrict themselves to participating as passive investors (e.g., family offices) and, most importantly, institutional investors who may be legally proscribed from directly engaging in high-risk investments (e.g., pension funds) are attracted by the limited partnership

convenient to early stage companies, due to significantly less costs. *See* Luciana Jhon Urrunaga and Anibal Manzano, *Corporate Structures for Latin American Startups*, Manzano Law (Jun. 19, 2023) (noting that “[t]he primary disadvantage of the Cayman Sandwich is cost, which requires startups to have legal teams in at least 3 jurisdictions (Cayman Islands, US, OpCo jurisdiction(s)) and comply with certain US tax obligations...” and that the “..structure may not be the best fit for pre-seed or seed stage startups or startups that have not closed (and do not intend to close in the short term) a priced round (equity financing).”)

⁵⁸ Cumming, Fleming, and Schwienbacher, *supra* note 36.

⁵⁹ Jia and Wang, *supra* note 35.

⁶⁰ Cumming, Fleming, and Schwienbacher, *supra* note 36.

⁶¹ In the United States, for example, while general partners are generally jointly and severally liable for all obligations incurred by the limited partnership (Section 404, (a) and (c), ULPA 2001), the liability of limited partners is limited to the amount they have contributed (Section 303, ULPA 2001).

⁶² *SEE* CLAUDIA ZEISBERGER, MICHAEL PRAHL AND BOWEN WHITE, *MASTERING PRIVATE EQUITY: TRANSFORMATION VIA VENTURE CAPITAL, MINORITY INVESTMENTS & BUYOUTS*, 6 (WILEY, 2017).

structure.⁶³ Without LPs' limited liability, venture finance activity would be significantly hampered.⁶⁴

Some VC funds investing in Latin America are established and capitalized in other countries (i.e., offshore funds) and thus follow the same structure.⁶⁵ Other funds established in Latin America also raise funds from foreign investors based, for example, in the United States and Europe.⁶⁶ In both instances, foreign investors are reluctant to invest in companies directly incorporated in Latin American countries.⁶⁷ This resistance may stem from either a "discretionary" decision by the fund manager or explicit provisions in the fund's constitutive documents, that are negotiated with the fund's LPs and precede investment decisions.

Indeed, the legal framework that governs investment funds in some Latin American countries has unique characteristics that make it difficult to replicate the US model and contribute to risk perception. For instance, in Brazil, the largest economy in the region, VC funds are structured as "fundos de investimento em participações" (FIP).⁶⁸ Until 2022,⁶⁹ FIPs operated under a regime of subsidiary liability. In general terms, investors (roughly equivalent to LPs) were liable for any negative net worth of the fund, with no limitation on liability. This meant that if the fund was found liable for any obligations related to its portfolio companies and lacked the resources to make such payments, the

⁶³ Jia and Wang, *supra* note 35.

⁶⁴ More precisely, limited liability was a fundamental milestone that allowed the flourishing of entrepreneurship and business activity in general, so much that it is almost inseparable from commercial endeavors in a market economy. *See, e.g.,* WILLIAM MAGNUSON, FOR PROFIT: A HISTORY OF CORPORATIONS 73 (2022). From a logical standpoint, the riskier the venture, the more pivotal a role played by limited liability.

⁶⁵ For example, Soft Bank's \$3Billion Latin America Fund II, which minted some of the region's unicorns, was based in Miami, Florida *See* SoftBank Latin America Fund, <https://www.latinamericafund.com/> Also see Pitchbook, SoftBank Latin America Fund II Overview, <https://pitchbook.com/profiles/fund/19422-82F> (last visited June 17, 2025).

⁶⁶ For example, Monashees, which invested in successful startups, such as Nubank and Rappi, is registered in Brazil and channels capital from international LPs to Latin American startups. *See* Sofia Drobychevskaya, *Top VC Funds in Latin America*, Vestbee (Oct. 31, 2023), <https://www.vestbee.com/blog/articles/top-vc-funds-in-latin-america> (last visited Mar. 1, 2025).

⁶⁷ BRIAN REQUARTH, VIVA THE ENTREPRENEUR: FOUNDING, SCALING, AND RAISING VENTURE CAPITAL IN LATIN AMERICA (2021): "Nowadays, as an investor, if I see that a company is raising money through a local entity, I will almost always pass. There are a number of reasons for an offshore structure, including, primarily, liability protection, tax optimization, clearer governance, investor familiarity, and more flexibility on an exit."

⁶⁸ These funds are regarded as "condomínios de natureza especial" (special-purpose condominiums) and "comunhão de recursos" (communion of resources). *See* Annex IV of the Securities and Exchange Commission ("CVM") Resolution No. 175/2022.

⁶⁹ *See* CVM Instruction 578/2022 and, subsidiarily, by CVM Instruction 555/2014.

manager (the GP) could (or rather, should) demand additional contributions from the investors. Although the 2022 amendments essentially enabled investors to opt out⁷⁰ and design an agreement akin to the one standardized in the US,⁷¹ concerns that LPs may be called to pay for portfolio companies' obligations persist.

Another concern relates to the possibility that the VC fund, as an independent entity, could be held accountable for the obligations of its portfolio companies. For example, Brazilian law considers business entities as separate legal persons, distinct from their members, and solely responsible for obligations arising from business activities.⁷² This core principle of limited liability, which was even restated in a 2019 amendment to the Civil Code,⁷³ can be rebutted in exceptional circumstances of blatant abuse of legal personality,⁷⁴ as is common in most legal systems under different doctrines to “pierce the corporate veil.”⁷⁵ In practice, however, some judicial decisions go beyond what is expressly stipulated in the law and expected by parties, holding partners of a company liable for its obligations, especially in matters related to labor legislation, environmental damages, and, less frequently, tax issues.⁷⁶ The lack of a consistent approach to piercing the corporate veil is not exclusive to Brazil but rather common in Latin America,⁷⁷ exacerbating the risks for investors, since a particular fund could, in theory, be held responsible for obligations assigned to its portfolio companies, potentially creating a scenario of portfolio-wide

⁷⁰ See Article 18, CVM Resolution 175/2022.

⁷¹ The issue remains somewhat controversial. For a thorough discussion of the subject, see RAPHAEL ANDRADE SILVA, *FUNDOS DE VENTURE CAPITAL E PRIVATE EQUITY NO BRASIL* (2022).

⁷² See, generally, JOSÉ LAMARTINE CORRÊA DE OLIVEIRA, *A DUPLA CRISE DA PESSOA JURÍDICA*. (SARAIVA, 1979); SYLVIO MARCONDES, *PROBLEMAS DE DIREITO MERCANTIL*. SÃO PAULO: MAX LIMONAD, 1970; ALFREDO LAMY FILHO, BULHÕES JOSÉ LUIZ PEDREIRA (Ed.S). *DIREITO DAS COMPANHIAS*. (2ª Ed. Forense, 2017).

⁷³ See Lei nº 10.406/2022 (Brazilian Civil Code), Article 49-A, sole paragraph. (stating that “the patrimonial autonomy of legal entities is a lawful instrument for the allocation and segregation of risks, established by law with the purpose of promoting enterprises for the generation of jobs, taxes, income, and innovation for the benefit of all.”)

⁷⁴ See, e.g., Lei nº 10.406/2022 (Brazilian Civil Code), Article 50.

⁷⁵ See, generally, JOSE MARIA LEZCANO, *PIERCING THE CORPORATE VEIL IN LATIN AMERICAN JURISPRUDENCE: A COMPARISON WITH THE ANGLO-AMERICAN METHOD* (2015)

⁷⁶ To be sure, the higher number of veil-piercing cases in Brazil could also be attributable to comparatively more frequent cases of abuse of the corporate form by related parties. This hypothesis is yet to be tested empirically. If proven correct, it would suggest that concerns about judges' competencies might be misplaced.

⁷⁷ JOSE MARIA LEZCANO, *PIERCING THE CORPORATE VEIL IN LATIN AMERICAN JURISPRUDENCE: A COMPARISON WITH THE ANGLO-AMERICAN METHOD* (2015)

“contagion.”

An additional concern relates to corporate law and regulations applicable to VC investments. VCs solve issues derived from information asymmetries and uncertainty by acquiring a combination of securities with contingent rights at different stages of the startup company’s lifecycle.⁷⁸ The ability to customize such securities is crucial to ensuring that founders and employees have adequate incentives and that investors’ interests are protected.⁷⁹ Like the structure of VC funds, the agreements that govern the fund’s relationship with the portfolio companies have been somewhat standardized.⁸⁰ Although boilerplate VC investment agreements typically contain a range of provisions over which parties can bargain (and not a one-size-fits-all formula),⁸¹ their implementation in Latin America can also be problematic. Legal systems in most Latin American countries, which follow the civil law tradition, have corporate law statutes that were designed for either small companies or listed firms, with comparatively greater normative rigidity.⁸² In Mexico, for example, companies were traditionally allowed to issue preferred shares with double-vote and no-dividend or vice versa, but not a series of shares with differentiated rights.⁸³

Over the last two decades, amendments to corporate statutes in most Latin American countries have facilitated VC investments.⁸⁴ There is also evidence that lawyers’ creativity and inventiveness have prevailed over attempts to saddle commercial activity with predetermined and immutable concepts.⁸⁵ Still, the perception of legal risk and uncertainty among foreign investors persists

⁷⁸ See Section II

⁷⁹ See Pereira, *supra* note 11.

⁸⁰ Robert P. Bartlett, Standardization and Innovation in Venture Capital Contracting: Evidence from Startup Company Charters (Sep. 10, 2023), <https://papers.ssrn.com/abstract=4568695> (last visited June 17, 2025)

⁸¹ See, e.g., National Venture Capital Association, Model documents (providing templates with annotations on how to adjust provisions to specific circumstances)

⁸² Francisco Reyes, *Modernizing Latin American Company Law: Creating an All-Purpose Vehicle for Closely Held Business Entities - The New Simplified Stock Corporation* *International Academy of Commercial and Consumer Law: Corporate Law*, 29 PENN ST. INT’L L. REV. 523 (2010).

⁸³ See Ley General de Sociedades Mercantiles (LGMS), art. 113. To be sure, a new corporate form was introduced in 2006, allowing the issuance of shares with differentiated rights. See Ley del Mercado de Valores — Diario Oficial de la Federación 12-30-2005, art. 13

⁸⁴ See, e.g., Chilean Law 20.190 (2007) (creating the “Sociedad por Acciones” and incentives for investments), Colombian Law 1258 (2008) (creating the “Sociedade por Acciones Simplificada”), and Mexican Ley del Mercado de Valores — Diario Oficial de la Federación 12-30-2005, art. 13.

⁸⁵ See RAPHAEL ANDRADE, *FUNDOS DE VENTURE CAPITAL E PRIVATE EQUITY NO BRASIL* (2022) (discussing contractual innovation and adaptation of standard VC terms in Brazil).

and explains why they condition their investments to the establishment of multi-jurisdictional structures.

B. The Cayman Sandwich Structure as a Risk Management Device

VCS interested in Latin American startups have developed alternative investment structures to hedge and manage legal risks.⁸⁶ One of the most prominent ones is the Cayman Sandwich. Through the Cayman Sandwich, the operational startup company (i.e., the Latin American target company, incorporated in Brazil, Colombia, Mexico, etc.) (OpCo) is entirely owned by a limited liability company, usually established in the state of Delaware (Delaware LLC). This Delaware LLC, in turn, is a wholly-owned subsidiary of a holding company incorporated in the Cayman Islands (Cayman Holding).⁸⁷

The Cayman Sandwich directly addresses investors' two main legal concerns discussed above. On the one hand, it insulates investors from potential liability by adding two corporate layers between the VC fund and OpCo's creditors. Even in exceptional circumstances that might justify disregarding the legal personality of the OpCo, a plaintiff would also have to pierce the veil of the Delaware LLC and the Cayman Holding to access investors' assets—a strategy that entails greater costs, time, and successful judicial decisions in three jurisdictions and, therefore, one with lower probabilities of success. A critical challenge for a potential plaintiff is to build a coherent case that satisfies the requirements of different doctrines, such as the “alter ego” in Delaware⁸⁸ and the “evasion principle” under Cayman Islands law.⁸⁹ On the other hand, the

⁸⁶ See Luciana Jhon Urrunaga and Anibal Manzano, *Corporate Structures for Latin American Startups*, Manzano Law (Jun. 19, 2023).

⁸⁷ See Alvaro Pereira, Raphael Andrade, *Venture Capital in Latin America: A Critical Look at the ‘Cayman Sandwich’ structure*, OXFORD BUSINESS LAW BLOG (2023). <https://blogs.law.ox.ac.uk/oblb/blog-post/2023/11/venture-capital-latin-america-critical-look-cayman-sandwich-structure> (last visited June 17, 2025).

⁸⁸ For a recent decision by the Chancery Court highlighting the difficulty of piercing the corporate veil of a Delaware LLC. See *Verdantus Advisors, LLC v. Parker Infrastructure Partners, LLC*, C.A. No. 2020-0194-KSJM, Order (Del. Ch. Mar. 2, 2022).

⁸⁹ See *Gol Linhas Aereas SA v Matlinpatterson Global et al*, CICA Civil Appeal 12 of 2019, Cayman Islands Court of Appeal (1 August 2020), at para 194 (citing English law as the main authority on piercing the corporate veil, in particular, Lord Sumption's account in *Petroleum Resources Ltd v. Prest* [2013] UKSC 34, [2013] 2 AC 415: “In English law, the [piercing the corporate veil] covered an amorphous net of principle, but was (similarly) founded on what he called the “evasion principle”, which depended on “a legal right which exists independently of the company's involvement” (at para [28]...).”).

Cayman Sandwich reduces the uncertainty over the content and protection of investors' rights in the startup company. By establishing Cayman Islands law as the law governing the transaction, foreign VCs also opt into a legal system perceived as more protective of their interests due to its similarity to those of the United Kingdom and the state of Delaware.⁹⁰

Additionally, the Cayman Sandwich offers relevant tax and exit advantages. Under Cayman Islands law, there are no taxes on corporate income, capital gains, or distributions to shareholders, making operations and exits cost-efficient.⁹¹ The structure also expands exit opportunities: investors have the option of selling their position in the Cayman Holding, the Delaware LLC, the OpCo, or a new entity resulting from the merger of two of these entities.

In light of these considerations, ambitious Latin American startups operate under the premise that, as they progress through the business development cycle, at some point in their trajectory, it will be convenient or necessary to convert (in market jargon, to “flip”) their corporate structure from a fully onshore model to a Cayman Sandwich model.⁹² This shift allows them to access larger capital pools with foreign VCs willing to support larger investment rounds. For example, Cornershop, a Chilean online grocery store company started in 2015, flipped early on, raising significant capital from international investors, until it was acquired by Uber in 2021, with many investors exiting in 2020.⁹³

The decision to flip, however, involves direct costs for the startup and indirect costs for Latin American economies and legal systems. We address each of them in the next section.

V. THE COSTS OF THE CAYMAN SANDWICH

⁹⁰ The decision to resort to Cayman Islands law is in line with a certain body of literature that identifies a firm's decision to incorporate in Delaware because of the relative familiarity of the parties involved in the transaction with Delaware law: the lingua franca effect. See Brian Broughman, Jesse M. Fried, and Darian Ibrahim, *Delaware Law as Lingua Franca: Theory and Evidence*, 57.4 J. L. & ECON. 865 (2014).

⁹¹ Cayman Islands Gov't, *Economy & Finance*, <https://www.gov.ky/economy> (last visited Mar. 31, 2025) (stating that there is “no income tax, company or corporation tax, inheritance tax, capital gains or gift tax”).

⁹² According to Latitud, 47.7% of all Latin American unicorns have a Cayman Holding as part of their corporate structure. See <https://www.latitud.com/blog/cayman-sandwich-corporate-structure-startups> (last visited June 17, 2025).

⁹³ Sarah Perez, *Uber to Become the Sole Owner of Grocery Delivery Startup Cornershop*, TechCrunch (June 21, 2021), <https://techcrunch.com/2021/06/21/uber-to-become-the-sole-owner-of-grocery-delivery-startup-cornershop/> (last visited Mar. 1, 2025).

A. Direct Costs for Startups

The adoption of the Cayman Sandwich structure naturally leads to an increase in direct costs for the startup. These costs can be divided into (i) operational and maintenance costs, (ii) costs of structuring investment rounds, and (iii) costs associated with a potential liquidity event (i.e., divestment or exit).

Regarding the first aspect, the creation of the two additional corporate layers means that the startup will need to incur expenses for incorporating these new entities. This involves hiring specialized professionals, such as lawyers and accountants, and covering fees and other administrative charges payable to government entities responsible for registering companies in each jurisdiction.⁹⁴ Furthermore, during the existence of the foreign entities, the startup may need to pay other operational and maintenance costs to ensure that all financial, legal, accounting, and tax obligations are properly fulfilled, thus avoiding the imposition of any penalties.⁹⁵

The second set of costs relates to the fundraising process, which requires the engagement of qualified lawyers who can advise in all three jurisdictions. It is crucial for founders and investors to have experienced legal advisors in the Cayman Islands, as it is the jurisdiction governing all financial and governance agreements. At this level, fundamental points of attention include, from a due diligence perspective, verifying the regular constitution of the Cayman Holding, analyzing documents and contracts related to previous fundraising rounds, and reviewing any long-term employee compensation plans, such as stock option plans and other equivalents, as well as negotiating the transaction documents. Similarly, specialized legal counsel in Delaware is also required to adhere with corporate and tax obligations, a breach of which can significantly impact the company's operations and financial viability. Concurrently, having a qualified team of lawyers in the OpCo's Latin American jurisdiction is crucial to ensure

⁹⁴ To form and operate a Delaware LLC, for example, companies must appoint and maintain a registered agent, "who may be either an individual resident or business entity that is authorized to do business in the State of Delaware. The registered agent must have a physical street address in Delaware." *See* Delaware Division of Corporations, *How to Form a New Business Entity*, <https://corp.delaware.gov/howtoform> (last visited Mar. 20, 2025).

⁹⁵ Even in the Cayman Islands, the jurisdiction with the lightless company law in the structure, companies are required to keep updated records, including beneficial ownership information. *See* Cayman Islands General Registry, *Companies Register: Beneficial Ownership*, <https://www.ciregistry.ky/beneficial-owner/> (last visited Mar. 20, 2025).

legal compliance and support the due diligence process, since virtually all business activities are conducted at this level.

Finally, and perhaps ironically, the startup may incur costs associated with unwinding the Cayman Sandwich during an exit. VCs typically exit by selling their interest in the startup to a strategic buyer or taking the invested company public through an initial public offering (IPO).⁹⁶ In Latin America, as in most regions of the world, IPOs are uncommon due to the illiquidity of stock markets, high listing, and compliance costs.⁹⁷ Instead, most VC divestments occur through sales to strategic buyers, such as competing companies or those operating in horizontally or vertically related markets.⁹⁸ These investors tend to prefer conducting such operations onshore; that is, they prefer to acquire equity stakes in companies incorporated in their own jurisdictions, rather than, for example, in the Cayman Islands. This preference may be related to such investors' greater familiarity with local legislation, the lower cost and complexity associated with structuring a transaction involving only the Latin American company, and greater tax efficiency from the buyer's perspective. It is frequent that, as a condition for closing the transaction, the startup is required to carry out a corporate reorganization, resolving the Cayman Sandwich structure and returning to the original structure, where only the Latin American company exists, of which the entrepreneurs and VC funds become direct shareholders. This naturally implies additional costs related, among other things, to the dissolution and liquidation of the Cayman Holding and Delaware LLC, the

⁹⁶ There is not a one-size-fits-all strategy for exiting venture-backed companies, but evidence shows that VCs often preplan exits as early as at the time of contracting, with relevant impacts on contract and securities design, and the allocation of political and economic rights between the parties. See Onur Bayar & Thomas J. Chemmanur, *IPOs versus Acquisitions and the Valuation Premium Puzzle: A Theory of Exit Choice by Entrepreneurs and Venture Capitalists*, 46 J. OF FIN. & QUANT. ANAL. 1755 (noting that relevant factors that impact the exit choice are competition in the product market, information asymmetry related to pricing, and residual private benefits of control post-exit to the entrepreneur) and James C. Brau *et al.*, *The Choice of IPO versus Takeover: Empirical Evidence*, 76 J. OF BUS. 583. On the decline of IPOs and their impact on startups and capital markets, see Elisabeth de Fontenay, *The Deregulation of Private Capital And The Decline Of The Public Company*, 68 HASTINGS L. J. 445 (2017) (noting a progressive decline in the number of IPOs in the United States; from 2001 through 2012, there were an average of only 99 IPOs per year, compared to 310 IPOs per year between 1980 and 2000), and Elizabeth Pollman, *Startup Governance*, 168 U. PENN. L. REV. 155 (2019) (noting that companies can stay private longer and still access larger pools of capital).

⁹⁷ CLAUDIA ZEISBERGER, MICHAEL PRAHL & BOWEN WHITE, *MASTERING PRIVATE EQUITY: TRANSFORMATION VIA VENTURE CAPITAL* (2017) 192;

⁹⁸ BAIN & CO., *GLOBAL PRIVATE EQUITY REPORT* (2024) (noting that exits through a sponsor to strategic sale accounted for nearly 80% of total exit value in 2023, while the IPO exit channel made up just 3%). https://www.bain.com/globalassets/noindex/2024/bain_report_global-private-equity-report-2024.pdf (last visited June 17, 2025).

reorganization of long-term employee compensation plans, and the potential transfer of assets between the entities involved. Furthermore, the unwinding may represent a taxable event from the perspective of the tax legislation of the countries involved. These additional expenses can strain the startups' resources, diverting funds and entrepreneurs' efforts that could otherwise be invested in core business activities and growth.

B. Indirect Costs: Venture Capital Markets and Institutional Costs

The Cayman Sandwich has additional, system-wide costs beyond those assumed by Latin American startups participating in specific transactions. We focus on two different but intrinsically related sets of costs. The first derives from exporting the development of private ordering solutions to resolve issues inherent to venture finance. By hampering domestic contractual innovation, the Cayman Sandwich slows the development of local venture capital markets. The second set of costs is one of opportunity—the prospects of developing judicial expertise in corporate law and financial contracting, on the one hand, and accurately assessing the impact of legal reforms, on the other.

1. Private ordering

Private ordering solutions are developed by first-movers, typically industry leaders or risk-tolerant players who identify recurrent issues and design alternative strategies to mitigate them.⁹⁹ These solutions are gradually tested and replicated by others, often with adjustments, until the “best” become market standard terms.¹⁰⁰

Despite being a dynamic industry that adapts to technological and micro and macroeconomic changes, the two core challenges that venture capital financing confronts, derived from information asymmetries and uncertainty, are recurrent and pervasive across legal systems: adverse selection (i.e., investors' inability to properly price startups due to information asymmetries) and moral hazard (i.e., the risk that entrepreneurs would extract private benefits, given that

⁹⁹ Frank H Easterbrook & Daniel R Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989).

¹⁰⁰ REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 18 (Third Edition ed. 2017).

they don't bear the full costs).¹⁰¹ The US VC market has developed functional and widely replicated solutions,¹⁰² including stage and syndicated financing,¹⁰³ high-powered incentives for entrepreneurs and employees,¹⁰⁴ boards as monitors with independent members that mediate relationships between entrepreneurs and investors,¹⁰⁵ and securities with special economic and voting rights.¹⁰⁶ Hence, entrepreneurs and investors could contribute to developing VC markets outside the US by replicating, testing, adjusting when necessary, and adopting such solutions.

Nonetheless, some of these contractual innovations might not be able to perform the same function elsewhere, as they may have emerged in response to distinctive features of a legal system that exacerbate common issues in particular ways. Indeed, many of these core issues and the value of their solutions are aggravated due to idiosyncratic regulations and practices. A well-documented example is the preponderant use of convertible preferred stock in the US, which, to a great extent, resulted from specific tax regulations and enforcement policies that might not be observed elsewhere. As documented by Gilson and Schizer,¹⁰⁷ and confirmed by Cumming and Johan,¹⁰⁸ the Canadian VC industry was able to develop functionally equivalent solutions to the issues typically resolved through convertible-preferred stock in the US. In other words, contractual innovations are, in many cases, context-specific.

Moreover, seemingly universal contractual innovations must overcome jurisdiction-specific challenges when replicated. Even if one concludes that the underlying problem exists and the solution is optimal from a conceptual standpoint, one has to wonder if it is replicable (i.e., can you actually enter into that agreement) and, if so, whether there are relevant differences in enforcement that may render it inviable or prohibitively costly.¹⁰⁹ For instance, because

¹⁰¹ Gilson, *supra* note 10.

¹⁰² See, generally, PAUL GOMPERS & JOSH LERNER, *THE VENTURE CAPITAL CYCLE* (2004).

¹⁰³ Paul A. Gompers, *Optimal Investment, Monitoring, and the Staging of Venture Capital*, 50 J. FIN. 1461 (1995).

¹⁰⁴ Yifat Aran, *Making Disclosure Work for Start-Up Employees*, 2019 COLUM. L. REV. 867 (2019); Abraham Cable, *Stock Options of Adhesion*, J. CORP. L. (2025).

¹⁰⁵ Brian Broughman, *Independent Directors and Shared Board Control in Venture Finance*, 9 REV. L. & ECON. 41 (2013).

¹⁰⁶ Bratton, *supra* note 10; Ronald J. Gilson & David M. Schizer, *Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock*, 116 HARV. L. REV. 874 (2003).

¹⁰⁷ Gilson and Schizer, *supra* note 106.

¹⁰⁸ Cumming and Johan, *supra* note 10.

¹⁰⁹ To be sure, in some cases the parties may have the option to enter into an alternative arrangement that achieves the same result but entails additional, idiosyncratic features (additional costs and/or inferior

convertible preferred stock is not allowed in China,¹¹⁰ and until recently, in many other jurisdictions,¹¹¹ its replicability has been rather limited. If the issue is well understood, an optimal local solution could be developed through private ordering and experimentation, enabling the identification of legal constraints that might merit reform or even additional contractual innovation.¹¹² For example, while the Chinese market has yet to develop a functional equivalent¹¹³ to convertible preferred stock (what it produced is a poor substitute),¹¹⁴ there is evidence of efforts from Italian entrepreneurs and investors to develop one.¹¹⁵

The contractual innovation framework advanced by Choi, Gulati, and Posner¹¹⁶ is helpful to illustrate these costs. According to it, the process of contractual innovation occurs in three subsequent stages. In the first, equilibrium stage, a particular contractual model is prevalent in the market, and due to switching and learning costs, is not subject to additional scrutiny by participants. In the second stage, an external “shock” prompts certain participants to come forward with proposed amendments to the prevailing model. Stage three is marked by competing proposals by market participants,

effectiveness). These are defined by Enriques, Nigro, and Tröger as “inferior alternative arrangements”. See Luca Enriques, Casimiro A. Nigro & Tobias H. Tröger, *Venture Capital Contracting as Bargaining in the Shadow of Corporate Law Constraints*, 445 SAFE WORKING PAPER 14 (2025).

¹¹⁰ See Lin Lin, *Contractual Innovation in China's Venture Capital Market*, 21 EUR. BUS. ORG. L. REV. 101 (2020).

¹¹¹ For a comparative analysis, see Pereira, *supra* note 11.

¹¹² That seem to be the case of Canada, where venture capitalist rely on a variety of securities to resolve the issues primarily address through convertible-preferred stock in the U.S. See Cumming and Johan, *supra* note 13.

¹¹³ See Luca Enriques, Casimiro A. Nigro & Tobias H. Tröger, *Venture Capital Contracting as Bargaining in the Shadow of Corporate Law Constraints*, 445 SAFE WORKING PAPER 13 (2025) (arguing that only if the substitutive arrangement (replacing the standard contractual solution) performs the same function (i.e. achieves the same result *at no higher cost* it can be deemed a *functional equivalent*).

¹¹⁴ Lin, *supra* note 110.

¹¹⁵ Paolo Giudici, Peter Agstner & Antonio Capizzi, *The Corporate Design of Investments in Startups: A European Experience*, 23 EUR BUS ORG LAW REV 787 (2022). There is, however, divergence as to whether these efforts have produced functionally equivalent solutions. See Luca Enriques & Casimiro A. Nigro, *Diritto societario italiano e venture capital: cosa (non) ci dice l'evidenza empirica?*, 23 SOCIETÀ – IL MENSILE 10 (2023) (arguing that the contractual clauses mentioned as empirical evidence by Giudici, Agstner and Capizzi are not functionally equivalent to the standard solutions developed in the U.S. since they face a number of efficacy problems under Italian corporate law). Also see Luca Enriques, Casimiro A. Nigro & Tobias H. Tröger, *Mandatory Corporate Law as an Obstacle to Venture Capital Contracting in Europe: Implications for Markets and Policymaking*, 446 SAFE WORKING PAPER 8 (2025) (presenting the findings of two companion papers that identify both German and Italian corporate laws as deterrents to the adoption of US-style VC contracts); and Luca Enriques, Casimiro A. Nigro & Tobias H. Tröger, *Venture Capital Contracting as Bargaining in the Shadow of Corporate Law Constraints*, 445 SAFE WORKING PAPER 32 (2025) (showing how German and Italian corporate laws contain a number of absolute or relative prohibitions to the adoption of most of the individual, widely used clauses in VC finance).

¹¹⁶ See J. Choi et al., *The Dynamics of Contract Evolution*, 88 N.Y.U L. Rev. 1 (2013).

one of which emerges in the end as the “new standard.”

Assuming this model, by exporting the finance and governance of VC-backed startups during a considerable extent of their lifecycle, the Cayman Sandwich structure virtually eliminates stages two and three of the contractual innovation process, therefore hampering iteration and experimentation at the local level—and, subsequently, the development of VC markets.

2. Institutional costs

Beyond VC markets, the Cayman Sandwich structure also deprives legal systems of institutional development opportunities. We address two that are immediately apparent and likely have additional implications: judicial expertise and legal reform.

a. Judicial expertise

The development of judicial expertise and legal certainty diminishes when most VC agreements are governed by foreign law. To appreciate the significance of this effect, it is necessary to recall that VC is characterized by heavily negotiated and complex agreements.¹¹⁷ Some of these agreements govern the VC fund, including the compensation and other rights and responsibilities of different GPs, on the one hand, and their relationship with GPs and LPs, on the other hand.¹¹⁸ Other agreements regulate the investment in the portfolio companies, each party’s representations, and the obligations they acquire with each other, e.g., disbursing the funds and closing schedules.¹¹⁹ Another set of agreements regulates the finance and governance of the portfolio company, specifying how economic and decision-making rights are allocated to different participants, including investors, founders, and employees.¹²⁰

These agreements contribute to resolving not only general issues in VC contracting (adverse selection and moral hazard) but also issues between

¹¹⁷ See Section II.

¹¹⁸ Cumming, Fleming, and Schwienbacher, *supra* note 36.

¹¹⁹ Andrew Zacharakis & Dean A. Shepherd, *The Pre-Investment Process: Venture Capitalists’ Decision Policies*, in HANDBOOK OF RESEARCH ON VENTURE CAPITAL 177 (Hans Landström (ed.) ed. 2007).

¹²⁰ Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281 (2003).

participants in specific transactions. For example, at the fund level, they may define the exceptional circumstances in which LPs can remove GPs;¹²¹ at the investment stage, the consequences for not complying with key provisions;¹²² and, at the portfolio company level, the procedures and degree of consensus required to approve exits and other fundamental transactions.¹²³

Although parties to VC agreements avoid litigation and generally comply with them for reputational reasons,¹²⁴ the credibility of such commitments relies on their enforceability: if push comes to shove, one must be able to revindicate their rights, judicially or through arbitration (or force a settlement through the credible threat of litigation). As shown before, the prevalence of the Cayman Sandwich structure reveals that international investors decided that Latin American legal systems are unable to provide that certainty.¹²⁵ Regardless of the merits of that assessment (which we challenge in section VI), the export of these agreements deprives local judiciaries of valuable experience necessary to support ever-complex business transactions—even beyond VC.

An updated body of case law on establishing and operating VC funds, clarifying the liability of its partners, would encourage investments by local LPs that currently purchase assets from more regulated sectors and foreign ones that prefer the Cayman Sandwich.¹²⁶ The higher degree of certainty afforded by a more active and experienced judiciary in this area could also benefit other asset managers subject to similar legal standards, such as private equity.¹²⁷

An even wider set of benefits can derive from the domestic resolution of disputes related to agreements between investors and the portfolio companies, such as stock purchase agreements and shareholders agreements. The enforcement of these heavily negotiated contracts with contingent terms and conditions requires an understanding of dynamic concepts in modern corporate finance, such as “calls,” “options,” and “exits,” which are prevalent

¹²¹ Kate Litvak, *Venture Capital Limited Partnership Agreements: Understanding Compensation Arrangements*, 76 U. CHI. L. REV. 161 (2009).

¹²² See, e.g., NVCA, Model Legal Documents, Stock Purchase Agreement (Updated January 2024)

¹²³ See, e.g., NVCA, Model Legal Documents, Certificate of Incorporation (Updated January 2024)

¹²⁴ Reputation plays a crucial role in the success of venture capital firms. See Rajarishi Nahata, *Venture Capital Reputation and Investment Performance*, 90 J. FIN. ECON. 127 (2008).

¹²⁵ See Section IV.

¹²⁶ These changes could contribute to the growth of investments in private markets. On this regional trend, see Philip T. von Mehren, *Private Equity Investment: The Outlook for Latin America*, 22 J. PRIV. EQUITY. 33 (2019).

¹²⁷ Id.

in VC but not necessarily exclusive to it.¹²⁸ By outsourcing the enforcement and law applicable to these agreements, the Cayman Sandwich strips domestic judiciaries and legal practitioners of relevant expertise that can support non-VC financings with local parties, including mergers, acquisitions, and voting agreements in which the company is also a party.

At the portfolio company level, the benefits of an active and expert judiciary enforcing the rights of shareholders, directors, and officers would be perceived by the entire economy, given that most companies are private and thus subject to the same default rules that govern venture-backed startups. As we detail below, there have been valuable substantial improvements in corporate law across Latin American countries that facilitate the allocation of cash flow and decision-making rights in startups, including multiple voting shares and class-based board representation.¹²⁹ These developments have been accompanied by simplified procedures for judicial enforcement, such as Colombian “proceso verbal sumario,” which enables the enforcement of contractual and legal obligations in a streamlined legal process within a month.¹³⁰ By contracting out of the legal system, the VC industry hampers the potential benefits afforded by these legal developments, which do not get tested judicially.

b. Legal reform and economic policies

The second institutional cost we identify from the use of the Cayman Sandwich structure in Latin America concerns legal reforms and sound policymaking. In the wake of the 21st century, the interest in promoting VC, entrepreneurship, and innovation has driven economic policies and reforms to corporate statutes and financial regulations.¹³¹ While many of them have succeeded in concrete ways, such as changing entrepreneurs’ preferences,¹³² the

¹²⁸ See, generally, Philippe Aghion, Patrick Bolton & Jean Tirole, *Exit Options in Corporate Finance: Liquidity versus Incentives*, 8.3 REV. FIN. 327 (2004).

¹²⁹ See Section VI.B.2.

¹³⁰ See, Código General del Proceso (Colombia), arts. 82, 390, and 391, and Ley 1258 (2008) (Colombia), arts. 24 and 43.

¹³¹ See, generally, Alvaro Pereira, *Designing Startup Corporate Law: A Minimum Viable Product*, 41 REV. BANK. & FIN. L. 367 (2022).

¹³² Alvaro Pereira, *Simplified Corporations and Entrepreneurship*, 21 J. CORP. L. STUD. 433 (2021).

use of the Cayman Sandwich structure curtails the efficacy of those efforts aimed at fostering VC: when relevant players opt-out from the legal system, it is difficult to distinguish the policies effecting positive change from those who are not, ultimately frustrating attempts of sensible tradeoff analysis. To appreciate the dimension of this impact, we consider the set of policies that are most common: those that aim to facilitate private ordering solutions through the relaxation of corporate legal rules and standards.

Generally, reforms relax corporate legal rules and standards to expand founders' and investors' range of agreements (i.e. to broaden private autonomy).¹³³ The aim is to facilitate parties' development of private ordering solutions to common problems, such as adverse selection and moral hazard, through the contingent allocation of cash flow and control rights in the portfolio company.

A common strategy has been to create new business entity forms with all the essential attributes of the corporation but with expanded flexibility to allocate economic and governance rights. For example, in 2006 Mexico introduced the SAPI, a regular corporation with "a diverse list of exceptions to the provisions of the General Law of Commercial Companies," that enable the issuance of different classes of shares with differentiated rights and obligations.¹³⁴ Chile introduced the SpA in 2007, a similar legal entity that also reduced registration costs and procedures.¹³⁵ In 2008, Colombia created the SAS, an equivalent corporate form introduced in a separate statute along with explicit rules for enforcing shareholders' agreements and a simplified process to resolve corporate disputes.¹³⁶

An alternative strategy to facilitate the allocation of economic and decision-making rights in the portfolio company has been the relaxation of existing forms. In Brazil, for instance, the rules applicable to the *sociedade limitada* and the *sociedade anônima*, the most common corporate structures, have been recently reformed to allow the issuance of preferred shares, with specific rights and obligations and create more flexible quorums for strategic decision-making

¹³³ See Pereira, *supra* note 23.

¹³⁴ Antonio Franck, *New Mexican Corporate Structure Sociedad Anonima Promotora de Inversion*, 13 LAW & BUS. REV. AM. 231 (2007).

¹³⁵ See Ley 20190 (2007) (Chile)

¹³⁶ See Ley 1258 (2009) (Colombia)

in *limitadas*, and enable the issuance of multiple voting shares in *anónimas*,¹³⁷ which are consistent with the standard venture capital contracting model.

Notwithstanding differences in the legislative approach and the degree of flexibility introduced by each of these reforms, all of them evidence, at the very least, a conscious effort from legislators towards granting parties more flexibility, thus facilitating the implementation of standard terms in VC.¹³⁸

These reforms successfully changed entrepreneurs' preferences: the SAPI is the preferred business form among entrepreneurs raising VC in Mexico, and the SpA and SAS are the most common legal entities in Chile and Colombia, respectively.¹³⁹ Moreover, the Colombian reform became a benchmark under the Organization of American States,¹⁴⁰ inspiring legal reforms in inter alia Argentina,¹⁴¹ Ecuador,¹⁴² Peru,¹⁴³ and El Salvador.¹⁴⁴

Still, we lack evidence on how entrepreneurs and investors have used it to resolve standard issues in VC. Furthermore, the fact that the Cayman Structure is used across the region suggests that the impact of these legal changes has either been insufficient for investors or not properly conveyed. In the next section, we distinguish perceived from actual legal risks—a necessary step to identify actionable measures to reduce the costs of the Cayman Sandwich.

VI. DISTINGUISHING PERCEIVED FROM ACTUAL LEGAL RISKS

The Cayman Sandwich emerged as an efficient solution for international investors interested in Latin American startups but concerned about the reliability of their legal systems.¹⁴⁵ Such concerns have persisted due to insufficient efforts to disprove the perception of legal risk, on the one hand, and

¹³⁷ See Law No. 10,406 (2002) (Brazilian Civil Code), article 1,076, as amended by Law No. 14,451/2022, and Brazilian Law No. 6,404 (1976), articles 16, IV, and 110-A, as amended by Law No. 14,195/2021 (buyout), <https://perma.cc/ZZ54-VB46> (last visited June 17, 2025).

¹³⁸ Vance H. Fried, Garry D. Bruton & Robert D. Hisrich, *Strategy and the Board of Directors in Venture Capital-Backed Firms*, 13 J. BUS. VENTUR. 493 (1998); Broughman, *supra* note 108.

¹³⁹ Pereira, *supra* note 135.

¹⁴⁰ See *Ley Modelo sobre Sociedades Por Acciones Simplificada*, Org. Am. States [add page number] (2021).

¹⁴¹ Argentinian Ley 27,349 (2017) (introducing the SAS).

¹⁴² Ecuadorian Ley Orgánica de Emprendimiento e Innovación, Registro Oficial No. 151 (2020) (introducing the SAS).

¹⁴³ Peruvian Decreto Legislativo 1409 (2018) (introducing the SAS).

¹⁴⁴ El Salvador, Decreto 905 (2023) (introducing the SAS).

¹⁴⁵ See Section IV.

deficient diagnoses of legitimate problems, on the other. Accordingly, to deter the use of the Cayman Sandwich structure and minimize its negative effects, it is imperative to address these two issues separately. In section VI.A, we reconsider the generalized perception of legal risk by uncovering issues with legal indexes, a dominant force sustaining that narrative, and contract law. In section VI.B, we propose a preliminary diagnosis of actual risks.

A. Perceived Legal Risks

1. Lifting the Veil of Legal Indexes

Legal indexes have been instrumental in perpetuating the perception of legal risk in Latin America, providing a useful metric for non-legal professionals—one that does not generally favor the region. In general terms, these indexes quantitatively measure the quality of legal systems using specific legal rules as proxies of the quality.¹⁴⁶ For example, the widely used Antidirector Rights Index resulted from six variables, each consisting of a legal rule favorable to shareholders.¹⁴⁷ The variable “proxy by mail allowed” aimed to capture rules that enable shareholders to vote, even if not present at a meeting, and thus would assign value one to jurisdictions allowing shareholders to mail their proxy vote received and zero to those not allowing proxy voting.¹⁴⁸

As with any attempt to rank human institutions, legal indexes are imperfect. Yet, indexes ranking the quality of legal rules relevant for businesses are readily available and relatively uniform,¹⁴⁹ providing investors, governments, and researchers with data to conduct otherwise excessively complex

¹⁴⁶ Mathias Siems, *Taxonomies and Leximetrics*, in THE OXFORD HANDBOOK CORPORATE LAW AND GOVERNANCE, 228 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2d ed. 2018)

¹⁴⁷ Rafael La Porta et al., *Law and Finance*, 106 J. OF POL. ECON. 1113, 1123 (1998) (“The index is formed by adding 1 when [1] the country allows civil code shareholders to mail their proxy vote to the firm, [2] shareholders are not required to deposit their shares prior to the general shareholders’ meeting, [3] cumulative voting or proportional representation of minorities in the board of directors is allowed, [4] an oppressed minorities mechanism is in place, [5] the minimum percentage of share capital that entitles a shareholder to call for an extraordinary shareholders’ meeting is less than or equal to 10 percent [the sample median], or [6] shareholders have preemptive rights that can be waived only by a shareholders’ vote. The index ranges from zero to six.”).

¹⁴⁸ *Id.* at 1122 (“Proxy by mail allowed: Equals one if the company law or commercial code allows shareholders to Company law or commercial mail their proxy vote to the firm, and zero otherwise.”).

¹⁴⁹ See, e.g., World Bank, *Doing Business*, <https://archive.doingbusiness.org/en/doingbusiness> (last visited Sept. 5, 2024)

comparative jurisdictional evaluations.¹⁵⁰ It is this easy access to uniform information about different areas of multiple legal systems that has led to the generalized use of legal indexes as a means to assess systemic legal risk, overlooking two important limitations: bias in their design and limitations by the collected data.

The most influential rankings of the quality (and, correspondingly, risk) of business laws for investors were updated annually by the World Bank in its Doing Business report.¹⁵¹ The report, in turn, was prepared using a series of legal indexes developed by La Porta et al.¹⁵² Given the report's wide reach and uniform data collection method, Latin America's consistent underperformance in the general ranking was naturally interpreted as evidence that its legal systems were comparatively riskier for entrepreneurs and investors. The reality, however, is that those findings are far from conclusive. A thorough academic examination by multiple researchers revealed that the design of these legal indexes and the data collection process favored common law countries over civil law countries.¹⁵³ Still, the report continued until 2020,¹⁵⁴ and its legacy persists,¹⁵⁵ influencing the perception of legal risk.

Even in the absence of bias, legal indexes have relevant limitations that are frequently overlooked, particularly in research that evaluates the quality of

¹⁵⁰ Mathias Siems, *Numerical Comparative Law*, 13 CARDOZO J. INT'L & COMP. L. 521, 538–539 (2005) (discussing the benefits and perils of quantifying large sets of legal rules, and concluding that this method “...has the potential to increase the practical value of comparative law...[but] its results may be limited or misleading.”).

¹⁵¹ See World Bank, Doing Business Archive, <https://archive.doingbusiness.org/en/> (last visited Sept. 5, 2024).

¹⁵² See La Porta et al., *supra* note 147; Simeon Djankov et al., *The Regulation of Entry*, Q. J. ECON. 37 (2002); Some measures of the quality of law were updated, based on revised methodology to prepare indexes. For investor protection, see Simeon Djankov et al., *The Law and Economics of Self-Dealing*, J. FIN. ECON. 430 (2008). A complete list of updated methodologies used to prepare the indexes for the Doing Business report, see World Bank, Doing Business Archive, Methodology, <https://archive.doingbusiness.org/en/methodology> (last visited Sept. 5, 2024).

¹⁵³ See, e.g., Spamann, *supra* note 21 (showing that, after correcting values reported in the first version of the antidirector index, “values are not distributed with significant differences between Common and Civil Law countries,” and therefore the quality of the law—measured by the same proxies—is unrelated to legal origins).

¹⁵⁴ World Bank, World Bank Group to Discontinue Doing Business Report (Sept. 16, 2021), <https://www.worldbank.org/en/news/statement/2021/09/16/world-bank-group-to-discontinue-doing-business-report> (last visited Sept. 5, 2024).

¹⁵⁵ See Alvaro Pereira, *Company Law Reform in a Post-‘Doing Business’ World*, OXFORD BUSINESS LAW BLOG (Oct. 5, 2021), <https://blogs.law.ox.ac.uk/business-law-blog/blog/2021/10/company-law-reform-post-doing-business-world> (last visited Sept. 5, 2024) (arguing that the Doing Business “became one of the most widely used datasets in cross-country empirical research on entrepreneurship (eg, Global Innovation Index)...[and that s]ince 2005, it reportedly influenced close to 4,000 legal reforms worldwide, many of which were explicitly tailored to improve countries’ ranking.”)

legal systems for VC. For example, the “anti-self-dealing index,” used by the World Bank’s influential Doing Business report to evaluate the quality of the law to protect minority investors,¹⁵⁶ is based on the rules mostly applicable to listed companies,¹⁵⁷ and addressing a specific type of self-dealing that is not prominent in the VC context.¹⁵⁸ The “enforcing contracts” ranking is not a conclusive proxy of the quality of investment dispute resolution either. It measures the quality of enforcements across jurisdictions based on a hypothetical legal dispute regarding the sale of “custom-made furniture,”¹⁵⁹ which is significantly different from enforcing a stock purchase or shareholders agreements. Consequently, it does not provide an accurate representation of the institutions that are actually relevant and used by entrepreneurs and investors. It overlooks the possibility of using arbitration, which is sometimes more common¹⁶⁰ and potentially more effective than enforcing contracts in jurisdictions that rank higher. Emerging comparative research on the quality of rules that more directly affect the VC-startup relationship shows significant improvements in Latin America, for example, in startups’ ability to issue shares with differentiated rights.¹⁶¹

¹⁵⁶ See World Bank, Doing Business Archive, Methodology <https://archive.doingbusiness.org/en/methodology> (last visited Sept. 5, 2024).

¹⁵⁷ See Djankov et al., *supra* note 152 at 432–433 (describing the methodology and explaining that, to collect data, they develop a questionnaire based on a case study involving a company listed in the country’s largest stock exchange whose controller also controls a target company in a proposed cash acquisition. Importantly, respondents’ answers were based on multiple sources, some exclusively applicable to listed firms: “Sources of law typically included: [1] company act; [2] civil and commercial code; [3] case law and judicial precedent; [4] stock market act and regulations; [5] stock exchange listing rules; [6] civil procedure code; and [7] criminal code.”) (emphasis added).

¹⁵⁸ Spamann, *supra* note 21 (showing that the Anti-Self-Dealing-Index is explicitly and deliberately measuring only “self-dealing”—in fact, “one type of self-dealing transaction, a concretely defined mispriced asset sale[,]” leaving out other legal rules that can protect shareholders against self-dealing, such as preemptive rights. Importantly, the latter are more relevant to prevent minority dilution attempts common in the venture capital context.).

¹⁵⁹ See World Bank, Doing Business Archive, Enforcing Contracts Methodology <https://archive.doingbusiness.org/en/methodology/enforcing-contractsmethodology> (last visited Sept. 5, 2024) (“The dispute concerns a lawful trans-action between two businesses (Seller and Buyer), both located in the economy’s largest business city...Pursuant to a contract between the businesses, Seller sells some custom-made furniture to Buyer worth 200% of the economy’s income per capita or \$5,000, whichever is greater. After Seller delivers the goods to Buyer, Buyer refuses to pay the contract price, alleging that the goods are not of adequate quality. Because they were custom-made, Seller is unable to sell them to anyone else. Seller (the plaintiff) sues Buyer (the defendant) to recover the amount under the sales agreement.”)

¹⁶⁰ See Section VI.B.3 below.

¹⁶¹ See Pereira, *supra* note 23.

2. Contract Law

VCS use a combination of contracts to control inherent risks, such as adverse selection, information asymmetries, and moral hazard. Restrictions to freedom of contract can limit parties' ability to reach mutually beneficial agreements, rendering VC investments inviable, prohibitively costly to enforce, or excessively risky.

In the books, civil law jurisdictions assure freedom of contract through the principle of private autonomy, which grants parties the right to "regulate, by the force of their will, based on their own interests, and shape the legal relationships established in their subjective sphere, respecting legal restrictions."¹⁶² Private autonomy, however, is not exercised unrestrictedly but within the space delimited by the necessary observance of legal norms of a cogent nature,¹⁶³ which, notwithstanding differences across legal systems, are justified by the protection of third parties.¹⁶⁴ The main contracts used in VC investments deal with the economic rights of the parties involved and are thus generally protected by the principle of private autonomy.¹⁶⁵ The challenge, therefore, is about enforcement, not about the quality of contract law.

B. Actual Legal Risks

Notwithstanding our objections to legal indexes' influence on the disproportionately negative perception of Latin American legal systems, we identify three legal risks that, if properly addressed, could deter the use of the Cayman Sandwich and minimize the costs we identified in section V: investor liability, corporate law, and enforcement.

¹⁶² RODRIGO TELLECHEA, *AUTONOMIA PRIVADA NO DIREITO SOCIETÁRIO* 127 (Quartier Latin ed. 2016).

¹⁶³ *Id.* at 139. (defining legal norms of cogent nature as "those in which legal imperatives do not open any fissures to individuals, depriving them of the power to dispose according to certain conveniences.")

¹⁶⁴ See NATALINO IRTI, *L'ORDINE GIURIDICO DEL MERCATO VII*, 4-5 (Laterza ed., 5th ed. 2003). See also MARTHE TORRE-SCHAUB, *ESSAI SUR LA CONSTRUCTION JURIDIQUE DE LA CATEGORIE DE MARCHE* 1 (LGDJ ed., 2002)

¹⁶⁵ Specific measures to enhance legal certainty have been introduced. See, e.g., Brazilian Economic Freedom Law (2019) Article 113 §2 (stipulating that parties can freely agree on rules for interpretation, filling gaps, and integration, different from those provided by law), and Article 421-A (providing that the "risk allocation defined by the parties must be respected and observed.")

1. Investor Liability

As explained above, international VCs investing in Latin America face two main liability risks.¹⁶⁶ On the one hand, the risk that VC funds could be held liable for obligations related to the operations of the portfolio companies, subjecting the first to a portfolio-wide “contagion”. On the other hand, the possibility that LPs could be compelled to make additional contributions beyond their originally committed capital on occasions when the fund does not have sufficient assets to meet potential payment obligations to the portfolio companies’ creditors.

Both liability risks emerge from the absence of a consistent approach to lifting the corporate veil in Latin America.¹⁶⁷ Bruno Salama, who studied the development of this doctrine in Brazilian jurisprudence, noted that “...the main focus of liability has shifted away from negligence toward debt...While the former had to be proved, the latter needs only to be paid. This shift in focus was not decreed, nor can it be expressly found in the rules of corporate law or in the rules of any other branch of law.”¹⁶⁸ Salama’s account illustrates how the absence of legislative clarity empowers judges to exercise wide discretion, which is uncommon in civil law jurisdictions and concerning, given that in most instances they lack expertise and experience in matters of corporate law. Indeed, it is an example of a regional pattern of judicial activism, which in this context alludes to judges actively developing new doctrines to protect labor and environmental rights, at the expense of legal certainty. Developing a consistent approach to the circumstances leading to extending corporate liability to shareholders is, thus, a matter of utmost importance in the region that, alas, has been unattended.

In contrast, policymakers have directly addressed the risks for limited partners. For instance, also in Brazil, Resolution No. 175/2022 of the Securities and Exchange Commission (CVM) explicitly established a rule authorizing

¹⁶⁶ See Section IV.A.

¹⁶⁷ See, generally, Jose Maria Lezcano, *PIERCING THE CORPORATE VEIL IN LATIN AMERICAN JURISPRUDENCE: A COMPARISON WITH THE ANGLO-AMERICAN METHOD* (2015).

¹⁶⁸ Harvard Law Today, *The End of Corporate Limited Liability in Brazil* (Feb 06, 2012), <https://hls.harvard.edu/today/the-end-of-corporate-limited-liability-in-brazil/> (last visited June 17, 2025) *Also see*, Mariana Pargendler, *How Universal is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil*, 58 COLUM. J. OF TRANSNAT’L. L. 1 (2019)

investment funds to limit the liability of unit holders (i.e., LPs) to the amounts they have subscribed, thereby waiving the obligation to make additional contributions in the event of a negative net worth of the fund. Furthermore, the CVM has included the modernization of FIP regulation in its regulatory agenda, suggesting that the rules governing VC investments will undergo further review. Chile established a similar provision in a comprehensive capital market reform in 2007,¹⁶⁹ which correlates with the surge in investments in private assets, including VC.¹⁷⁰ These positive developments can potentially reduce some of the costs of the Cayman Sandwich, for they improve domestic VC funds' ability to raise capital from foreign LPs.

All in all, developing a clear theory to pierce the corporate veil in exceptional circumstances could significantly reduce legal risks for investors. Consistent with the civil law tradition, such an improvement could be made through legal reforms defining the circumstances under which the corporate veil may be pierced (and when it should not), providing more legal certainty for investors.

2. Corporate Law

A second set of actual risks concerns corporate law. Traditionally, rules of corporate law in Latin America are deemed to be more rigid (e.g., than those of Delaware), which can limit startup founders' and investors' ability to reach mutually beneficial agreements through replication of standard models developed in the U.S.¹⁷¹ In some cases, functionally equivalent alternatives to these standard models might not be readily available, rendering VC investments inviable, prohibitively costly to enforce or excessively risky.

For example, the dual model system of corporate law adopted in Brazil, through which the two most widely adopted corporate forms are regulated in different statutes, sets forth a number of mandatory norms that are not subject to private autonomy and freedom of contract, and likely conflict with certain standard terms in VC. Since most of these norms are not explicit, but rather

¹⁶⁹ See Ley 20190 (2007)

¹⁷⁰ von Mehren, *supra* note 126.

¹⁷¹ See, generally, Pereira, *supra* note 132.

derive from high-order principles of corporate law, conflicts are not evident at first sight, demanding in-depth interpretation and scrutiny.¹⁷² Ironically enough, the widespread adoption of the Cayman Sandwich structure magnifies the problem: by exporting the finance and governance of successful startups, it prevents thorough experimentation by market participants and judicial revision.

Still, we observe a trend towards more flexible corporate law rules across Latin America that can inform further developments. In Chile, for example, startups adopting the SpA corporate form can expand the board's powers to "temporarily or permanently" increase capital.¹⁷³ These enhanced powers enable the structure of a board-centered corporate governance model that prevails among US VC-backed companies, in which investors can share or even seize control despite being minority shareholders.¹⁷⁴ In Colombia, a legal reform explicitly states that shareholders' agreements are binding for the corporation and all shareholders, as long as such agreements are registered in the company's record and the company is a SAS corporation.¹⁷⁵ Although these examples do not reflect a uniform pattern or conclusive solutions, they evidence positive developments in corporate law and experiences from which the region can learn to minimize the risks associated with corporate law.

3. Enforcement

The lack of reliable and efficient dispute resolution mechanisms is also an important consideration sustaining the perception of legal risk in Latin America. That perception is grounded in two elements. On the one hand, the region's prevalent civil law tradition does not afford judges the flexibility and swiftness required by dynamic business environments. On the other hand, the lack of specialized decision-makers.

¹⁷² See Raphael Andrade, *Is Brazilian Corporate Law suitable for Venture Capital contracting?*, OXFORD BUSINESS LAW BLOG (2024), <https://blogs.law.ox.ac.uk/oblb/blog-post/2024/04/brazilian-corporate-law-suitable-venture-capital-contracting> (last visited June 17, 2025) (noting that the prevalent forms of liquidation preferences, anti-dilution clauses, and put option rights in Brazilian practice might be deemed void, be subject to hold-up problems or not be enforceable) and Raphael Andrade & Felipe Ferreira, *Contratos em Venture Capital e Direito Societário Brasileiro: Limites e Desafios* (on file with authors).

¹⁷³ (Ley 20190 (2007), article 17, adding article 434 to the Commerce Code (the company "may authorize the board in a general or limited manner, temporarily or permanently, to increase the capital in order to finance the ordinary management of the company or for specific purposes."))

¹⁷⁴ Fried, Bruton, and Hisrich, *supra* note 141.

¹⁷⁵ Colombia, Ley 1258 (2008), art. 24.

Judges have been at the heart of the traditional distinction between common law and civil law that has contributed to the perception of high legal risk in Latin America. In general terms, civil law judges are bound to apply the written law, while common law judges can create legal rules to resolve new issues.¹⁷⁶ Because businesses frequently innovate at a faster pace than legislators, common law judges are comparatively advantageous, offering quicker solutions and contributing to the development of the legal system by rules that are created to resolve issues not anticipated by the legislator.¹⁷⁷ Since most Latin American countries follow a civil law tradition, this characterization has led to the default perception of their legal systems as less business-friendly, and, as we intuited above, efforts to change such perception have been insufficient.

The second element is the lack of specialized decision-makers. Establishing specialized courts requires significant legal and institutional reforms. Even with changes in government, the political will and consensus required for such an ambitious enterprise have eluded policymakers in the region. Still, we identified two positive developments that might inform changes in the region.

The first is Brazilian CVM Resolution 175/2022, which requires companies backed by VC to resolve corporate conflicts through arbitration.¹⁷⁸ The CVM had supported arbitration as early as 2015 when it explained in a public hearing that the goal was to facilitate the involvement of the FIP manager (i.e., the general partner) and standardize the procedures in case of conflicts, which would otherwise be subject to the judicial system in different regions of the country.¹⁷⁹ Although the measure directly tackles investors' concerns, it also prevents the formation of jurisprudence accessible to market participants, which could serve as a guide, providing greater security and predictability in structuring

¹⁷⁶ See, generally, Seon Bong Yu, *The Role of the Judge in the Common Law and Civil Law Systems: The Cases of the United States and European Countries*, 22 INT'L AREA REV. 35 (1999).

¹⁷⁷ See, generally, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Legal Determinants of External Finance*, 52.3 J. FIN. 1131 (1997), and Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106.6 J. POL. ECON. 1113 (1998).

¹⁷⁸ CVM Resolution 175/2022, Annex IV, Article 8, IV.

¹⁷⁹ See Public Hearing Report SDM No. 05/2015 (in which the CVM stated that "investments can be made nationwide and are subject to the judicial system of different regions, and adherence to arbitration, besides being a recommended policy in governance codes, aims to standardize the procedures to be adopted in case of conflict, favoring the monitoring and involvement in disputes by the FIP manager [general partner].") Also see CVM Instruction 578/2015.

transactions (as is the case in Delaware). Therefore, arbitration only partially alleviates the risks derived from a lack of a specialized decision-maker.

The second development is the empowerment of specialized administrative agencies with jurisdictional powers to resolve corporate disputes, a solution successfully tested in Colombia. In 2012, the country created a specialized Company Court (*Delegatura para Procedimientos Mercantiles*) that operates as a division of the *Superintendencia de Sociedades*, the executive branch agency responsible for monitoring companies since the 1930s.¹⁸⁰ The creation of the Court was controversial because it threatened the separation of powers by entrusting the adjudication of corporate law disputes to a quasi-judicial body that ultimately operated under the executive branch.¹⁸¹ Still, its advocates prevailed by showing that it would help resolve pervasive enforcement problems and that, in fact, it was not an unusual practice in well-established democracies.¹⁸² In other words, it was an alternative (or second-best solution) to a comprehensive judicial reform, and it has proved successful in two important aspects. First, it has enabled the swift resolution of corporate disputes. Virtually no corporate dispute was resolved judicially in Colombia and, after the creation of the Court in 2012, hundreds of cases are filed annually and decided within a year.¹⁸³ Second, given that it deals exclusively with corporate law disputes, it has been able to develop lines of precedents in crucial corporate topics, ranging from directors' duties to the enforcement of shareholders' agreements.¹⁸⁴

The challenges associated with dispute resolution mechanisms in Latin America remain a significant concern, contributing to perceptions of legal risk

¹⁸⁰ For a detailed description of the court and the debates around its creation, see 2 FRANCISCO REYES VILLAMIZAR, *LATIN AMERICAN COMPANY LAW* 34-47 (2012).

¹⁸¹ Id.

¹⁸² Sebastian Boada Morales, *Modernizing Colombian Corporate Law: The Judicial Transplant of the Business Judgment Rule*, 5 THE INDONESIAN JOURNAL OF INTERNATIONAL & COMPARATIVE LAW 147, 150-151 (2017) (noting that "critics of this institutional arrangement fail to realize that such structures, based on executive-judiciary hybrids, are common around the world and have sometimes functioned for centuries in well-developed democracies. Indeed, prominently, among other examples are: the French Council of State [Conseil d'État], which currently works as the highest administrative body, the supreme court of administrative justice, and an advisor to the executive branch; and also the Takeover Panel in the U.K., which "may give rulings on the interpretation, application or effect of rules" with binding effect.").

¹⁸³ Court's decisions are also easily accessible online at www.supersociedades.gov.co/web/procedimientosmercantiles/jurisprudencia-mercantiles (last visited June 17, 2025).

¹⁸⁴ Id.

for international investors due to the lack of specialized decision-makers. While initiatives like Brazil's CVM Resolution 175/2022 and Colombia's Company Court offer partial solutions to mitigate legal risks, they address only some of the underlying challenges. Arbitration, though useful, limits the creation of public legal precedents, while Colombia's Court highlights the potential for targeted reforms but raises concerns about the separation of powers and judicial independence. These efforts demonstrate progress but also highlight the need for more permanent, comprehensive reforms to enhance legal predictability across the region.

VII. CONCLUSION

The Cayman Sandwich structure has facilitated the growth of Latin American startups by attracting global VC investment. However, this paper has shown that it comes at a significant cost to the region's institutional and VC market development. The indirect consequences of exporting corporate governance and financial transactions to foreign jurisdictions hinder local legal innovation and impede the assessment of the impact of domestic reforms aimed at fostering a more vibrant VC ecosystem. Addressing both perceived and actual legal risks is crucial for reducing the need to rely on this structure. Market participants and legal scholars should focus on dispelling obsolete assumptions about Latin American legal systems, while policymakers must consider implementing reforms that provide more robust investor protection, greater flexibility in corporate governance, and more reliable enforcement mechanisms. By doing so, Latin America can reduce the costs of the Cayman Sandwich, allowing its legal systems and VC markets to evolve alongside its entrepreneurial ecosystem.