Outline for M&A Panel Discussion
at UIA/NYSBA M&A Conference on 8 June 2017

Topic: "Initial Negotiations and Documentation – Letter of Intent, Non-Disclosure Agreement"

1. **At what stage of the M&A process does a client usually get you involved (i.e. do you usually get involved when the client needs an NDA or only when LOI negotiations start or pre-NDA during the structuring phase)?**

   Our firm usually gets involved during the pre-NDA structuring phase. Experience has shown that plain vanilla NDAs may not address all needs of our clients and quite often clients are not aware and/or do not have full assessment of all potential risks involved by taking wrong choices during pre-NDA structuring phase. At this stage, clients usually understand (at least in the Brazilian market) that a NDA it is not only about protecting confidential information or the scope extent of such information (which is also extremely important), but to have e.g. non-compete, non-publicity, antitrust provisions etc. We understand that such provisions are quite usual for more mature markets, but – although it may come as a surprise – it is not widely spread in Brazil. The problem, however, still in enforcing such NDAs, should any violation occur.

2. **What is the earliest that you have been involved in an M&A transaction and what were your tasks? Why should a client involve lawyers in initial negotiations or project assessment stage?**

   We have been involved in many M&A transactions as from shareholder's first decision to sell. This actually has become a regular practice in Brazil (at least within our firm), as most companies have large unknown contingencies and the Brazilian market might be a quite blurry territory when it comes to tax, consumer and labor liabilities.

   At the buying side, a proper due diligence is usually capable of mapping all contingencies, however, providing legal advice to the selling side is more

challenging, as sometimes companies are not fully aware of their own contingencies. That is the reason this approach has proven to be very useful and value-adding to companies positioned at the selling side.

By knowing its contingencies (and sometimes eliminating them) a company (a) may increase its value, as pricing usually is always influenced by contingencies, and (b) has leverage in the bargaining process of a M&A transaction.

In this context, our role is to assist the company through a value-adding process, by identifying opportunites and eliminating risks and contigencies. We act as business advisors through all stages of the M&A process.

3. Letter of Intent: binding Vs. non-binding

In the preliminary stages of a M&A transaction, parties often choose to estabilish the basic terms and conditions of an initial agreement (with respect to a merger or aquisition) by negotiating and entering into a letter of intent (LOI).

LOIs are usually executed a non-binding basis, as parties (at least in Brazil) tend not to formalize any commitment in such early stages of a M&A process. In other words, parties tend not to take on such commitments prior to securing enough information to evaluate the target company.

However, there is a crucial element behind the usual choice of pursuing a non-binding LOI instead of a binding one. Most companies in Brazil are privately-held and there is little or perhaps no available information in the market capable of instructing the potential buyer (or merging company) in its decision to invest.

In a context of a country which does not share the same political and/or economic stability as USA or some major countries in Europe, we understand that achieving the main goal of a LOI (which is to inject a degree of certainty into the early bargaining process of a M&A) may not be possible, as the risk involved in such transactions goes far beyond party's control; thus we usually advise our clients to execute NDAs or, if the other party is resilient to carry on

negotiations based on a NDA, enter into non-binding LOI. That way we keep negotiations more flexible.

Considering political and economic risks impact directly any decision to invest, we usually advise our clients to properly assess all information related to the target company in order to have full information prior to committing themselves into a M&A process.

4. a) What provisions are market standard for NDAs in your jurisdiction (e.g. do you usually have contractual penalties in your NDAs)?
b) Are there any NDA provisions which are particular to your jurisdiction?
c) Is eliminating all confidential information and destruction of all confidential materials feasible in practice after the termination of a transaction? Should a party keep certain documents for internal records and to defend itself in case of dispute resolution?

NDAs in Brazil vary greatly depending on the complexity and size of the transaction, as well as the stakes involved. Under general terms, we could say that in its content, NDAs try to:

(i) **Scope of Confidential Information**. Eliminate risks by covering all potential harm that the misuse of confidential information may cause to a company.

(ii) **Avoid Unfair Competition**. This clause is usually challenged under the constitutional rule that protects freedom of competetion.

We have listed below a judgment from the Judicial Court of the State of Rio de Janeiro addressing this issue.

Process no. 0089197-46.2009.8.19.0001

Court: Judicial Court of the State of Rio de Janeiro

Action: Appeal (Indemnification Action)

Plaintiff: COTESA ENGENHARIA LTDA.

Defendant: TRANSMISSORA ALIANÇA DE ENERGIA ELÉTRICA S/A

Judgment Date: March 15th, 2017

Summary of the Decision:

In order to achieve the acquisition of Plaintiff's total or partial shares, the parties initiated a "due diligence" process and decided to celebrate a non-disclosure agreement.

However, after the end of negotiations, Plaintiff alleged that Defendant appropriated its "know-how" and started to engage its employees to work for Defendant.

The judgement denied the Appeal, confirming that the documents did not confirm such abusive conduct of Defendant. Also, it stated that under the principle of free competition the companies are free to operate with any activity in order to prevent the breach of the economic order.

(iii) **Non-compete.** In this kind o provision the receiving party usually agrees not to (i) enter into or start a business in competition with the diclosing party; and (ii) seek to hire disclosing party`s employees.

We have listed below a judgment from the Judicial Court of the State of São Paulo addressing the first issue.

Process no. 011.9869-06.2013.8.26.0000

Court: Judicial Court of the State of São Paulo

Action: Interlocutory Appeal

Plaintiff: ESCOPO SUPORTE A DECISÕES EMPRESARIAIS LTDA. E GERALDO DE QUEIROZ FERREIRA NETO

Defendant: URBAN SCIENCE APPLICATIONS INC.

Judgment Date: August 29th, 2013

Summary of the Decision:

The URBAN Case deals with the malicious breach of the negotiations and the non-fulfillment of obligations under the Non-Disclosure Agreement celebrated between the parties. The parties maintained negotiations regarding the future acquisition of the operations by Urban, which gave rise, from a non-disclosure agreement, to the transfer of confidential information. Having the property of such information, Urban collected and used the information shared in the transaction, resulting in total breach of the non-disclosure agreement and acting without good faith.

A Declaration and Indemnity Action was proposed to prevent URBAN from opening a subsidiary in Brazil and proceeding to explore the same branch of activity based on the information collected from the Plaintiff during negotiations of the acquisition transaction.

The amount requested by Plaintiff for compensation of damages was of R$ 2.353.844,52.

As a result, the Appeal was not granted based on the principle of free competition provided under Article 170, IV of the Brazilian Federal Constitution.

The Judicial Court of the State of São Paulo enforcying the non-compete provision related to employees of the disclosing party:

Process no. 2143615-29.2014.8.26.0000

Court: Judicial Court of the State of São Paulo

Action: Interlocutory Appeal

Plaintiff: GAFISA S.A. and ALPHAVILLE URBANISMO S.A.

Defendant: CIPASA DESENVOLVIMENTO URBANO S.A. e HSI HEMISFÉRIO SUL INVESTIMENTOS S.A.

Judgment Date: December 14th, 2014

Summary of the Decision:

The Plaintiffs, GAFISA and others, filed an Injunctive Relief against the Defendants, CIPASA and others, to prevent the hiring of any employees or directors of ALPHAVILLE (Plaintiff), as well as to refrain from using, publishing or disclosing any confidential information of the Plaintiffs, according to the clauses of the Non-Disclosure Agreement celebrated between the parties.

Considering that the first instance decision dismissed the request of the Injunction Relief, the Plaintiffs appealed from such decision.

In the judgement of such Appeal it was granted the order of the Injunctive Relief and it confirmed the violation of the non-disclosure obligations under the agreement celebrated between the parties.

(iv) **Indemnity.** Covering direct and indirect damages. In this case, the problem we usually find in courts is to quantify such damages. Due to the fact that Brazilian law does not contemplate punitive damages, judges are not inclined to accept generic pleas for indemnification without material proof of damage. Damage extent is hard to prove in several cases.

We have listed below a judgment from the Judicial Court of the State of São Paulo addressing this issue.

Process no. 1077652-82.2014.8.26.0100

Court: Judicial Court of the State of São Paulo

Action: Breach of contract

Plaintiff: GAFISA S.A. and ALPHAVILLE URBANISMO S.A.

Defendant: CIPASA DESENVOLVIMENTO URBANO S.A. e HSI HEMISFÉRIO SUL INVESTIMENTOS S.A.

Judgment Date: June 28th, 2016

Summary of the Decision:

The present action regards a Negative Covenant Action with Indemnification Obligation regarding the breach of the Non-Disclosure Agreement celebrated between the parties. Gafisa (Plaintiff) and HSI (Defendant) were negotiating the sale of Alphaville and decided to celebrate a non-disclosure agreement to protect the confidential information shared during the negotiations.

In the decision it was ruled that the celebration of a non-disclosure agreement between two large corporations aiming the safeguard of confidential information does not confront the legal principle of free competition provided under the Brazilian Federal Constitution.

The decision was in the sense to order the Defendants to fulfill its legal and contractual obligations under the agreement, therefore, to end the infringement to the non-disclosure obligations under penalty of R$ 100.000,00 (one hundred thousand reais) in case of default.

***Also, the second request regarding the compensation was not granted due to its broad request that did not fulfill the legal requirements**.*

(v) **Contractual penalties.** Sometimes very hard to negotiate as receiving parties are usually inclined to accept general indemnity clauses, instead of fixed penalties.

(vi) **Execution by all Shareholders or Beneficial owner of the receiving party**. We usually request shareholders or beneficial owners to execute NDAs or any other document containing confidentiality provisions, to avoid parties to “hide” behind the corporate vail.

(vii) **Publicity Restriction.** The information that the company is on an ongoing M&A process may affect its image in the market.

We have listed below a judgment from the Judicial Court of the State of São Paulo addressing this issue.

> ***Process no. 0132785-39.2008.8.26.0100***
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> *Court: Judicial Court of the State of São Paulo*
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> *Action: Appeal (Indemnification Action)*
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> *Plaintiff: NPI DA AMAZÔNIA LTDA.*
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> *Defendant: SONOPRESS-RIMO INDÚSTRIA E COMÉRCIO S/A*
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> *Judgment Date: May 15th, 2013*
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> *Summary of the Decision:*
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> *The present case refers to the request of compensation for a supposed practice of unfair competition by the Defendant by using confidential information safeguarded under the non-disclosure agreement celebrated between the parties.*
>
> *The reason for the non-disclosure agreement lied on the fact that the Defendant would acquire the Plaintiff's shares and, as such commercial transaction requires, Plaintiff's confidential information was shared to the Defendant.*
>
> ***The Plaintiff alleges that Defendant acted illegally by using the information protected under the non-disclosure agreement, engaging its employees, disclosing to the market its destructive condition and capturing customers.***
>
> *Initially, the Plaintiff and the Defendant shared the same real estate to performance its activities, establishing a cooperation relationship of a lease. It was impossible to prevent the employees of having any ties or connection, since they shared the same office. In the meantime, the parties celebrated a non-disclosure agreement considering the negotiations for the acquisition transaction.*
>
> *Such acquisition transaction did not occur and the parties terminated their partnership.*
>
> ***The ruling denied the Appel based on the facts that the Plaintiff was already in a bad financial condition prior to the celebration of the non-disclosure agreement and had already exposed the company to third parties for sale. It was not possible to characterize Defendant's conduct as abusive or illegal.***

These majors points seem very reasonable and sometimes are taken for granted. However, as we can see from these recent judgements, enforceability of NDAs in Brazil still a challenge to overcome.

As per the destruction of confidential information after termination, we believe that maintaining certain documents for internal record, allowing (in theory) receiving parties to better defend themselves in case of dispute resolution, may not be as efficient as it seems. This is because matters involving NDA's breach are usually associated with the breach of the duty of "not to disclose" and not of the information itself. In addition, the burden of proof lies on plaintiff and not on the defendant.

5. **When would you rather start an M&A process with an LOI and when with an SPA? How often do you see an LOI being used as opposed to starting the negotiations directly on the basis of an SPA?**

We rarely see M&A cases where negotiations start directly on the basis of an SPA. The market standard in Brazil is to firstly execute a NDA and in some cases a non-binding LOI (but the usual is to start with a NDA). LOIs are only executed at a stage where negotiation is more mature and parties are able to assess and establish detailed information with respect to the target company.

It is also common to have the figure of Memorandum of Understanding (MOU), which are considered a more detailed version of LOIs. As parties do not wish to where parties to imply a legal commitment or cannot create a legally enforceable agreement, this document creates a perfect instrument to establish detailed but non-binding understaning among parties.

Although it is not usual to to start an M&A process with a SPA, if information related to the target company is publicly available and parties fell confortable to carry on the transaciton, there is no need to execute a LOI. Audited and public-held companies may unite these elements and provide a positive informational environment to the selling side. Another situation, happens in M&A processes carried out between group companies or in management buy-out situations. As we can see, in all cases information is fully available to the buying side to instruct its decision to invest.

The choice to start an M&A process with a LOI is taken when there is some information, but not enough to start drafting a SPA.

6. What are the usual contents of a standard LOI in your jurisdiction?

In brief, standard LOIs in Brazil usually contemplate the following provisions:

1) Non-Binding/Binding Commitment;
2) Full description of the business and assets;
3) Price estimate;
4) Payment terms;
5) General covenant conditions, aiming to lock in the financial condition of the target company;
6) Transaction design;
7) Due Diligence provision; and
8) Exclusivity provision;

These are some provisions, but they usual vary according to the size and complexity of each transaction.