SHARE PURCHASE AGREEMENTS IN BRAZIL

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I. INTRODUCTION.

The recent historical evolution of M&A transactions in Brazil has had a relevant impact on the form and drafting of the agreements that govern these transactions in the country.

Until the early 90s, the Brazilian economy was essentially based on investments made jointly by the public and the private sector. Private sector investments were restricted to sectors in which there were benefits and subsidies granted by the government in addition to customs barriers to competitors.

There was a certain amount of foreign investment at that time, but as the economy was driven by nationalist principles (market reserves and replacement of imported products), foreign companies basically came to Brazil to invest in protected sectors. Their investments were normally made directly in the development of new projects and not in the acquisition of existing companies (with few exceptions). These factors reduced the amount of strategic investments in the local market. The model negatively affected our economy, impairing our competition capacity and delaying the development of an internal consumer market.

Those factors also had a very significant impact on the way that M&A transactions were conducted in Brazil. There were few complex M&A transactions and those that existed were not as sophisticated as in other jurisdictions. Local transactions were scarce, and the ones that were implemented essentially involved small business and non-strategic acquisitions. Most Brazilian M&A transactions were governed by agreements that were designed to simply comply with legal requirements and that were intended for less qualified players.

After 1990, many changes occurred in Brazil and several reforms were introduced with the purpose of modernizing our economy and creating stronger local markets. Many existing commercial restrictions were lifted, the participation of the public sector in the economic activity was reduced and many state-owned companies were sold to private investors. Moreover, several laws and regulations were enacted in order to give Brazilian and foreign investors equal treatment, with the removal of various legal restrictions to the foreign capital.

In the wake of those changes, there was an important movement of foreign companies interested in investing locally to take advantage of the Brazilian internal market and to base their local operations closer to the source of raw materials used in their industries. In reaction to this movement, and in order to protect their market share, local players adhered to the trend and many of them decided to consolidate their positions in the local market through the acquisition of competitors and complementary business.

This phenomenon affected the Brazilian market as a whole, and the volume and size of M&A transactions in particular. The agreements governing M&A transactions had to be adapted to this new reality and to the more sophisticated players. Matters involving guarantees, indemnification procedures, condition for the implementation of the transaction, non-compete covenants (among others) were reviewed and dealt with in different manners, which constituted an important challenge for Brazilian and foreign lawyers involved in those types of transactions.

The impacts referred to above were particularly relevant on the structuring and drafting of share purchase agreements (and other similar acquisition agreements). In the past, the typical Brazilian agreement was simpler and the parties relied heavily on the implied transcription of many aspects of the Brazilian laws into the agreements. In order to bring the views of both foreign investors and local sophisticated players to a common position, the structure of Brazilian agreements had to be reviewed. Many contractual procedures and provisions were adapted in order to comply with this new trend, and the local agreements went through a process of standardization, following the international pattern of the typical common law agreements.

II. SHARE PURCHASE AGREEMENTS IN BRAZIL.

As opposed to the US and the UK, the Brazilian legal system follows the codified or civil law system, similar to those adopted by the continental European countries. As such, our legal system is essentially based on the existing laws and regulations, with judicial precedents, customs and practices applied as interpretation tools (with very few exceptions) rather than as enforceable rules.

The general principle prevailing in the Brazilian contractual system is that, with some exceptions derived from public order principles, the will of the parties ("*autonomia da vontade*") shall prevail, and the parties shall thus be free to negotiate and agree on the terms and conditions of the agreements. Civil and commercial laws are normally applicable in a complementary or subsidiary manner to the agreement and, therefore, the parties have a relatively broad range of options to negotiate the terms and conditions that will govern their relationship. The parties are only prevented from adopting terms and conditions that could be considered as being in conflict with certain laws and principles considered of public interests (rules regarding capacity of the parties, legality of the object of the agreement, labor rights or tax effects of the transactions, among others).

The Brazilian Civil Code contains the basic rules applicable to the generality of agreements in Brazil, including with respect to the capacity of the parties, the required formalities for the validity of the agreements and the enforceability of the parties' obligations. Most importantly, the Brazilian Civil Code provides for certain principles

that shall be complied with by all parties to an agreement governed by the Brazilian laws. As examples, Articles 421 and 422 of the Brazilian Civil Code establish the obligation of the parties to comply with the duty of good faith while negotiating and performing an agreement, and to observe its social purposes.

In addition, the Brazilian Civil Code (Articles 481 to 532) contains some rules specifically governing purchase and sale agreements, but the parties are generally free to contract otherwise. While these legal provisions could technically apply to several aspects of share purchase agreements, under the new reality of the Brazilian M&A market, very few of those legal provisions are effectively used. In most cases, the terms of the agreement itself is what govern the parties' relationship.

There are other legal provisions that may be applicable to Brazilian share purchase agreements depending on the structure of the agreement and/or certain factors related to the target company (*i.e*, its size, nature of its liabilities, economic sector, among others). Examples of such provisions are: (i) the rules of Brazilian corporate law, with respect to the legal rights attached to the shares, transfer of title procedures and other aspects related to the legal structure of the target entity being acquired; (ii) the rules of the Brazilian labor and tax laws, (iii) antitrust regulations; and (iv) whenever the acquired entity is involved in a regulated sector, the specific regulations applicable to that particular sector (mining, telecommunication, energy etc).

III. KEY ASPECTS OF TYPICAL SHARE PURCHASE AGREEMENTS IN M&A TRANSACTIONS IN BRAZIL.

(i) Choice of Applicable Law.

As pointed out above, there has been a tendency of standardization of Brazilian share purchase agreements. The common practice is to use the very detailed and elaborated agreements that are typical of the common law system, covering essentially every and all aspect of the transaction. However, it is very important to mention that, in Brazil, a very detailed and lengthy agreement may not have the same effect that it has in the common law countries due to certain differences between the two legal systems. Firstly, for the reasons stated above, certain provisions of Brazilian law are considered of public order and consequently the parties are not free to agree otherwise. Contractual provisions that are in conflict with such public order rules may be considered invalid. Secondly, even when the parties agree with the language of a contractual provision, the wording may have a different meaning in Brazil when compared to the practice in other jurisdictions.

Therefore, the first decision that the parties negotiating a share purchase agreement in a cross-border transaction should make is to choose the applicable law to govern

the agreement and the parties' relationship. The choice of the applicable law does not imply an acknowledgment that one system is better than the other, but we normally call the attention of the parties negotiating an M&A transaction in Brazil to some of the differences between the legal systems. The most important differences are described below:

(a) *Good Faith Principle.*

While both the common law system and Brazil's civil law system recognize the importance of good faith in the interpretation and in the performance of a share purchase agreement, the usage of this principle is not necessarily the same.

A common law agreement would be interpreted as containing an implied covenant of good faith and fair dealing that protects the expectations of the parties with respect to each other and to the purpose of the agreement. However, the basic principle in common law agreements is the predictability and enforceability of an agreement as it is drafted. The good faith covenant is normally considered as a gap-filler to preserve the parties' original intent while drafting the agreement.

Different from that concept, the good faith principle in Brazil (Article 422 of the Brazilian Civil Code) has a broader scope and is incorporated into the agreement as a whole. Its effects shall be considered from the negotiation phase to the performance of the contractual terms, adding to the agreement principles of justice and fairness to govern the parties' relationship. This means that, when applying the Brazilian laws, a judge would have a large discretion in interpreting and even interfering in the agreement, including by deciding that a party may have exceeded its good faith obligation in claiming its rights if the judge understands that the exercise of the contractual rights would conflict with the good faith obligation imposed on the party in the performance of the agreement.

(b) *Indemnification.*

Although indemnification obligations under both systems may look similar, there are certain differences that require proper attention and understanding. Under Brazilian laws, the indemnification obligation is normally related to direct losses and include loss of profits unless the parties agree otherwise. Indirect and punitive damages are usually not recognized on the grounds that indemnification is meant to restore the non-breaching party's situation to what it would have been had the breaching party complied with the agreement, and are not meant to punish the breaching party. Moreover, the concept of "diminution in value" of an asset does not exist in our laws and in order for it to be properly covered by the indemnification obligations, there would have to be a specific language in the agreement.

(c) *Materiality Qualifiers for Indemnification Purposes.*

Though they are very common in agreements subject to both systems, it is relevant to point out that terms such as “relevant” or “material” do not constitute legal concepts in Brazil nor have been analyzed in sufficient court precedents to allow a certain degree of predictability of the impact of the inclusion of such qualifiers in an agreement. In order to address the concerns raised by the discussions involving these matters, usually the parties to a Brazilian law agreement include certain objective criteria (such as value thresholds) to reduce the possibility of disputes regarding the effect of the qualifiers.

(d) *MAC Clauses.*

Not differently from the discussions regarding the materiality qualifiers, there have not been sufficient court precedents determining the correct interpretation of material adverse event clauses in share purchase agreements subject to Brazilian laws.

However – and in this aspect differently from the prior subject –, the Brazilian Civil Code contains two articles dealing with changes affecting the economic balance of agreements. Article 317 provides that, if an unforeseeable event occurs and causes a clear disproportion between the liabilities of the parties as agreed at signing, it is possible for a party to demand the revision of the terms and conditions of the agreement. Article 478 provides that, if the performance of an agreement brings excessive hardship to one party and extreme benefits to the other party due to extraordinary and unforeseeable events, the negatively affected party may request the termination of the agreement.

Although these two provisions have been in force since the early 2000s (when the Brazilian Civil Code became effective), there are few court precedents involving discussions about such rules. Therefore, it is difficult to predict how they would be applied by a Brazilian judge in cases relating to share purchase agreements, especially when the transaction is entered into by qualified and informed parties that have been duly and professionally advised.

In view of these circumstances, it is recommendable that the parties include in the provisions of the agreement some objective criteria establishing the scope of the MAC provision.

In addition, it is also advisable in those cases that the parties agree on whether or not the provisions of Articles 317 and 478 would continue to apply to the terms of the agreement.

There are some discussions as to whether a waiver with respect to those rights would be valid or not. The Brazilian doctrine does not have a final position, and, to our knowledge, there has not been any precedent in our courts in which the matter has been examined. In our view, however, the waiver should be valid to the extent that it is clear that the transaction was not consumer-related, and involved qualified and informed parties, duly and professionally advised.

(ii) Choice of Jurisdiction.

The second important decision that the parties have to make involves the determination of the applicable jurisdiction to resolve disputes related to the share purchase agreement. In addition, the parties have to determine whether the agreement will be subject to normal courts and to arbitration. If they choose arbitration, the venue of the arbitration and the applicable rules are next decisions to be made, so that the appropriate language can be included in the agreement.

Under the Brazilian system, the choice of jurisdiction is valid and accepted, provided that the agreement does not involve matters that would be subject to the exclusive jurisdiction of the Brazilian courts. On the other hand, there are no discussions with respect to the choice of arbitration to resolve disputes arising out of an agreement subject to Brazilian laws. Since Brazil is a signatory to the New York convention, arbitration awards rendered abroad are enforceable in Brazil under the same grounds as a foreign award rendered by courts of another country.

The determination of the appropriate jurisdiction and/or arbitration normally involves the discussion of several aspects. As the assets (or shares, for a share purchase agreement) are located in Brazil, the parties have to bear in mind aspects related to the specific performance of the agreement and the fact that, for a foreign award to be enforceable in Brazil, it has to be ratified by the Brazilian Superior Court of Justice (*Superior Tribunal de Justiça*). The ratification procedure normally takes at least one (1) year, which may affect the effectiveness of any decision providing for specific performance of the agreement.

In addition, very often the acquisition agreement in an M&A deal is only one of the agreements governing the transaction. In many transactions, there can be two or more agreements such as service agreements, transition agreements and shareholders agreements. In those cases, the parties have to pay special attention to the need of having all agreements compatible amongst themselves so as to avoid contradictory and/or conflicting interpretations. In such cases, it may be convenient to have all the agreements subject to be same set of rules and to the same jurisdiction (or to the same arbitration tribunal and rules).

IV. RELEVANT PROVISIONS OF A BRAZILIAN SHARE PURCHASE AGREEMENT.

Following the standardization of the share purchase agreements related in Brazil, the basic structure adopted in most local and cross-border transactions is similar to the one adopted in other jurisdictions. Therefore, a share purchase agreement would contain typical provisions, including the identification of the parties, a preamble with "whereas clauses", definitions, purposes, purchase price, closing conditions, representations and warranties, covenants, indemnification obligations and other typical provisions of this type of agreement.

(i) Whereas clauses.

Usually, and especially in the past (before the enactment of the new Brazilian Civil Code), not much importance was given to the whereas clauses, describing the background and the reasons that led to the parties to enter into the agreement. However, after the enactment of the new Brazilian Civil Code, these clauses have become more important as they can provide the judge with additional means to assess the good faith of the parties in the negotiation and in the performance of the agreement.

As pointed out above, the good faith principle has become one of the key principles for the interpretation and enforcement of agreements in Brazil. Such principle grants to the judge a degree of discretionary capacity to go beyond the simple language of the document and to consider other aspects of the relationship between the parties. In his decision-making process, the judge can even go to the point of restricting the exercise of contractual rights by one of the parties, if such exercise could be considered as being in breach of the duty of good faith.

(ii) Price and Price Adjustment.

A share purchase agreement in Brazil (as in any other jurisdictions) must contain clear provisions regarding the purchase price and its adjustments. The purchase price provisions must be carefully drafted in order to encompass the various aspects related to the determination of the price, its payment and retention mechanisms (if any). Matters regarding exchange rate impact and price adjustments resulting from the due diligence process are of fundamental importance and the agreement should include, if possible, a simplified procedure for the determination of the final purchase price in the event of disputes or disagreements between the parties with respect to the price adjustments.

Usually, disputes regarding the purchase price determination in the context of a price adjustment are submitted to an expert designated by the parties (an accounting firm and, in certain cases, an investment bank) whose final decision shall be binding and

final. However, there have been discussions in Brazil with respect to the effects of the decision taken by such expert, if one of the parties does not agree with its ruling. The question that arises is whether the ruling would be enforceable by itself or should the parties submit the matter to the dispute resolution section of the agreement.

The discussion involves the constitutional principle in Brazil that a contractual provision through which a party waives its rights to go to court (or to arbitration) with respect to any particular matter is not valid. Therefore, the party that disagrees with the ruling should be allowed to go to court (or arbitration, if provided in the agreement), to challenge such ruling, regardless of the language of the agreement. In order to overcome this question, our recommendation is to include in the agreement a specific provision stating that the rules governing the price adjustment procedures should be considered as a special arbitration procedure.

The purchase price determination in M&A transactions in Brazil is usually based on the completion accounts model (which often includes adjustments resulting from due diligence findings), rather than the locked box approach. The locked box approach presents certain difficulties as a result of the "gun jumping" restrictions arising out of the Brazilian antitrust regulations that prevents the buyer from interfering in the business that is being acquired or to control its development until the antitrust clearance is granted. In addition, leakage restrictions are normally very complex and time-consuming to be agreed upon and therefore the parties normally prefer to base the price on the closing value of the business.

(iii) Closing Conditions.

A Brazilian share purchase agreement usually has the normal closing conditions as provided for in agreements governed by other legal regimes in sophisticated transactions. It is just worth mentioning that, since the enactment of the new Brazilian antitrust law (Law No. 12.529/2011), the closing of any M&A transaction involving parties that meets certain monetary thresholds must be subject to the prior approval of the Brazilian Antitrust Agency ("CADE").

This new legislation on antitrust prior clearance has generated several discussions with respect to the responsibilities derived from a denial by the CADE to approve the transaction. In the event the agreement does not contain specific rules governing the consequences of the transaction being refused, it is assumed that the parties have decided to share this risk, and, therefore, that the agreement may be terminated without consequences or penalties for both sellers and buyers. However, this matter has been subject to several debates, and in some transactions the parties have agreed to include specific provisions to govern the impact of an antitrust clearance denial. The wording of these provisions shall be very carefully drafted and include a cooperation undertaking by the parties. Usually, they include a break-up fee to be paid

by the buyer if the CADE approval is not granted, as it is assumed that the buyer should be aware of the antitrust impacts and consequences of the transaction to its business and to the market.

(iv) Representation and Warranties / Indemnification.

Brazilian share purchase agreements usually contain typical representations and warranties materially similar to those provided for in standard common law agreements. Such representations and warranties generally cover the various aspects of the transaction, including its validity, title of the shares, absence of encumbrances and general conditions of the target entity and of its business. The accuracy of the target's financial statements, the absence of hidden liabilities, the existence and effectiveness of all licenses and approvals necessary for the target to develop its activities, and the absence of civil, tax, labor and other contingencies and liabilities are normally the most important representations.

Most M&A transactions in Brazil involve a due diligence process either prior to the execution of the agreement or between signing and closing. The effects and impacts of the disclosures made during the due diligence process are still subject to many discussions in Brazil. In most Brazilian M&A transactions, the information disclosed during the due diligence process is not an exception to the obligation of the seller to indemnify the buyer for the matters and risks properly disclosed, unless such exception is specifically provided for in the share purchase agreement.

Sandbagging provisions are relatively frequent in Brazilian agreements. Normally the buyer asks to include a pro-sandbagging provision in order to be sure that its right to be indemnified for a breach of a representation will not be affected by any disclosure or knowledge of a fact or circumstance not specifically dealt with in the agreement.

In the event the agreement does not regulate specifically the sandbagging situation, it is not easy to predict how a Brazilian court (or arbitration tribunal applying Brazilian law) would decide the matter, but probably it would have to look at it considering the various principles of the Brazilian Civil Code, more particularly the good faith principle. If it remains clear that the buyer did not exercise his good faith duties (to be determined considering the circumstances of the case) or intentionally led the seller to believe that it would not ask for indemnification with respect to a breach of a representation regarding the particular fact or circumstance, it is fair to assume that a Brazilian judge would take the position that the seller would not be obliged to indemnify the buyer for any damages resulting from such breach.

However, in the absence of evidences that the buyer failed to comply with his good faith obligation, and assuming the normal procedure in this kind of transaction (in which the seller is responsible for preparing and providing the disclosure schedules to

the agreement), it would be fair to assume that the judge would take a view favorable to the buyer, particularly in agreements contemplating a very detailed list of representations complemented by disclosures schedules and other documents incorporated by reference. In this case, it would be reasonable to sustain the position that the parties' intention was to contemplate through the agreement all their rights and obligations, and, therefore, any exception to the indemnification obligation of the seller for a breach of a representation would have to be specifically included in the agreement (or would have to result from a matter of law).

(v) Compliance Matters.

Brazil has recently enacted specific regulation (Law No. 12.846/2013) aiming at: (i) preventing bribery and corruption practices in the relationship between private entities and the public administration; and (ii) urging local companies to implement compliance practices. This new regulation came in the sequence of widely reported corruption scandals in Brazil, which are affecting several sectors of the Brazilian economy. The new legislation essentially provides for the objective responsibility of a legal entity for wrongdoings carried out by their officers, representatives and employees to their benefit. In addition, the law provides for the joint and several responsibility of all affiliated entities for all penalties and damages imposed on the legal entity.

In view of this new regulation, the parties to Brazilian M&A transactions shall act carefully when dealing with compliance issues, as very often even a well conducted and deep due diligence may not capture risks that are beyond the limits of the target company. Therefore, in addition to the due diligence, a very detailed representation shall be required from sellers (especially from those that ordinarily deal with the public sector) in order to have the risks derived from the joint and several liability in those matters duly protected. Buyers may also consider asking for specific guarantees to that effect in the share purchase agreements, considering that the statute of limitations applicable to these matters are longer than for most of the other liabilities.

(vi) Environmental Matters.

Traditionally the parties to a M&A transaction in Brazil would be most concerned with tax and labor issues and the derived liabilities, no matter the size of the transaction and the target's industry. Nowadays, however, environmental issues have become one of the most complex issues in local transactions as they may generate liabilities that are often very difficult to assess and may reach very relevant amounts. In fact, Brazilian laws governing environmental liabilities, with some variation depending on the region, are among the most complex, complete and strict regulations anywhere in the world. Contamination is considered a civil infraction and a crime at the same time, imposing severe financial liabilities and criminal charges to the company and

sometimes its officers. In addition, statute of limitations are also very long and they are normally counted from the time the facts were uncovered, and not from when the damages were caused.

Although transactions involving targets that may have environmental exposures are normally preceded by a careful due diligence process conducted by specialized firms, it often happens that facts unknown to both the seller and the buyer come up later in time and expose a major liability of the target - and thus of the new controlling entity - for the remediation costs, even if contamination has taken place before the entity was acquired.

These aspects involving environmental matters also require special attention in the share purchase agreement and a very detailed and specific representation shall be included covering the various risks. Moreover, the buyer may consider requesting special guarantees in connection with risks associated with these matters, including a holdback and advance cleaning procedures.

(vii) Survival Time of the indemnification obligations.

Brazilian M&A share purchase agreements normally provide for a survival time for indemnification obligations that exceed the regular practice in many other jurisdictions, especially with respect to labor and tax liabilities. This is mainly due to the complexity of our legal system in what relate to those issues. The survival period normally takes into account the different statutes of limitation applicable to each sort of liability. Nevertheless, it is also true that in certain transactions the parties agree to reduce those survival periods, but normally continuing to establish different times according to the type of liability. Current practice in Brazil usually adopts the following survival periods:

- General liabilities – 1 to 4 years
- Tax liabilities – 5 to 6 years
- Labor liabilities – 2 years
- Environmental – 10 years or statute of limitation
- Compliance – Statute of limitation

(viii) Indemnification Guarantees.

Indemnification guarantees in Brazil are widely used in share purchase agreements. Normal guarantees are: (i) sellers' direct guarantee; (ii) holdbacks; and (iii) escrow mechanisms. There are no patterns for the type of guarantees to be required, and they may vary depending on the nature of the transaction and the sellers' ability to meet its obligations. Insurance for representations and warranties are not normally used in Brazil.

(ix) Non-Competition Provisions.

Non-compete provisions are very common in Brazilian M&A transactions. These provisions are customarily inserted into share purchase agreements to restrict the seller from managing, developing or owning an interest in a legal entity engaged in the same activity of the target company. They are normally followed by the typical non-solicitation and confidentiality obligations imposed on the seller with the purpose of preserving the acquired business as it has been acquired, and of not submitting the target company to an unfair competition after closing.

Similar to other jurisdictions, however, those provisions are subject to some restrictions as a result of their possible impacts on competition. These restrictions have been included in guidelines issued by the CADE, which are no different from those adopted in the US and by the EU Commission. In those guidelines, there are three restrictions which are normally imposed: (i) a time restriction: the provision cannot be valid for more than 5 years; (ii) a geographic restriction: the restriction cannot exceed an area specifically established in the agreement; and (iii) a product or service restriction: the provision cannot restrict the seller to operate with other products or services in Brazil, different from those explored by the target entity.

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