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*The information in this booklet provides an overview of the fundamental legal considerations to be addressed when acquiring or establishing a business in Brazil. This publication is for general information only and should not be used as a basis for specific action without obtaining legal advice.*

## **Acquiring Business in Brazil**

### *INTRODUCTION*

This paper examines some of the legal and other issues that an entity organized under a non-Brazil jurisdiction should consider when evaluating an acquisition of a business based in Brazil. The term “business” is used broadly in this paper to include free-standing companies, subsidiaries and divisions of companies, and any collection or aggregation of assets that forms an operating enterprise. This paper focuses primarily on the acquisition of privately held businesses in negotiated transactions. It does not address the additional considerations involved in the acquisition of a Brazilian public company through tender offers.

This paper provides a high-level review of the acquisition process in Brazil, identifies the principal participants and their roles, describes the primary acquisition documents and their main features and mentions a few regulatory issues that need to be considered. This paper provides a high-level review of the acquisition process in the US, identifies the principal participants and their roles, describes the primary acquisition documents and their main features and mentions a few regulatory issues that need to be considered.

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*FOREIGN INVESTMENT RESTRICTIONS*

Brazil is generally very open to foreign investments and allows for non-resident companies or individuals to invest, direct or indirectly, in the vast majority of local industries and businesses. There are few restrictions limiting the equity participation of non-residents in the capital of local companies in target sectors, such as, for example, media and broadcasting, airlines authorized to operate domestic flights and mining. There are also restrictions on direct or indirect ownership and use of rural property as well as on ownership of real estate properties located in the country's border areas.

*FOREIGN EXCHANGE CONTROL*

All transactions between non-resident and resident companies or individuals are subject to foreign exchange regulations and must be completed through the Brazilian Official Exchange Market. Foreign exchange is subject to strict control by the Central Bank of Brazil ("BACEN") although, in practice, the effective control over inbound and outbound transactions is exercised by the Brazilian private banks intermediating such transactions.

*FUNDING AND FOREIGN CAPITAL REGISTRATIONS*

*Foreign buyers quite often decide to form a subsidiary holding company in Brazil to consummate the acquisition of a local business although no impediment for a direct acquisition exists. For tax reasons, the acquisition of business through a subsidiary holding company is advisable. In any case, the funds to be remitted to Brazil to either fund the acquisition vehicle or pay the purchase price to seller must be registered with the so-called RDE-IED Module of the BACEN. All foreign direct investments (investments in equity) are subject to such registration that, once completed, allows for capital repatriations and distribution of profits at any time and does not require the BACEN prior authorization. In case a local subsidiary is formed, foreign buyers may also consider doing the funding through an intercompany loan or financing, which are subject to registration with the so-called RDE-ROF Module of the BACEN. Once such registration is*

*completed, the loan or financing proceeds may be wired to Brazil without any type of prior authorization from the BACEN.*

*Both registrations are done electronically and quite simple to be made.*

### *INITIATING THE TRANSACTION*

Typically, the acquisition process will be initiated in one of three ways. There may be an existing relationship between the foreign buyer and the domestic seller, and the transaction may be initiated and negotiated directly between the parties. The prospective foreign buyer might instead be approached by the seller's investment banker to determine the buyer's level of interest in an acquisition of a certain type or size of business. In making this initial contact, the investment banker may not identify the particular target, or the banker might provide very limited "teaser" information to solicit interest in a possible transaction. Finally, the prospective foreign buyer might retain its own investment banker to locate possible sellers meeting specified parameters with which the buyer can then attempt to conclude a transaction, either directly, or most often, with the help and assistance of the investment banker.

### *ACQUISITION VEHICLE*

As mentioned in Section 4, one of the first decisions for a prospective foreign buyer involves establishing a presence in Brazil, if it has not already done so in connection with other business operations. Because the formation of a branch in Brazil requires authorization through a presidential decree and is more time and cost consuming, foreign buyers quite often opt to form a local subsidiary to serve as the acquisition vehicle. The most commonly used entities for Brazilian acquisitions are limited liability companies (sociedades limitadas) and corporations (sociedade anônimas).

### Limited Liability Companies

The limited liability companies have lower level of formality and are most used by foreign buyers intending to form a wholly owned subsidiary. On the other hand, they cannot issue securities and are generally not adequate for joint venture enterprises since the approval of certain fundamental matters require votes from partners representing at least seventy-five percent (75%) of their capital. Limited liability companies are also not required to publish their financial statements, which may be an advantage for foreign buyers in terms of costs savings and confidentiality. Notwithstanding the foregoing, as of April 7, 2015, limited liability companies incorporated under the State of São Paulo and falling into the definition of “large company”, i.e. the company or group of companies under the same control which have had, in the previous fiscal year, (i) total assets exceeding BRL 240 million or (ii) annual gross revenues exceeding BRL 300 million, are under the obligation to publish their financial statements. The issue though has generated many debates and is still controversial.

### Corporations

The corporations are regulated by a detailed legal framework and allow for more sophisticated corporate governance structures, as well as enhanced financing flexibility and transparency. They may take the form of a privately held (fechada) or publicly held (aberta) company depending on whether the intention is to have their securities traded on the over the counter market or the stock exchange. When opting for a corporation, foreign buyers commonly use the privately held corporation for local acquisitions. The corporations are required to publish their financial statements and shareholders’ resolutions are generally taken by majority of votes.

### Similarities and Preferred Acquisition Vehicle

Limited liability companies and corporations in Brazil are afforded the same treatment under the applicable tax laws. Please note, however, the tax jurisdiction of foreign buyers may treat the local companies’ profits and losses differently depending on their corporate type.

In terms of liability, both vehicles limit the liability of their partners or shareholders to the amount they have paid in consideration for their quotas or shares although Brazilian courts may disregard the corporate entity, and make equity holders personally liable, in case of fraud or illicit acts.

There are no minimum capital requirements in connection with the formation of either limited liability companies or corporations. However, recently incorporated companies intending to engage in import and export activities are required to have a level of capital that is consistent with the import and export transactions to be carried out.

As between limited liability companies and corporations, by far the most common structure is the limited liability company. The acquisition vehicle, be it a corporation or a limited liability company, will often be formed as a subsidiary of its foreign parent, and each will provide flexibility of operation and a higher level of liability protection to the parent corporation.

### *DEAL STRUCTURE*

The two most commonly used acquisition structures of Brazilian businesses are a stock transaction or an asset transaction or, when the target business is operated by or across several subsidiary entities or divisions of the seller, a combination thereof. Other acquisition structures include capital increases or corporate restructurings, such as mergers, including reverse mergers, and spin offs. In Brazil, the purchase of assets may attract the target's liabilities, particularly of tax and labor nature if such assets form an operating enterprise or an establishment, as such term is defined by the Brazilian laws. Therefore, strictly from a successor liability standpoint, there may be not a great difference between stock transaction and an asset transaction. Please note, however, that there are alternatives to mitigate successor liability in the context of an asset deal. The tax impact on buyer and seller constitutes an important driver in determining the most suitable structure for the potential acquisition.

- **Stock Transaction**

A stock transaction implies full succession of seller for the target's business and operations although the parties may regulate the retention of certain liabilities by the seller under the respective share or quota purchase agreement. Prior to the consummation of the transaction, it is common for the target to engage in corporate restructurings in order to transfer assets and liabilities that are not included in the scope of the transaction.

A stock transaction may be preferable over an asset deal in some circumstances, such as: (i) if the foreign buyer does not own an operating facility in Brazil and intends to continue the operations of the acquired business through the target; (ii) if a premium (ágio) is to be paid in consideration for the acquired stock, the correspondent amount may – subject to statutory requirements – allow amortization and generate tax deductible expenses in connection with the target's operations going forward, and (iii) if the target has tax losses that may be offset against future taxable income.

- **Asset transaction**

As mentioned in Section 7, the purchase of assets may attract the target's liabilities, particularly of tax and labor nature if such assets form an operating enterprise or an establishment. More specifically, the Brazilian Tax Code (Código Tributário Nacional - "CTN") provides that the company that acquires, for any purpose, a commercial, manufacturing or professional establishment, or goodwill, and continues the respective commercial operation, under the same or another corporate name, will be liable for the taxes assessed on the acquired establishment:

- ✓ in full, if seller completely ceases to carry out any kind of commercial, manufacturing or professional activity; or

- ✓ on a subsidiary basis with seller, in case the latter continues to carry out the business or starts, within six (6) months as from the date of the sale, a new activity in the same or another business segment.

Although the CTN limits the liability of the purchaser to the tax debts related to the acquired establishment or goodwill, in practice the extension of such liability will be defined according to the greater or lesser relevance of the transferred establishment or goodwill vis-à-vis the seller's business as a whole. The CTN further provides that the assignment or lien of assets owned by a taxpayer is deemed as a tax fraud when such taxpayer has tax debts regularly listed for collection by the Brazilian tax authorities, except if such taxpayer has sufficient assets to guarantee the full payment of such debts.

Employment succession is also characterized when the ownership of one or more establishments of the employer is transferred to another entity or when employees continue to perform the same activities at the same location after the transfer of assets and liabilities from the original employer to another entity.

Notwithstanding the above, the parties may regulate the retention of liabilities by seller under the respective asset purchase agreement.

Because the obtainment of certain licenses, registrations and authorizations in Brazil may be time consuming, foreign buyers that do not have an existing operating facility in Brazil may wish to consider structuring the transaction as a stock deal instead of an asset transaction.

## THE ACQUISITION PROCESS AND DOCUMENTATION

### Confidentiality Agreement

Virtually all serious discussions and negotiations between a prospective buyer and seller begin with the execution of a Confidentiality Agreement as a precondition to the buyer obtaining access to the information it will require to decide whether and how to formulate a proposal to purchase the target. Except in those situations where the proposed transaction involves the formation of a joint venture or where the prospective buyer is proposing to pay consideration other than cash, most Confidentiality Agreements are unilateral, meaning that they provide access to confidential information to, and restrictions on, the use of that information by the prospective buyer only.

The Confidentiality Agreement will provide the prospective buyer, and its advisers and representatives, with access to the seller's confidential information for the limited purpose of evaluating whether to engage in a transaction with the seller. The information provided cannot be used for any other purpose, and must be returned or destroyed in the event the buyer elects not to go forward with a transaction. The seller might also ask for a provision restricting the ability of the prospective buyer to hire away its employees in the event the prospective buyer elects not to go forward with the transaction. Other commonly negotiated provisions include the extent to which the confidential information can be shared by the prospective buyer with its outside advisors and representatives including debt and equity financing sources, disclaimers with respect to the accuracy or completeness of the information provided, provisions with respect to sensitive information, term and termination.

### Due Diligence

When the appropriate Confidentiality Agreement is in place, the parties may proceed with the "due diligence" phase of the transaction, which generally describes the investigative process the prospective buyer and its advisors will engage in to determine whether or not to make an offer for the target; and, if so, the terms of that offer. The due diligence process will cover financial, business,



operating and legal issues relating to the target and its business. Due diligence is most often performed by a team made up of the buyer and its financial and operational personnel, accountants, and legal counsel. In addition, consultants may be used for environmental, employee benefits, insurance and other reviews. For large or complex transactions, the due diligence process can be a lengthy, time consuming and expensive undertaking.

While the process may take different forms depending upon the stage of the transaction, it generally begins with a specific due diligence request prepared by the buyer and its counsel requesting access to and the right to review a wide range of documents and other information relating to the target and its business. Special attention should be devoted to certain specific areas, such as tax and labor, which are of great concern from a Brazilian legal standpoint.

The information and documents assembled by the seller and response to the due diligence request are often made available to a prospective buyer in a designated data room, which can be a physical location controlled by the seller, or, as is often the case today, a virtual (internet-based and password protected) data room established and populated by the seller. In either situation, access to the data room materials will be limited to designated representatives of the buyer who are subject, directly or indirectly, to the confidentiality restrictions of the Confidentiality Agreement. In order to expedite the process, buyer may request its counsel to independently access or search information on the target that is publicly available, such as, for example, corporate documents, owned real properties and existing litigation. The due diligence process is often staged, with particularly competitive or other sensitive information being withheld until a transaction is probable. In some cases, the parties may structure a third party review process for competitively sensitive information designed to address possible implications under antitrust laws.

The ultimate product of the legal due diligence phase may be a due diligence report prepared by the buyer's attorneys, that identifies what has been examined and any exceptions or concerns identified as part of the review. A due diligence report is commonly produced to summarize the findings.

The diligence reviews may continue through all stages of the acquisition process, before and after negotiation and execution by the parties of the definitive acquisition agreement and through to the closing, although the vast majority of the diligence reviews should certainly be completed before the definitive agreement is delivered.

### **Process Diverges**

The acquisition process diverges depending on whether the proposed transaction involves one buyer and one seller, or the prospective buyer is one participant in an auction process being conducted by the seller. In Brazil, most part of acquisitions involves one buyer and one seller. Each type of transaction will be considered separately.

### **One Buyer, One Seller**

If the transaction involves one buyer and one seller, then the next step might involve the preparation and possible execution of a letter of intent relating to the potential transaction. A letter of intent will normally contain provisions which are drafted to be non-binding, and other provisions intended to be binding. The non-binding provisions generally relate to the structure and economic terms of the proposed transaction. While at this stage of the process there is no final agreement between the parties on economic terms, it is sometimes desirable to memorialize the parties' discussions of deal structure, price and other key economic terms before incurring the expense of drafting and negotiating a definitive acquisition agreement and incurring additional costs of continuing diligence. The non-binding understandings that might appear in a letter of intent include the proposed purchase price and payment and adjustment terms, the terms of employment agreements with key target management personnel, and a description of other key provisions, including indemnities, tax

considerations and allocations, noncompetition restrictions, transition arrangements, special intellectual property licensing agreements, and closing conditions, all which are to be included in the definitive agreement.

In addition to the non-binding provisions, a letter of intent often will contain binding provisions. From the buyer's prospective, these might include a provision for continued access by the buyer and its representatives to the facilities, personnel, books, records, documents and data of the seller, and a provision requiring the seller to deal exclusively with the prospective buyer for some period of time in order to see if a definitive agreement can be reached between the parties. Other binding terms may include allocation of transaction expenses, term and termination of the letter of intent, and dispute resolution.

### **Auctions: Buyer's View**

Although most part of acquisitions in Brazil involves one buyer and one seller, actions processes may take place, particularly if the target is a big company. These processes are not locally regulated and follow international standards. While the "one buyer, one seller" sales process and the competitive auction process result in comparable transactions — the sale of the target to one buyer — they differ in many important respects. One difference is that the auction process is controlled by the seller, and if successfully planned and implemented, may create a competitive bidding environment and may or may not result in a higher price. Moreover, because the seller controls not only the auction process, but certain of the terms and conditions of sale, bidders can find themselves under pressure to overbid on the purchase price while agreeing to water down or eliminate provisions from the definitive acquisition agreement that would normally be for the buyer's benefit.

The auction process many times begins with the distribution to prospective bidders of a short summary describing the target and its business, commonly referred to as a "teaser." If the prospect has an interest in participating in the auction process, it will then enter into a confidentiality

agreement in order to receive the “confidential information memorandum” (CIM) prepared by the seller with the help of its investment banker and sometimes the seller’s attorneys. The CIM will generally describe the target, its business, operations, assets, management and prospects and will include historical and forecasted financial information. A bidder will also receive what is commonly called a “bid process letter” that describes the rules for bidding, and provides the seller’s right to terminate or modify the bid process at any time. A bidder may or may not get access to the data room at this point for preliminary due diligence reviews prior to making an initial bid.

Many auctions are divided into two phases or bidding rounds. In the first round (phase 1), bidders are asked to submit initial non-binding bids and generally are asked not only to specify a price or price range, but also specify the methodology and assumptions made to reach that price. A bidder will also describe any required financing it will need for the transaction and the steps taken to secure that financing. The bidder will have to disclose in the bid process letter those conditions to which its final bid will be subject, including additional due diligence, corporate and regulatory approvals, and completion of necessary financing.

From these initial or phase 1 bids, a smaller group of bidders, determined by the seller and its advisors as offering the best combination of price, terms and the ability to consummate the transaction, is selected. This smaller group of bidders will then be invited to participate in a phase 2 round, in which they will be asked to “improve” their bids (and therefore their chances of success) by increasing the purchase price and/or eliminating some of the conditions to closing from their phase 1 bids. Additional diligence reviews may be offered as well as an invitation to one or more “management presentations” at which the prospective bidder will meet with existing management, receive detailed presentations on the operations of the target and be afforded the ability to ask questions and receive answers from management. The prospective phase 2 bidders will also often receive at this time a definitive acquisition agreement prepared by the seller (and therefore, “seller friendly”) to be marked up and submitted as part of the phase 2 bid. The phase 2 bid process letters

are substantially similar to those used in the first round, except that the bid in the phase 2 letter may be required to be binding through a specified date, and will contain few, if any, conditions (such as additional due diligence or availability of financing).

While phase 2 calls for a marked-up definitive acquisition agreement to accompany the bid increasingly the custom is that the bidder will submit an “issues” list and make its bid subject to resolution of those issues in connection with the negotiation and completion of a mutually satisfactory definitive acquisition agreement.

### **Definitive Acquisition Agreement**

The principal acquisition document for a negotiated transaction, the definitive acquisition agreement, can take various forms and be known by various names, depending on the structure of the transaction. Because Brazil is a civil law country and its laws are codified and have been enacted by governmental authorities, agreements are generally less detailed. However, acquisition of businesses in Brazil by foreign buyers follows the widely accepted international standards and, as a result, definitive agreements tend to be detailed and specific as in the US and other European jurisdictions.

A Definitive Acquisition Agreement will usually contain the following principal provisions:

- ✓ In a transaction structured as a stock or equity acquisition, the target company’s authorized and issued shares or quotas to be acquired. In a transaction structured as an asset acquisition, a definition and description of the assets that will be acquired and liabilities assumed and those that will be excluded and retained by the seller.
- ✓ Detailed representations and warranties by the seller, including those relating to the authorization and authority to complete the transactions, the organization and capitalization of the target, known and contingent liabilities, litigation affecting the target or the proposed transaction, title to assets, intellectual property matters, product and warranty

responsibilities, compliance with environmental, labor, tax and other applicable laws, the accuracy and completeness of financial statements of the target company, and many other of the aspects of the target company and its business.

- ✓ Target company, and many others of the aspects of the target company and its business and assets. The seller also will prepare and deliver a set of disclosure schedules which will include exceptions to the representations and warranties.
- ✓ The purchase and payment terms, and any pre or post-closing purchase price adjustments and confirmation procedures.
- ✓ The provision for any escrow or holdback, to serve as a source of indemnification for breaches of the agreement by the seller.
- ✓ Affirmative and negative covenants, most of which require the seller to take certain actions and refrain from others prior to the closing.
- ✓ Conditions to the closing of the transaction, including receipt of necessary regulatory approvals or third-party consents, the continued accuracy of the representations and warranties in all material respects, performance of covenants, and the absence of material adverse changes, and closing deliveries.
- ✓ Termination rights, which generally spell out the circumstances under which the buyer (and sometimes the seller) might be entitled to terminate the transaction, generally because one or more of the closing conditions have not or cannot be met, the seller has breached the agreement, or the target company has suffered a material adverse change or event since the execution of the definitive agreement. Prior to the closing, a definitive acquisition agreement can be terminated by a buyer in the event it is has negotiated a “no-shop” clause and the seller violates a “no-shop” clause by soliciting or negotiating with other interested prospective buyers once the definitive acquisition agreement has been signed. This provision, if triggered, can also result in the payment of a termination fee as it may be negotiated between seller and buyer.

- ✓ Most definitive acquisition agreements contain a provision whereby the seller will indemnify the buyer, post-closing, against losses and damages suffered by the buyer arising from breaches of representations, warranties and covenants by the seller and may also include specially negotiated indemnities covering specifically identified contingent and other liabilities. The indemnification obligation of the seller with respect to representations and warranties will often extend for stated periods which may be different for some representations and warranties (including, for example, environmental and tax) and without a stated period in the case of other representations and warranties (including, for example, title to assets or the stock being acquired) following the closing, and may be subject to a specified deductible in favor of the seller and a cap, or ceiling amount, beyond which the seller will not have any further indemnification obligation, although such limitation is less common in the context of Brazilian agreements in general.
- ✓ The scope, survival periods, limitations and disclaimers as to the indemnification provisions and whether they are to be the exclusive remedy can be expected to be intensely negotiated by the parties.

### **Regulatory Approvals: Antitrust Approval**

The agency that has the primary responsibility for competition-related issues in Brazil is the Administrative Council for Economic Defense (“CADE”). As of 30 May 2012, transactions subject to a mandatory competition filing may only be closed and consummated after receiving the respective clearance from CADE. Until the clearance is granted, the parties to the transaction are required to remain independent from each other.

Any transactions producing effects in Brazil, such as, mergers, acquisitions, joint ventures and associations are subject to mandatory competition filing if the applicable thresholds are met. Effects are broadly defined to include transactions in which the target or any of the parties thereto has assets or legal entities or revenues originated in Brazil, including through exports and regardless of their amounts.

Transactions that meet the following two thresholds are subject to the mandatory filing and review:

- ✓ If the proposed buyer or seller has registered a gross turnover or volume of business in Brazil in an amount equal to or exceeding BRL 750 million based on the financial statements of the previous fiscal year, and
- ✓ The other party has registered a gross turnover or volume of business in Brazil equal to or exceeding BRL 75 million based on the financial statements of the previous fiscal year.

The filings should be made after the execution by the parties of the first binding document but there is no deadline set forth under the applicable law. Failure to make a mandatory filing or the practice of ‘gunjumping’(i.e., the failure to comply with standstill obligations) are subject to the imposition of fines by CADE ranging from BRL 60 thousand to BRL 60 million, in addition to the administrative proceedings to review competition aspects of the transaction. There is a flat fee of BRL 45 thousand per filing payable to CADE.



### **Regulatory Approvals: Approvals Under Brazilian Regulations**

Acquiring “control” of institutions engaged in regulated businesses in Brazil, including for example, banking, insurance and telecommunications require separate governmental approvals. The scope and extent of these regulatory requirements, and the compliance with them, are not covered in this paper, but can be dealt with separately with respect to particular buyers and targets that might be affected by such laws and regulations.

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