10-1-1979

Brazil

LEGAL MEMORANDUM

The issue presented for discussion is whether the controlling stockholder of a Brazilian mixed-capital company (*sociedade de economia mista*)[1] or a Brazilian public company (*empresa pública*)[2] is jointly[3] or subsidiarily liable[4] for the obligations of the controlled company.

Based on the definitions established by law,[5] there are, for purposes herein specified, only two relevant differences between a mixed-capital company and a public company, both primarily of a formal nature, to wit: (i) a mixed-capital company always operates as a corporation, while a public company may adopt any business form permitted by law; and (ii) all of the stock of a public company is owned by the Union, while less than all (but at least the majority) of the voting stock of a mixed-capital company is owned by either the Union or another entity of the Indirect Administration. On the other hand, a mixed-capital company and a public company have the following characteristics in common: (a) each is created by special law; (b) each has a legal identity separate from the entity or entities constituting it; (c) each has its own patrimony; (d) each is a legal entity of private law; and (e) each has as its purpose the performance of economic activity undertaken by the Government. Except in special cases, such as bankruptcy, the relationships of both with third parties are governed by private law.

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1. A mixed-capital company is a legal entity of private law, created by law for the purpose of undertaking economic activity as a corporation (*sociedade anonima*), the majority of whose voting stock belongs to the Union or an entity of the "Indirect Administration" (*Administracao Indireta*). *See also* Article 5, III of Decree-Law No. 200 of February 26, 1967.

2. A public company is a legal entity of private law, with its own patrimony and its capital owned exclusively by the Union, created by law for the purpose of undertaking economic activity which the government effects for reasons of necessity or administrative convenience, it being entitled to adopt any business form permitted by law. *See also* Article 5, II of Decree-Law No. 200. Both mixed-capital companies and public companies form part of the so-called Indirect (federal) Administration (along with autonomous governmental agencies) and are regulated by Decree-Law No. 200 of February 26, 1967, as amended by Decree Law No. 900 of September 29, 1969.

3. The term "jointly liable" is used to indicate when an individual or entity is a co-obligator and is jointly, primarily and equally liable with all other obligors, without an obligee having the duty to first exhaust its remedies against any of the other obligors.

4. The term "subsidiarily liable" is used to indicate when an individual or entity is only secondarily liable and an obligee has to exhaust its remedies first against the primary obligor.

5. *See* notes 1 and 2, *supra*.

In addition, doctrine has apparently established the following related precepts: the other political subdivisions of the Federative Republic of Brazil—the states, municipalities and the Federal District—may also create mixed-capital companies and public companies, respectively, which have the same legal identity as their respective parents, providing that the law creating the parent company expressly permits the creation of such subsidiaries.

Article 896 of the Brazilian Civil Code specifies that joint liability cannot be presumed, but must be established by law or by agreement of the parties. Based on the foregoing, in order for the controlling stockholder of either a mixed-capital company or a public company to be jointly liable for the obligations of the controlled company, in general, it would be necessary that the law creating the controlled company specifically so provide. In the absence of any such express provision, it appears that the controlling stockholder would have to intervene specially in any given transaction of the controlled company and specifically declare its joint liability with the controlled company in order that any creditor of the controlled company could subsequently claim the joint liability of the controlling company with respect to that particular transaction.

Although it is rather common in certain credit operations that the controlling company agrees, contractually, to assume joint liability for the repayment of the credit borrowed by its controlled company, we are not aware of any law creating a mixed-capital company or a public company which includes a provision that the controlling stockholder is jointly liable for the obligations of such mixed-capital company or public company.

Article 242 of the Brazilian Corporations Law (Law No. 6,404 of December 15, 1976) expressly provides the following:

> Art. 242—Mixed capital companies are not subject to bankruptcy but their assets are attachable and executable, and the legal entity controlling it is subsidiarily liable for its obligations.

Based on this express provision of law, it is clear that the controlling stockholder of a mixed-capital company is subsidiarily liable for the obligations of the controlled company.

The issue of whether the controlling stockholder of a public company is also subsidiarily liable for the obligations of the controlled public company is complicated to some extent by the fact that the drafters of Article 242 of the Corporations Law failed to include public companies within the statute's scope. There is no express reference

to this point in Brazilian legislation presently in effect. Notwithstanding the foregoing, it is reasonable to conclude that the controlling stockholder of a public company would be subsidiarily liable for the obligations of the controlled company in the same manner and to the same extent that the controlling stockholder of a mixed-capital company would be liable for the obligations of such controlled company pursuant to Article 242 of the Corporations Law. This conclusion is based upon the following analysis.

Respected Brazilian legal scholar, J. C. Sampaio Lacerdo commented upon the legal nature of public companies: "The State . . . should indemnify the unpaid creditors, subsidiarily, because otherwise it would be violating the public interest."[6]

Several Brazilian legal scholars support the position that the rule of subsidiary liability set forth in the aforecited Article 242, with respect to mixed-capital companies, was included therein in light of the exemption from bankruptcy granted by Article 242 to mixed-capital companies.[7] Jose Washington Coelho bases his argument on the view that such exemption from bankruptcy was aimed at saving the State from the "demoralizing odyssey" of prolonged and unexpected bankruptcy proceedings. Darcy Arruda Miranda, on the other hand, has justified his position with the argument that such exemption from bankruptcy keeps the administration of mixed-capital companies from falling into the hands of private sector creditors.

Regardless of the particular rationale adopted, it is also reasonable to conclude that the same reasons exist for granting the same exemption from bankruptcy to public companies, since *all* of their capital belongs to the State and, consequently, there is an even greater "public interest" in keeping their administration from being transferred to the private sector. Furthermore, as pointed out above, the two crucial differences between a mixed-capital company and a public company are merely formal in nature and, accordingly, do not justify different treatment regarding such a substantive point.

If one concludes that a public company is, like a mixed-capital company, exempt from bankruptcy in accordance with the first part of

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6. Lacerda, J. C. Sampaio, XII REVISTA DE DINEITO MERCANTIL at 19-25.

7. *See generally* Coelho, Jose Washington, *Aspectos Polemicos de Nora Lei das Sociedades Anonimas*, ED. RES. TRIBUTARIA, at 198 (Sao Paulo, 1977); Miranda, Darcy Arruda, Jr., BREVES COMMENTARIOS A LEI DE SOCIEDADES POR AZOES, Ed. Sarava, at 326-7 (Sao Paulo, 1977).

Article 242 of the Corporations Law, one should, *a fortiori*, also conclude that the last part of Article 242 applies likewise to a public company, to wit: the controlling stockholder is subsidiarily liable for the obligations of the controlled company. Jose Washington Coelho comments in this regard as follows: "[T]he exemption which the law has granted to the State, ensuring it immunity from the dramatic institution of bankruptcy, should also include, as it has included, a compensatory or indemnification provision: the State is liable, subsidiarily, for the obligations of the company controlled by it."[8]

We therefore conclude that the controlling stockholder of either a Brazilian mixed-capital company or a Brazilian public company is not "jointly liable" for the obligations of the controlled company, and the controlling stockholder of a Brazilian mixed-capital company is "subsidiarily liable" for the obligations of the controlled company. Furthermore, the controlling stockholder of a Brazilian public company is most likely subsidiarily liable for the obligations of the controlled company.

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8. *Id.*