

4-1-1978

The Issuance of Debentures in Brazil

Follow this and additional works at: <http://repository.law.miami.edu/umialr>

Recommended Citation

The Issuance of Debentures in Brazil, 10 U. Miami Inter-Am. L. Rev. 245 (1978)

Available at: <http://repository.law.miami.edu/umialr/vol10/iss1/16>

This Legal Memorandum is brought to you for free and open access by Institutional Repository. It has been accepted for inclusion in University of Miami Inter-American Law Review by an authorized administrator of Institutional Repository. For more information, please contact library@law.miami.edu.

LEGAL MEMORANDUM

THE ISSUANCE OF DEBENTURES IN BRAZIL

This memorandum deals with the Brazilian law on the issuance of debentures. This matter is currently governed by Chapter V of Law No. 6,404 of December 15, 1976 (the Corporation Law) from articles 52 to 74. Law No. 6,404 reformulated the entire institution of debentures in order to permit companies to obtain direct loans from the capital market. It revoked legislation which had not adequately facilitated the procurement of funds from the public.¹

BASIC CHARACTERISTICS OF DEBENTURES IN BRAZIL

Debentures are credit instruments of uniform value, in either bearer or endorsable form, which represent long-term loans obtained by companies. The credit rights which debentures confer upon their owners against the company are defined in the deed of issuance and in the certificate (article 52).

A company may effect more than one issuance of debentures, each of which may or may not be divided into series. Debentures of the same series must have the same face value and must grant their owners the same rights (article 53). The face value of the debenture is expressed in national currency, although it may be expressed in foreign currency in certain cases permitted by law. This face value must be identical for all debentures of the same series. The face value in national currency may be monetarily corrected according to the correction indices applicable to instruments of public debt or according to the fluctuation of the exchange rate (article 54). Although the face value of the debentures must necessarily be determined by the general shareholders' meeting, in open companies this determination may be delegated to the administrative council (article 59, par. 1).

The date of maturity of the debentures, as established in the deed of issuance or the certificate, may be determinate or subject to certain events, such as default in the payment of interest or dissolution of the company (article 55, par. 3).

A company may stipulate partial amortization, create amortization funds, and reserve the right to partial or full early redemption of debentures of the same series (article 55).

1. Until the enactment of Law No. 6,404, debentures were governed by Decree No. 177-A of September 15, 1893. The inflexibility of Decree No. 177-A hindered the use of debentures in Brazil as an instrument of finance.

The law establishes that the amortization or partial redemption of debentures of the same series and of the same annual maturity shall be effected by drawing lots, except when they are quoted at a price below their face value. In the later case they must be acquired through the stock exchange (article 55, par. 1).

A company is free to acquire debentures of its own issuance, provided that it pays a price equal to or below their face value and registers the acquisition (article 55, par. 2). The company may maintain its own debentures in a portfolio in order to regulate the market. It may even do so to profit from a devaluation of the debentures on the market. This provision makes feasible a liquidity fund with direct participation on the part of the company. However, such participation is subject to the following risks:

- (a) Forcing the devaluation of the debentures for later acquisition; and
- (b) becoming an instrument of "election" for privileged creditors in the case of imminent or predictable "concordata" or bankruptcy.

In order to avoid these risks, any decision to negotiate with a company's own debentures should be carefully examined by the fiduciary agent and by the general debentureholders' meeting.²

Besides fixed or varying interest and a refund premium, debentures may assure a participation in the profits of the company (article 56).

Debentures may also be converted into shares, particularly as regards the relation of quantity and value (article 57, item I). Article 57 assures the shareholders a right of first refusal to subscribe to issues of such debentures (article 57, par. 1). In addition, the prior approval of the debentureholders is required to amend the by-laws for purposes of: (1) Changing the objective of the corporation; and (2) creating preferred shares or changing the existing advantages to the detriment of the shares into which the debentures may be converted (article 57, par. 2). Provisions to avoid the dilution of the conversion value, by bonus or subscription, may be freely stipulated.

THE DIFFERENT TYPES OF DEBENTURES

Article 58 provides for four types of debentures according to the guarantee they offer:

- (1) *With in rem guarantee.* These debentures are guaranteed by mortgage, antichresis or lien on certain assets of the company.

² Santos, Theóphilo de Azeredo - "S.A. para Empresários" - Index - The Data Bank - Rio de Janeiro - 2nd edition - undated.

(2) *with floating charge*. These debentures are guaranteed by the assets of the company, with preference over any other debt instruments except for credits with preference over general privileged credits, namely:

- (a) labor credits (total salaries and one-third of the severance pay for contractual rescission);
- (b) tax credits;
- (c) credits with in rem guarantees; and
- (d) credits with special privileges on certain assets;

(3) *without preference*. These debentures enjoy no preference and are classified as general credits.

(4) *subordinate*. These debentures are subordinate to the claims of other creditors of the company, including general creditors. Subordinate debentures only have preference over the claims of shareholders in the assets which may remain in the case of liquidation of the company.

Debentures with floating charge have general privileges under the bankruptcy law.³ In addition, article 58, paragraph 1, expressly establishes that such debentures possess a general privilege with respect to the assets of the company. This privilege, however, does not preclude negotiation of the disposition of such assets. The floating charge is thus a preferred right to the present and future assets of the company. It nevertheless allows the company to retain the right to modify these assets in the normal course of business. (The floating charge and the in rem guarantee may be cumulative as permitted under article 58, paragraph 2).

In accordance with article 58, paragraph 3, newly issued debentures with floating charge are subject in preference to those of previous issuances. Priority is established according to the date of registration of the deed of issuance. The debentures of the same issuance, however, have the same rights. In order to reinforce the rights of owners of debentures without preference or of subordinate debentures, the law provides that the company's obligation not to dispose of or encumber its assets may be claimed against third parties, provided that this condition is stated in the title registration of the assets (article 58, par. 5).

THE ROLE OF THE FIDUCIARY AGENT

The role of the fiduciary agent of the debentureholders is defined by articles 66 to 70. The fiduciary agent must perform duties similar to those of a trustee under Anglo-Saxon law, with powers to control the acts of the com-

3. According to Article 102, Paragraph 3, item I, of Decree-Law No. 7.661 of June 21, 1945 ("The Bankruptcy Law"), general priority is enjoyed by the creditors which are attributed such priority under civil and commercial law.

pany which affect the debentureholders' rights and interests. For example, when debentures are issued in the capital markets, the fiduciary agent is obliged to intervene in the deed of issuance by public or private instrument. (article 61, par.1). In such cases the Securities Commission may determine that the fiduciary agent, or at least one of the fiduciary agents, be a financial institution duly authorized by the Central Bank of Brazil to administer or hold in custody third party property (article 66, par. 2). The law thus attempts to ensure that the fiduciary agent does not have a conflict of interests (article 66, par. 3).

The duties of the fiduciary agent are basically the following (article 68, pars. 1 and 3):

(a) To protect the rights and interests of the debentureholders with the diligence and care that an honest and active man usually employs in the administration of his own property;

(b) to prepare an annual report regarding the fulfillment of the obligations assumed by the issuing company and the subsistence of the guarantees;

(c) to notify the debentureholders about possible defaults on the part of the corporation;

(d) to resort to any action to protect the rights or defend the interests of the debentureholders.

Upon exercising its duties, the fiduciary agent may declare debentures matured and charge the principal and interest subject to the conditions of the deed. The fiduciary agent may also execute in rem guarantees and petition for bankruptcy if there are no in rem guarantees (article 68, par. 3). The additional functions of the fiduciary agent are to authenticate debenture certificates, administer the amortization fund, maintain the assets given in guarantee in custody and effect payments of interest, amortization and redemption (article 69).

The expenses incurred by the fiduciary agent to protect the rights and interests of the debentureholders are added to the indebtedness of the issuing company. This additional amount enjoys the same guarantees, having priority over the debentures in the order of payment (article 68, par. 5).

AUTHORIZING THE ISSUANCE OF DEBENTURES IN BRAZIL

If the debentures are issued by an open company, the general shareholders' meeting may authorize the administrative council to establish the date and conditions of maturity, amortization and redemption, payment of interest, participation in profits and refund premium, as well as of the procedure for subscription or placement and the type of the debentures (article 59, par. 1). The general debentureholders' meeting may be called at any

time by the fiduciary agent (who must always attend the meeting), by the company, by the debentureholders of a same issuance or series which represents at least 10 percent of the debentures in circulation, or by the Securities Commission (article 71, par. 1).

The company may effect open issuances of indeterminate value and serial number, if it observes the limit of its capital (article 59, par. 2) and the principle that new issuances may not be made before the previous issuances have been placed or cancelled (article 59, par. 3). As a general rule, the value limit for the issuance of debentures is the company's capital (article 60). The limit may, however, reach 80 percent of the encumbered assets in the case of debentures with in rem guarantee, or 70 percent of the book value of the assets less its debts secured by in rem rights in the case of debentures with floating charge (article 60, par. 1). Subordinate debentures are not subject to these limits since they only have preference over shares (article 60, par. 4).

The encumbered assets are generally those which form part of the assets and liabilities of the company before the authorization of the issuance of the debentures, but it is possible to have the assets ascertained after the investment permitted by the issuance. In the latter case, the funds will be subject to control by the fiduciary agent of the debentureholders (article 60, pars. 1 and 2). The Securities Commission⁴ is given the authority to establish other restrictions as well (article 60, par. 3).

The deed of issuance and its registration are subject to the rules established in articles 61 and 62. The deed, which may be a public or private instrument, establishes the rights, guarantees and other clauses and conditions, specifically those which have been approved by the Securities Commission as standard and compulsory for debentures which are to be negotiated on the stock exchange or over-the-counter market (article 61, par. 3).

The procedural requirements for the issuance of debentures are provided for in article 62, as follows:

- (1) The filing at the commercial registry of the minutes of the general shareholders' meeting which approved the issuance;

4. The Securities Commission was created by Law No. 6.385 of December 7, 1976, and its Internal Regulations were approved by the Minister of Finance under Portaria No. 327 of July 11, 1977. The Securities Commission is an autonomous body linked to the Ministry of Finance, having its own legal identity and assets. Its head office and jurisdiction is in the City of Rio de Janeiro, State of Rio de Janeiro. It is managed by a President and four Directors appointed by the President of the Republic and removable "ad nutum." The President of the Securities Commission is a member of the National Monetary Council. The function of the Securities Commission are to discipline the securities market, including the issuance of debentures.

(2) the publication of the minutes as filed. Pursuant to the provisions of article 289, the publication shall be made in an official newspaper of the Union or of a State, in accordance with the place where the company's head office is located, and in another newspaper of wide circulation published in the locality of the company's head office. If there is no newspaper published in the locality of the company's head office, publication shall be made in any newspaper of wide circulation locally. The Securities Commission may require that this publication also be made in a newspaper of wide circulation in each place where the debentures are negotiated on a stock exchange or in the over-the-counter market. Such publications must be duly registered at the commercial registry;

(3) the registration of the deed of issuance at the real estate registry of the locality of the company's head office. This registration is essential for the validity of the issuance. Debentures guaranteed by a floating charge on the assets of the company enjoy a right of priority, in the order of their registration; and

(4) the inclusion of in rem guarantees, if any. As mentioned above, the debentures may be guaranteed by mortgage, antichresis or lien on certain assets of the company, and it is necessary to comply with the applicable requirements for the inclusion of each type of guarantee, in order that it should be valid against third parties. In the case of mortgage of property, for example, it is necessary to register it at the real estate registry of the place where the mortgaged property is located.

Another important innovation introduced by Law No. 6.404 is the certificate of pledged debentures, issued exclusively by financial institutions to represent a guarantee of pledged debentures, as provided for in article 72. This is an additional instrument to obtain public savings to finance companies. When the market does not favor the placement of debentures, the financial institution may absorb and underwrite the debenture issuance and then issue its own certificate of pledged debentures.

AUTHORIZING THE ISSUANCE OF DEBENTURES ABROAD

Current law permits obligations to be contracted in foreign currency if the contract is executed abroad or, when executed in Brazil, if one of the parties is resident or domiciled abroad. The company may thus issue debentures stipulating payment in foreign currency for placement abroad or with creditors resident or domiciled abroad.

Reversing the position taken by former legislation, the creditor of an obligation contracted in Brazil now has priority over credits under debentures issued abroad by foreign companies authorized to operate in Brazil. This general rule is subject to only one exception: if the issuance was previously authorized by the Central Bank of Brazil and the proceeds are invested in an establishment situated in Brazil, this priority will not apply (article 73, par. 1). Also note that only the principal and interest of debentures registered with the Central Bank of Brazil may be remitted abroad (article 73, par. 2).

The provisions of article 73 do not cover loans which are contracted abroad by Brazilian companies for investment in Brazil and which are subject to the prior authorization of the Central Bank of Brazil. For purposes of remitting amortization and interest payments, the registration of such loans presupposes the transfer of funds to Brazil.

In the past, foreign companies authorized to operate in Brazil have issued debentures abroad. Brazilian companies which have or come to have branches in other countries may issue debentures there to finance their local operations. They need not transfer the proceeds to Brazil. The owners of such debentures may nevertheless attach the assets which the issuing company owns in Brazil, even if the proceeds of this collection cannot be remitted abroad due to a failure to register the loan with the Central Bank of Brazil. article 73 thus protects the other creditors of the company in Brazil by assuring them priority over such foreign debentureholders⁵.

If the company is Brazilian, the issuance of debentures abroad with in rem guarantee or with floating charge will require the prior authorization of the Central Bank of Brazil (article 73). For other kinds of debentures (without preference or subordinate), or in cases where the assets given in guarantee are situated abroad, the issuance will be free and will not require Central Bank authorization.

The issuance of debentures abroad must not only comply with the requirements of article 62, but will also require the registration (at the real estate registry of the company's head office or establishment) of the other documents required by the law of the place of issuance. These documents must be authenticated according to applicable law, legalized by the Brazilian Consulate abroad and accompanied by a translation into Portuguese prepared by a sworn translator. In the case of a foreign company, it will also be necessary to file at the commercial registry (and subsequently publish) the act which authorized the debenture issuance according to the by-laws or laws of the place of the head office (article 73, par. 3).

5. This information is expressly contained in "Exposição Justificativa das Principais Inovações do Projeto da Lei das Sociedades por Ações".

Finally, it should be noted that the negotiation of debentures issued abroad in the Brazilian capital market requires the prior authorization of the Securities Commission (article 73, par. 4).

WALTER DOUGLAS STUBER*
Pinheiro Neto & Cia.
São Paulo, November 1977

*Mr. Stuber received his law degree from the Law School of the University São Paulo.