Relevant Innovations in the Draft Bill of the New Brazilian Company Law
RELEVANT INNOVATIONS IN THE DRAFT BILL OF THE NEW BRAZILIAN COMPANY LAW

The press has widely publicized the news that the President of the Republic submitted to the National Congress Project of Law (a draft bill hereafter "The Project") No. 2.559/76, which proposes to give the country a modern and efficient company law. Separately, the National Congress also received a bill for the creation of the Comissao de Valores Mobiliarios (Securities Commission) which will govern and control the activities of the capital market.

Considering the novel features of the Project and the interest it has awakened, we shall highlight the provisions of most importance, not only because of the changes they make in current legislation, but also because of the innovations which they incorporate in the text of the future law.

Throughout this memorandum all references to "company" should be understood to mean the Brazilian corporate form called Sociedade Anonima.

I.—OPEN AND CLOSED COMPANIES

The Project makes a basic distinction between Open and Closed companies depending on whether their shares or securities are negotiated in the stock exchange or in the over the counter market. The securities of an Open company may only be negotiated in the stock exchange or in the over the counter market if the Company is duly registered with the Comissao de Valores Mobiliarios (CVM). Open companies are subject to stricter rules and to greater control on the part of the CVM, so as to assure compliance with the law and protection of the investors. In Closed companies, the founders or shareholders have more freedom in the choice of statutory provisions, minority protection, classes of shares, creation of participation certificates, limitations on share circulation, etc.
II. — SECURITIES

The Project expands the rules applicable to shares in general. In addition, it regulates several kinds of securities and permits companies to use such securities as an important means of attracting savings and strengthening the economic situation of a company.

The following securities are covered by the draft bill: shares of stock (common, preferred, and usufructuary), participation certificates, debentures and debenture pledge certificates, and subscription rights certificates.

The form and circulation of the securities covered by the draft bill can be summarized as follows: registered, endorsable, bearer, book entry shares (represented only by an entry in the company's books), bank deposit of exchange shares, and certificates of bank deposit.

III. — INCORPORATION

Companies must have at least two shareholders. Where the initial capital is to be subscribed by the public, the company may issue its shares only after registration with the CVM and if the subscription is made through a financial institution. Other legal requirements similar to those contained in the current law must also be met and a general meeting of incorporation held (Arts. 82 to 87).

In cases where the company is incorporated with private subscription, the current option permitting such subscription to be effected at a general meeting or under a public deed is maintained.

The objectives of the company must be precisely and fully established in order to avoid abuses by the majority shareholders, the parameters of the objectives being required for the specific purpose of permitting the identification of an abuse of power, among other factors. The Project allows participation in other companies even if such participation is not set forth as one of the company's objectives (Art. 2).

The Project contains an innovation with respect to the names of companies i.e., these no longer need to include an indication of the main business objective. The use of the word companhia (company) at the end of the name is forbidden (Art. 3).

The first cash contributions towards the issuance price of the shares are to be deposited with the Banco do Brasil S.A. or with another bank authorized by the CVM.
The Project creates the position of controlling shareholder, attributing to it certain duties toward the minority shareholders, the company, the employees and the community, and making the person liable for the damages caused by acts of abuse of power, as defined in Art. 117.

IV. — THE SHARES

The Project maintains the same types of shares existing under the current law. Closed companies are permitted to have different classes of common shares with the right to vote on the occasion of filling positions on the company’s administrative bodies (Art. 16).

Preferred shareholders have the possibility of enjoying management benefits by permitting them to elect members of the administrative bodies. Even statutory amendments may be subject to the approval of the preferred shareholders. This right given to the preferred shareholders was, in the past, accepted by some broadminded Commercial Registries, but unfortunately not by others (Art. 18).

The Project has also changed the maximum percentage which may be represented by preferred non-voting shares. This percentage is now limited to two-thirds of the total shares issued, subject to certain restrictions.

Bearer shares will no longer be entitled to vote.

The existing types of shares have been maintained and book entry shares created. These shares are to be deposited in deposit accounts, in the name of their holders, with financial institutions chosen by the holders from among those authorized by the CVM (Art. 34). The authorized financial institutions may also act as agents for the custody of exchangeable shares. A certain number of exchangeable shares may be deposited with a financial institution which will assume the obligation to return to the depositor the same number of shares that was initially deposited, together with any additional bonus or other shares that may have been issued. Such return need not consist of shares with the same numeration or certificate identification (Art. 41).

Total freedom has been given for the determination or non-determination of the par value of the shares. In the case of shares without a par value, the founders of the company shall establish the price of issuance upon incorporating the company, while the General Meeting or the Administrative Council will determine the price on the occasion of subsequent capital increases.
According to Article 36 of the Project, a Closed company may have its bylaws impose restrictions on the circulation of registered shares. When such restrictions are created by a later statutory amendment, they will affect only the shareholders who give their approval by means of an entry in the proper book.

The provisions of Article 40 are important in that they expand the burdens that may be imposed on shares. These include fiduciary alienation in guarantee and assure, subject to approval in the company's books, that a commitment to sell shares or a right of first refusal is enforceable against third parties.

In Articles 31 and 118 the Project introduces an innovation by establishing a requirement for the registration of judicial adjudication of shares and providing for the shareholders to enter into agreements on the purchase and sale of shares, the rights of first refusal or the exercise of voting rights. The effectiveness of such agreements is questionable under the current company law.

V. — GENERAL MEETINGS AND REPRESENTATION

An innovation of a practical nature is the possibility of discussing and voting on any matter at an annual general meeting, provided that the requisites of Art. 131 are satisfied.

The attorney-in-fact representing a shareholder at a general meeting need not be a shareholder himself. Such representative may be a lawyer, or manager of the company or even a financial institution in the case of an Open company. The effectiveness of the term of representation has, however, been limited to less than one year. We believe that the Project should have been more flexible in this respect, giving the appointer the freedom to determine the period of effectiveness of the respective power of attorney.

A shareholder residing or domiciled abroad will have to have an attorney-in-fact in Brazil with sufficient powers to receive service of process.

Apart from the establishment of a quorum for general meetings and resolutions, the Project permits Closed companies to require a larger quorum for resolutions on certain matters specified on the company's bylaws.
The Project introduces an innovation by permitting arbitration in cases of tie votes on resolutions voted at the general meeting. If the procedure to be followed in the case of such arbitration is not set forth in the bylaws, the respective resolutions may be submitted to the courts of justice.

The minutes of general meetings may be drawn up or published in abbreviated form, transcribing the resolutions passed and observing the provisions of Article 130.

With respect to the period within which the notice summoning general meetings must be published, the Project has established that on the first call this period will be eight days from the date of the first publication, thus eliminating the dubious interpretation of the current text. The third call has been considered useless and eliminated by a provision establishing that on the second call the general meeting may be held with any quorum.

Upon the request of a shareholder of a Closed company holding at least 5% of the capital stock, general meetings may also be summoned by telegram or registered letter.

The possibility of holding a general meeting without prior summons when all shareholders are present has been made into a legal provision. To date this possibility only existed under Ruling No. 18 of the National Trade Registration Department.

The publication of the management’s report on the company’s business, financial statements and the auditors’ report, if any, has become compulsory even if all shareholders are aware of the content of these documents. The general meeting called to examine the management accounts will require the presence of at least one manager and of an outside auditor, if any. The shareholders present at the meeting may, however, dispense with the presence of such manager and auditor.

Statutory amendments relative to the matters set forth in Article 136 will still require the specified quorum in addition to the approval of shareholders representing at least 50% of the voting capital. Section 2 of Art. 136 gives the CVM the right to reduce this quorum in the case of an Open company. Of great importance is the change which the Project introduces in respect of the right of withdrawal of a dissenting shareholder relative to the matters listed in items I, II, IV and VIII of Art. 136. The right of withdrawal is given not only to the dissenting shareholder present at the
general meeting, but also to the dissenting shareholder who has abstained from voting or did not attend the meeting. This right may be exercised by requesting the company to reimburse the value of the dissenting shareholder's shares within a period of thirty days from the publication of the respective minutes of the general meeting.

VI. — ADMINISTRATIVE COUNCIL AND BOARD OF DIRECTORS

The management of the company may be entrusted to the Administrative Council and to the Board of Directors, or only to the Board of Directors, as established in the bylaws. In cases of companies with authorized capital, an Administrative Council is mandatory. In other Open capital companies, the CVM is given the right to determine whether or not an Administrative Council will be required.

According to the Project, the Administrative Council must have at least three members with certain duties (Article 142). In the election of the Council, Article 141 permits the shareholders representing 10% of the voting capital to demand a multiple vote under which each share would have as many votes as the number of Council members, with the right to cast the votes for a single candidate, or to apportion them among several candidates. This provision was taken from the cumulative vote procedure provided under United States law for purposes of protecting the minority shareholders.

The Board of Directors must be composed of at least two directors appointed by the Administrative Council or, if the company has no such Council, by the general meeting.

Either individuals or corporate entities, who need not be shareholders, may be elected to management positions. At least two-thirds of the Administrative Council and the entire Board of Directors must be composed of individuals residing in Brazil or of corporate entities established in Brazil. The President of the Administrative Council must be an individual residing in Brazil.

Unlike the current company law, the Project does not require a pledge of company shares in guarantee of the management on the part of the company's administrators.

The Project provides for the election of deputy members to the Administrative Council, and Article 151 deals with the replacement of Council members and directors.
The Project is progressive in regulating the resignation of directors. Such resignation will be effective for the company from the time of submission, and for bona fide third parties from the time of filing with the Commercial Registry and of publication, which can be arranged directly by the resigning director.

The remuneration of the directors and administrators continues subject to the wishes of the general meeting, which will determine such remuneration in accordance with the responsibilities attributed to the manager, the time he dedicates to the company's business, his competence and professional reputation, and the market value of the services he renders. The bylaws may give the managers the right to a share of the company's profits, provided that such share does not exceed their total annual remuneration nor 10% of the total profits, whichever is less.

The Project goes into more detail than the current law with respect to the duties and responsibilities of the managers. It also provides that upon taking office the managers of Open companies must present a list of the shares, subscription rights certificates, share purchase options and debentures convertible into shares that they own of the company's issuance, or of the issuance of companies controlled by or belonging to the same group.

VII. — AUDIT COMMITTEE

The bylaws must set forth whether the Audit Committee will function on a permanent or temporary basis. If temporary, the Audit Committee may be re-established at any time upon the request of shareholders representing at least 10% of the voting capital or 5% of the non-voting capital. Each period will end on the date of the next subsequent annual general meeting.

The right to elect a member of the Audit Committee and his deputy, given to the holders of non-voting preferred shares or of restricted voting shares, may also be extended to the minority shareholders who jointly represent 10% or more of the company's voting stock. The other shareholders shall have the right to elect the two other members and their deputies.

The members of the Audit Committee must be individuals with a university degree and the remuneration of each active member may not
be less than 10% of the average remuneration paid to the company’s directors, without considering any profit sharing.

VIII. — CHANGES IN THE EQUITY CAPITAL

The capital of the company may be changed by means of an increase:

(a) with the approval of the annual general meeting, for purposes of monetary correction of its value;

(b) with the approval of the general meeting or by resolution of the Administrative Council, in the case of companies with authorized capital;

(c) upon the conversion of debentures or participation certificates into shares and upon the exercise of the rights given under subscription rights certificates or under share purchase options; or

(d) by resolution of the extraordinary general meeting determining an amendment to the bylaws, in the event that authorization for an increase has not been given or is exhausted.

The capital may also be changed by means of a reduction through resolution of the general meeting in the case of a loss, limited to the amount of accumulated losses, or in the case of excess capital.

The Project regulates the system of authorized capital, changing the provisions of Law No. 4.728 which permitted companies to have authorized capital. With respect to share purchase options, the Project is more specific and determines that the bylaws may provide for the company to grant such options to administrators, employees or individuals who render valuable services to the company or to another company under its control.

The present company law permits the subscribed capital of a company to be increased only if it is fully paid up. The Project allows such increases by means of subscription of new shares provided that at least 75% of the subscribed capital has been paid up. The bank deposit is no longer required in capital increases through share subscription.

Article 172 carefully regulates the rights of first refusal to the subscription of shares in capital increases, particularly when the capital is divided into shares of several kinds and classes. Article 173 provides the possibility of exclusion from this right in the case of Open companies or in the case of a share subscription with funds derived from tax incentives.
IX. — FINANCIAL STATEMENTS

The change made in this area is extraordinary and is aimed at a standardization of financial statements and at a more accurate reflection of the company’s real economic and financial situation in the interests of the shareholders and of third parties. The intent is to eliminate the abuses that have been committed in the past and to reinforce the public confidence in the securities market by means of the publication of the real financial situation of companies.

At the end of each fiscal year, companies will be obliged to draw up a balance sheet reflecting their net worth and a statement giving the profits and losses accumulated during the year, apart from a statement of the results of the year and a statement of the origin and investment of funds. The publication of these financial statements must indicate the corresponding figures of the statements of the previous fiscal year to permit comparison. The Project deals in detail with company accounts and with the criteria to be adopted in its financial statements (Articles 177 to 189).

X. — PROFITS, RESERVES AND DIVIDENDS

The Project establishes precise rules for the deduction of losses and the order of profit sharing; it defines net profit, restricts the creation of statutory reserves, regulates the utilization of reserves and establishes the origin of dividends. One of the limitations imposed by the Project is that the balance of the profit reserves, excluding contingent profits, may not exceed half of the company’s capital. In the case of such an excess, the general meeting will provide for its utilization in capital payment or its increase, or in dividend distribution. The Legal Reserve has been maintained at the present levels although the Project has permitted its application to set off losses or increase the capital.

In our opinion, the Project should have restricted the obligation of establishing a minimum dividend for Open companies. In these companies it is appropriate for the minority shareholders to obtain more efficient protection which would also serve to attract public savings to the securities market or to investment funds. In Closed companies, however, the shareholders should have the freedom to decide whether a minimum dividend should be established or not.

The bylaws may set forth a mandatory minimum dividend to be paid by the company in each fiscal year. In cases where the bylaws are
silent on the point, the distribution of one half of the net profit of the fiscal year is required by the law after the deduction of profit sharing, income tax provisions and contingency reserves, if any. The bylaws may establish the dividend as a percentage of the profits or capital, or according to other criteria provided that the dividend is precisely defined. It is forbidden to subject the minority shareholders to the opinion of the majority or of the administrative bodies of the company.

In order to assure that the minority shareholders are entitled to receive a minimum dividend as determined by law, the Project establishes that the minimum dividend established by means of an amendment to bylaws that are silent in this respect may not be less than 25% of the net profit of the fiscal year, adjusted as required by the Project.

In the case of Closed companies, the general meeting may distribute a dividend below the mandatory dividend or retain all the profits, provided that the procedure is approved by all the shareholders present at the meeting.

The mandatory minimum dividend also need not be distributed if the administrative bodies of the company can justify that its distribution would be detrimental to the company’s financial situation. In this event the undistributed profits should be held in a special reserve and, if not absorbed by the losses, should be paid out as dividends when the company’s financial situation has improved.

Where a legal or statutory provision requires balance sheets to be drawn up at six-month intervals, the bylaws may provide for dividends to be distributed on the basis of the profit ascertained in such six-month balance sheets. Interim dividends may also be distributed if authorized by the bylaws but only on the basis of the profits accrued or reserved in the last annual or six-month balance sheet.

If the project is enacted and the requirement for the distribution of a mandatory minimum cash dividend prevails, we would advise investors resident or domiciled abroad who have a direct interest in a Brazilian company to form a holding company. This holding company would be a Brazilian Limitada company and would serve to avoid payment of the withholding tax of 25% (15% in the case of countries with which Brazil has signed a double taxation treaty, or 10% in the case of Japan) and of the distribution tax of 5%. By having the dividends of the foreign investment paid out to the holding company, the foreign investor would be
favored by the fact that the above mentioned taxes would only be payable when dividends are distributed by the holding company.

XI. — PARTICIPATION CERTIFICATES

Participation certificates have not undergone any changes and have been maintained as securities not representing a participation in the share capital but only in the company’s profits. In the case of Open companies, the participation certificates may be sold for a price or freely distributed to an employee benefit company or foundation. The participation certificates which are distributed free of charge will have their effectiveness limited to ten years except when held by employee benefit companies or foundations.

XII. — DEBENTURES

The Project has improved the obsolete and limited legislation on debentures by giving them characteristics capable of attracting public funds.

The Project admits four kinds of debentures, which may or may not be convertible into shares. These are debentures issued with a real guarantee, debentures issued with a floating guarantee, debentures issued without privileges and debentures subordinate to other creditors. Debentures may be converted into shares, are subject to monetary correction, may participate in the company’s profits and are effective for an indeterminate period of time as permanent debentures. The Project has created the Fiduciary Agent of the Debenture Holders, requiring his intervention in the issuance of all debentures to be negotiated on the market and in the issuance of debenture pledge certificates by duly authorized financial institutions. Article 73 deals with the issuance of debentures in other countries and provides for the protection of the Brazilian creditors of the company by giving them priority over the foreign debenture holders, except in cases where the debenture issuance was approved by the Central Bank of Brazil or its proceeds were invested in a company established in Brazil.

XIII. — SUBSCRIPTION RIGHTS CERTIFICATES

This is a new form of security similar to the United States “stock purchase warrant,” which permits a company to negotiate subscription
rights within the limits of its authorized capital. The holder of these certificates obtains the right to subscribe to shares of the company's capital upon presentation of the certificate and payment of the issuance price. The subscription rights certificates may be issued nominatively or to bearer.

XIV. — SPLIT

The Project establishes rules for the transformation, merger and consolidation of companies, going into more detail than the current company law. It also deals with a totally new matter — split — which is an operation by which a company transfers a part or all of its assets to one or more companies formed or to be formed for such purpose, the transferring company being extinguished or maintained depending on whether the split was total or partial. The company or companies that absorb all or a part of the assets succeed the transferring company in all its rights and obligations on the occasion of the split.

An innovation, introduced by the Project, is the requirement that operations of merger, consolidation or split be subject to the prior approval of the company's debenture holders.

XV. — ASSOCIATE, CONTROLLING AND CONTROLLED COMPANIES

The provisions respecting this area are entirely new and are intended to govern the association of companies, a practice which has been occurring in Brazil since the Second World War.

Associate companies are defined as companies that participate in each other's capital with an interest of at least 10% but without the power of control.

A controlled company is defined as a company in which another, the controlling company, has a direct or indirect interest permitting permanent control of the corporate resolutions and of the election of the majority of the managers.

Associate, controlling and controlled companies may form a corporate group and will be subject to special rules. The most important of these
are the prohibition of mutual participation, the obligation to render information on relevant investments, the requirement for consolidated financial statements, and that the manager of one company not favor an associate, controlling or controlled company to the detriment of his own company.

Article 252 permits the creation of fully-owned subsidiaries having a Brazilian company as their sole shareholder, such creation to be effected by means of a public deed or by the acquisition of all the subsidiary’s shares by a Brazilian company.

The Project is comprehensive in the section which deals with the transfer of the control of Open companies. It establishes the applicable rules, requires proper disclosure of such transfers and subjects the operation to prior governmental approval in the case of companies functioning under governmental authorization.

The Project has attempted to protect and defend the minority in the case of transfer of control by private negotiations or public offer, as also in the case of merger of a controlled company.

XVI. — COMPANY GROUPS

Controlled and controlling companies may form a corporate group in which they maintain their own distinct personality and assets. Article 270 defines the concept of Brazilian control for purposes of determining the nationality of the corporate group. Common management, common policies and consolidated or separate financial statements are some of the characteristics of a corporate group, in which the managers are not liable for having favored one company to the detriment of the other.

XVII. — CONSORTIUM

This is another form of joining two companies for a specific undertaking. The consortium has no legal personality of its own and the obligations of the undertaking are individually assumed by each of the companies participating in the consortium. The consortium agreement and any amendments thereto should be filed with the Commercial Registry.
XVIII. — MIXED-ECONOMY COMPANIES

An entire chapter of the Project deals with this corporate form which may also have its capital divided into shares. The Project establishes the applicable rules, the business objectives, the obligations of the controlling shareholders, the form of management and the right of the minority shareholders to be represented on the Administrative Council and on the Audit Committee.

XIX. — STATUTE OF LIMITATIONS

Articles 286 to 289 deal with the application of the statute of limitations by introducing some modifications, and subjecting lawsuits and their time periods to greater restrictions. The prescriptive period is reduced to two years for lawsuits filed to annul resolutions passed at, among others, improperly called meetings, resolutions which contravene the law or the bylaws, or resolutions vested with errors, fraudulent intent, fraud or simulation. The two-year prescriptive period begins to run on the date of the respective resolution.

XX. — GENERAL AND TEMPORARY PROVISIONS

Among the general provisions, we would mention the requirement that companies always make their announcements in the same newspaper, and that any newspaper change be preceded by a notification to the shareholders in the excerpt of the minutes of the annual general meeting of the company.

Indemnities payable for losses and damages as a result of lawsuits based on the Project will be subject to monetary correction up to the calendar quarter of actual payment or settlement.

Bearer shares will be allowed in companies engaged in the purchase and sale of real property constructed or under construction, in the incorporation of buildings or in the purchase and sale of lots of land with construction already on site or contracted for.

Once the Project has been enacted into law it will become effective sixty days after its publication but will be immediately applicable to companies incorporated after the publication date. Existing companies
will be given a period of one year from the effective date to adapt themselves to the new law by means of general meetings.

Existing companies will be given a period of three years from the effective date of the new law to eliminate any reciprocal shareholdings.

The Project also contains some temporary provisions relative to financial statements, reserves and participation of mixed-economy companies. Articles 59 to 73 of Decree Law No. 2.627 of September 26, 1940 have been maintained in force for companies requiring governmental authorization for their operation and for the opening of Brazilian branches of foreign companies.

Concluding our comments, we affirm the Project is highly progressive and, if approved, will give Brazil a legislation more appropriate for the modern companies of today.

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