Freshfields Bruckhaus Deringer

What *directors* of Brazilian subsidiary companies *need to know*

Brazil

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June 2014

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Welcome to our guide for directors and prospective directors of subsidiary companies in Brazil.

While the duties of a subsidiary company's directors often coincide with the strategy and requirements of the parent company, this is not always the case. Depending on the jurisdiction or the circumstances, a subsidiary company's directors may need to act independently of the parent.

The directors may also risk personal liability. Increasingly, for example, regulators and enforcement agencies around the world are taking a much tougher line on bribery, corruption and cartel abuses. So directors will wish to know the extent to which they can be protected against these risks – for example through being indemnified and/or insured.

We hope you find this guide useful as an introduction to your role as director.

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Chapter 1
The regulatory framework for directors' duties and corporate governance

What is the regulatory framework for unlisted private companies incorporated in Brazil?

Legal framework

Corporate equity investments in Brazil are mainly structured via two types of companies; both are limited liability:

- limited liability company (*Sociedade Limitada*); or
- corporation (*Sociedade Anônima*).

The Brazilian legal framework for companies comprises the Civil Code, which governs limited liability companies, and the Federal Corporations Act, which governs both publicly and privately held corporations.

All companies are also subject to their respective incorporation documents (by-laws or articles of association).

Legal system: civil law

Brazil has a civil law system, generally comprising the Federal Constitution, federal, state and municipal laws and administrative rules.

As opposed to a case law system, judicial decisions in Brazil generally do not take binding effect on all individuals and entities (the *erga omnes* effect), although they are used as a useful representative source for interpretation.

Chapter 2
General duties

Where do these duties come from and to whom do I owe them?

The fiduciary duties of managers[1] of limited liability companies are mainly in the Civil Code. For a corporation, such fiduciary duties are mainly in the Federal Corporations Act.

All companies and their managers are also subject to the relevant incorporation documents (by-laws or articles of association).

You owe your fiduciary duties to the company and its shareholders, as a whole, not to other group companies, individual shareholders or any group of shareholders. Under Brazilian law, except in the event of an insolvency, fiduciary duties are not owed to constituencies such as employees. 'Insolvency' (chapter 6 below) addresses the rights owed to creditors in the context of insolvency.

Management structure

Limited liability company (*Sociedade Limitada*)
The Civil Code does not prescribe any formal management structure for limited liability companies. As a rule, these entities are both managed and represented by one or more officers, each of whom must reside in Brazil. The partners owning a limited liability company may choose to create a board of directors (or another form of managerial body), by inserting provisions in the company's articles of association.

Corporation (*Sociedade Anônima*)
Under the Federal Corporations Act, a corporation must be managed by a board of officers. There may also be a board of directors, but this is only mandatory in specific cases (eg in publicly held corporations).

A corporation's officers will always be vested with powers to represent the corporation. And the board of directors, if there is one, will be responsible for overseeing and supervising the board of officers and ensuring that the day-to-day activities of the company are consistent with the business guidelines fixed by the board of directors.

In contrast with an officer, a member of the board of directors may reside abroad, provided that a Brazilian resident is appointed as the director's attorney-in-fact with authority to receive service of process on his or her behalf.

A company's by-laws may provide for other managerial or advisory bodies. The members of such bodies are also subject to the same duties owed by managers, as further described below.

Finally, under the Federal Corporations Act, shareholders may require that an audit committee be installed.[2] The audit committee may be installed for a given fiscal year or permanently. While the members of the audit committee are not considered to be part of the management of a corporation, audit committee members are subject to the same duties owed by managers.

1
In this guide, the term 'manager' is used to refer either to an officer, to a member of the board of officers or to a member of the board of directors.

2
For privately held corporations, shareholders representing at least 10 per cent per cent of voting shares or 5 per cent per cent of non-voting shares may require the installation of a statutory audit committee. A privately held corporation is a company that is not registered with the Brazilian Securities Commission and, therefore, its securities are not publicly traded.

Chapter 2
General duties

What are my general duties?

As a manager, your fiduciary duties can be classified into two main categories: a duty of care and a duty of loyalty.

These two categories also comprise several ancillary, but equally important, duties.

- **Duty of care.** You must carry out your functions with the same care and diligence as would be employed by an industrious and honest businessman. Most scholars break down the duty of care into the following sub-categories:
  - duty to display reasonable skill;
  - duty to exercise your mandate for the benefit of the corporation in pursuit of its corporate objectives;
  - duty to seek information;
  - duty to investigate; and
  - duty of oversight.
- **Duty of loyalty.** You must act bona fide in the best interest of the company. You may not benefit, nor cause third parties to benefit, in any way, from your position, in lieu of the company. Not only should you refrain from using your mandate for personal benefit, but you must also ensure that your personal interests do not harm, nor prevent the company from benefiting from any business opportunity that would otherwise be available to it. Furthermore, as a manager, in the event of any conflict of interest between the company and any third party (including yourself), you must take certain measures to ensure that the interest of the company prevails (see chapter 3, 'Conflicts'). Lastly, the duty of loyalty also encompasses a duty of confidentiality.

To what extent am I liable if any of these duties are breached?

As a rule, a manager is not liable if he or she acts within his or her regular 'managing powers'.

Regular managing powers are conferred on managers by the Federal Corporations Act and/or the company's by-laws, in the case of a corporation and by the Civil Code and/or the company's articles of association, in the case of a limited liability company.

A decision is considered to have been taken within regular managing powers if:

- made on an informed basis;
- the manager can show that he or she acted with reasonable diligence; and
- the manager has no personal interest in the subject matter of the decision.

The business judgement rule, widely accepted in Brazil, provides that a decision made by managers within their regular managing powers cannot be second-guessed by a court or a regulator – regardless of whether or not the company has been harmed as a result.

Chapter 2
General duties

What are the consequences if I breach these duties?

As a rule, a manager is shielded from liability in connection with damages suffered by the company as a result of the performance of his or her obligations, provided that such actions are within his or her regular managing powers. However, a manager may be held personally liable for damages suffered by the company, its shareholders or any other third parties, as a result of his or her actions and/or omissions when:

- performed negligently (*culpa*) or by wilful misconduct (*dolo*); or
- in breach of the law or of the company's constitutional documents.

A manager will not be held liable for damages caused by actions performed by other managers, except if the manager:

- has consented to such practice;
- has acted negligently in not detecting such practice; or
- was aware of such practice and did not act to prevent it.

In any such case, managers may protect themselves against liability in accordance with the Federal Corporations Act by:

- formalising their dissent in the minutes of the company's administrative body in which such manager sits; or
- informing the administrative bodies of the company, the audit committee (if applicable) or the shareholders at a general meeting.

Civil liability

If you are found to have breached your duties, two types of civil liability claims can be brought against you.

- **Corporate claim.** Subject to a prior resolution of the shareholders, this claim may be filed by the company itself to recover losses suffered as a result of a manager's breach of fiduciary duties. In the event the filing of a lawsuit is approved by the company's shareholders and the company fails to file such claim within three months as of the date of approval, any shareholder of the company may do so, by filing a derivative suit on behalf of the company. If the general shareholders' meeting resolves against filing such action, a derivative suit may be brought by any group of shareholders representing at least 5 per cent of the company's capital stock.
- **Individual claim.** Any third party (ie shareholders, creditors, fellow managers, members of the audit committee) may file a claim to recover damages ensuing from a manager's breach of fiduciary duties.

Criminal liability

Managers may be held criminally accountable for, among other matters:

- money laundering;
- fraud;
- bankruptcy fraud; and
- environmental offences.

Administrative liability

Companies performing regulated activities are also subject to the supervision of governmental authorities (such as the Brazilian Electricity Regulatory Agency or the Brazilian Oil and Gas Agency).

In this regard, not only the company but its managers and shareholders are also subject to specific administrative rules and may be held liable for the breach of specific regulatory duties within the jurisdiction of the agency at hand.

Can the 'corporate veil' be pierced in Brazil?

Piercing the 'corporate veil' (or looking behind the corporate entity to the individuals involved) to attach personal liability is accepted in Brazilian courts but only applied in specific circumstances (especially in relation to tax, labour and environmental matters, as discussed further in this guide).

Courts may disregard the corporate veil if, cumulatively: third parties have been harmed by fraudulent, abusive, illegal or ultra vires conduct (acting beyond authority) of managers and/or shareholders; managers and/or shareholders would otherwise be shielded by the corporate entity to obtain an inequitable result; and the company is not capable of satisfying its obligations. The burden of proof is placed on the third party seeking to impose personal liability on a manager or shareholder.

Notwithstanding the above, specific statutes provide for different and broader standards for piercing the corporate veil. In this regard, courts may impose personal liability on managers and/or shareholders under certain circumstances within the following fields of law:

- tax;
- labour;
- environmental;
- consumer; and
- antitrust.

Chapter 3
Conflicts

What are my duties relating to conflicts?

A manager is deemed to be in conflict when his or her personal interests clash with those of the company. Managers are under a duty to assess and identify any conflicts of interest.

If a manager is faced with a conflict of interest, Brazilian law provides that he or she must:

- inform the other managers within the same administrative body of such conflict;
- refrain from participating in any relevant decision-making process; and
- refrain from taking part in the relevant transaction.

If a manager votes on a subject matter, and is later found to have had a personal interest therein, he or she may be held liable and all actions taken in connection with that resolution may be held null and void as a result of a judicial order made ex officio or claim made by any injured party (eg the company, a shareholder or another injured third party).

The following represents a non-exhaustive list of circumstances that should be fully disclosed to, and approved by, other managers of a company:

- an acquisition of assets from a company owned by a manager of the purchasing company;
- execution of loan agreements between a company and any of its managers; and
- engaging services from an entity controlled by a manager.

A company's articles of association (or a corporation's by-laws) may subject the performance of a transaction between the company and its manager to the prior approval of the board of directors or the shareholders.

In the event such a transaction is found to have been carried out under unfair conditions, the existence of such approval shall not exempt the any manager or shareholders from any liability incurred as a result thereof. However, the fairness of a transaction may not subsequently be questioned by a manager or shareholder that had previously voted to approve it.

As a rule, if the manager is conflicted, he or she must refrain from taking part in the relevant resolution.

Chapter 4
Environmental, health and safety and competition laws

What are my obligations towards the environment?

Any individual or company that damages the environment will be held liable for such action and subject to civil, criminal and administrative sanctions.

Civil liability

Environmental damages may be assessed on the offender irrespective of evidence of any wrongdoing (strict liability).

Administrative liability

Administrative liability may be imposed, irrespective of actual damage, for violation of environmental laws. If such liability is verified by an environmental authority, the offender may be subject to administrative penalties, such as fines, closing a facility and loss of or restrictions on tax incentives.

Criminal liability

Criminal liability may be imposed for committing an environmental crime under the Federal Environmental Crimes Act as a result of negligence (*culpa*) or wilful misconduct (*dolo*). If such liability is verified, the offender may be subject to criminal sanctions that range from fines to imprisonment (individuals) or dissolution (companies).

Criminal liability may be extended to individuals who have any involvement, whether direct or indirect, in the environmental crime, as well as to those who were aware of the criminal behaviour, but did not act to prevent it. Officers, members of the board of directors, attorneys-in-fact, employees, auditors and other agents may be held criminally liable.

Managers and personal liability

A manager may only be held personally liable for environmental damages caused by the company within the criminal sphere, as set out above if the corporate veil of such company is pierced, in which case a manager may be held liable for the economic burden of such compensation.

The corporate veil of a company may be pierced if it is deemed as an obstacle to the compensation of environmental damages caused by such company.

What are my obligations in respect of health and safety?

Managers must comply, and cause the company to comply, with the rules and regulations for health and safety, which are provided by the Ministry of Labour. These obligations include:

- informing employees of the occupational risks that may arise within the workplace, as well as the means to prevent and limit such risks and the related measures adopted by the company;
- allowing a representative of the employees to take part in site inspections to ensure compliance with health and safety rules; and
- establishing internal procedures to be adopted in the cases of employment-related accidents or illnesses.

Health and Safety-related liabilities may be imposed on a manager who wilfully violates, instructs or consents to the violation of health and safety rules.

Furthermore, a manager may be held personally liable if the corporate veil of a company is pierced. The corporate veil is more regularly pierced by Brazilian labour courts and does not require the production of evidence of fraudulent, abusive, illegal or ultra vires behaviour by managers or shareholders.

What are my obligations concerning competition law?

Managers may be held jointly and severally liable for anti-competitive practices in which they engage.

Acts regarded as anticompetitive include cartel, refusal to deal, resale price maintenance, tie-in sales, bid rigging and any other practices that have as their purpose or effect:

- substantially lessening competition;
- increasing profits arbitrarily; or
- abusing a dominant position.

Managers are subject to fines ranging from 1 per cent to 20 per cent of the fine imposed on the company in case of negligence (*culpa*) or wilful misconduct (*dolo*) on their part.

Fines imposed on a legal entity may range from 0.1 per cent to 20 per cent of the entity's or group of entities' gross revenues in the economic sector affected by the conduct at hand, in the year before the beginning of the investigation. Specifically in the case of cartels, managers are also subject to two to five years' imprisonment, plus a criminal fine.

In addition, managers can be held personally liable for anticompetitive practices if the relevant company's corporate veil is pierced by the Brazilian Antitrust Authority (CADE) (see chapter 2, 'General duties', 'Can the 'corporate veil' be pierced in Brazil?'). According to Brazilian Competition Law, a company can have its corporate veil pierced in circumstances of abuse of rights, abuse of power, violation of law, illegal act or fact, violation of the company's by-laws or articles of association, bankruptcy, insolvency and termination or interruption of the company's activities as a result of a breach of a manager's fiduciary duties.

Chapter 5
Restricted transactions

Are there restrictions on particular transactions between the company and me?

Brazilian Law does not generally prohibit related-party transactions, such as those between a manager and company.

Nevertheless, related-party transactions must be disclosed to the Brazilian Federal Revenue in a company's tax statements and in the company's financial statements. Moreover, such transactions must be executed on an arm's-length basis (see chapter 3, 'Conflicts').

Are there prohibited acts or transactions under Brazilian Law?

Brazilian Law expressly prohibits the following.

- **Acts of liberality.** Any act that involves the use of the company's assets or implies a cost to the company, in each case without compensation, is prohibited.
- **Improper use of company's funds.** Without prior approval of the shareholders or the board of directors, a manager must not borrow any of the company's assets or goods, nor use its goods, services, funds or assets for personal benefit, whether directly or indirectly, or for the benefit of any third party.
- **Personal gain.** A manager must not, directly or indirectly, receive any personal gain from third parties as a result of his or her position, except if permitted under the relevant constitutional documents or previously consented to by shareholders.

Nonetheless, the managers may, in certain cases and in light of their social responsibilities, authorise the implementation of reasonable acts of liberality (as explained above) for the benefit of employees or the community of which the company is a part.

What about the company giving me a loan?

A loan from the company to one of its managers is subject to the same rules as related-party transactions explained in this chapter and in chapter 3, 'Conflicts'. Such loans are, therefore permissible provided that they are previously approved by the shareholders or the board of directors as provided for in the company's articles of association.

Chapter 6
Insolvency

To whom do I owe my duties in an insolvency situation?

In an insolvency situation, managers have greater exposure to liability, as the constituencies to which their duties are owed are expanded to include creditors. Nonetheless, in such case, managers may only be held liable if they are found to have wilfully acted to harm creditors or the insolvent estate.

The Federal Bankruptcy Act contemplates three different reorganisation proceedings:

- judicial reorganisation;
- extrajudicial reorganisation; and
- bankruptcy/liquidation.

Reorganisation proceedings

The company may continue to operate, while implementing its financial reorganisation plan. Managers remain in control of the company's activities throughout the process.

Notwithstanding the above, managers may, during the course of a judicial reorganisation proceeding, be removed from office if there is strong evidence of actions performed by wilful misconduct or that qualify as crimes against creditors. In such cases, personal liability may be imposed on the relevant managers.

Bankruptcy/liquidation proceedings

During bankruptcy/liquidation proceedings, managers are permanently removed from the company's management, which is entrusted to a court-appointed trustee (*administrador judicial*). However, a manager may still be held liable for damages caused to the bankrupt estate or to creditors prior to its removal.

How can I incur liability?

In an insolvency scenario, managers may be liable for any damages wilfully caused to third parties with the aim of harming creditors or obtaining undue personal gain.

The Bankruptcy Act provides for a series of actions that, if wilfully performed by a manager, as proved in court, may result in both civil and criminal liabilities being imposed on such manager. Such actions include:

- disposal of assets of an insolvent company in violation of the plan;
- disclosure of confidential information related to the company's operations and business;
- withholding material information from or disclosing false information to bankruptcy court; and
- undertaking obligations that reduce the value of the company's assets or that are designed to benefit certain creditors, while being harmful to others.

Chapter 6
Insolvency

When should my company stop trading?

A company should stop trading if there is no reasonable argument or evidence to support that it will be able to avoid liquidation. In such cases, the company must initiate an out-of-court winding-up process by liquidating its assets and indebtedness, or file for a bankruptcy/liquidation court proceeding.

If, however, a company is facing temporary financial hardship but is still economically and operationally viable, it should continue to trade. Nevertheless, in such case, the company should consider filing for recovery under either a judicial or extrajudicial reorganisation proceeding. Although the managers are kept in office, certain actions may be subject to prior approval of creditors and/or the relevant court, such as the sale of certain assets.

Furthermore, managers should be aware that certain actions, performed within a certain time frame (usually 90 days) before a bankruptcy ruling or judicial reorganisation filing may be ruled ineffective before creditors, if deemed to have been harmful to the insolvent estate. As a rule, actions performed by managers within their regular managing powers are not affected by this legal provision.

What practical steps can I take if my company's solvency is in question?

Whether the company is facing financial hardship or duly performing its activities in its regular course, managers will always be subject to and must perform their functions in compliance with its general duties (see chapter 2, 'General duties').

Managers are not subject to any prescribed duties during an insolvency situation (such as a requirement to seek professional advice or hold regular board meetings).

In any event, the most advisable course of action if the company is nearing insolvency would be to focus on protecting the value of the company, to minimise losses to creditors, to be kept informed of the company's financial circumstances and to know to whom duties are owed.

What if I sit on the boards of two companies of the same group and one of those companies is in financial trouble?

As mentioned in chapter 1, in Brazil, both limited liability companies and corporations have limited shareholder liability. So, as a rule, liabilities incurred by one company under an insolvency proceeding or financial hardship condition should not affect its affiliated companies, managers or shareholders.

Nonetheless, liability may be extended to a manager who, by wilful misconduct (*dolo*), breaches his or her general duties (see chapter 2, 'General duties') with the purpose of harming creditors or the insolvent estate. If this behaviour is verified, such manager's assets may be seized and be used by the relevant court to compensate for the damages caused.

Chapter 7
Indemnification, insurance and ratification

What do I need protection from?

A manager can be held liable for damages caused to the company, shareholders and/or any stakeholders (eg creditors, employees) when in breach of his or her general duties (see chapter 2, 'General duties').

As a rule, liability will be imposed on a manager on the proof of negligence (*culpa*) or wilful misconduct (*dolo*). Nonetheless, some statutes provide that a manager may be held liable irrespective of proven negligence or wilful misconduct, such as, environmental and consumer laws.

Managers of, for example, financial institutions under investigation by the Brazilian Central Bank may be subject to having their assets seized.

Managers may be subject to liability imposed by courts (civil, federal and criminal), administrative bodies (eg Brazilian Electricity Regulatory Agency) and self-regulatory organisations (eg Federal Management Counsel).

Can the company indemnify me against liabilities?

A company may indemnify a manager for damages suffered as a result of his or her position as a manager by means of an indemnity letter.

Although widely adopted by Brazilian market practice, indemnity letters are not (in contrast with directors and officers (D&O) insurance) regulated by the Brazilian insurance authority (SUSEP). Greater flexibility is therefore available under indemnity letters than under D&O insurance. Nevertheless, as a rule, indemnity letters do not cover damages caused by wilful misconduct.

Any restrictions or limitations (such as exceptions regarding gross negligence) may be provided for in the indemnity letter, but may be questioned by Brazilian courts.

Chapter 7
Indemnification, insurance and ratification

What about insurance?

A company may also take out D&O insurance, in which case, the relevant indemnification will be paid directly by the insurance company to the manager.

In contrast with an indemnity letter, D&O insurance is regulated by the Brazilian insurance authority (SUSEP) and, therefore, offers less flexibility to the contracting parties.

As insurance companies are highly regulated in Brazil, mainly with respect to their solvency, a manager is offered greater financial protection with respect to the receipt of indemnity proceeds.

Under D&O insurance, indemnification is only payable on proof and assessment of the damage, and, in any event, cases of wilful misconduct will not be covered.

Is it possible for shareholders to ratify a breach of duty that I committed?

If damages are caused to a company as a result of the breach of duties by a manager, the manager cannot be exonerated from liability irrespective of previous approval or subsequent ratification by shareholders' resolutions.

However, once financial statements and accounts are approved by shareholders, without reservations, managers will be fully exonerated from any liabilities, except in cases of error, wilful misconduct, fraud or misrepresentation.

Chapter 8
Recent developments

Increased enforcement of anti-corruption practices: enactment of the Brazilian Anti-Corruption Act

In 2013, a new law aimed at charging legal entities for corrupt practices was enacted (the Anti-Corruption Act). It came into force on 29 January 2014. Before the law came into force, liabilities related to corrupt practices could only be imposed on individuals, not on legal entities.

Any legal entity incorporated under Brazilian law or that has a branch or any offices in Brazil may, irrespective of evidence of any wrongdoing (strict liability), be held liable (in both civil and administrative spheres) for acts against any foreign or domestic administration, including:

- direct or indirect offering of any unlawful advantage to a public official (including third parties related to such public officials);
- acts of fraud or manipulation in public bids or contracts with public entities; or
- the financing, funding or sponsoring of acts that are prohibited under the Anti-Corruption Act.

The Anti-Corruption Act subjects the offender to penalties, such as fines of up to 20 per cent of a company's revenue and the payment of compensation for the damages caused. Parent companies, subsidiaries, other affiliates and consortia are jointly liable for the payment of fines and damages.

An offender may also be subject to seizure of assets, rights or consideration acquired as a result of an illegal practice; partial suspension or prohibition of activities; mandatory dissolution; and prohibition from receiving donations, grants, subsidies or funding from public entities and public financial institutions.

A company's liability under the Anti-Corruption Act does not in any way eliminate or affect liability that may be imposed on a manager who, by negligence (*culpa*) or wilful misconduct (*dolo*), was involved in a corrupt practice.

Notwithstanding the above, managers may be held liable under the Anti-Corruption Act in the event the company's corporate veil is pierced.

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