Asset acquisition documents Q&A: Brazil

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This Q&A provides jurisdiction-specific commentary on *Standard document, Asset purchase agreement: Cross-border*.

Asset acquisition documents

1. In an asset or a business purchase, what are the main acquisition documents and who is generally responsible for preparing the first draft?

For transactions involving the acquisition of assets or an entire business (which would comprise the transfer of an establishment), the main acquisition documents are:

- Asset purchase agreement (buyer usually prepares the first draft).
- Disclosure schedules qualifying the seller's representations and warranties in the asset purchase agreement (seller usually prepares the first draft).
- A guarantee agreement is sometimes signed as an ancillary document (buyer usually prepares the first draft).

Depending on the type of assets that are being transferred to the buyer, some specific requirements must be fulfilled in accordance with Brazilian law, such as filing requirements.

For transactions involving the acquisition of the shares/quotas of a company, the main acquisition documents are:

- Share purchase agreement (buyer usually prepares the first draft).
- Disclosure schedules qualifying the seller's representations and warranties in the share purchase agreement (seller usually prepares the first draft).
- Shareholders' agreement (buyer usually prepares the first draft), for a purchase of less than 100% of the shares of the target company.
- Amendment to the articles of association of the target company (buyer usually prepares the first draft), if the target company is a limited liability company, or the share transfer book (seller usually prepares the first

draft) if the target company is a corporation (the two most common types of legal entities adopted in Brazil are the limited liability company (*Limitada* or *Ltda.*) and the corporation (S.A.)).

- A management or service agreement to retain company executives is usually signed, as well as ancillary documents (buyer usually prepares the first drafts).

A share pledge agreement or other type of guarantee agreement is sometimes signed as an ancillary document (buyer usually prepares the first draft).

> 2. Outline the structure and key substantive clauses in an asset or a business purchase agreement. Are seller warranties/indemnities typically included and what main areas do they cover? In relation to cross-border transactions with a connection to the UK, have you noticed the introduction of any "Brexit" wording or an increase in the use of material adverse change clauses?

An asset purchase agreement usually includes the following sections:

- Identification of the parties.
- Recitals.
- Purpose of the agreement.
- Purchase price and payment conditions.
- Representations and warranties regarding title to the shares and other aspects of the business of the target company.
- Guarantees related to the transaction.
- Indemnification obligations of the parties.
- Termination.
- Miscellaneous or general contract provisions.

Brazilian standard purchase agreements usually contain all the clauses included in *Standard document, Asset purchase agreement: Cross-border*. However, the clauses are generally grouped in fewer sections, such as pre-closing conditions, post-closing conditions, indemnification among others.

We have not experienced the introduction of any Brexit-related clause or language, or any amendments to the wording of other usual clauses. However, after the COVID-19 pandemic outbreak, material adverse change clauses have gained importance in all types of agreements.

The law and jurisdiction for disputes are normally chosen in accordance with the location of the assets, as provided under Brazilian law. Depending on the amount involved in the transaction, the parties normally provide for

arbitration in the event of a dispute. We have not seen any change regarding the choice of jurisdiction in the past years.

3. Is it common to have recitals at the beginning of an asset or a business purchase agreement? How is a court likely to interpret the agreement if the recitals are inconsistent with the substantive terms of the agreement?

It is common to have recitals at the beginning of an asset purchase agreement. Under Brazilian law, agreements are interpreted in accordance with the principles of good faith and taking into account the intention of the parties, rather than by strict reference to the wording of the document. Therefore, in the event of inconsistency between the recitals and substantive terms of the agreement, the courts will aim to give effect to the parties' intention.

4. With regards to terminology, which of the following alternative wording is more commonly used (if any), in an asset purchase agreement governed by the law of your jurisdiction:

- "Signing" or "exchange"?
- "Closing" or "completion"?
- "Disclosure schedule" or "disclosure letter"?
- "Closing agenda" or "documents list"?
- Any other?

The following terms are commonly used:

- Signing.
- Closing.
- Disclosure Schedule.
- Closing agenda.

5. Please outline common conditions precedent. Are there any circumstances in which a condition precedent may be invalid or unenforceable?

Conditions precedent may include:

- Shareholder or board approval.
- Approval of the transaction by public authorities.
- Reorganisation of target business or corporate structure of target.
- Industry specific consents.
- Relevant third-party consents (such as change of control provisions in contracts).

Conditions precedent that are not in accordance with the law may be invalid or unenforceable.

6. Is it implied that parties will use reasonable endeavours to fulfil conditions precedent within their control if there is no express obligation? Are the parties under a general duty to act in good faith in your jurisdiction?

Under Brazilian law, the parties to a contract must act in good faith (*Article 113, Brazilian Civil Code*). If there is a list of conditions precedent that each party is responsible for, it is implied that each party must use their best efforts to fulfil those conditions. However, it is recommended that the language in a conditions precedent clause should be specific and should clearly state the obligations of each party, to avoid any question regarding its interpretation.

7. Are there any foreign investment control rules in your jurisdiction that may be relevant in relation to an asset or a business acquisition?

Brazilian companies with assets or net equity in an amount equal to or greater than BRL250 million, and foreign investment participation in their capital, must submit four yearly economic financial reports to the Brazilian Central Bank, according to the following schedule:

- Reference date 31 December, by 31 March of the following year.
- Reference date 31 March, by 30 June.

- Reference date 30 June, by 30 September 30.
- Reference date 30 September, by 31 December.

In addition to information regarding foreign investors (such as voting equity interest and country of the final beneficial owner of the investors), the following information must be disclosed in the report:

- Paid in capital.
- Net equity.
- Assets and liabilities.
- Net profits or losses accrued in the reference period.
- Distribution of profits within the reference period.
- Estimated enterprise value.
- Income or expense arising from impairment.
- Financial income or expense arising from exchange variation.

All Brazilian companies that receive foreign investment must keep up-to-date information regarding their net equity and corporate share capital allocation. This information must be notified to the Central Bank's RDE-IED system:

- Within 30 days from the date of the event that changed the foreign investor's equity interest (including the acquisition of an equity interest).
- Annually, by 31 March, with respect to the reference date of 31 December of the previous year, except for companies that have already presented an economic financial report.

If the Brazilian entity has part or all of its quotas/shares held by foreign investors, every change in its capital stock must be registered with Central Bank of Brazil, regardless of whether the funds are sent by the foreign investor or by a Brazilian shareholder.

The Brazilian company has the sole and exclusive responsibility to notify/register the Central Bank of Brazil. The following breaches with regard to the provision of information to the Central Bank of Brazil may attract penalties:

- Failure to register required information.
- Late registration of required information.
- Providing false, incomplete or incorrect information.

8. Are any terms implied by law as to the seller's title to the assets? Do these vary depending on the asset or category of assets being transferred? Is any specific wording necessary and do buyers normally impose a higher standard than is implied by law?

The seller's title to the assets will depend on the type of asset that is being transferred to the buyer. Assets such as cars, real property, intellectual property and other specific assets have specific requirements for the registration of their title.

9. If part or all of the consideration consists of new shares in the buyer or an exchange of assets, what provisions is the asset purchase agreement likely to contain in relation to those shares or assets?

The asset purchase agreement must state the class and the number of shares to be received as consideration, or provide details of the assets and their corresponding title (if there is one). It must also include a representation as to the ownership of the shares or assets, free and clear of any encumbrances.

10. What are the most common price adjustment mechanisms used in an asset purchase agreement governed by the law of your jurisdiction?

Price adjustments may normally occur through indemnifications or reductions of the pending instalments.

11. What factors are likely to affect the timeline of an asset purchase?

The factors that may affect the timeline of an asset purchase are:

- Shareholder or board approval.
- Reorganisation of the target business or changes to the corporate structure of the target.
- Relevant third-party consents (such as change of control provisions in contracts).

12. Which act or document is used to transfer the assets or business in your jurisdiction? Would this act or document be regarded as the core closing step? Does this vary depending on the asset or category of assets being transferred (for example, would it be different in case of moveable assets or properties)?

The act or document for the transfer of assets will depend on the type of asset transferred. Depending on the asset, the transfer title may be drafted by a Public Notary or be a private instrument.

13. Are there any stamp, document or transfer tax or other charge, or notarial or other fees, to be paid in your jurisdiction in connection with the transfer of assets or a business?

Depending on the asset that is being transferred, stamps or notarial fees may be required for the filing of the transfer. If the asset is real property, the buyer must pay 2% to 3% of the price in taxes for the transfer of the title. Regardless of the type of asset, if the seller makes a capital gain on the sale, it may be subject to taxes at rates varying from 6% to 34%, depending on the type of the transaction.

14. Can a seller (or its advisers, including legal advisers) be liable for pre-contractual misrepresentation, misleading statements or similar matters?

Sellers can be liable for pre-contractual misrepresentation, misleading statements or similar matters. Buyers may have the right to seek compensation for damages, to the extent that they are able to show that they were induced by a specific representation to enter into the asset purchase contract. Sellers' advisers, including legal advisers, cannot be liable to buyers for pre-contractual misrepresentation, misleading statements or similar matters. Buyers must rely on legal or other advice provided by their own advisers.

15. Do you draw a distinction between protection by warranty and protection by indemnity?

We usually define a warranty as a guarantee from the seller concerning the assets or business of the target company. If a warranty proves to be false, incomplete, misleading or fraudulent, and the buyer suffers any loss as a result of the misrepresentation, the buyer can claim damages. The buyer must prove the amount of the losses it suffered. The liquidation procedure is usually provided in the agreement. If it isn't, it would be defined by arbitration or by a court.

An indemnity, on the other hand, is a promise by the seller to indemnify and reimburse the buyer for any loss suffered by the buyer because of a breach of a warranty, a breach of a covenant, damages regarding the assets or business related to acts or facts occurred before closing, or other matters. The amount of the loss may be pre-determined by the parties, or it can be determined on a case by case basis according to the effective loss suffered by a party. In either case, the buyer must evidence the amount of loss it suffered, but in the former the process of liquidation of such damages will be less time consuming.

The above would also apply to cross-border transactions.

Standard document, Asset purchase agreement: Cross-border: clause 7 and *clause 13* comply with applicable Brazilian laws.

16. Are apportionments and prepayments provisions usually inserted in an asset or business purchase agreement to ensure that neither the seller nor the buyer obtain a benefit they have not paid for, or incur a cost without receiving a benefit?

Apportionments and prepayments provisions are not widely used in asset or business contracts in Brazil. Generally, the parties agree on a price to be paid on closing. The buyer will then, within a specific period after closing, perform an audit to confirm the information used in the price calculation. If the information is different from the original, the purchase price is adjusted, and the buyer pays the difference to the seller, or vice versa.

If the seller does not agree with the result of the audit, the agreement will usually provide for rules allowing the seller to perform its own audit. If the dispute continues, the parties will jointly perform a third audit, or settle the dispute by arbitration.

Please find below suggested changes to the wording of certain sub-clauses of *Standard document, Asset purchase agreement: Cross-border: clause 10*:

"10.1. The Advance Receipts shall belong to the Buyer, and the Seller shall pay to the Buyer the full amount of the Advance Receipts [(excluding any amount in respect of Taxes for which the Seller is required to account)][and shall hold such sum in trust for the Buyer until it is paid]"
"10.2 The Prepayments shall belong to the Seller, and the Buyer shall pay to the Seller the full amount of the Prepayments [(excluding any amount in respect of Taxes for which the Buyer is required to account)][and shall hold such sum in trust for the Seller until it is paid]"
"10.5 The parties shall use all reasonable endeavours to draw up and agree a statement of the Advance Receipts referred to in *Clause 10.1*, the Prepayments referred to in *Clause 10.2* and the apportionments referred to in *Clause 10.3* and *Clause 10.4* and the balance owing by one party to the other in respect of the same as soon as practicable after the Closing Date. If such statement has not been prepared and agreed within [10] Business Days after the Closing Date, either party may refer the matter for determination in accordance with the procedure detailed in *Clause 10.6*.

Payment of the balance agreed, or determined pursuant to *Clause 10.6*, shall be made within [10] Business Days after such agreement or determination, as an adjustment of the Purchase Price."

17. What assets or liabilities would transfer automatically to the buyer in an asset or a business sale? Is it possible to exclude the automatic operation of the transfer?

The seller's assets, liabilities and contracts would transfer automatically to the buyer only in the case of a purchase of the seller's entire business. The buyer will be considered to have purchased the seller's entire business if it purchases the totality of the seller's assets, or a portion of the assets representing an independent business or production line that the buyer can operate independently after the transaction closes.

The parties can expressly agree to exclude the automatic transfer of assets, liabilities and contracts.

18. Is it usual to draft an asset or a business purchase agreement with extensive warranty protection?

It is usual to draft asset or business purchase agreements with extensive warranty protection whenever the buyer acquires a substantial part of the seller's assets or an entire business of the seller.

If the buyer is to acquire only a few assets or a part of a business, the warranties will usually be restricted to title to those assets and their operation and conditions.

The answer would not be different where a transaction involves cross-border elements.

Standard document, Asset purchase agreement: Cross-border: clause 7 and *clause 13* comply with applicable Brazilian laws.

19. How common are actions for breach of warranty?

Actions based purely on breach of warranty are not, to our knowledge, common. The parties to an asset or business purchase agreement will usually only start a claim if they have suffered an actual loss and must make a payment. The cause of such a loss could be a breach of warranty, but it will most likely be associated with a liability of the target company which is not necessarily derived from a breach of warranty, but which already existed and was not disclosed in appropriate disclosure schedules. Where the warranties did not include all liabilities, or had qualifications that

excluded some liabilities, the existence of such liabilities would not be a breach of the warranties, but could generate a loss to the buyer and an indemnity obligation on the part of the seller.

20. What remedies can be sought for breach of warranty?

It is common for the buyer to request a clause providing that, without affecting the buyer's ability to claim damages on an appropriate basis, the seller will be required to pay the buyer an amount equal to:

- Any liability of the buyer which arises from any breach of any of the warranties.
- A liability which would not have existed or arisen, had the warranties been true.

It is also possible to provide for termination of the agreement, usually before closing.

21. Can the agreement confer the benefit of warranties and indemnities or other terms of the agreement on a third party that is not a party to the agreement, and would that party be able to enforce them directly?

The agreement can confer the benefit of warranties and indemnities, or other terms of the agreement, on a third party. However, third parties cannot enforce these benefits directly. Third parties cannot be bound by the terms of a purchase agreement if they are not a party to it.

Standard document, Asset purchase agreement: Cross-border: clause 34 complies with applicable Brazilian laws.

22. In the absence of agreement can the benefit of warranties be assigned to a later transferee of the assets or the business?

No, warranties can only benefit parties to whom they are expressly given.

23. If acting for the sellers, are there any common limitations sought on the extent of warranties?

The most common limitations sought on the extent of warranties are:

- A qualification that some warranties are given "to the best of the seller's knowledge".
- The exclusion of certain matters, by specifying them in the disclosure schedules.
- A maximum (or cap) and a minimum (or floor) amount for compensation for damages.
- A time limitation for damages claims (including, but not limited to, warranty claims).

24. What is the usual time limit for claims for breach of general commercial warranties and tax warranties?

The usual time limit for civil liabilities, including commercial warranties, is one to three years. The time limit for tax warranties can be extended to five years, which is the statute of limitation for most tax liabilities.

Standard document, Asset purchase agreement: Cross-border: clause 8 complies with applicable Brazilian laws.

25. Are warranties usually qualified by disclosure? If so, where are these disclosures found (for example, in a disclosure letter or a disclosure schedule attached to the asset or business purchase agreement)?

Warranties are usually qualified by disclosure schedules, drafted by the seller and then delivered to the buyer. They are attached to the asset or business purchase agreement as an exhibit so that it is possible to say, after closing, what was disclosed by the seller to the buyer before the acquisition, and what was not.

Standard document, Asset purchase agreement: Cross-border: Schedule 16 complies with applicable Brazilian laws.

26. In the disclosures, do the sellers provide both general disclosures (disclosure of certain matters which appear in public records and/or which the buyer ought to be aware of based on searches or

enquiries which a buyer might/ought to make) and specific disclosures (relating to actual matters which if not disclosed would be in breach of warranty/warranties given in the asset or business purchase agreement)?

Sellers provide both general and specific disclosures. They usually do so to avoid a breach of warranty and the responsibility to indemnify the buyer. It is preferable to disclose extra information, rather than risking liability for some omission.

27. Are specific disclosures usually cross-referred to the warranties to which they relate?

Yes, disclosure schedules are usually numbered or referred to according to the number of the clause they relate to.

28. If a buyer has actual knowledge of a matter which qualifies a warranty (but this matter has not been formally disclosed by the sellers in the disclosure letter or disclosure schedule), can the buyer still sue for breach of warranty?

If the agreement provides for the seller's obligation to indemnify the buyer for pre-closing liabilities, whether or not the seller disclosed the liabilities to the buyer, and whether or not the buyer had actual knowledge of the matter, will not affect the seller's obligation to indemnify the buyer. The seller's obligation will be to indemnify the buyer for losses effectively suffered by the buyer, not only those suffered purely as a result of the breach of warranty.

However, if the seller is required under the agreement to indemnify for breach of warranty only (as opposed to indemnifying for losses effectively suffered by the buyer), the situation is more complicated. Where applicable, purchase agreements usually provide that the buyer's due diligence on the target company will not release the seller from its obligation to disclose all aspects of the business to the buyer, as well as to provide the buyer with all applicable representations and warranties. The buyer can always try to sue the seller for breach of warranty, but if there is sufficient proof that the buyer had full knowledge of the matter, the court may rule in favour of the seller. It is unlikely that a buyer will receive any indemnification for breach of warranty.

Compensation for breach of warranty would be calculated according to the material proof of the losses. The buyer must effectively demonstrate the damage and the value it represents. Evidence of the losses can be demonstrated by receipts for any disbursements, lawsuits, appraisal reports and other things. If there is no damage (or if the buyer was not able to prove it), there will be no indemnification for losses.

29. If there is a delay between signing and closing to satisfy a condition precedent, does the asset or business purchase agreement usually provide for warranties to be repeated at the time of closing?

If there is a delay between signing and closing to satisfy a condition precedent, the share purchase agreement usually provides for warranties to be repeated at the time of closing.

30. Is it common for the seller to take out insurance against warranty claims?

No, it is not common for the seller to take out insurance against warranty claims.

31. If the buyer is concerned about the seller's ability to pay compensation for breach of warranty, how could you address these concerns?

These concerns could be addressed in a guarantee, to be defined according to the details of the deal. It is very common to provide for an escrow account, a security on real estate assets, or a personal guarantee to protect the buyers' interest in the event of a breach of warranty.

32. Is it common to state that the purchase price is deemed to be reduced by the amount of any payment made under the warranties and indemnities? If so, is this wording effective for tax purposes (that is, that claims are treated as an adjustment to the consideration rather than being subject to capital gains or other relevant tax, to the extent the latter applies)?

It is common to insert this type of wording in the contract. The enforceability of this contractual arrangement from a tax point of view is uncertain. It will depend on the other circumstances and elements of the business.

There are cases where the price paid is qualified as an advanced payment of the purchase price, others where it is considered subject to further adjustments and others where it is considered to be the final price subject to an obligation of indemnification. Tax authorities tend to consider the whole of the value transferred to the seller or put at the seller's disposal as the price subject to tax. Any interpretation on this matter will also depend on the specific features of, and circumstances surrounding, the transaction.

33. Is it common to provide that the sellers will not compete with the target business for a given period after closing? If so, are there any restrictions on the duration and scope of these provisions?

It is reasonable and very common to include a non-compete clause. There are no legal restrictions concerning the territory, the duration and the scope of such a clause. However court decisions usually uphold restrictions based on reasonable standards, in light of the business or assets transferred and other circumstances applicable to the parties involved.

A non-compete clause cannot normally prevent sellers from operating in a business unrelated to the transferred assets or business. The territory covered by a clause should be limited to areas that present a relevant connection with the assets or business transferred, and a clause may be considered abusive if it encompasses a larger territory.

A non-compete clause should last for a reasonable period, and this restriction cannot be overridden by the market standards applicable to the relevant business. The reasonable period will be determined according to market standards, negotiation between the parties and the consideration related to the purchase. The courts have often held that the duration of a non-compete clause should be limited to five years.

Non-compete restrictions that are too broad and extensive may be difficult to enforce. For cross-border transactions, the same rules would apply, although it may be more difficult to restrict the territory if the assets are transferred cross-border.

34. Is it common to have an entire agreement clause (excluding liability for any representations or warranties made during the course of negotiations that are not included in the agreement)?

Yes, it is common. The wording of *Standard document, Asset purchase agreement: Cross-border: clause 26* is appropriate for Brazil. However, under Brazilian law, contracts are interpreted in accordance with the principles of good faith and customs of the place, and taking into account the intention of the parties, rather than by reference to the literal meaning of the document.

Therefore, there are limitations on the enforceability of entire agreement clauses. An entire agreement clause will not prevent the courts or the parties from relying on statements or documents "extrinsic" to the agreement that cast light on the meaning of the agreement and the implicit intention of the parties.

35. Can an asset or a business purchase agreement provide for a foreign governing law? If so, are there any provisions of national law that would still automatically apply?

An agreement can be governed by foreign law. If the agreement is governed by a foreign law, as dispute resolution mechanism, the parties should either make recourse to arbitration (see *Question 36*) or choose the courts of the same jurisdiction as the governing law as exclusive forum, to avoid misinterpretation, increased costs and bureaucracy. If the assets to be transferred are Brazilian, then all Brazilian tax laws relating to capital gain as well as local rules regarding the transfer of the shares will apply. If the target assets are located in Brazil, they will remain subject to local laws even if sold to a foreign entity under an agreement executed abroad and subject to foreign laws.

36. What form of dispute resolution is commonly provided for in asset or business purchase agreements?

Parties in dispute usually resort to arbitration rather than a judicial procedure lawsuit. This is because the parties may appoint specialised arbitrators who usually (but not always) have a better and more specific knowledge of the matters in discussion than regular court judges.

The arbitration procedure tends to be swifter than a lawsuit; lawsuits in Brazil usually take a long time to be concluded, with several instances of appeal and review of decisions. In addition, it is very common to elect a national chamber as the one competent for the dispute resolution (in the case of agreements governed by Brazilian law). The same considerations usually apply to cross-border transaction.

37. Is it common practice (or a legal requirement) that each page of the agreement, schedules and/or appendices are initialled by the parties on execution of the agreement?

It is common practice, although not a legal requirement, that all pages of the agreement and its schedules, appendices and exhibits are initialled by the legal representatives of the parties, to show that they have read and approved each page of the agreement (and not only the signature pages).

Digital signature software with authentication mechanisms is now widely used to certify signatures in documents and to authenticate documents issued by public authorities. In Brazil, a digital signature is only valid if supported by a digital certificate accepted by Brazil's Public Key Infrastructure. Scanned and electronic signatures are insufficient

to grant validity to a private contract. Authentication and certification services are provided in accordance with Brazil's Public Key Infrastructure by accredited certifying companies such as Boa Vista, Certisign, Digitalsign, OAB (Brazilian Bar Association), Serasa and Serpro.

38. In which scenarios is a shareholders' resolution required as one of the documents that the seller and/or buyer must deliver at closing?

A shareholders' resolution (or approval by any other relevant board) would be required if, according to the seller's or the buyer's bye-laws (or articles of association), since the shareholders must authorise in advance the execution of any of the closing documents. Specific shareholders' resolutions may also be required by the seller's or the buyer's bye-laws (or articles of association).

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