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M&A TRANSACTIONS INCREASE IN 2009

The retraction in the global economy at the end of 2008 and the beginning of 2009 hasn't slowed the mergers and acquisitions market in Brazil. According to a study by the National Association of Investment Banks (*Associação Nacional dos Bancos de Investimento – Anbid*), the volume of M&A transactions in the first quarter of 2009 was 31.9% greater, in terms of value, than the whole of 2008. The study shows that 20 transactions, totaling R\$132.4 billion, occurred in the first four months of the year.

"Consolidation has shown itself to be a good solution for companies in the current economic scenario. Given the lack of liquidity, due to falling revenues and the scarcity of credit, mergers and acquisitions are a way for companies to continue to grow or at least not lose market share, which is important for them if they are going to be well positioned when the market turns around," comments Alex Cukier, one of BM&A's corporate law partners.

Another noteworthy aspect of the growth in M&A transactions is the larger role nationally-owned companies have played, resulting in stronger Brazilian businesses which are better prepared to compete in the international market.

Acquisition of distressed businesses has also contributed to the significant number of M&A transactions during the economic crisis. "The recent M&A transactions include several companies under judicial recovery, whose debt restructuring debt involved an exchange of control or the entry of new shareholders who were able to provide funds to the company," explains Cukier.

The second quarter of the year also saw a large volume of mergers and acquisitions, and BM&A advised clients in a number of significant transactions.

At least until the end of 2009, mergers and acquisitions will be largely directed to the survival of large businesses, though the generation of economies of scale and preserving or increasing market share, and the movement toward internationalization of Brazilian businesses seen over the last few years is likely to continue.

"More M&A transactions are expected in the second half of 2009, especially in the financial, energy and civil construction sectors, and they will probably be selective and large-scale, following the trend established in the first half of the year," predicts Cukier.



Alex Cukier, partner of Corporate area at Barbosa Müssnich & Aragão

CVM CONSIDERS NEW PROXY RULES

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June 1st saw the end of public consultation on the new regulations on shareholder information and voting proxies proposed by the Brazilian Securities Commission (*Comissão de Valores Mobiliários* – CVM).

The draft regulations are inspired by the Proxy Regulations under the Securities Exchange Act of 1934 and create a new, compulsory document, similar to the proxy statement required in the United States, which must be circulated to shareholders when they are asked to grant a proxy for the exercise of their voting rights at shareholders' meetings.

The proposed regulations also establish rules on notices of shareholder meetings and the information and documents to be provided to shareholders on the matters to be considered at the meeting. The notice of meeting must state the minimum percentage of the company's capital to be represented by shareholders who request cumulative voting, reaffirming CVM Instruction 167/1991 on this point. In addition, the matters to be considered at the shareholder meeting must be specified in the notice of meeting, and the "general matters" topic currently permitted by CVM Instruction 341/2000 will no longer be possible.

According to the draft regulations, a proxy solicitation will be considered to be public, and therefore subject to the new requirements, when (i) it uses public means of communication, such as television, radio, periodicals, newspapers and websites; (ii) it is directed to more than five shareholders, if made by the management of the company or its controlling shareholder; or (iii) it is directed to more than 50 shareholders, if made by any other person.

Public proxy solicitations must be accompanied by information and documents related to voting rights and the matters on the agenda for the meeting, as well as other information and documents listed in the draft regulations, although this information and documentation can be posted on a website indicated in the proxy solicitation rather than being circulated in paper form.

Proxies granted in response to a public proxy solicitation must specify the vote to be cast on each of the matters referred to in the solicitation document. When officers, directors or members of the fiscal council will be elected at the shareholders' meeting, proxy solicitations made by the company's management must give shareholders to the option of voting for management candidates and for candidates nominated by shareholders who represent at least 0.5% of the company's capital.

Regardless of the media used, all material accompanying public proxy solicitations must be available to shareholders on the CVM's website at the time the request for proxies is made.

As for the costs associated with public proxy solicitations, the proposed regulations give the company the option of making a website available to allow shareholders to grant proxies on-line (with a function for identification of the users), or reimbursing investors for expenses incurred in making the public proxy solicitation, limited to publication of up to three newspaper announcements, printing and sending the proxy solicitations to the shareholders, and attorneys' fees. The company is required to reimburse 100% of these expenses if the candidate proposed by the investor is successful, and 70% if the candidate is not elected.

Companies that accept on-line proxies will be required to allow shareholders who represent at least 0.5% of the company's capital to include their proxy solicitations on the website, with equal emphasis given to all proxy solicitations, whether by minority shareholders, by management or by the controlling shareholder.

Lastly, the draft regulations deal with requests for a list of shareholders' addresses for the purposes of public proxy solicitations, pursuant to art. 126§3 of Law 6404/1976. According to the new regulations, a company is required to provide a list of its shareholders' addresses within two days after a request is made by shareholders who represent at least 0.5% of the company's capital. The company can require authentication of the signature on the request, copies of documents that prove that the person signing the request has powers to represent the requesting shareholder, and a declaration by the shareholder that the list will be used to make a public proxy solicitation, but no other requirement can be imposed by the company, and no fee can be charged for furnishing the information.

Public proxy solicitations under CVM's proposed regulations could well become an efficient means of shareholder representation at shareholder meetings. By giving shareholders the possibility of granting proxies on-line, the new regulations may help solve a constant problem in companies with a high degree of shareholder dispersion: the difficulty in achieving a quorum at shareholders' meetings. The ease of granting electronic proxies may encourage more shareholders to participate.

In the United States, the implementation of the SEC's Notice and Access system of electronic proxies has resulted in a significant reduction in the costs of mailing proxy kits and, at the same time, a considerable decline in actual attendance at shareholders' meetings.

ARTICLE 745-A OF THE CODE OF CIVIL PROCEDURE AND EXECUTION OF JUDGMENT DEBTS

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The reform of judicial procedure that began in 2005 was clearly intended to speed up the enforcement process and so ensure that creditors can obtain quick and efficient satisfaction of the debts owed to them. While many different means can be employed to improve the enforcement of debts, there can be no doubt that the objective itself is essential not only to a market economy, but also to any judicial system that wishes to project legal security to its users and to society in general.

Article 745-A of the Code of Civil Procedure (“CCP”) acquires particular importance in this context, since it encourages debtors to pay their debts rather than challenge execution proceedings, by offering the benefit of payment in installments: “Within the time period for filing an opposition to execution, the execution debtor may, by acknowledging the debt owed to the execution creditor and depositing 30% of the amount under execution, including court costs and attorneys’ fees, apply to pay the remainder in up to six monthly installments, subject to adjustment for inflation and interest of 1% per month.”

The possibility of acknowledging the debt, paying down 30% and paying the rest in installments was created by Law 11,382/2006, which governs execution proceedings based on extrajudicial title. Opening a small parenthesis, Brazilian law allows creditors to proceed directly to execution when their claim is certain, liquid and enforceable, and the document evidencing the debt meets certain formal requirements. This summary process is referred to as an “execution proceeding based on extrajudicial title” because it is not based on “judicial title” or, in other words, on a judgment by a court.

The question that arises is whether the same option is open to execution debtors in execution proceedings based on a judgment. In other words, does article 745-A apply in the case of execution proceedings based on judicial title?

Article 475-R of the CCP provides that “the rules that govern execution proceedings based on extrajudicial title have secondary application to the execution of judgments.”

Despite this provision, the courts are not unanimous on the question of whether an execution debtor can opt to pay his debt in installments during the phase when judgment is being enforced, not least because of the procedural differences between the two types of execution proceedings for collection of liquid and certain amounts.

In enforcement of judgments, the execution debtor is given notice to pay within 15 days, on pain of a 10% fine,

pursuant to article 475-J of the CCP: “If a debtor who has been found liable to pay a sum that is certain or that has been liquidated fails to make payment within fifteen days, the amount of the award shall be increased by a fine of ten percent and, on application by the creditor and subject to the provisions of art. 614 (II) of this Law, a warrant of attachment and evaluation shall be issued.”

In a significant part of the cases decided by the Court of Appeal of São Paulo, the court has taken the position that allowing the debtor the benefit of paying the award in installments pursuant article 745-A of the CCP would contradict the provisions of article 475-J of the CCP, which makes failure to pay subject to a 10% fine over the unpaid amount. In addition, this line of cases argues that there is no express provision in the legislation that would allow article 745-A to apply to payment of judgment debts.

In short, this school of thought finds a logical incompatibility between articles 745-A and 475-J, and concludes that payment in installments can apply only in execution proceedings based on extrajudicial title.

However, there are a number of other decisions by the Court of Appeal of São Paulo that take the opposite view, finding that article 745-A of the CCP does apply to enforcement of judgment debts. In this line of cases, the court refers to the principle of effective process established in art. 5 (LXXVIII) of the Federal Constitution and reasons that it is more advantageous to the creditor to have the debtor acknowledge the enforceability of the debt and pay it in installments than to have the debtor drag out the enforcement proceeding through challenges and oppositions. This school of thought also finds support for its interpretation in art. 620 of the CCP, which provides that executions should be processed in the manner that is least onerous for the debtor.

In an attempt to reconcile article 475-J and 745-A of the CCP, a number of these cases hold that even where the debtor deposits 30% of the judgment debt and applies for payment in installments, the 10% fine under article 475-J applies to the part of the debt not secured by the initial 30% deposit.

Clearly, the precedents on the question of whether judgment debtors can benefit from payment in installments under article 745-A of the CCP are still unsettled. The trend seems to be, however, that article 745-A is restricted to execution proceedings based on extrajudicial title and does not apply in proceedings to enforce judgments.

LAW 11,941/2009: A NEW DEFINITION OF “RELATED COMPANY”

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On May 27, 2009, Provisional Measure 449 of December 3, 2008 was converted into Federal Law 11,941. In addition to amending the federal tax legislation on payment in installments of tax debts and granting tax amnesties in some cases, Law 11,941/2009 changed the definition of “related companies” (*sociedades coligadas*) under article 243 of the Brazilian Corporations Law (Law 6404/1976). Companies are now related when “the investing company has a significant influence”, whereas formerly companies were related if one held an interest of 10% or more in the other, without controlling it.

According to article 37 of Law 11,941/2009, one company will have a significant influence over another when it holds or exercises the power to participate in decisions on financial or operational policies, but does not control the other company. The Law also provides that significant influence is presumed to exist when one company holds at least 20% of the voting stock of another, but does not control it.

Compared with the earlier definition of related companies, the legislator not only increased the interest one company must hold in another (from 10% to 20%), but also, by referring to voting rather than total stock, emphasized the importance of the influence exercised by one company over the management of the other. The concept of significant influence has thus acquired an important role in identifying related companies, especially since the minimum holding fixed in the legislation now establishes only a presumption that companies are related.

“Significant influence”, or the “power to participate in decisions on another company’s financial or operational policies” to use the words of Law 11,941/2009, is subject to different interpretations. As a result, in situations where companies are not presumed to be related because one does not hold at least 20% of the voting stock of the other, it will be necessary to examine the actual involvement of the investing company in the financial and operational management of its affiliate. Obviously, objective criteria for determining what constitutes “significant influence” are needed, otherwise the decision as to whether companies are related will be left to the agents responsible for enforcing the provisions of Law 11,941/2008, opening the way to subjective interpretations, especially in borderline cases. It is not clear, for instance, that “significant influence” exists when a shareholders’ agreement provides for a veto

on certain operational matters, or the right to appoint a member of the board of directors.

The new definition of related companies had appeared in similar form in the amendment made by Law 11,638 of December 28, 2007 to article 248 of the Brazilian Corporations Law, which deals with investments that are subject to the equity method of accounting. As amended, article 248 provides that the equity method applies to “investments in which the corporation has a significant influence over the company’s management or in which it holds 20% or more of the company’s voting stock, and investments in controlled companies and in other companies that are part of the same group or are under common control.” One of the changes introduced by the amendment was to exclude the adjective “relevant” to describe the investments subject to the equity method, adding the notion of “significant” influence.

The changes introduced to the concept of a related company by Law 11,638/2007, however, were limited to accounting matters. Now, the definition of related companies has been systematically unified in the Brazilian Corporations Law, and all references in the legislation to “related company” must be interpreted according to the new concept of “significant influence”.

As a result, businesses will have to review their investments in related companies to ensure that they are still in compliance with article 244 of the Brazilian Corporations Law, which prohibits reciprocal holdings between related companies. Information on related companies in management’s annual report and in explanatory notes to financial statements, required by articles 243 and 247 of the Brazilian Corporations Law, will also be affected.

However, the concept of “related company” now established in the Brazilian Corporations Law applies only for the purposes of that legislation. In some cases, special legislation establishes a different definition, or refers to the definition to be adopted. If the special legislation is silent on the meaning of the term “related company”, the general rule under Law 11,941/2009 will apply, which provides that the concept of related companies established in article 1099 of the Civil Code (“a company in which another company holds ten percent or more of its capital, but does not control it”) should be used.

MAJOR CHANGES COMING IN THE REGULATIONS ON SECURITIES ISSUES AND TRADING

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In recent months, the Brazilian Securities Commission (*Comissão de Valores Mobiliários – CVM*) has submitted draft regulations for public consultation and made a number of changes to the rules governing securities issues and trading in securities. The CVM's initiatives include:

Public Consultation 07/2008 – Draft regulations on registration of listed companies – Public Consultation on the regulations that will replace CVM Instruction 202/1993 ended on May 30th and the CVM is now reviewing the results of the consultation process. The new regulations will govern registration of publicly-traded companies. One of the biggest changes proposed by the CVM is the replacement of the Annual Information form (IAN) by a Reference Form (*Formulário de Referência*). The new form will be more complex than the current IAN and its contents will be similar, in large part, to those of a prospectus. The idea behind the change is that listed companies should disclose more and better information to the market on a regular basis, and submit a simpler document to supplement the basic Reference Form when they make public offerings. The procedure is similar to offerings in the United States using the 20F and F3 forms, and is inspired by the Shelf Registration System defined by the International Organization of Securities Commissions. Another innovation is the classification of listed companies into three categories, based on the markets in which their securities are traded. The information companies are required to disclose in their Reference Forms will reflect their classification.

Public Consultation 01/2009 on amendments to CVM Instruction 400/2003 – In Public Consultation 01/2009, the CVM asked for comments on proposed amendments to CVM Instruction 400/2003, particularly with respect to: (i) public securities offerings by small and mid-sized companies; (ii) the blackout period; (iii) limitation of the obligation to carry out a viability study; (iv) the silent period; and (v) trading by market makers. Of particular interest is the CVM's proposal to limit issuers' obligation to carry out a viability study to cases when the offering is for the formation of a company and when the issuer is in the pre-operational phase. The proposed change is based on the fact that issuers routinely request a waiver of the viability study, and the significant risk that viability studies represent for the issuer, especially when the offering is international, because such studies necessarily involve projections and estimates. In fact, the volume of applications for a waiver of the viability study requirement has been so great that the CVM has issued a specific ruling (*Deliberação 533/2008*) on the matter. Another point worth

highlighting is the amendment to fix the length of the silent period, which is left open by the current regulations. The CVM proposal is that the silent period begin 60 prior to the date of application for registration of the offering.

Public Consultation 04/2009 on regulations to replace CVM Instruction 122/2009 – In this public consultation, the CVM presents proposed regulations establishing procedures and ethical standards applicable to securities brokering in regulated markets. Under the proposed regulations, securities brokers would be required to adopt a compliance standard throughout their organizational structure, replacing the traditional compliance function, in which only certain persons are responsible for monitoring securities transactions. In its proposal, the CVM introduces the concept of suitability, and securities brokers would be required to determine whether a given transaction is suitable to the client's profile. If brokers believe that the transaction does not fit their clients' profile, they would be required to obtain a declaration from the client stating, among other things, that the client is aware of the risks of the transaction.

CVM Instruction 476/2009 – In these regulations, the CVM deals with public securities offerings with restricted sales efforts and trading in such securities. According to Instruction 476/2009, commercial paper, bank credit certificates (*cédula de crédito bancário*, a negotiable promissory note issued in favor of a financial institution) that are not backed by the financial institution, non-convertible debentures and real estate or agribusiness receivable-backed securities may be distributed through restricted sales efforts offerings. Offerings of this type must be directed only to qualified investors, through registered securities brokers. No more than 50 investors may be approached and no more than 20 investors may acquire the securities. Investment funds will count as a single investor if the investment decisions of the funds are made by a single manager. The securities may only be traded on the regulated markets 90 after the offering, and cannot be traded on the stock exchange unless the issuer is a listed company. This restriction will not apply if the issuer subsequently registers with the CVM and submits a prospectus, in accordance with applicable regulations.

Together with Instruction 476/2009, the changes the CVM proposes to make in the Brazilian securities regulations are significant, and the new regulations, when issued, will have a considerable impact on the Brazilian market.

THE SUPERIOR COURT OF JUSTICE AND THE TAX LIABILITY OF SHAREHOLDERS AND MANAGERS

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The 1st Section of the Superior Court of Justice (*Superior Tribunal de Justiça* – STJ, Brazil’s highest court on non-constitutional matters), which is responsible for ensuring uniformity in decisions involving federal tax issues, recently issued important judgments on the tax liability of shareholders and managers of legal entities (art. 135 of the National Tax Code).

The importance of the decisions comes from their potential effect on all similar cases pending before the Superior Court of Justice and other federal and state appeal courts throughout the country, since the STJ’s judgments follow the rule under art. 543-C of the Code of Civil Procedure (CCP), which provides for “repetitive appeals” and requires all courts of second instance to apply the interpretation of the law adopted by the STJ.

In Special Appeal no. 1.101.728, the STJ confirmed that the simple failure by a legal entity to pay tax when due is not enough to impose personal liability on the entity’s shareholders and managers. In other words, shareholders and managers will have personal liability only when they act beyond the limits of their powers, or contrary to the law or the bylaws or articles of association of the company, as provided for in art. 135 of the National Tax Code.

The judgment in Special Appeal no. 1.104.900 settles questions related to the burden of proof of tax liability and the appropriate procedural instrument for defense of shareholders and managers who are defendants in tax collection proceedings.

The STJ decided that when a shareholders’ or managers’ names appear on the Certificate of Tax Debt Subject to Collection (*Certidão de Dívida Ativa*, which must be presented in order to bring an action to collect taxes), it falls to them to prove that they had no involvement in the events that gave rise to the tax debt or that they did not act outside the scope of their powers or contrary to the law or the company’s bylaws or articles of association. In effect, the STJ took the position that the presumption that a tax debt included in the list of Tax Debts Subject to Collection is liquid and certain presupposes the shareholder’s or manager’s liability for the debt.

The STJ’s conclusion on this point is worrying, since it could encourage the practice of automatically including managers and shareholders in tax

collection proceedings against legal entities, without investigation into their effective responsibility for the debt, and without giving them the opportunity to challenge the administrative decision to hold them liable for the company’s tax debts.

Another source of concern is the potential difficulty of producing evidence in favor of the manager or shareholder in certain cases, particularly given that they have the burden of proving a negative: that they did not act outside the scope of their powers or contrary to the law or the company’s bylaws or articles of association. Evidence of the individual’s function and powers within the company, and the period of time he or she was associated with the company, could be fundamental to the success of the defense, and to avoiding attachment of the individual’s property by reason of the company’s tax debts.

The STJ’s decision also considered the procedural instrument that shareholders and managers should use to defend their interests in tax collection proceedings. The STJ held that when the defense involves the production of evidence, the appropriate instrument is an opposition to execution (*embargos à execução*), which requires the petitioner to present security for the debt under collection, in one of the forms provided for in the legislation (deposit into court, bank guarantee, assets, shares and other rights, among others).

In the STJ’s view, the “pre-execution exception” (*exceção de pré-executividade*), which is a plea that raises preliminary questions going to the validity of the instrument on which the collection is based or the enforceability of the debt itself and does not allow for the submission of evidence, can be used only when the defense involves questions of law alone, which the court can decide *ex officio*, such as the allegation that the debt is time-barred.

In summary, while on one hand the STJ confirmed that shareholders and managers cannot be held liable for any and all tax debts owed by legal entities, on the other it imposed a significant procedural burden on managers and shareholders involved in tax collections against legal entities, who will now have to take even greater care in order to protect their personal property from liability for corporate tax debts.

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GRAPHIC DESIGN AND LAYOUT
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PHOTOLITHO Davanzo
PRINTED BY J. Sholna

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The BM&A Review texts were produced by Barbosa, Müssnich & Aragão Advogados, BM&A Consultoria Tributária and BM&A Propriedade Intelectual professionals.

