

**LIMITED LIABILITY COMPANIES
UNDER THE NEW BRAZILIAN CIVIL CODE**

With the enactment of Law n. 10.406, of January 10, 2002 (New Brazilian Civil Code - "NCC"), the Brazilian legal framework applicable to private relations will change considerably. The NCC will only become effective as of January 11, 2003, but Brazilian legal doctrine is already trying to anticipate the discussions that may arise with respect to the most controversial issues in the new Code.

We point out herein some of the innovations and controversial questions raised by the NCC with respect to the regulation of limited liability companies. It is important to note that the conclusions we have reached are preliminary and none of the opinions herein stated may be considered conclusive, for the NCC may be amended even before it becomes effective. In fact, there are already a number of Bills with the purpose of amending several provisions of the NCC, including Bill n. 6.960, of 2002, which provides for a number of changes as regards limited liability companies.

(i) Applicable legislation

Limited liability companies (LIMITADAS)¹ are currently governed by Decree 3.708, of January 10, 1919, and are called *sociedades por quotas de responsabilidade limitada*. Such companies are commonly used in Brazil, especially because their legal and managerial structures are more flexible than those of *sociedades anônimas* (CORPORATIONS)². Quotaholders' liability is limited to the total amount of unpaid

¹ Note: Please note that with the exception of joint ventures (consortium and *sociedades em conta de participação*), all other kinds of associations are incorporated legal entities in Brazil. Thus, Brazilian law does not acknowledge the concept of a partnership as it exists in US law. Therefore, a limited liability company (LIMITADA) is an incorporated legal entity.

² Note: We shall use the word CORPORATION to designate *sociedade anônima*, which is the Brazilian equivalent to the Spanish *sociedad anónima*; the French *société anonyme*; the Italian *società per azioni* and the German *aktiengesellschaft*.

capital; once the corporate capital is fully paid up no further liability applies to quotaholders, except those quotaholders who are in charge of the management of the LIMITADA, as regards unpaid taxes, social security and labor debts.

However, once the NCC becomes effective, LIMITADAS will lose some of their flexibility and running costs will increase. LIMITADAS will be governed by the provisions of Book II, Title II, Subtitle II, Chapter IV of the NCC and will be called simply *sociedades limitadas* (limited companies). The NCC does not change quotaholders' liability.

(ii) Adaptation of existing LIMITADAS to the NCC

As mentioned above, the NCC will only become effective as of January 11, 2003. However, pursuant to article 2.031 of the NCC, LIMITADAS that were incorporated before the NCC becomes effective will have one year, from the date on which the NCC becomes effective, to adapt themselves to its provisions. Thus, existing LIMITADAS will have from January 11, 2003 until January 11, 2004 to adapt to the NCC. Nevertheless, it is important to point out that article 2.033 of the NCC provides that any amendment to the articles of association of a LIMITADA, as well as any corporate reorganization, will be governed by the provisions of the NCC as of January 11, 2003.

(iii) Applicable legislation in case either the NCC or the articles of association are silent

Decree n. 3.708/19 (article 18) currently provides that the Brazilian Corporations Law (Law n. 6.404, dated December 15, 1976, as amended) shall apply to LIMITADAS in case the articles of association are silent.

However, article 1.053 of the NCC sets forth that, in case of silence of Chapter IV (articles 1.052 through 1.087) of the NCC, LIMITADAS shall be governed by the

provisions of the NCC applicable to *sociedades simples* (Chapter I – articles 997 through 1.038), which are defined as companies that are not engaged in business activities (*atividades empresariais*), namely, economic activities carried out for the production or sale of goods or services. The Brazilian Corporations Law will only govern LIMITADAS if it is so provided for in their articles of association. The Brazilian Corporations Law was enacted in 1976 and, although it has been amended several times, most of the controversies raised with respect to its provisions have been solved. Therefore, we recommend that the articles of association of existing LIMITADAS should be amended in order to provide expressly that the Brazilian Corporations Law will apply in case either the NCC or the articles of association are silent.

Pursuant to Bill n. 6.960, article 1.053 of the NCC should be amended to provide that LIMITADAS will be governed by legislation applicable to CORPORATIONS, as currently set forth in article 18 of Decree n. 3.708/19, in case Chapter IV of the NCC is silent.

(iv) Participation of foreign companies in the corporate capital of LIMITADAS

Pursuant to article 1.134 of the NCC, foreign companies may participate in the corporate capital of Brazilian CORPORATIONS (*sociedades anônimas*). Because the possibility of foreign companies participating in the corporate capital of Brazilian LIMITADAS is not expressly permitted, one could ask if such participation is not allowed.

The above mentioned article 1.134 has about the same wording of article 64 of Decree Law n. 2.627, of September 26, 1940. Legal doctrine and court decisions have construed article 64 as applicable to CORPORATIONS because Decree-Law n. 2.627/40 governs exclusively such kind of companies, which does not mean to say that it implicitly prohibits the participation of foreign investors in other kinds of companies. Therefore, pursuant to such understanding, in the absence of specific prohibition, LIMITADAS may have foreign participation.

The problem we face with respect to the NCC is that article 1.134 is a general rule, in a chapter that applies to all kinds of companies, and not only to CORPORATIONS. Therefore, we cannot anticipate if the interpretation of article 64 of Decree Law 2.627/40, which allows the participation of foreign companies in the corporate capital of LIMITADAS, will be kept with respect to article 1.134 of the NCC.

(v) May a legal entity be a manager of a LIMITADA?

Decree 3.708/19 allows legal entities to be managers of LIMITADAS, but management in such cases must be delegated to individuals. It is not clear under the NCC if managers of LIMITADAS must be individuals or if legal entities may also be appointed. Article 1.060 provides that these companies should be managed by one or more persons (*peçoas*), which, in Portuguese, means both individuals (*peçoas físicas*) and legal entities (*peçoas jurídicas*). On the other hand, article 997, VI, which lists the clauses that must be stated in the articles of association of *sociedades simples* (see item (iii) above) sets forth that only individuals can be managers of *sociedades simples*. However, article 1.054 provides that article 997 shall also govern the articles of association of LIMITADAS, as applicable. Pursuant to Bill n. 6.960, article 1.060 should be amended to provide that only individuals may be managers of LIMITADAS.

(vi) Quotaholders' meetings

In accordance with article 1.072 of the NCC, resolutions of quotaholders may be passed in a *reunião* or in an *assembléia*, both of which mean “a meeting” and the basic difference is that an *assembléia* is mandatory when a LIMITADA has more than 10 quotaholders and has to be called through publication of notice. Such publication may be dispensed with if all quotaholders are present or acknowledge in writing the place, date, time and agenda of the relevant meeting.

The LIMITADA with more than 10 quotaholders must hold at least one quotaholders formal meeting annually to approve the financial statements, as required for CORPORATIONS. Unless the articles of association specifically regulate the informal meetings, a LIMITADA with less than 10 quotaholders will have to observe the same rules and formalities required by the NCC for formal meetings³.

According to article 1010 of the NCC, votes are counted according to the par value of the quotas, since quotas may have different par values (see vii below). However, in case of a dead-lock, paragraph two of article 1010 provides that the resolution will be passed by a majority of quotaholders, irrespective of the number of quotas held by each one of them. If the dead-lock remains the case will be decided by a Court. This may be one of the most relevant changes introduced by the NCC and may substantially affect LIMITADAS whose quotaholders are not members of the same group. It is too soon to anticipate to what extent establishing otherwise in articles of association or quotaholders agreements will prevail in courts over such provision of the NCC. LIMITADAS which are practically wholly-owned subsidiaries and can guarantee the unanimous vote of quotaholders at all times will not be affected.

Pursuant to Decree n. 3.708/19, resolutions of quotaholders are passed by a majority of votes (that is, 50% plus). The NCC sets forth minimum voting requirements with respect to some subjects. In some cases, the NCC provides that the articles of association may adopt different voting requirements from those established in the NCC, such as decisions about the removal of managers who are quotaholders, by votes representing 2/3 of the corporate capital (article 1.063, first paragraph). In other cases, the NCC provides for mandatory voting requirements, which cannot be reduced by the articles of association, such as:

- (a) the appointment of managers who are not quotaholders, if permitted by the articles of association, by the unanimous vote of the quotaholders, if the corporate capital is not yet paid-up, and by 2/3 of the votes, if the corporate capital has been paid-up (article 1.061);

³ It should be noted that the law does not define what is a formal or an informal meeting.

- (b) amendments to the articles of association, mergers, amalgamations, dissolution of the company or termination of a winding-up process, by votes representing at least 3/4 of the corporate capital (article 1.076, I);
- (c) the appointment of managers in a separate document, the removal of managers, the remuneration of managers and the application for *concordata* (similar to a Chapter 11 reorganization) by votes representing at least 1/2 of the corporate capital (article 1.076, II); and
- (d) in other cases not provided for either by the law or by the articles of association, by the votes of the majority of the quotaholders attending the relevant meeting (article 1.076, III).

(vii) Divisibility of quotas

The corporate capital of a LIMITADA is divided into quotas, which may have the same par value or not. According to Decree n. 3.708/19, quotas are indivisible. Pursuant to article 1.056 of the NCC, quotas are indivisible as regards the company, except with respect to their transfer. In such case, article 1.057 will apply. This article provides that, if the articles of association are silent, a quotaholder may transfer its quota, wholly or partly, to another quotaholder (without the approval of the other quotaholders) or to a third party (if there is no opposition of quotaholders holding 1/4 of the corporate capital).

It is not clear what kind of consequences the divisibility of quotas will bring about. It is possible to hold that in case of a partial transfer a condominium will be established; it is also possible to hold that new quotas will be created with the fraction of the former. We believe that, in most companies, the divisibility of quotas will have no practical effect, since the par value of quotas is usually very low (for instance, R\$ 1,00) and the same for all quotas; therefore, it is not likely that there will be any partial transfer of quotas. In any event, in order to avoid doubts of interpretation, we recommend that the articles of association of LIMITADAS should be amended to provide for a low par value equal for all quotas (i.e. R\$ 1,00) and that quotas be made indivisible.

(viii) Audit Committee

The NCC expressly provides that LIMITADAS may have an Audit Committee (*Conselho Fiscal*). The members of the Audit Committee may be quotaholders or not, but must be residents of Brazil. The responsibilities of the members of the Audit Committee are set forth in article 1.069 of the NCC, but their main responsibilities are to examine the company's books and issue their opinion with respect to the company's financial condition, and inform about mistakes, fraud, crimes they might find out or become aware of, recommending the appropriate or necessary measures to be taken by the company.

It should be noted that the NCC does not contemplate the possibility of LIMITADAS having a Board of Directors (*Conselho de Administração*).

(ix) Capital reductions

The Brazilian Corporations Law provides that the shareholders may resolve upon the reduction of the corporate capital in two cases: if there are losses, up to the amount of the accrued liabilities (*prejuízos acumulados*) or if they think the corporate capital is overestimated (article 173).

In accordance with article 174 of the Brazilian Corporations Law, capital reductions with the refund to the shareholders become effective 60 days after publication of the minutes of the relevant meeting. During this period, the company's unsecured creditors (*credores quirografários*) may oppose the capital reduction. Once that term expires, the minutes of the meeting may be registered with the Trade Board.

There are no provisions in Decree n. 3.708/19 with respect to the reduction of the capital of LIMITADAS. But, according to Trade Board regulations, there is no need to wait the 60-day term to register a capital reduction with respect to LIMITADAS.

The provisions of the NCC applicable to capital reductions are very similar to the provisions of the Brazilian Corporations Law on the matter.

In accordance with article 1.082 of the NCC, LIMITADAS may reduce their corporate capital by amending the articles of association, in the following cases: (i) after the corporate capital is paid-up, if there are irreparable losses; and (ii) if the corporate capital is overestimated in relation to the company' s purposes.

In the case of item (i) above, the capital reduction shall be made by reducing the par value of quotas proportionately and it becomes effective upon registration of the minutes of the relevant meeting in the competent Trade Board.

In the case of item (ii) above, the capital reduction shall be made by refunding a portion of the capital to the quotaholders or by canceling the obligations that are still pending, provided that in both cases there shall be a proportionate reduction of the par value of the quotas. In this case, the NCC provides that the capital reduction becomes effective 90 days after publication of the minutes of the relevant meeting. During this period, the LIMITADAS' unsecured creditors (*credores quirografários*) may oppose the capital reduction. Once that term expires, the minutes of the relevant meeting may be registered with the competent Trade Board.

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/s/

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