THE ECONOMIC FREEDOM ACT

CLIENT ALERT

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THE REAL DEAL OR NOT MORE THAN A STATEMENT OF GOOD INTENTIONS?

On September 20, 2019, Law No 13.874 (the so called "Economic Freedom Act", or "EFA"), entered into force. The EFA was originally introduced in the Brazilian legal system by means of Provisional Presidential Measure (*Medida Provisória*) No. 881, published on April 30, 2019 ("MP 881"), with the stated aim of promoting a "cultural change in the relations between public authorities and private agents".

The EFA establishes that the state intervention in private relations shall be exceptional and has several provisions aiming at reducing the Brazilian red tape. The EFA has other business friendly provisions (for example, including in written law certain precedents of the Superior Court of Justice ("STJ"), regarding the disregard doctrine *(desconsideração da personalidade jurídica).*

All in all, the EFA is an important piece of legislation that can have lasting positive effects in the way business is done in Brazil. Of course, the cultural change which is required to make it effective will only come if the principles and provisions of the EFA are embraced (and genuinely supported) by the public servants in all levels of government, including the Brazilian judges that may be requested to apply these principles in court cases.

We have prepared a brief guide with the main changes introduced by the EFA relating to the so-called rights of economic freedom, and provisions that may affect private relations.

1. GUIDING PRINCIPLES

Brazilian bureaucracy is infamous. Brazil is placed 110th (out of 190) in the Doing Business World Bank ranking, and performs appallingly in some sub-rankings that relate to interactions with the State: starting a business (140th out of 190), construction permits (175th out of 190) and paying taxes (184th out of 190). In addition, Brazil is one of the most (if not the most) litigious countries in the world, with the Brazilian Courts having received an staggering 28 million new cases in 2018, or almost 11.8 thousand cases per 100,000 population. Laws such as EFA aim to bring these numbers to a more rational level, which would enable Brazil to more fully exploit its potential.

The EFA states the following as guiding principles: (i) guarantee of freedom in the exercise of economic activities; (ii) the good faith of the individual before the public authorities; (iii) the subsidiary and exceptional State intervention in the exercise of

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economic activities; and (iv) the recognition of the vulnerability of the individual before the State.

Some of these statements are not new (the Brazilian 1988 Federal Constitution, for example, already provided for free enterprise right, free exercise of economic activity and the minimal and exceptional intervention of the State in the exploitation of economic activity), but in practice these rights are routinely denied, making it notoriously difficult for private agents to initiate and develop economic activities in Brazil.

Some examples of the presence of the guiding principles described above:

(i) Article 3, subparagraph I of the EFA, which provides that so-called "low risk economic activities" can be developed without the need of any authorization for the entrepreneur to exercise the respective activity. The low-risk activity classification, however, will depend on further guidance from the Executive Branch; and

(ii) Article 3, subparagraphs IX and X of the EFA, which respectively provides that the individual (a) shall be immediately and promptly informed of the maximum period stipulated for the examination of their request, and the expiration of such deadline will imply tacit approval for all purposes, except in the cases expressly forbidden by law and (b) may file any document through microfilm or digital media (according to requirements to be established by regulation), which shall be treated as a physical document for all legal purposes.

2. AUTONOMY OF WILL AND INTERPRETATION OF CONTRACTS

2.1. Contract Interpretation

The EFA introduced interpretation guidance to Article 113 of the Civil Code. According to the EFA, the following shall also guide interpretation of a contract: (i) if the contract is confirmed by the behavior of the parties after the conclusion of the deal; (ii) correspond to market usages, customs and practices related to the type of business; (iii) correspond to good faith; (iv) is more beneficial to the non-drafting party; and (v) correspond to what would be the reasonable negotiation of the parties on the issue discussed, according to the other provisions of the business and the economic rationality of the parties.

In addition, a second paragraph has been inserted in Article 113 of the Civil Code to provide that parties may freely agree on rules for the interpretation, filling of gaps and integration of legal transactions other than those provided for by law, which means that the parties will be free not only to stipulate additional interpretative rules, but also to amend or even exclude the application of the new interpretative rules set out by the Economic Freedom Act.

2.2. The limits of the social function of the contract

The EFA included a provision in article 421 of the Civil Code to qualify the doctrine of "social function" of a contract by stating that "in private contractual relations, the principles of minimum intervention and the exceptionality of contractual revision shall prevail."

The original wording of Article 421 of the Civil Code (that specified the "social function" of contracts) had a general nature, giving great margin to the discretion of the Judiciary Branch in specific cases. Often, this exercise entailed a judicial reinterpretation of contractual rights and obligations, causing insecurity and unpredictability to contracting parties. The EFA aims at avoiding excessive judicial intervention or activism in private contractual relations. It remains to be seen how this innovation will be applied from now on by the Judiciary Branch.

2.3. Contract review or termination parameters

The EFA also introduced Article 421-A to the Civil Code, to provide that civil and business contracts are assumed to be equal and symmetrical until the presence of concrete elements justifying the removal of this presumption, except for the legal regimes provided for in special laws and also ensuring that (i) the parties may establish objective parameters for the interpretation of the negotiating clauses and their review or resolution assumptions; (ii) the risk allocation defined by the parties is respected and observed; and (iii) the contractual review only takes place in an exceptional and limited manner

This provision does not exactly represent a change in the legal system, but only serves the purpose of reinforcing private autonomy, expressly stating that the parties will be free to stipulate the terms and conditions of the contracts they enter

into and that, in relation to the matters defined, the contractual revision by the Judiciary Branch should be an exceptional measure.

In this respect, the Economic Freedom Act reinforced the principle of the contracts' obligation (*pacta sunt servanda*).

3. DISREGARDING OF THE CORPORATE ENTITY

3.1. Changes in the Civil Code

Although limited liability is the general rule in Brazil, Brazilian statutes may subject shareholders (and managements) of Brazilian entities to residual liability for certain types of liabilities. As a matter of practice judges have imposed residual liability to direct and indirect shareholders of Brazilian companies (and even affiliates and directors/officers) for – among others - labor and consumer protection liabilities of Brazilian entities. There have been instances in which judges went after the ultimate parent and (in labor cases) other companies members of the same economic group. Both labor and consumer protection relations tend to have a 'social' or 'distributive' approach (employees and consumers are deemed the 'weak link of the chain') and judges will often pay lip service to the concept of limited liability or reject it altogether.

The EFA - unfortunately – had a somewhat timid approach by inserting in the written law certain precedents already established by the STJ, with respect to the disregard doctrine in the Civil Code only (not necessarily in other contexts such as labor, consumer, environmental and anti-corruption, for example).

Article 50 of the Civil Code, in its original wording, provided that the abuse of legal personality would be characterized by misuse of purpose or patrimonial confusion (concepts hitherto not defined in the Civil Code).

With the new wording included by the EFA, (i) it was stated in the Article 50 that only the managers or partners of the legal entity directly or indirectly benefited by the abuse may have their private assets affected as a result of the disregard and (ii) defined the concepts of misuse of purpose and patrimonial confusion.

With regard to the definition of misuse of purpose, the EFA states that the express intent (of the beneficiary partners or administrators) to injure creditors or to perform illegal actions is now required; the EFA also defines patrimonial confusion as the company's repetitive fulfillment of its partner or manager's obligations (or vice versa) and the transfer of assets or liabilities without effective consideration (or the practice of other acts of breach of patrimonial autonomy).

Another provision was also introduced in the sense that the existence of an economic group without the presence of a misuse of purpose or patrimonial confusion does not authorize the disregarding of the corporate entity (under the terms of fourth paragraph of Article 50) and does not constitute misuse of purpose merely the expansion or alteration of the original purpose of the specific economic activity of the company (under the terms of fifth paragraph of article 50).

Although already recognized by Law No. 13.105 of March 16, 2015 (Code of Civil Procedure), the "inverted" disregard of the corporate entity (i.e. the possibility of extending the obligations of partners and/or managers to the company in case of misuse of purpose and patrimonial confusion) was inserted in Article 50 of the Civil Code.

In addition, an express provision was also inserted in the Civil Code, by including Article 49-A, in the sense that the company shall not be confused with its partners, associates, founders or managers and that the patrimonial autonomy of legal entities is a lawful instrument with the purpose of stimulating enterprises, for the generation of jobs, tax, income and innovation for the benefit of all.

It is important to note that the new rules on disregard of the corporate entity are restricted to civil matters and do not specifically apply to the discussion of labor, environmental, consumerist and other such liabilities, which are regulated by specific laws.

4. LIMITATION OF PARTNERS' LIABILITY

4.1. One-member limited liability company

An important innovation introduced by Economic Freedom Act is the possibility that the limited liability company may be organized by a sole partner, pursuant to first paragraph introduced to Article 1.052 of the Civil Code.

The second paragraph of Article 1.052 of the Civil Code was also introduced, in the sense that if the company is incorporated with a single shareholder, shall apply to the acts of incorporation of the sole shareholder the provisions of the articles of association, where applicable.

The one-member limited liability company will probably make the incorporation of the limited-liability proprietorship (*empresa individual de responsabilidade limitada* – "EIRELI") provided for in Article 980-A of the Civil Code unusual, given the requirement in that article that the capital stock of EIRELI, duly paid up, not less than 100 (one hundred) times the highest minimum wage in force in Brazil at the time of the establishment of EIRELI.

Civil Code also prohibits that the same individual owns more than one EIRELI (pursuant to second paragraph of Article 980-A). The purpose of this prohibition was precisely to prevent abuse of corporate entity and fraud to creditors.

Since the Economic Freedom Act did not introduce the same prohibition for one-member limited liability company and did not require the payment of minimum capital stock for its incorporation, it will be necessary to verify how this new structure will in fact be used and if creditors protection mechanisms will be adopted.

In addition, although the possibility of limited liability company's incorporation by 1 (one) sole shareholder was inserted, no exception was made in Article 1.033, subparagraph IV, of the Civil Code, which provides that, when the lack of plurality of members is not reconstituted within 180 (one hundred and eighty) days, the company will dissolve.

The provision of Economic Freedom Act (Article 19, IV) that repealed item IV of Article 1.033 of the Civil Code was vetoed on the (correct) argument that it applied not only to the limited liability company. Even without an express remark - similar to that provided for in Article 1.033, sole paragraph, of the Civil Code (which provides for the possibility of conversion into EIRELI or individual company) - it seems to us that, with the veto, the dissolution rule for not recomposing the plurality of shareholders will only be applicable if, within 180 (one hundred and eighty) days, the remaining partner does not decide to maintain the company with only one (1) partner, reforming the articles of association for this purpose. At this point, it should be seen how the Commercial Registry will react in such cases.

4.2. Limitation on liability of the holder of the limited-liability proprietorship - EIRELI

An express provision was also introduced in the Civil Code that, except in cases of fraud, the assets of the holder of EIRELI will not be confused with the assets of the EIRELI, as per seventh paragraph of Article 980-A of the Civil Code included by Economic Freedom Act.

5. LIMITATION ON LIABILITY OF QUOTA HOLDERS OF INVESTMENT FUNDS AND FIDUCIARY SERVICES PROVIDERS

5.1. Discipline of investment funds

Economic Freedom Act also introduced a specific chapter in the Civil Code to deal with investment funds (per Articles 1.368-C to 1.368-F). Article 1.368-C provides that investment funds have a special condominium nature and are intended for investment in financial assets, assets and rights of any nature. This definition is in line with what was already established by the Brazilian Securities and Exchange Commission ("CVM").

Given that specific reference has been added to investment funds for the application of financial resources, assets and rights of any kind, it is understood that the provisions of the Civil Code introduced by the Economic Freedom Act apply to both equity investment funds, regulated by CVM Instruction 578 of August 30, 2016, as amended ("CVM Instruction 578") and to all other classes of investment funds currently existing, regulated by CVM Instruction 555 of December 17, as amended ("CVM Instruction 555").

Pursuant to the second paragraph of Article 1,368-C, the CVM shall be responsible for disciplining investment funds.

Another important change has been introduced in the third paragraph of Article 1.368-C in the sense that the registration of the Investment Fund's Regulations before the CVM is a sufficient condition to guarantee its publicity and the effects against third parties. Thus, the need to register the document before the Registry of Deeds and Documents would be unnecessary.

However, it will be necessary to verify how this exemption will be applied in practice, given that CVM Instruction 578 expressly provides that the operation of the investment fund will be automatically granted by the CVM by means of the protocol with the CVM certifying that the Act of Incorporation and the Regulation of the investment fund were duly registered with a notary's office, pursuant to Article 2, item I, of CVM Instruction 578.

Pursuant to Article 1.368-F of the Civil Code, introduced by the Economic Freedom Act, investment funds regulated by CVM shall follow the provisions of Articles 1.368-C to 1.368-F of the Civil Code.

5.2. Rules applicable to quota holders of investment funds and fiduciary services providers

Another important innovation with regard to investment funds introduced by Economic Freedom Act is that the fund's regulation may (i) limit the liability of each quota holder to the value of their quotas; (ii) limit the liability of fiduciary service providers to fulfill their particular duties (i.e., without solidarity) with the quota holders and among themselves; and (iii) quota classes with distinct rights and obligations, with the possibility of segregated equity constitution for each class (which will only be responsible for obligations linked to the respective class), pursuant to Article 1.368-D of the Civil Code, introduced by the Economic Freedom Act.

Prior to the changes introduced by Economic Freedom Act, the limited liability was expressly provided for only in the Brazilian legal system for real estate investment funds (and was applicable only to the quota holders of these funds, not to their fiduciary service providers), pursuant to Law No. 8.668, of June 25, 1993.

Pursuant to Article 15 of CVM Instruction 555, the quota holders of investment funds are subject to liability for the fund's negative equity, without prejudice to the possibility of the administrator and manager being liable, if the investment policy or concentration limits provided for in the respective fund regulations and CVM Instruction 555 are not observed.

In addition, pursuant to CVM Instruction 555, the Investment Fund's Services Agreement regulated by said Instruction shall provide for joint liability between the administrator and the service providers of the fund for any losses incurred by the quota holders (caused by the administrator and/or service providers due to conduct contrary to the law, CVM rules and fund regulation). CVM Instruction 578 also provides for the same, except for contracting services specifically related to portfolio management.

Furthermore, pursuant to Article 1.368-D, first paragraph, of the Civil Code, the adoption of limited liability, if so, established by the respective regulation, by fund initially constituted without this limitation, will only cover facts occurred after the change in regulation of the investment fund.

Given the absence of specific CVM regulation to address the innovations introduced into the Civil Code by Economic Freedom Act, it will be necessary to wait for these CVM regulations, so that the fund regulations may be amended to provide for limitations on the liability of the quota holders and the service providers.

The possibility of establishing the limitations described above may enhance predictability and legal certainty for investments made through funds, as well as providing an incentive for fiduciary service providers to be increasingly active and innovative in this market.

Finally, the Economic Freedom Act also introduced the applicability to investment funds of the civil insolvency rules provided for in Articles 955 to 965 of the Civil Code, if the liability-limited investment fund does not have sufficient assets to cover its debts. This rule excludes the possibility of bankruptcy or judicial recovery of the investment fund.

The civil insolvency may be filed in court by creditors, by the investment fund's quota holders pursuant to the respective regulations, or by CVM, as provided for in first and second paragraphs of Article 1.368-E of the Civil Code.

6. CHANGES IN THE CORPORATIONS LAW

With respect to Brazilian Corporations Law, the possibility of waiver of signature of subscription list or bulletin of underwriting in the act of subscription of shares to be held in cash has been inserted, if the public offering in question occurs through a system managed by an entity. administrator of organized securities markets, pursuant to second paragraph of Article 85 of the Brazilian Corporation Law, introduced by the Economic Freedom Act.

It is a measure to reduce bureaucratization in favor of publicly held companies, stimulating access to the capital markets.

7. CHANGES IN THE LAW OF MERCANTILE COMPANIES' PUBLIC REGISTRY

The EFA also introduced several amendments to Law No. 8.934 of November 18, 1994 ("Law of Boards of Trade"). Among them, we highlight the obligation for the registration of the articles of incorporation, their amendments and extinctions to occur independently of prior governmental authorization. The public agencies should be informed by the National Network for the Simplification of Registration of Companies and Businesses (Redesim) only about the records in which the public agencies express interest.

In addition, pursuant to the new sole paragraph of Article 41 of the Law of Boards of Trade, applications for the filing of (i) corporations' acts of incorporation; (ii) acts related to the transformation, incorporation, merger and spin-off of mercantile companies; and (iii) the acts of incorporation and alterations of consortium and group of companies, as provided for in Brazilian Corporation Law, shall be decided within five (5) business days from the date of receipt by the competent Board of Trade.

For other filing requests not mentioned above (such as amendments to the articles of association of limited liability companies), the deadline for the decision to be granted by the competent Board of Trade shall be 2 (two) business days (otherwise the acts will also be considered filed).

Another important change is the granting of automatic registration for the filing of articles of incorporation and changes of limited liability companies, if the following requirements are met: (i) approval of prior consultation of the viability of the business name and location and (ii) use of established standard instrument by the National Department of Business Registration and Integration (DREI). This measure will certainly reduce bureaucracy, allowing parties to adapt articles of association to the specificities of the company.

Pursuant to the third paragraph introduced to article 63 of the Law of Boards of Trade, the authentication of the acts taken to filing in the Board of Trade is waived in the cases in which the lawyer or the accountant of the interested party declares, under their personal responsibility, the authenticity of the copy of the respective document.

The Law of Boards of Trade now also provides that the acts of incorporation, amendments, transformation, merger, spin-off, dissolution and termination of registration of legal entities may also be carried out by electronic system, created and maintained by the federal public administration. The threat of potential competition of a yet to be created federal register can serve as an stimulus for the state-run Boards of Trade to be more efficient.

8. CHANGES IN THE CONSOLIDATION OF THE LABOR LAWS (CLT)

The changes introduced by Economic Freedom Act in Consolidation of the Labor Laws ("CLT"), in order to reduce bureaucracy in Brazilian entrepreneurship, concern (i) the annotations of the employment contract and the work permit; (ii) the annotations of the work hours; and (iii) the Digital Bookkeeping System for Tax, Social Security and Labor Obligations (E-Social).

8.1. Annotation of the Employment Contract and Work Permit

Amendments and revocations of the wordings contained in Articles 13, 14, 15, 16, 29, 40 and 135 of the CLT were introduced with the implementation of the electronic Employment and Social Security Record (*Carteira de Trabalho e Previdência Social* - "CTPS"). The physical record will only be issued on an exceptional basis and the Ministry of Economy is responsible for this attribution. These are some of the changes introduced by Economic Freedom Act in the CLT.

With the entry into force of Economic Freedom Act, CTPS will be linked only to the employee's CPF. The employer will have 5 (five) business days to make the note of the hiring through a new electronic employer registration. Within 48 (forty-eight) hours after the CTPS note, the worker shall have access to the information.

Finally, item II of Article 40 of the CLT is revoked, removing the need for proof of CPTS notes for purposes of dependents' evidence before the Social Security.

For entrepreneurs, the changes simplify the hiring bureaucracy and follows the digital trend. Indirectly mitigates poor and inaccurate records - therefore, it is positive.

8.2. Annotation of Working Hours

Amendments and revocations were also implemented in the wording of Article 74 of the CLT, in order to increase from 10 (ten) to 20 (twenty) the number of employees of the establishment so that the employer has the obligation of control and registration of working hours.

The working hours will be noted by manual, mechanical or electronic, according to the administrative regulation of the Ministry of Economy, being possible the pre-annotation of the rest period. There are also new rules for noting the working hours of those who work outside the employer's establishment.

Finally, by written individual agreement, collective agreement or Collective Work Convention, the notation of the day by the "exception" regime (i.e., notation of the extraordinary working day only) will be allowed.

The changes seem positive for business owners, especially the change regarding the minimum number of employees required to register time. The original CLT'S wording is very old and economic activity much more modest. Thus, the amendment seems to be truer to the spirit of the norm than its current literalness.

The notation of the time of the external employee must be understood in accordance with the rule of Article 62 of the CLT, therefore, being applicable only in cases where it is possible to control the employee's journey.

Annotation by exception regime is more practical and provides advantages for the employer by simplification, without prejudice to the employee. The argument sometimes put forward that it would inhibit overtime registration would in fact serve any form of notetaking or there would be less overtime litigation.

8.3. E-Social

Finally, the E-Social, which unifies the sending of worker and employer data, will be replaced, at federal level, by a simpler system of digital information on social security and labor obligations.

The operational difficulties of the system are noticeable, just seeing the successive postponements. This is not about deleting records, but about looking for a more efficient digital system.

The original proposal for general permission to work on Sundays was not included in the final wording of the Economic Freedom Act, as well as the regulation of the alteration of the rest day and the additional.

9. CHANGES IN THE CONSUMER LAW

The Economic Freedom Act does not expressly change any Article of Law 8.078 of November 11, 1990 ("Consumer Defense Code" or "CDC")[1]. Thus, the option of the said Act has been to not restrict consumer rights, at least not those expressly provided for in the CDC. By ensuring 'the free definition, in unregulated markets, of the price of products and services as a consequence of changes in supply and demand' (Article 3, III), the Economic Freedom Act was even more specific and expressly excluded from this scope the consumer protection laws, as well as competition laws and other provisions protected by federal law (Article 3, third paragraph, II, of Economic Freedom Act). But that was the only exclusion related to consumer rights, that is, only with regard to product pricing.

[1] In this regard, see comments on disregarding of the corporate entity in item 3.1 above, for example.

The consumer protection system in Brazil is not limited to what is provided in the CDC, but is composed of a series of regulatory provisions and rules that make up a vast system that transcend the Consumer Defense Code, so that the changes introduced by the Economic Freedom Act should also affect consumer relations, even allowing some protective perspectives to be relaxed, as long as they do not directly address provisions of the CDC.

Publicity and Advertising. A clear example of the impact of Economic Freedom Act on consumer relations refers to the greater flexibility of the criteria to be observed for advertising services and products.

The Article 4 of Economic Freedom Act defines it as "the duty of the Public Administration [...] to avoid the abuse of regulatory power in such a way as to unduly [...] restrict the use and exercise of publicity and advertising in an economic sector, except as expressly prohibited in Federal Law" (item VIII). In this context, not being expressly prohibited by the CDC, there is no doubt that the Economic Freedom Act has given the supplier companies greater freedom in the advertising of products, precisely in order to avoid undue restrictions regarding such right of expression, communication and/or interaction directed to the public aiming at the promotion, dissemination or sale of a product or service.

We are at your disposal if you have any questions or need additional information.

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