

2002

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### Recommended Citation

Joaquim de Paiva Muniz, *Management and Corporate Control of Limited Companies under the New Brazilian Civil Code*, 8 LAW & BUS. REV. AM. 455 (2002)  
<https://scholar.smu.edu/lbra/vol8/iss3/7>

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# Management and Corporate Control of Limited Companies Under the New Brazilian Civil Code

*Joaquim de Paiva Muniz\**

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## I. Limited Liability Companies Under the New Civil Code

The Brazilian Federal Congress recently enacted a new Civil Code, which will become effective on January 11, 2003. Following the example of the Italian Civil Code of 1942, the new Brazilian Civil Code sets forth new rules for almost all business entities. Excepted from the new rules are corporations (*sociedades por ações*), which will continue to be governed by Law 6.404, of December 15, 1976, as amended (the "Corporations Law").

The limited liability company (*sociedade limitada*) (LLC) is the most important corporate form in Brazil, adopted by a majority of Brazilian companies.<sup>1</sup> The reason for its popularity, is that an LLC provides its partners with a flexible structure, making it easier to organize the company, so as to best accommodate their needs. Moreover, limited liability companies do not require costly formalities, such as publishing corporate acts in newspapers or maintaining mandatory corporate books. Decree 3708/1919 (the "*Limitadas Act*"), which has governed limited liability companies for more than eighty-three years, has been highly criticized, especially for its failure to adequately protect minority partners against abuse by controlling partners.

The corporate law provisions of the new Brazilian Civil Code, attempt to remedy the deficiencies of the current rules in the area of LLCs. However, in reality, the provisions shape LLCs into more complex entities similar to a corporation. Consequently, limited liability companies may lose some of their primary advantages, such as the simplicity of organization, and the flexibility granted to partners to structure the company according to their needs. Furthermore the new Civil Code grants LLC partners more rights than

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\* I would like to thank Lorena Leonel, of Trench, Rossi & Watanabe—associated with Baker & McKenzie, for her assistance in this research.

1. In the last twenty years over 99 percent of the legal entities organized in Brazil adopted the corporate form of *sociedade limitada*. (title of article), VALOR, Oct. 2, 2000.

any other Brazilian corporate form (please see the chart at the end of this article, with a comparison of rights given to the partners of limited liability companies, and those given to shareholders of corporations).

Furthermore, additional rights granted to minority partners, as per the new Civil Code, may unbalance the correlation of power in limited liability companies, to the extent that the controlling partner will need the other partners' consent for the approval of several relevant corporate decisions. For instance, any amendment to the articles of organization will require the approval of partners, holding at least two-thirds of the corporate capital. In contrast, the current legislation provides that the articles of organization may be amended through the approval of partners holding the majority of the corporate capital.

Another illustration of new rights conferred to minority partners is the creation of special quorums for appointment of managers, who according to the legislation currently in force, may be nominated by the majority partners. By way of example, according to article 1.061 of the new Civil Code, the appointment of third party managers will require the approval of two-thirds of the partners, regardless of their respective equity participation, unless the corporate capital has not been fully paid, in which case third-party managers may only be appointed by the unanimous approval of the partners.

The new Civil Code opens several windows for abuse of powers from the minority partners of a limited liability company, since such minority partners will have disproportionately strong bargaining power. The imposition of super-majority quorums for critical decisions will certainly nurture corporate impasses, foster extremely costly buy-outs of minority equity holders, or force the dissolution of healthy companies. For this reason, a renowned Brazilian author mourned the "sad end of *sociedades limitadas*,"<sup>2</sup> since those corporate forms will probably no longer be used in joint ventures with minority partners, and most current joint ventures with such a feature will expectedly be transformed into corporations.

A brief description of the most significant amendments to the limited liability companies' legal framework, with regard to management and corporate governance, so as to provide the reader with an overview on this matter, follows.

## II. Management

A limited liability company may be run by its partners (managing partners), or by third parties (third-party managers). The appointment of a managing partner requires the approval of the partners representing the majority of the corporate capital, if it is made by a separate act, or by 75 percent of the corporate capital, if the managing partner is appointed in the articles of organization. On the other hand, the managing partner nominated in the articles of organization, may only be dismissed upon the affirmative vote of partners representing at least sixty-six percent of the corporate capital. If the managing partner is appointed in a separate document, he or she may be dismissed by partners representing the majority of the corporate capital.

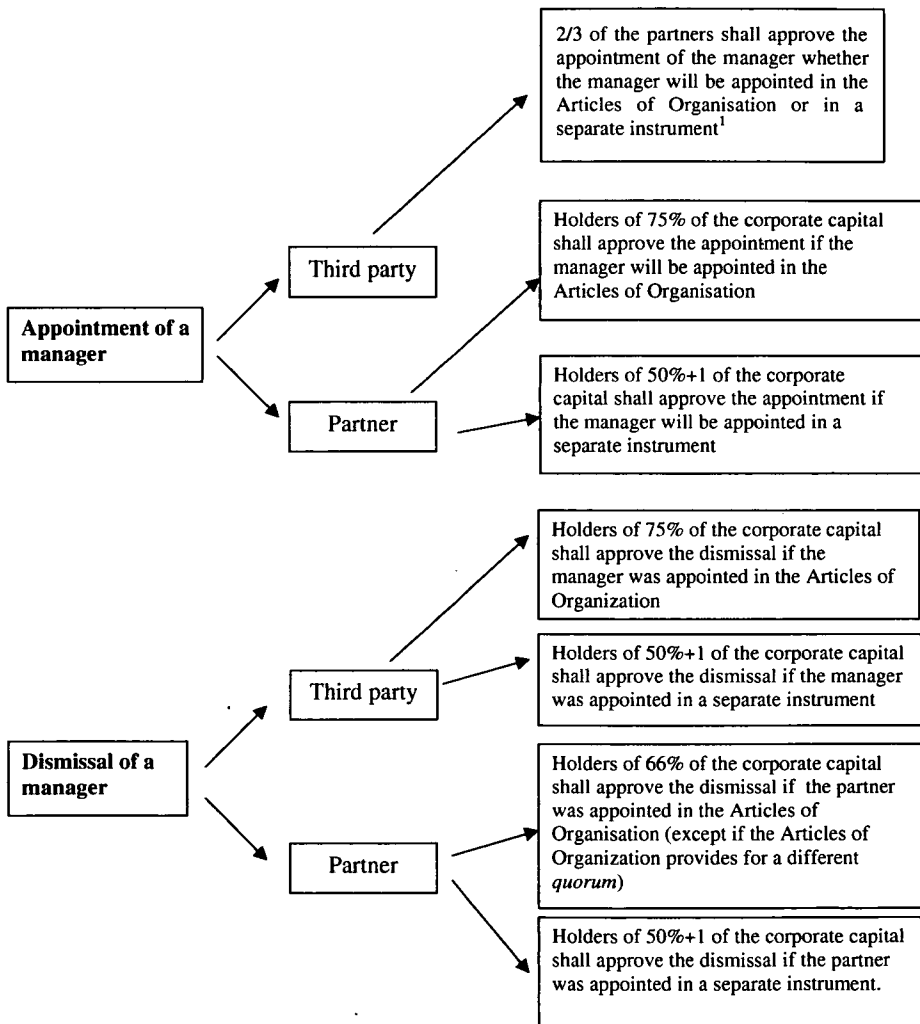
If the corporate capital has been fully paid, third-party managers may be appointed by two-thirds of the quota-holders, regardless of their respective participation in the

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2. See Mello Franco, *O Triste Fim Das Sociedades Limitadas No Novo Código Civil*, in [July/Sept. 2001] *REVISTA DE DIREITO MERCANTIL*, issue 123, at 81-85.

corporate capital. Otherwise, the appointment of third-party managers requires the partners' unanimous consent. However, professional managers may be dismissed by partners representing 75 percent of the corporate capital, if they were appointed in the articles of organization, or by the majority of the corporate capital, if they were appointed in a separate document. The partners may not set out in the articles of organization, a different quorum for appointment and dismissal of managers. See Chart 1 which summarizes such new intricate rules regarding the appointment and dismissal of managers:

Chart 1.



<sup>1</sup>We are assuming herein that the corporate capital has been paid in. All quotaholders shall approve the appointment of the managers if the corporate capital is *not* fully paid in.

### III. Corporate Resolutions

Unlike the Corporations Law, the *Limitadas* Act does not provide for periodic partner meetings to resolve relevant corporate issues. Corporate decisions are usually taken by means of partner resolutions or amendments to the articles of organization.

In order to remedy this situation, the new Civil Code sets forth that the following corporate acts are conditioned upon prior approval of partners, at a duly convened meeting or assembly:

- examination, discussion, and approval by a simple majority of the partners present at the meeting or assembly of the annual financial statements;
- appointment and dismissal of managing partners or third-party managers, including the decision regarding their compensation;
- any amendment to the articles of organization, which requires the vote of partners holding 75 percent of the corporate capital;
- merger or dissolution of the company, or a decision to cease the company's liquidation procedure, which also requires the affirmative vote of partners holding 75 percent of the corporate capital;
- appointment and dismissal of the trustee in the liquidation proceeding and judgment of the accounts rendered by such trustee, which requires simple majority; and
- a request of mandatory composition with creditors (*concordata*), which requires an affirmative vote of partners holding more than 50 percent of the corporate capital.

The difference between partners' assemblies and partners' meetings, is that the former are subject to certain formalities while the latter are not. Prior to partners' assemblies there must have been a call published three times in the press. The first call must be published eight days prior to the date on which such assembly is scheduled to be held. If it is verified that the number of partners necessary for the installation quorum of the assembly, was not met on the scheduled date,<sup>3</sup> a second call may be requested, provided that it is published three times in the press, the first of which was published five days prior to the date on which such assembly is scheduled to be held. Partners' assemblies are only mandatory if the limited liability company has more than ten partners.<sup>4</sup> Regarding partners' meetings, the articles of organization may freely set out the applicable proceedings to be followed to perform such corporate acts. Partners' assemblies or meetings are not necessary, if all the partners make a decision, in writing, as to the subject matter of such assembly or meeting.<sup>5</sup>

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3. A partners' assembly must be installed upon the presence of partners holding at least three-fourths of the corporate capital, in the first call, or with any number of partners, in a second call. C.C. (Civil Code of Brazil) art. 1.074, de 11 de enero de 2002, D.O. date of publication.

4. C.C. art. 1.072, §1, de 11 de enero de 2002, D.O., 2002.

5. C.C. art. 1.072, §3, de 11 de enero de 2002, D.O., 2002.

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#### IV. Audit Committee

Currently, the applicable legislation does not regulate LLCs' organization of audit committees.<sup>6</sup> The new Civil Code sets forth that the articles of organization may provide for an audit committee, composed of members appointed by both controlling and minority partners. Minority partners holding at least 20 percent of the voting capital may elect one member of the committee.<sup>7</sup> The articles of organization must establish the rules governing the operation of the audit committee. Nonetheless, the provision for an audit committee in the articles of organization is not mandatory.

However, the new Civil Code failed to provide for other mechanisms for inspection of limited liability companies by the minority partners. Such a provision may have been useful for compulsory independent audits and mandatory publication of financial statements.

#### V. Conclusion

The new legal frame for limited liability companies is disappointing, since the new Brazilian Civil Code transforms this kind of company into a more formal organization, closer to a corporation, thereby making it less desirable to businessmen who were attracted by the flexibility granted by the former rules.

Furthermore, the new Civil Code overprotects the minority partners, who may have veto powers over almost all relevant corporate decisions ranging from the appointment of managers to the amendment to the articles of organization. Whereas the *Limitadas* Act failed to provide the minority partners with sufficient corporate voice, the new Civil Code heads in the opposite direction, granting minority partners disproportionately strong bargaining power.

It is questionable, however, to what extent such additional powers will really prevent abuse by controlling partners. Because the new Civil Code has failed to create efficient mechanisms for management inspection, it seems that the practical results of the new political rights given to the minority partners, will be nothing but the boosting of corporate impasses and deadlocks. Legislators missed a great opportunity to build up a legal system suitable for the needs of Brazil's businessmen and entrepreneurs at the dawn of the Twenty-First Century.

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6. C.C. art. 1.066, de 11 de enero de 2002, D.O., 2002.

7. C.C. art. 1.066, §6, de 11 de enero de 2002, D.O., 2002.

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TABLE 1. COMPARISON OF RIGHTS CONFERRED TO THE PARTNERS OF LIMITED LIABILITY COMPANIES AND SHAREHOLDERS OF CORPORATIONS<sup>8</sup>

	<i>Limited Liability Companies</i> ( <i>new Brazilian Civil Code</i> )	<i>Corporations</i> ( <i>Law No. 6404/76</i> )
Partners With Less than 20% of the Voting Capital	Quotaholders holding at least 20% of the voting capital have the right to elect one member of the audit committee, if the articles of organization provide for such corporate body (Article 1.066).	<ol style="list-style-type: none"> <li>1. Shareholders holding at least 5% of the voting capital may call a shareholders' meeting. (Article 123).</li> <li>2. Minority shareholders holding at least 10% of the voting capital have the right to elect one member of the audit committee (Article 161).</li> <li>3. Minority shareholders holding 15% of the voting capital or 10% of the nonvoting capital have the right to elect one member of the Board of Directors (Article 141, §4).</li> </ol>
Partners With More than 25% of the Voting Capital	Quotaholders holding more than 1/4 of the voting capital may veto the transference of quotas from another quotaholder to a third party, unless the articles of organization provide otherwise. (Article 1.057).	Shareholders holding at least 25% of the voting capital may install a shareholders' meeting in a first call (Article 125), unless the shareholders' meeting is called to amend the by-laws, in which case it may only be installed by shareholders representing 2/3 of the voting capital.
Partners With More than 50% of the Voting Capital	<p>The quorum to approve the following corporate actions is the majority of the voting capital:</p> <ol style="list-style-type: none"> <li>1. Appoint the managing partners, if those partners are not indicated in the articles of organization (Article 1076, II).</li> <li>2. Dismiss nonpartner managers (Article 1076, II).</li> <li>3. Fix the compensation of the managers, in the event such compensation is not established in the articles of organization (Article 1076, II).</li> <li>4. Request the judicial composition of creditors (<i>concordata</i>) (Article 1076, II).</li> <li>5. Exclude a partner from the company, unless the articles of organization authorizes the controlling quotaholder to do so, provided that there is a fair cause for such exclusion (Article 1.085)</li> </ol>	<ol style="list-style-type: none"> <li>1. The shareholders holding the majority of the voting capital are entitled to appoint the majority of the members of the Board of Directors (Article 141 §7).</li> <li>2. The quorum to approve the following corporate actions is the majority of the voting capital (Article 136): <ol style="list-style-type: none"> <li>(a) merger or spin-off of the corporation;</li> <li>(b) participation in a corporate group;</li> <li>(c) amendment to the corporate purpose; and</li> <li>(d) end of the liquidation or dissolution.</li> </ol> </li> </ol>

Continued

8. This chart was prepared by Luiz Otávio Villela and Danielle Almeida, of Trench, Rossi & Watanabe—associated with Baker & McKenzie.

TABLE 1. Continued

	<i>Limited Liability Companies (new Brazilian Civil Code)</i>	<i>Corporations (Law No. 6404/76)</i>
Partners With 2/3 of the Voting Capital	Dismiss a managing partner. (Article 1063, §1). The articles of organization may provide for a different quorum.	Installation of a shareholders' meeting to amend the by-laws (Article 135).
Decision that Requires the Approval of 2/3 of the Partners	Appoint nonpartner managers (Article 1061).	N/A
Partners With 75% of the Voting Capital	<ol style="list-style-type: none"> <li>1. Modify the Articles of Association (Article 1076, I).</li> <li>2. Call the Quotaholders' Meeting in first call (Article 1074).</li> <li>3. Approve merger or dissolution of the company (Article 1076, I).</li> <li>4. Cease the company's liquidation procedure (Article 1076, I).</li> <li>5. Assign quotas to a third party without the other quotaholders' prior consent (Article 1.057). The articles of organisation may provide otherwise.</li> </ol>	N/A
Unanimous Approval of the Partners	N/A	Transformation of the corporation into other kind of company (Article 221).



