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## Drafting Contracts under Brazilian Law: A Practical Guide to Enforceability

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## **SHORTER ARTICLES, COMMENTS AND NOTES**

# **Drafting Contracts Under Brazilian Law: A Practical Guide to Enforceability**

### **Introduction**

The goal of this article is to provide American lawyers who represent enterprises that transact business in Brazil with insights into the drafting of contracts which are to be governed by Brazilian law and with respect to which rapid and effective judicial decisions may be required. Of necessity, such a subject can only be treated in an introductory manner. But it is the hope of the authors that this article may prove immediately useful in aiding communication between American and Brazilian attorneys engaged in drafting contracts, thereby leading to a better understanding of the ways in which the business objectives of an American company can most effectively be tailored to the requirements of Brazilian contract law.

When an American company or its Brazilian subsidiary intends to enter into a major contract in Brazil, it is quite common for the company's attorneys in the United States to send a model or draft contract to Brazilian attorneys for review, the model or draft being based on the company's American and, perhaps, non-Brazilian international experience. Such a practice can be very valuable insofar as it indicates to the Brazilian attorneys the type of legal and business result contemplated by the American company. However, there is a tendency for such a model or draft to become the basis for the final contract in a way which may not serve the company's best interests and which may cause needless misunderstandings in negotiations with Brazilian parties.

This tendency may result from several factors. First, the American attorneys may request their Brazilian counterparts to review the model or draft with an eye toward altering provisions which are not enforceable in Brazil. Indeed, some companies, for reasons of internal continuity, like to have their contractual relationships as uniform as possible throughout the world. Brazilian attorneys, however, may be reluctant to raise what may seem to be largely theoretical questions based on a difference in legal cultures.

It is the thesis of this article, however, that such questions can be of significant practical importance. In order to help encourage discussion between American and Brazilian attorneys with respect to such questions, this article briefly reviews the nature of the Brazilian courts responsible for enforcing civil contracts and then makes several specific suggestions regarding the drafting of contracts under Brazilian law.

## **I. Brazilian Judicial Culture**

During the past fifteen years, American law has begun to become known in, and have some impact on, Brazil. This has been the result of two factors: an increased tendency during that period for Brazil to look upon the United States, rather than Europe, as a source of social ideas; and an increasing number of Brazilian attorneys who have studied or had professional experience in the United States. The impact of American law has had some positive results, perhaps the most notable of which is the well drafted Corporations Law, enacted in 1976.<sup>1</sup>

Most Brazilian attorneys with direct legal experience in the United States, however, tend to seek and find employment either with subsidiaries of American companies or with law firms which deal with American clients. We are not aware of any judge presently sitting who has received training in the United States.<sup>2</sup> Almost without exception, Brazilian judges have sought and found the roots of their judicial culture in Roman, Italian, French and German law, all of which are far closer to the Brazilian legal tradition than is American law.

The average Brazilian judge, therefore, even in the sophisticated courts of Rio de Janeiro and São Paulo, has almost no knowledge of American law. It is to this average judge that a contract drafted in Brazil must address itself, seeking to communicate to him the real nature of the parties' agreement.

In so preparing a contract, it is important to be aware of one other factor. Due to an understandable preoccupation with economic development, Brazil has been unwilling to devote financial resources to systems generally viewed as not being economically productive. The courts are such a system. The number of Brazilian judges is very small in relation to the population they serve,<sup>3</sup> and judges normally do not have funds to hire law clerks. Although the Civil Procedure Code of 1973 sought to establish mechanisms that would

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<sup>1</sup>Law of Dec. 15, 1976, [1976] Law No. 6.404 (Braz.)

<sup>2</sup>Judges are selected through public examination. Most attorneys taking the examinations have a professional background in litigation.

One exception to the general rule that judges have little knowledge of American law was the late judge of the Supreme Federal Tribunal, Dr. Aliomar Baleeiro, who was well versed in American law.

<sup>3</sup>According to the "Associação dos Magistrados," an association of judges in Brazil, there are only 4,730 judges in Brazil.

eliminate judicial delay due to economic realities,<sup>4</sup> no significant change resulted, and relatively simple actions can take years to be resolved.

## II. Practical Aspects of Drafting Contracts

Given the situation outlined above, Brazilian judges and tribunals, with little time available to review each case pending before them, tend to decide most rapidly, and interpret most reasonably, actions involving questions which can be most immediately understood. Contracts embodying Brazilian law and doctrine presented in its most familiar form will, therefore, be far more readily enforceable than will American style contracts which have been adapted for use in Brazil.

What elements should a contract contain or not contain in order to best fit within familiar patterns of law and doctrine? Obviously, to a certain extent this must be decided within the factual context of each contract. However, the general points set forth below may help the American attorney working with Brazilian contracts to more fully appreciate certain aspects of Brazilian contract law.

### A. *The Contract Should Preferably Fall within a Juridical Structure Well Known Under Brazilian Law*

In common law countries, there is an underlying feeling that law is, or should be, an articulation of rules emerging from the real social and commercial activities of the people. Contracts, therefore, may assume an almost infinite variety, reflecting the particular wishes of the parties. New contract forms (such as franchising) can evolve with relative freedom.

In contrast, Brazilian law, which is in the tradition of Roman, German, and French law, is based on codes which, although not related to commercial realities, largely represent legislators' and academics' views of the way law should be. As a civil law jurisdiction, Brazil theoretically seeks to codify all major legal contingencies.<sup>5</sup>

For most types of business relationships encountered in the society, therefore, a distinct pattern or type of contract is clearly provisioned in law or

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<sup>4</sup>Law of Jan. 11, 1973, [1973] Law No. 5.869 (Braz.). Article 275 of the law provides for summary proceedings under certain circumstances. Article 133 provides that judges may be held liable for losses and damages brought about by judicial delay or otherwise where the judge acts fraudulently or with malice or refuses or fails to take, or delays in taking, any due action without just motive.

<sup>5</sup>Relationships between contracting parties are generally not viewed as being only a private matter. The concept of the public interest is constantly present in legislation and is manifested to a much greater degree than in the United States through various prescribed contractual forms, determinations that specific matters are legally unacceptable, requirements for certain legal formalities, and special instruments. There is a joke among Brazilian lawyers that "everything which is not specifically permitted under Brazilian law is prohibited." Although this is an exaggeration, it all too often reflects the attitude likely to be encountered in the courts.

doctrine. This permits one to know in advance how to draft a contract so as to correspond to the form which will immediately provide legal doctrinal support for the parties' intentions. The title of the contract should be that generally used, and its clauses should be typical. Clauses which are not typically encountered in a certain type of contract should be relegated to another contract or contracts.

The tendency of American attorneys to include a variety of different obligations of both parties in a single contract can prove confusing to Brazilian judges accustomed by their legal culture to review contracts within the construction of a specific legal type. Confusion on the part of the judge can result in considerable delay and, at times, unexpected decisions.

An example of successful adaptation to this aspect of Brazilian legal culture is that provided by the American oil companies, which have been operating in Brazil for many years.<sup>6</sup> These companies have developed a system, similar in effect to franchising in the United States, in which they enter into a series of specific contracts with their dealers, having separate contracts for supply of gasoline, rental of equipment, mortgages, grant of business development rights, and the like. Brazilian courts have acknowledged the validity of this approach.<sup>7</sup>

#### *B. Contractual Language Should Be as Direct and Objective as Possible*

As noted above, Brazilian law seeks to create a standard pattern for each type of contract which the legislators see in the real economic world. In conjunction therewith, Brazilian law manifests a preference for concise and unambiguous contractual language in which each word and expression should attempt to fit within well-known meanings recognized at law, thereby eliminating doubts as to interpretation. A Brazilian contract should, therefore, avoid the use of synonyms and the repetition, in different words, of various provisions in the contract. Such devices have the result of prejudicing the *communication* of the contract, thereby possibly resulting in judicial confusion with respect to the intention of the contracting parties.

It is also not advisable to redraft in different language contract clauses which are in essence already articulated in the applicable law. Indeed, it should be noted that, insofar as a certain type of contract is obligatorily subject to certain legal provisions, it is unnecessary and inadvisable to repeat the contents of those provisions in the contract at all; a simple citation to the article or articles in question is preferable, although even this is not necessary.

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<sup>6</sup>As oil importation and refining are the monopoly of the Government company, Petróleo Brasileiro S.A. (Petrobrás), foreign oil companies engage only in distribution.

<sup>7</sup>See, e.g., *Abastecedora de Combustíveis Veranense Ltda. v. Cia. Atlantica de Petróleo*, Ap. Civ. No. 26.896, [1976] 2a. Câmara Civil, Veranópolis, R.G.; *Ribeiro v. Cia. Atlantica de Petróleo*, Ap. Civ. No. 44.331, [1975] 1a. Câmara Civil, Alcada, R.J.

In sum, any attempt to be either linguistically creative or verbose in the drafting of a contract can lead to confusion or unexpected interpretations and should therefore be avoided.

*C. Parallel Covenants, Ancillary to the Main Purpose of the Contract, Are Not Likely to Be Enforceable and Should Be Eliminated Where Possible*

It is relatively common to encounter in contracts prepared by American attorneys lists of ancillary obligations which must be observed by each party. For example, a contract might require one party to secure permission from the other for any change in its shareholders, to refrain from merger, to use a certain accounting method, or to deliver certain accounting or corporate documents. It is very unlikely that a Brazilian court will consider a party to be in breach of a contract for failure to comply with such ancillary covenants where the principal obligation is being met.

This is due to the fact that, as mentioned above, Brazilian law provides for certain set types of contracts. The nature of the principal obligations of these contracts is predetermined, and as long as such obligations are met, ancillary obligations will be of no effect except in the event the complaining party can prove that breach of these ancillary obligations actually resulted in damages to it, in which case a judgment for damages might result. However, this would be a long and complicated process not geared to quick enforceability.

It is not that ancillary matters cannot be included in a Brazilian contract. They can be, and should be, but only where they are truly important to the principal obligation, and the nature of that importance should be fully articulated. Thus, if one is going to attempt to limit changes in the other party's shareholders, one should explain, for example, that one has entered into the contract on the basis of the particular skill and reputation of the existing shareholders. Even then, if after a stockholder change no negative effects were notable, it is unlikely a Brazilian court would enforce the provision.<sup>8</sup> And, as with all uncommon provisions, such ancillary matters will probably cause delay and confusion with respect to enforceability.

*D. Clauses that Give One of the Parties Complete Discretion to Determine the Object, Time, Manner or Amount of an Obligation (Discretionary Clauses), Are Not Permissible*

Clauses considered impermissibly discretionary under Brazilian law are fairly frequently encountered in contracts prepared by American attorneys

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<sup>8</sup>Article 5 of the Introductory Law to the Civil Code of September 4, 1942, provides that "in applying the law, the judge will attend to the social objectives to which it is directed and to the exigencies of the common good." C. Civ. art. 5 (1942). (Braz.) Based on this provision, the courts have taken the position that they will not generally consider a contract to have been breached where its principal obligation has been fulfilled, especially where rescission of the contract would have negative social consequences.

for use in Brazil. For instance, a sales contract which provides the price will be established in the seller's catalogue, that prices will increase at a rate to be established by the seller, and that delivery must be made within a reasonable time period, will probably not be enforced.

Brazilian courts have almost universally held discretionary clauses to be without effect, and, indeed, the Brazilian Civil Code states that such clauses are null and void.<sup>9</sup> Therefore, in drafting a clause in which it is desired that one party should have the right to select the object, time, manner or amount of an obligation, it is necessary to set definite limits on the range of selection and to expressly state which of the parties may make such selection.<sup>10</sup> Thus, with respect to the object or manner of the contract, a list of specific alternatives and statement as to which of the parties is to choose among them should be included in the contract. Similarly, a definite period or periods of time in which the obligation is to be performed and a maximum amount to be paid should be set, once again with a clear statement as to which is the selecting party. As long as the selecting party remains within the specified alternatives or range, the other party will be bound.

It should be emphasized that the term "reasonable," often used in American contracts to limit the range of a party's discretion (for example, "within a reasonable time"), is not generally recognized by Brazilian courts as being legally meaningful. Such a clause will be treated as an impermissible discretionary clause.

The use of discretionary clauses will, at best, result in substantial delays while the court determines the nature of the contractual obligation. At worst, such clauses can result in a judicial holding far different from the parties' original intentions, and the party seeking to enforce the discretionary clause may find that it has very little on which to base its action.

#### *E. The Contract Should Not Depend on the Availability of Specific Performance*

Unlike England and the United States, Brazil has no legal tradition of equity courts. Specific performance as a contractual remedy remains very rare, except in a few highly specialized situations.<sup>11</sup> Contracts in Brazil, therefore, must be drafted on the premise that the only remedy available will be penalties and damages. Proof of damages, however, is a complex matter not conducive to rapid enforcement. Consequently, it is often advisable to have a

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<sup>9</sup>C. Civ. art. 115, 1125 (Braz.).

<sup>10</sup>See C. Civ. art. 884-888 (Braz.). Where the contract is silent as to which party makes the selection between alternative methods of payment, the debtor (party making payment) may make the selection. C. Civ. art. 884 (Braz.).

<sup>11</sup>One such situation, for example, occurs with respect to shareholders, agreements duly registered with a sociedade anônima. Law of Dec. 15, 1976, [1976]. Law No. 6.404, art. 118, § 8 (Braz.) See generally C. Civ art. 878-883 (Braz.); Law of Jan. 11, 1973 [1973] Law No. 5.869 (Braz.) (codified in C. Civ. P. art. 632-645 (Braz.) ).

provision for liquidated damages in the contract, preferably one calling for a certain payment (in an inflation-indexed amount) per day of violation.

*F. It is Usually Advisable to Have the Contract Governed by Brazilian Law and Subject to the Jurisdiction of Brazilian Courts*

Many American attorneys provide, almost as a matter of course, that contracts shall be governed by the laws and subject to the jurisdiction of the state where the company's headquarters are located. This is generally not advisable in Brazil.

Normally, the Brazilian party will neither be present nor have assets in the United States. Securing service on a Brazilian party from the United States presents problems, and even where this is done, it is generally not feasible to enforce an American judgment in Brazil.<sup>12</sup> Thus, the American party is put in the position of having to sue in Brazil, and the clauses calling for governance by American law and/or jurisdiction of an American court will result in confusion and delay. The probable result is that the Brazilian court will eventually ignore such clauses and apply Brazilian law, and even if an attempt to apply the appropriate American law is made, Brazilian law will dominate wherever the two conflict.<sup>13</sup>

On the other hand, the Brazilian party to the contract will essentially have the choice of suing the American party either in the United States or Brazil, as the former jurisdiction will recognize the jurisdictional clauses and the latter will not. Thus the Brazilian party has both a choice of forums and, because of the tendency of the Brazilian courts to apply Brazilian law, a choice of laws, neither of which is open to the American party.

Protection of the American party's interest as well as efficiency of enforcement, therefore, recommend that in most cases the contract be governed by Brazilian law and subject to the jurisdiction of Brazilian courts.

*G. Care Should Be Taken as to Who Signs the Contracts on Behalf of the Brazilian Party*

The person contractually committing a Brazilian company should be a person permitted to do so under the company's articles or charter. Brazilian law enforces this point quite rigidly. Especially with respect to public held companies, it is important that the American party investigate the Brazilian company's articles—available in the Commercial Registry—to discover what corporate limits and safeguards may exist and who is authorized to bind the

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<sup>12</sup>Foreign decisions must be ratified by the Supreme Federal Court. C. Civ. P. art. 483 (Braz.). In practice this is almost never done. Furthermore, Brazilian courts have jurisdiction over all obligations to be performed in Brazil and all matters arising out of acts practiced in Brazil, and they are not barred from hearing causes of action which are in the process of being adjudicated outside of Brazil. C. Civ. P. art. 88-89 (Braz.).

<sup>13</sup>See C. Civ. P. art. 337 (Braz.).



company, that is, which and how many directors or quotaholders should sign.

The question of who signs the contract on behalf of the Brazilian party becomes even more important where the contract contains clauses limiting the American party's liability. It is the authors' opinion that in light of the renunciation of rights which the Brazilian party makes, such a contract should be signed by directors or attorneys-in-fact with specific powers to alienate, without payment, property of the company. Although this may be impracticable with respect to simple sales contracts for merchandise, any limitation of liability in a contract which, by its value, is of unusual importance to the Brazilian company (including especially contracts involving the purchase of capital goods) may be set aside if the Brazilian party becomes insolvent and the limitation of liability is deemed to be a cause of such insolvency, except where the contract has been signed by a person with specific powers to agree to such limitation.

### **Conclusion**

The foregoing discussion contains certain suggestions which may help initiate a dialogue between American and Brazilian attorneys. These suggestions are by no means exhaustive, nor are they hard bound rules which must be followed in all cases. Like most such suggestions, they are to be weighed in the context of the client's general interests.

American and Brazilian attorneys can greatly benefit their joint clients by working in close harmony in preparation of contracts to be carried out and judicially enforced in Brazil. In order for this harmonious relationship to occur, it is sufficient that each recognize his respective area of activity. The American attorney should be concerned with clearly communicating the business objectives of the contract, discussing the problems arising from such with his Brazilian counterpart, monitoring any possible repercussions the contractual arrangement might have for his client under American or other non-Brazilian law, and generally coordinating the legal aspects of his client's international operations. On the other hand, the Brazilian attorney must take responsibility for the viability and effective enforceability of the contractual arrangements under Brazilian law and doctrine, basing the arrangements on his knowledge of Brazilian legal culture and judicial developments. The result can be greater certainty that the client's business objectives are being carried out in a legally effective manner which permits more complete and rapid enforceability.

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