Memorandum of understanding (commercial) Q&A: Brazil

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Brazil-specific information concerning the key legal and commercial issues when entering a memorandum of understanding in anticipation of a future commercial transaction.

This Q&A provides country-specific commentary on *Standard document, Memorandum of understanding (commercial): Cross-border*.

This Q&A forms part of *Cross-border commercial transactions*.

Memorandum of understanding

1. Are memoranda of understanding (MoUs) frequently put in place in your jurisdiction for a general commercial purpose?

MoUs are frequently put in place in Brazil, to set out the general terms of negotiation before the parties enter into a commercial agreement or as a document which states the expected behavior of the parties during the negotiation phase of a commercial relationship.

They are more common in some specific circumstances, such as:

- At the beginning of a long-term commercial relationship.
- Where negotiation of an agreement is expected to be difficult or threatens to hinder the final deal.
- Throughout complex and expensive commercial relationships in general.

MoUs are generally not binding. However, they may be considered complete contracts when they have all the elements of the formal agreement that is yet to be entered into (such as price, obligations of the parties and so on).

Other forms of preliminary agreements are also used before entering into the final agreement to achieve the same results as those expected of MoUs, such as letters of intent (LoIs), term sheets and general offers.

2. Would there be a presumption that an MoU is not legally binding in your jurisdiction?

Yes, there is a presumption that an MoU, as a whole, is not legally binding in Brazil. This is due to the fact that an MoU is more commonly used as a preliminary agreement, and therefore its nature is not to legally bind the parties, but rather to settle the main terms and conditions that will govern the negotiation that will lead to the final agreement.

However, some sections of an MoU are usually drafted to be legally binding, such as:

- Confidentiality undertakings.
- Non-solicitation of employees, customers, suppliers and so on.
- Sections regarding liability restrictions.
- Governing law.
- Sections regarding the lack of third-party rights.
- Jurisdiction and choice of venue.
- Exclusivity clauses (providing for a period during which the parties will not negotiate with third parties for similar purposes).
- Sections regarding division of costs between the parties.

There are statutory provisions regarding preliminary agreements in Brazil which state that the parties have the right to enforce a preliminary agreement which:

- Is registered.
- Has no right to retract (that is, an express provision allowing the parties to walk away from the final deal if they wish to do so).
- Contains all the essential elements of the agreement to be entered into by the parties.

(*Articles 462-463, Brazilian Civil Code*.)

The parties may include express terms regarding the limitations of the binding obligations (see *Question 12*).

3. What are the formalities required for the formation of contracts in a commercial context in your jurisdiction?

There are formalities required for the formation of contracts in Brazil. They are divided into subjective and objective requirements.

The subjective requirements are:

- The existence of at least two parties.
- The generic capability of the parties to enter into a contract (*sections 3-4, Brazilian Civil Code*).
- The specific capability of the parties to enter into contracts. Some contracts may only be executed by specific individuals: law services can only be provided by lawyers, for example.
- Consent of all the parties to the agreement.

The objective requirements are:

- The scope of the contract must be lawful and in compliance with Brazilian standards of good moral principles and decency.
- The scope of the contract must be physically possible.
- The obligations must be determined or determinable.
- The contract must have a monetarised value, so that the parties might be entitled to damages in the event of breach.

4. Would an obligation to negotiate in good faith be enforceable in your jurisdiction?

Yes, the obligation to negotiate in good faith is enforceable in Brazil. Section 422 of the Brazilian Civil Code governs good faith in contracts. It states (in a free translation) that "the parties will uphold, when executing and throughout the performance of the contract, the principles of integrity and good faith".

Under Brazilian law, good faith is divided into objective good faith; and subjective good faith. While the former is measured according to objective criteria, the latter is interpreted as a state of mind (that is, the true intention of the party).

Due to its impalpable nature, subjective good faith is impossible to enforce. Objective good faith, however, can be observed through the actions of the party. For a party to act in objective good faith, its actions must not be negligent, reckless or constitute malpractice. The analysis of whether or not a party acted in good faith is done on a case by

case basis, taking into consideration the scope of the agreement and the situation of the parties. A lack of objective good faith must be proved for it to be enforced.

The parties can also stipulate in the contract a set of actions which shall or shall not be considered bad faith. For those actions, there is no burden of proof. Therefore, it is advisable to include in an agreement a clause concerning actions which shall and shall not be considered bad faith.

The obligation to negotiate in good faith is enforceable in Brazil. It is commonly applied by judges as a ground for their decisions.

5. What period would obligations of confidentiality typically endure under an MoU in your jurisdiction?

Confidentiality undertakings established in an MoU in Brazil will usually endure until the execution of the final agreement, which will normally settle other confidentiality obligations between the parties. Should no final agreement be entered into, the confidentiality undertakings will endure for as long as the parties have agreed in the MoU.

It is common to see MoU confidentiality clauses drafted to state that the term will endure for a determined number of years or until the execution of the final agreement, whichever occurs first. The parties are generally free to choose the time period. However, it is common practice to limit the duration of confidentiality undertakings to five years. An obligation of confidentiality that does not specify an end date might not be effective should one of the parties attempt to enforce it.

6. Are there any limitations on the use of non-solicitation restrictions in your jurisdiction?

There are no specific limitations on the use of non-solicitation restrictions in Brazil. However, there are some issues that may arise, such as:

- Competition law issues, from the continued obligation not to engage in certain markets or activities with certain players.
- Discussions about the abusive nature of a non-solicitation restriction, which may lead the undertaking to be annulled in court.

Competition law issues may arise whenever the damage is to society in general (a damage to free competition or free initiative). From an anti-trust point of view, there may be a problem if both:

- The non-solicitation clause restrains or in any way damages free competition or free initiative (even if the party who wrote it did not intend it to).
- One of the parties:
    - has control of the relevant market of goods or services;
    - arbitrarily increases its profits; and
    - exercises a dominant position abusively.

(*Article 36, Law 12.529/2011 (Brazilian Anti-Trust Law)*.)

The possible risk in connection with a non-solicitation restriction relates to the extent of damages that the party in breach may be asked to pay. If the obligations imposed on this party (and the corresponding penalty) are excessive and the party decides to take the matter to court, there is a risk of the judge ruling that the clause is abusive and therefore voiding it. Therefore, it is advisable to impose non-solicitation restrictions for a maximum of five years and to be as specific as possible as to the extent of the clause (that is, whether it applies to a certain business, suppliers, key employees and so on). The extent of *Memorandum of understanding (commercial): Cross-border: clause 6* is not likely to be problematic in Brazil, as it has a reasonable time period, it would be applicable to certain types of employees and customers, and it contains criteria that will likely suffice in the event of proving the breach in court

> 7. Would it be standard practice to include a provision like *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 6.4* (providing an express remedy for breach a non-solicitation restriction) in your jurisdiction? What other remedies might be available to a party in the event of a breach? Would paragraph 6.4 potentially prevent recovery?

It is not unusual to provide an express remedy for a specific breach. However, this is more commonly used for the principal obligation of the contract. *Standard document, Memorandum of understanding (commercial): Cross-border: clause 6.4* is fully valid and enforceable. However, if a breach has an express remedy, this remedy must be proportionate to the breached undertaking.

As indemnities can be used in Brazil, it is standard practice to introduce a general section regarding any penalties for breach of contract and to apply it subject to a cap equal to a fixed percentage of the total value of the contract. Agreements frequently establish a specific penalty for breach of non-solicitation and non-compete undertakings.

Breach of contract entitles the non-breaching party to seek remedies in court, which are usually translated into payment of damages to be assessed by the court. In some circumstances, specific performance is also available to the non-breaching party.

To remedy the effects of a breach of contract, the parties may agree on certain guarantees (such as mortgages, collateral, liens and so on), or may purchase insurance.

8. Are there any limitations on the use of exclusivity or lock-out provisions in your jurisdiction?

There are no specific limitations on the use of exclusivity or lock-out provisions in Brazil. However, if the limitations are considered abusive or harmful to competition, there might be restrictions on their use (see *Question 6*).

9. Would it be standard practice to include an indemnity to cover breach of exclusivity like *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 7.7* in an MoU in your jurisdiction?

Yes, it would be standard practice to include an indemnity to cover breach of exclusivity, such as that in *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 7.7*.

Should there be no provisions regarding indemnities in the contract, the default rule establishes the standard scope of indemnities, which include losses, damages, loss of profit and monetary adjustment (*Articles 402-405, Brazilian Civil Code*). In some agreements, the parties restrict these statutory indemnities by excluding, for example, loss of profit and indirect damages.

10. Does the law of your jurisdiction dictate which governing law and jurisdiction will apply to an MoU?

Section 9 of the Introductory Law to the Brazilian Legal System (in a free translation) determines that "concerning obligations, the applicable law is the law of the country in which they were stipulated".

Therefore, if an MoU is executed in Brazil, the Brazilian laws are applicable. If it is executed elsewhere, the law of that country will apply when enforcing obligations in Brazil, to the extent that it does not contradict Brazilian law.

The parties may choose different governing laws and jurisdictions depending on the foreign elements connected to the MoU (for example, if there is a foreign party). However, if the obligations are to be enforced in Brazil, the statutory provision mentioned above clearly favours choosing Brazilian law and jurisdiction.

If the parties choose arbitration as the means of conflict resolution, there are no restrictions and the parties are free to appoint a foreign governing law.

11. Are there any clauses in *Standard document, Memorandum of understanding (commercial): Cross-border* that would be ineffective or not standard practice in your jurisdiction?

All clauses in *Standard document, Memorandum of understanding (commercial): Cross-border* are effective in Brazil and are used by Brazilian lawyers. Clauses regarding third-party rights are unusual, although they are fully enforceable between the contracting parties.

Regarding the language of the agreement, it is worth mentioning that, if a conflict arising from the agreement reaches the Brazilian courts, the Portuguese version of the contract or the sworn translation into Portuguese are the documents which will be taken into account by the judges.

12. Are there any other clauses that it would be usual to see in an MoU and/or that are standard practice in your jurisdiction?

Some clauses that are not contained in *Standard document, Memorandum of understanding (commercial): Cross-border* are common practice in Brazil. Very usual ones are:

- A stipulated/predicted schedule for the parties to negotiate and enter into the final agreement, complete the due diligence, calculate the final price and so on.
- Provisions regarding due diligence.
- A list of all obligations the parties must comply with to maintain or start the negotiation.
- A specific clause stating that the undertakings are not binding on the parties except for certain clauses (for example, confidentiality, exclusivity, governing law, choice of venue and so on).
- A clause regarding alternative dispute resolution methods, such as arbitration or mediation clauses, or a veto on use of these (arbitration is very commonly included in commercial MoUs and agreements in Brazil).

Less frequently included, but also seen in Brazilian MoUs are:

- Guarantee clauses.
- Notices and communication between the parties.
- Obligations to negotiate in good faith.

Clauses regarding pricing and valuation of obligations and monetary adjustment are also sometimes included in Brazilian MoUs.

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