

## THE BRAZILIAN EXPERIENCE WITH RESPECT TO TENDER OFFERS

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### 1. Introduction

The first tender offer in Brazil occurred in October 1971, when Macrosul S.A. sought takeover of Sulbanco [1]. It was at the height of a period during which the Brazilian Government's Ministry of Finance encouraged the formation of financial conglomerates [2]. Credit from the Central Bank of Brazil was made readily available to selected financial institutions [3] who then engaged in private negotiations with target company controlling shareholders. Sales were negotiated for as much as ten times the market value of the shares, and non-controlling, or minority shareholders were rarely invited to tender their shares at the premium price [4]. Controversy arose over this questionable practice of failing to offer the premium to the minority shareholders, and in 1973 the first legislative proposals to remedy the situation were brought before the Congress [5]. The following year, the Council of Economic Development [6] dealt with the issue in its Second National Economic Development Plan of 1974. Specifically, it called for reformulation of the Corporation Law with a view toward preventing the controlling shareholders' shares from obtaining a higher resale value than that of the non-controlling, or minority shareholders' shares [7]. Thus, it sought to protect the economic interests of the minority shareholders in the event of a privately negotiated sale of a controlling block of shares. Pursuant to this Plan, the Economic Development Council issued the following guidelines for reformulation of the Corporation Law: "The Law shall require that the transfer of a substantial portion of the voting capital of a public company be effected through a tender offer transaction so as to ensure that minority shareholders receive treatment equal to that received by the controlling shareholders [8]".

A shift away from this policy occurred in June 1976, when the Economic Development Council included in its draft Corporation Law a provision that asserted the right of the controlling shareholders to receive a premium price upon transfer of

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controlling blocks of shares with the exclusion of the minority shareholders [9]. This provision served to underscore the need to protect the minority shareholders and it was rightfully rejected by the Senate [10]. In its place, the Senate approved Senator Lehman's proposal which would give minority shareholders the same right to receive a premium price that the controlling shareholders had. On December 15, 1976, the New Corporation Law [11] was finally enacted, granting equal treatment to controlling and minority shareholders in the event of a transfer of control of a public company.

As is evident in this introduction to the Brazilian tender offer regulatory system, tender offers and their regulation are relatively new events in Brazil. There are no reported judicial decisions concerning the regulatory legislation, and the various regulatory authorities have yet to establish clear and dependable guidelines for policy and enforcement. Thus, the primary purpose of this article is to describe the tender offer regulatory system and underlying transaction. The concept of corporate control under Brazilian corporation law affects some of the legislation and so it is also explained. Finally, some specific issues that have arisen, or are likely to arise under the system, are also addressed.

## 2. Regulatory framework

The Brazilian tender offer regulatory system is organized according to types of tender offers. Basically, tender offer types are characterized by the circumstances under which they are made. They fall into four groups: transfer of control, acquisition of control, consolidation of control, and going private. All other types of tender offers, such as those made for the acquisition of a non-controlling or control consolidating block of shares, are not specifically regulated in Brazil. Instead, they are transacted according to general contract law principles.

Transfer of control tender offers, also called "compulsory tender offers", are required by the Corporation Law to be made to *all* shareholders whenever the controlling shareholder enters into an agreement to sell his shares to another party, thereby transferring his control of the corporation. Such offers are not considered to have been voluntarily made; rather, they are mandatory in the wake of friendly private negotiations between the controlling shareholder and another party. They are governed by Part VI of the Corporation Law, which assigns regulatory responsibility to the National Monetary Council (*Conselho Monetário Nacional*) and the Securities Commission (*Comissão de Valores Mobiliários*). Tender offers made for acquisition or consolidation of control differ from compulsory offers in that they are wholly voluntary and are in fact the sole means by which the offeror gains a controlling block of the corporation's shares. Such offers are extended to all shareholders *at the outset* and involve no privately negotiated sales between the offeror and any shareholder. They are governed by Part VII of the Corporation Law and regulated by the Securities Commission. Going private tender offers are mandatory

“any and all” offers for the shares of a target corporation. Thus, they seek out all shareholders, whether voting or non-voting. This feature, of course, distinguishes them from compulsory, acquisition of control, and consolidation of control tender offers which seek out only shareholders who own voting stock. They are governed by Directive 3 of the Securities Commission, which also governs cancellation of public company registration.

Compulsory tender offers are administered primarily by the National Monetary Council [12] whose authority is expressly granted by Article 254 of the Corporation Law. However, it has delegated much of its day-to-day responsibility to the Securities Commission [13]. As a result, the compulsory tender offer is governed directly by two documents: Resolution 401 of the National Monetary Council and Directive 3 of the Securities Commission. Voluntary tender offers, *i.e.* acquisition of control, consolidation of control, and going private tender offers are regulated directly by the Securities Commission, under authority granted by the Corporation Law. In addition to these two main regulatory bodies, the stock exchanges (*bolsas de valores*) exercise limited regulatory authority over the conduct of their members and aid in enforcement of the tender offer law and regulations [14].

The Securities Commission, the regulator with the most pervasive role in the tender offer regulatory system, is empowered to use numerous enforcement devices. It may examine the accounting records, books and documents of both individuals and corporations involved in the tender offer transaction and it may require such persons to appear at an administrative proceeding to answer questions or provide additional information. If the Commission determines that there has been a violation of the Corporation Law, the Securities Commission Law or administrative regulations, it may impose any of a number of penalties including, but not limited to, a fine, suspension of an officer of a publicly held corporation, and cancellation of a company’s registration. Appeal of a penalty may be made to the National Monetary Council which established the procedures by which the Commission conducts its investigations. Criminal action may only be taken by the Attorney General.

### 3. The Brazilian concept of corporate control and the tender offer regulatory system

The Brazilian Corporation Law specifically defines control in terms of exercised power on the part of an individual, legal entity, group of individuals or groups of legal entities joined together by a control agreement or under common control. A controlling shareholder or group of shareholders is one that: (a) has sufficient votes at general shareholders’ meetings to push through the resolutions it wants and to elect the majority of the company officers, *and* (b) actually exercises its power to direct or influence corporate policies and activities [15]. Honorary, future, and intermittent control are insufficient. Consequently, if a majority shareholder

chooses to remain aloof from corporate affairs, a minority shareholder can be a controlling shareholder.

The title of controlling shareholder carries with it statutory obligations and liabilities for abuses of power [16]. Among the former is the duty to respect the interest of all the other shareholders of the corporation and to refrain from damaging them. Failure to ensure the making of a tender offer to the non-controlling shareholders in the event of a transfer of control is deemed by law to be a breach of this duty and subjects the controlling shareholder to Securities Commission penalties. Thus, it is of critical importance that the Securities Commission and the shareholders be able to determine who is the controlling shareholder of a corporation undergoing a negotiated transfer of control.

Transfers of non-controlling, minority blocks of stock can create confusion in the situation where several non-controlling, minority shareholders knowingly sell their shares to a party and thereby transfer a number of shares sufficient to bestow upon the purchaser control of the corporation. It is impossible then to distinguish between a mere sale of a block of stock and an actual transfer of corporate control. National Monetary Council Resolution 401 attempts to resolve the difficulty with a new definition of controlling shareholder [17]. It establishes that the controlling shareholder can be a minority shareholder or a group of minority shareholders that is able to gather an absolute majority of votes at the last three shareholders' general meetings. These meetings need not have occurred within a particular span of time. This is troublesome because during an ongoing struggle for corporate control shareholders general meetings could be convened as many as three times within a single fiscal year. The Resolution approach is troublesome too because it allows a controlling shareholder who has not participated in one of those last three general meetings to sell his shares without having to comply with the simultaneous tender offer requirement.

Another issue that arises in connection with the concept of corporate control relates to the statutory requirement that the controlling shareholder actually use his power to direct corporate affairs. For the purposes of section 254 of the corporation law, such requirement must be construed as applied to the purchaser and not to the seller of corporate control. Otherwise, a non-controlling majority shareholder could sell his shares to a party which intends to exert control over the corporation without complying with the simultaneous tender offer rule. Thus, in such a situation the parties to the transaction would have to comply with the simultaneous tender offer rule.

Indirect control of corporations is another situation that raises potential problems for the regulatory system, especially when it takes the form of a holding company. For instance, in the event that a holding company disposes of controlling shares that were part of its assets, the minority shareholders of the controlled company would be entitled to receive the premium price for their shares. Similarly, the simultaneous tender offer would be required in the event that the controlling shareholder sold its interest in the holding company itself. In the latter case, the

value of the controlled company shares would be deemed equal to that of the holding company shares.

Negotiated transfers of indirect control might also occur in the situation where a controlling shareholder organizes a holding company which is incorporated as a limited liability company and the subscribed capital paid in with controlling shares of the corporation, assessed at par value. This would undoubtedly be considered a sale of corporate control, and as such trigger the obligation for the controlling shareholder to comply with the simultaneous tender offer rule. If the holding company shares were worth less (because of the company's liabilities) than the controlled company shares, the Securities Commission would determine the price for the latter. From this amount, the Commission would then deduct the liabilities of the holding company to arrive at a figure that accurately reflected the value of the shares owned by the controlled-company shareholders.

#### 4. The tender offer transaction

In order for a tender offer to be made the offeror must arrange to have a financial institution act as guarantor for all his financial commitments with respect to the offer. Thus, for example, if the offeror fails to pay for shares he has agreed to purchase, the guarantor financial institution will undertake the payment. This so-called "covenant of warranty" is completely separate from a loan agreement which the offeror might enter into with a financial institution for purposes of financing the offer at the outset.

Once the covenant of warranty is arranged, the tender offer must, to become effective, be announced in the press. An offering document, signed by the offeror and the investment bank or securities firm guaranteeing payment, serves as the announcement. Its contents are specified in National Monetary Council Resolution 401 [18] and Securities Commission Directive 3 [19], and include information about the offeror, the price of the shares sought to be acquired, the offering period, the method for acceptance of the offer, and the procedure in case the number of shares tendered exceeds the offeror's expressed limit. It must then be filed with the Securities Commission within twenty-four hours of its initial publication.

If the offer involves a partial or total exchange of securities instead of cash, it must be filed with the Commission prior to its publication in the press. In addition, the offering document for such a tender offer must describe the structure and such items as revenue, net income, shareholders equity, capital stock, and book value of outstanding stock of both the target company and the company whose stocks are being offered in the exchange. This of course is intended to facilitate comparison between the companies. Also, the offering document must describe the changes in or evolution of the market price of the shares that are the object of the tender offer. Only corporations with outstanding authorized stock are permitted to issue shares in connection with this sort of tender offer. This is so because such corpora-

tions may issue shares up to the authorized limit regardless of the procedures statutorily prescribed for charter amendments, the compliance with which would conflict with the tender offer regulatory provisions.

If the offer is made as a result of a sale of control, the offeror must disclose the terms and conditions set forth in the sale of control agreement and explain the way in which the sale price was calculated. The offeror must also reveal the extent of its participation in the target company's capital and the purpose of its offer. It must disclose any intentions to alter the target company's structure by means of merger, consolidation, or change in legal form (for example, from corporation to partnership) and it must reveal any plans to integrate the target as a division of a larger company or to cause it to go private. Finally, the offeror must inform the target company shareholders of its intentions to maintain, expand, diversify or alter the company's line of goods and/or services.

Disclosures must be accurate and complete. It is unlawful to misrepresent or omit material facts about the offer, the companies involved or the offerors's plans. In the event of non-disclosures or omissions, criminal, civil, and administrative penalties may be imposed upon directors and officers of the offering company and the financial institution. In compulsory tender offer situations insiders of the target company may also be subject to such penalties.

Until the tender offer is announced and thereby made public, the offeror, the financial institution, the stock exchanges and the Securities Commission are all bound to secrecy concerning the impending tender offer. Market manipulation and defensive maneuvers on the part of controlling shareholders and incumbent management are thereby minimized or eliminated. Breach of the duty of secrecy subjects the offenders to the full range of penalties discussed earlier.

Tender offers are considered to be irrevocable, even in the situation where a competing offer is announced [20]. If the latter event occurs, it nullifies all sell orders previously signed in acceptance of the first tender offer. The first offeror's only recourse in such a case is to improve his offer by raising the price or to postpone the closing date of the offer so as to make it coincide with that of the competing tender offer. A price increase can be made only once and must be at least 5% of the original price. Furthermore, it must be effective at least ten days before expiration of the offering period and it must be retroactive to all shares taken up before the price increase.

The required minimum offering period varies with the type of tender offer being made. Compulsory tender offers must remain open for at least thirty days; voluntary tender offers must remain open for at least twenty days. Tendered shares may be taken up until the last day of the offer.

The minimum number of shares which can be sought in a tender offer depends on the number of shares owned by the controlling shareholder. If control is exercised by shareholders owning the absolute majority of the company's voting stock, the amount to be acquired must be equal to 50% or more of the equity. If, on the other hand, control is based upon ownership of a minority interest, the amount of

shares sought to be acquired must be equal to the percentage necessary to exercise such control. In actuality, it is impossible to determine *a priori* whether a tender offer for a block of shares is aimed at acquiring a minority interest in, or control of, the target company. Under these circumstances the law governing acquisitions of corporate control via tender offer must be construed also to apply to tender offers for blocks of stock.

The number of shares necessary to constitute a block of shares is equal to the number of voting shares which enable the holders thereof to elect members of the company's board of directors. Ownership of 10% of the company's voting stock entitles the shareholder to request the action of the Fiscal Council and to elect one of its members; it also entitles the shareholder to request adoption of cumulative voting for the election of members of the board of directors. Thus, acquisition of 10% or more of the voting stock of the company is deemed acquisition of a block of stock. The articles of incorporation of some companies grant preferred shares voting power thus enabling the owners thereof to elect one or more members of the board. In such instances, if a transaction involves the transfer of preferred stock of the company, a tender offer to the minority shareholders should be mandatory.

Directors and officers of the offering company as well as of the target company are charged with the obligation to act in the best interests of the target-company shareholders. Thus, target company management must rigorously conform to the equal treatment mandate of section 254. In addition, despite the fact that the law is not explicit on the matter, target management should express its opinion concerning the offer, especially if it believes that the offer is contrary to the shareholders' best interests. This obligation exists because management stands in a fiduciary position as regards the corporation and its shareholders. Management's recommendation to reject or accept the offer must be legally and economically based and it is held responsible for the sufficiency of the information given to the shareholders in connection with such recommendations.

It has been suggested that management has the duty to commence litigation or take other measures to block the offer if it believes the offer to be detrimental to its shareholders. However, defensive tactics aimed solely at defeating the offer are unlawful and considered an abuse of power. Thus, during the pendency of an offer, management should not be allowed to alter the company structure, distribute extra dividends, issue new shares, or acquire its own shares for the sole purpose of thwarting the offer. Controlling shareholders are similarly restricted.

While it is entitled to express its opinion regarding the offer, the target company management may not interfere with a shareholder's ultimate decision whether to accept or reject the offer. Acceptance of the tender offer is accomplished by signing, in accordance with the terms set forth in the offering document, an irrevocable sale or exchange order addressed to the financial institution indicated in the offering document.

There are three methods of payment for stock purchased in a tender offer: cash, stock, or part cash and part stock. Cash payment is usually at a price higher than

the market value of the tendered securities. When liquidity is short or non-existent, the price may be equal to market value. The precise offering price is generally fixed by market forces. If the price is unfairly low (although above market price), it is up to the controlling shareholders or to interested third parties to make a competing offer and thus raise the stakes. The price for stock acquired by private transfer of control is, of course, fixed by the sale agreement. Stock payment can only take certain prescribed forms: already issued stock, debentures, promoters' shares convertible into equity securities, stock options, treasury shares, shares issued by a third party that are part of the offeror's portfolio, and federal, state, and municipal bonds owned by the offeror. A combination payment, that is stock and/or cash, presents a problem. Since some shareholders could potentially be receiving stock, and others cash, there could be a violation of the equal treatment mandate. Therefore, the question has been raised whether to consider this type of tender offer a single transaction or two separate transactions. It is submitted here that this is only a single transaction because there is only a single purpose involved, *i.e.* to acquire an interest in a target company. Offeree shareholders in such a situation are well informed and aware before acceptance of the offer that not everyone's consideration will have precisely the same value.

### 5. Resolution 401 and the compulsory tender offer

Resolution 401 of the National Monetary Council interprets section 254 of the Corporation Law and limits the powers of the Securities Commission to enforcement of the section's equal treatment for minority shareholders rule. It defines "transfer of control" [21] and its interpretations encompass such items as pro rata procedures, offering period rules, intermediation by financial institutions, and contents and publication of offering documents.

Some of its interpretations of the law are especially noteworthy and even troublesome. For instance, the Resolution affords the offeror the opportunity to propose cash payment for minority shares, regardless of whether the transfer of control agreement provides for installment payment for the controlling shares [22]. In that case, the offering price to the minority shareholders must be equal to that agreed upon by the offeror and controlling shareholder, less any interest charged by the controlling shareholder to the offeror. It must be monitored by the Securities Commission to ensure that the difference in price reflects the interest rate and the monetary correction for inflation that prevailed at the time of the original transaction. The Commission is empowered to revise the price if it determines that the minority shareholders have been short-shrifted. Another problematic item in the Resolution allows the offeror to deduct from the minority shares' price an amount corresponding to the value of the commitments (*e.g.* corporate debts, intellectual property rights) undertaken by the controlling shareholder [23]. Section 254 does not mention such a price reduction anywhere. This price reduction contradicts the Corporation Law's goal of equal treatment for minority shareholders. It also serves as an

example of the way in which the Council has broadened its own authority, going beyond the procedural authority originally given to it. The Resolution's treatment of voting versus non-voting stock is also problematic because it makes the equal treatment rule applicable only to voting stock [24]. Consequently, non-voting stockholders are not recipients of a tender offer in the event of a transfer of control. Section 254 of the Corporation Law does not make this distinction; rather, it speaks only of "minority shareholders". If one takes the view that non-voting stock should be excluded because it confers upon its owner no control over the company, then the Council's interpretation is both reasonable and logical. However, when the Corporation Law created common and preferred stock, it aimed at attaining a balance between different shareholders' interests by allowing the corporations to suppress preferred shareholders' voting rights and instead offer them financial benefits not available to common stock shareholders. To exclude the preferred shareholders from the equal treatment rule would diminish their expected equity benefits considerably. This financial harm would contradict the very purpose for which the Corporation Law established non-voting preferred stock [25].

## Notes

[1] The public announcement of the takeover attempt was made on October 15 in Porto Alegre, capital of the State of Rio Grande de Sul. As it turned out, the attempt failed and Macrosul withdrew its offer. However, the question of the legality of the attempted takeover became a controversial subject and the beginning of the push toward tender offer regulation.

[2] The purpose behind this policy was to shrink the then disproportionate size of the banking sector. The result of the policy was formation of financial conglomerates that operate in all credit and investment sectors of the financial market, and that provide such additional services as leasing, insurance and pension funds.

[3] Created by Law No. 4595 of December 31, 1964, the Central Bank of Brazil is a government agency responsible for the execution of policies determined by the National Monetary Council. In this capacity its relevant functions are to control all forms of credit, to authorize the operation of financial institutions, to supervise such institutions, and to effect loan operations for banks.

It is not to be confused with the Bank of Brazil which is a governmental corporation, organized to be the country's main executor of banking services. In this capacity it performs numerous functions. As agent for the National Treasury it receives tax and other federal revenue payments, provides for the execution and necessary payments of the country's general budget, executes and controls the government's export policy, and collects voluntary deposits from financial institutions.

[4] A notable exception to this practice occurred in November 1973: The *Cooperativa dos Produtores de Açúcar e Alcool* spontaneously extended its tender offer to the non-controlling shareholders of the *Companhia União dos Refinadores*. This action was applauded publicly by the Sao Paulo Stock Exchange.

[5] Brazil is a Federal Republic [*Republica Federativa do Brasil*] formed by a union of states, a federal district, and territories, under a representative government. Legislative power is exercised by a Congress formed by a Chamber of Deputies and a Senate. Deputies are elected by direct popular vote, three per State. Judicial power is exercised by the Supreme Federal Court, Federal Appellate Courts, Federal Judges, plus Military, Labor, and Electoral Courts. The States have their own judiciary for state matters.

[6] The Council of Economic Development is the President's advisory council. Its plans must be submitted to the Congress for approval.

[7] "In order to protect minority shareholders and develop the associative spirit amongst private business concerns, the Corporation Law shall be reformulated with a view to the following objectives: to prevent each share of the majority holder from obtaining a higher market value than that of the minority shareholder . . . ."

[8] Statement of Intent 14 of the Economic Development Council, dated June 25, 1974.

[9] Statement of Intent 196 of the Economic Development Council, dated June 24, 1976.

[10] Proposed legislation goes first to the Senate, then to the Chamber of Deputies for approval.

[11] Law No. 6404 of December 15, 1976.

[12] Created by Law No. 4595 of December 31, 1964, the National Monetary Council is the top level policy-making agency for Brazil's financial system. Its responsibilities include, but are not limited to: coordinating the internal and external monetary, credit, budgetary, fiscal and public debt policies; regulating the formation and operation of financial institutions; and establishing policies and rules for the capital markets. The Council is composed of the following members: Ministers of Finance, Economic Planning and Industry and Commerce; Presidents of the Central Bank of Brazil, the Bank of Brazil, the National Bank of Economic Devel-

opment, and the National Housing Bank; Chairman of the Securities Commission (CVM); and three persons appointed by the President from among citizens of high moral standing and well known for their expertise in financial and economic matters.

[13] The Securities Commission, created by Law No. 6385 of December 5, 1976, is a government agency linked both to the Ministry of Finance and to the Executive. It is administered by five commissioners, one of whom acts as Chairman. All five are appointed directly by the President and may be dismissed *ad nutum*. The Chairman is a voting member of the National Monetary Council.

The Commission is charged with regulation and control of the following activities: (1) issuance and distribution of securities in the market; (2) trading and brokerage in the securities market; (3) organization and operation of, and transactions on, the stock exchanges; (4) administration of securities portfolios and the custody of securities; (5) auditing of open companies; and (6) services rendered by securities consultants and analysts.

Securities include (1) shares, founders' shares, debentures and their respective coupons and subscription bonuses, (2) certificates of deposit of securities, and (3) any other securities created or issued by corporations at the discretion of the National Monetary Council.

[14] Pursuant to Central Bank Resolution 39 the stock exchanges are empowered to supervise their brokers' activities and to provide the market with certain commercial and operational information. In addition, pursuant to the Securities Commission Law, Law No. 6385 of December 7, 1976, the stock exchanges have administrative and financial autonomy and are considered to be ancillary organs of the Securities Commission.

[15] Law No. 6404, art. 116.

[16] *Id.*, arts. 116 and 117, respectively.

[17] National Monetary Council Resolution 401, item IV.

[18] *Id.*, item XVIII.

[19] Securities Commission Directive 3 (*Instrução CVM No. 03 de 17 de Agosto de 1978*), item IX.

[20] A question that arises in connection with competing offers is whether it would be lawful to have a competing offer when the original one is compulsory, *i.e.* arising out of a private sale of corporate control. In such a case, it is submitted, a competing tender offer would be perfectly lawful. The competing offer, however, would be restricted to minority stock since the control stock would already have been acquired by the offeror.

[21] National Monetary Council Resolution 401, item 2.

[22] *Id.*, item 14.

[23] *Id.*, item 15.

[24] *Id.*, item 1.

[25] Such a result also would support the view that publicly held companies should not be allowed to issue significant numbers of non-voting shares.

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