CARLTON FIELDS

Due Diligence in Cross-Border Acquisitions Paving the Road to Enter or Run Away From a Deal in Brazil

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With the great majority of foreign jurisdictions already adopting U.S.-style acquisition documents in connection with business acquisitions, U.S. investors experience a larger sense of comfort in negotiating their equity investments in new markets. This comfort level is increased by the fact that in many of these foreign jurisdictions, an increasing number of U.S.-trained lawyers is available to serve as local counsel for purposes of negotiating the terms and conditions of the applicable agreements. This is certainly the landscape a foreign investor finds in Brazil. In this scenario, one of the key concerns relates to the due diligence process which remains largely impacted by local rules, regulations, customs and practices. Initiating the due diligence on the right foot is imperative to secure a good deal or escape from a bad one. For this purpose, U.S. investors should be prepared to ask the right questions and set adequate parameters for the legal due diligence, which parameters will largely depend on the size of the deal and the appetite to risk of the investor. In Brazil, the main areas of concern are tax, labor and litigation. For tax due diligence, U.S. investors should try to avoid overlap between the work to be performed by accounting and tax personnel, on the one hand, and tax counsel on the other, as both sets of work product must complement each other. As a matter of practice in Brazil, the local tax counsel will be responsible for analysis of materialized liabilities, i.e., administrative and judicial proceedings, focusing on the estimation of the maximum exposure and the chances of success. Accounting and tax personnel, on the other hand, analyze tax policies and practices adopted by the target, in an effort to identify contingencies that may materialize in the future. Unless a clear pattern of behavior of the Brazilian tax authorities is identifiable, it is difficult to predict if bad practice or policies will result in an administrative or judicial proceeding. However, accounting and tax personnel are generally able to determine the maximum exposure of a potential proceeding and will rely on the opinion of tax counsel to determine the related risk of loss, if and when a claim is initiated by the authorities. In practice, it is not common to set threshold limitations for the tax portion of the due diligence, as consequences should not be measured by potential immediate losses but rather by potential long term negative effects. Labor due diligence is primarily influenced by the characteristics of Brazilian labor rules and regulations, which offer a paternalistic treatment to employees. Similar to the tax portion of the due diligence, the Brazilian labor counsel focuses on ongoing labor litigation while accounting and tax personnel look into the labor policies and practices adopted by the target. However, unlike the tax analysis, a materiality threshold is generally determined by the investors with the assistance of local legal counsel, in an effort to focus on what is really relevant on the labor side. Finally, litigation due diligence is materially influenced by the sector in which the target operates, with a distinction between strategic and core business litigation. In order to increase productivity and objectivity, the investor must set realistic thresholds for review of litigation related to the core business, discarding the analysis of minor issues which will not materially impact the affairs of the target. In all consumer-related businesses, special attention should be paid to setting the appropriate methodology for analysis of consumer claims, as they often come in a large number before the Juizados Especiais Cíveis (the small claims courts) and require an adequate review by sampling. On the other hand, proceedings that may affect the entire sector in which the target operates, often carry a strategic concern and must be carefully analyzed, irrespective of the amounts involved. Therefore, although a globalized legal environment facilitates the negotiation of agreements for acquisitions in Brazil, U.S. investors must dedicate their efforts at the beginning of the acquisition process to carefully define the scope and materiality thresholds for the due diligence process jointly with competent local counsel, in order to improve their chances to make an adequately informed decision, whether such decision is to sign and close a good deal or simply walk away.

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