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Inclusion of Arbitration Agreement in the By-Laws of Corporations

Law No. 13,129, dated May 26, 2015 amended the Brazilian Arbitration Act (Law No. 9,307 dated September 23, 1996) largely by enshrining therein the understanding of Brazilian courts on many of its formerly controversial aspects, such as the entering of partial awards, the government's standing to be a party to an arbitration, and the requests for preliminary relief and injunction prior to the commencement of an arbitration.

It also amended the Brazilian Corporations Act (Law No. 6,404 dated as of December 15, 1976 – "BCA") so as to regulate the effects of the inclusion in the by-laws of an agreement to arbitrate disputes upon dissenting shareholders.

Pursuant to novel article 136-A of the BCA, if the inclusion of an arbitration clause in the corporation's by-laws is approved at a shareholders' meeting, then all shareholders are bound thereby, but any dissenting shareholder will have the right to withdraw from the corporation and have its shares redeemed by the corporation in cash (the "Redemption Right", or "*direito de retirada*").

Article 136-A is based on the understanding of certain scholar authorities rather than being the result of the evolution of case law – which is scarce on this topic. It puts an end to a heated debate on how to reconcile the majority principle that permeates the law of corporations (i.e., minority is bound by the majority vote) with the principle of consent to arbitrate (i.e., a party may not be forced to waive its constitutional right to submit disputes to the Judiciary).

The Redemption Right is an inalienable statutory right under the BCA, and is reserved for key matters the approval of which at the shareholder's meeting may affect the fundamental incentives of the minority shareholder to invest in the corporation. It may only be exercised if the majority of the voting stock has resolved to approve a change in the nature or structure of the corporation (certain corporate consolidations, spin-offs, mergers and acquisitions, change in the corporation's business purpose, and so forth) or the limitation or suppression of certain rights of the shareholders (predefined minimum dividend, preferences attached to the type or class of preferred stock held by the dissenting shareholder, and so forth).

Hence, by setting forth that a dissenting shareholder may withdraw from the corporation if the adoption of arbitration in the by-laws is approved, Law No. 13,129/15 implicitly acknowledges that the right to sue and be sued and to have the corporation sue or be sued in a court of law is a key shareholder's right. This is a satisfactory compromise solution to the clash between the principles of corporate majority and consent to arbitration.

Unfortunately, Law No. 13,129/15 is technically flawed as to how long the term to exercise the Redemption Right is. Article 137, item IV, of the BCA sets it on thirty days following the publication of the minutes of the relevant shareholders' meeting. It was not amended by Law No. 13,129/15 and as a consequence it continues to list only the previously existing matters the approval of which triggers the Redemption Right.

The 30-day term set forth in article 137, IV, should still apply notwithstanding this technical flaw:

1. There is no reason to differentiate between terms to exercise the Redemption Right.
2. This is in line with the systemization of Law No. 13,129/15. Pursuant to novel article 136-A, 1st paragraph, of the BCA, the arbitration agreement becomes binding exactly thirty days after the publication of the minutes of the shareholders' meeting.
3. The alternative construction – no time limit to exercise the Redemption Right – would cause uncertainty to the corporation and the remaining shareholders.

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Items I and II of novel article 136-A, 2nd paragraph, of the BCA carve out two circumstances in which the dissenting shareholder may not exercise the Redemption Right upon approval of the inclusion of the arbitration agreement in the by-laws: (a) if such inclusion has been approved as a condition for listing the corporation's securities in a stock exchange segment requiring a free float of no less than 25% of each type and class of share, or (b) if such inclusion regards a publicly-traded corporation the shares of which are dispersed in the market and have liquidity.

The first carve-out is a not-so-subtle nod to the listing segments of São Paulo Stock Exchange (the BM&FBovespa) for corporations with a higher level of corporate governance. Admittance into the "*Novo Mercado*" and the "*Nível 2*" segments is contingent upon both (a) a minimum free float of precisely 25% of the shares and (b) consent to arbitrate disputes in BM&FBovespa's "*Câmara de Arbitragem do Mercado*".

The rationale behind this carve-out is laudable – individual Redemption Rights should not hinder the adoption of enhanced corporate governance standards that benefit the whole capital market. However, the way this was structured by article 136-A of the BCA may prove problematic. The São Paulo Stock Exchange might unilaterally lower the threshold for admittance into all of its listing segments to less than 25%, which would immediately render this statutory carve-out completely innocuous. It is also not clear how this carve-out will work in the context of admittance into the two current "*Bovespa Mais*" segments, which do require a 25% free float but limit this requirement to seven years.

As for the second carve-out, liquidity and dispersion are cumulative requirements. Liquidity under the BCA means that the shares are part of a relevant securities index in Brazil or abroad as defined by the Brazilian Securities Commission (the "*Comissão de Valores Mobiliários*" – "CVM"); article 9 of CVM's Regulation No. 565, dated as of June 15, 2015, endorsed only one such index, which is the Ibovespa. Dispersion means that the indirect or direct controlling shareholder holds less than half of each type and class of stock; this is not how the capital stock of many of Brazilian corporations is structured. This all means that this second carve-out has a very narrow scope, and minority shareholders' Redemption Rights have been safeguarded to a great extent.

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