Legal Bulletin
October 2017

The Labor Reform and M&A Transactions

Law No. 13,467, of July 13, 2017, which alters the Brazilian Labor Code (*Consolidação das Leis do Trabalho* - CLT), will become effective on November 11, 2017. The new legislation, referred to as "Labor Reform", brings innovations that can be relevant in mergers and acquisitions transactions, including a change in the definition of economic group (*grupo econômico*) and the limitation of liability of former shareholders.

Definition of Economic Group

The CLT and case law currently in force establish that whenever one or more legal entities are under the direction, control or management of another, an economic group exists, as a result of which each of the applicable companies may be held jointly and severally liable for labor obligations of the others, regardless of whether or not a group exists under corporate law.

For the characterization of an economic group, it is not necessary that different companies perform the same economic activities or that they are subject to the same control (vertical relation). The relationship between companies that form a same group may be established horizontally, by mere coordination, by means of participation in enterprises of common interest of the entities, as this allows the sharing of benefits and cash flows between them.

There are Labor Court decisions holding that simply by having shareholders in common (*identidade de sócios*) – whether individuals or entities – two or more companies may be deemed under to common control.

This is obviously a matter of great concern for any party intending to acquire a partial stake in a Brazilian legal entity, thereby risking being held liable for labor obligations not only of the target company, but also of its other shareholders and of the managing team.

Protection against such a risk is usually sought by means of indemnification clauses in the acquisition documents, which however often present difficulties. For instance, the contractual protections should be effective for the duration of the share holding and be binding on shareholders who might not have participated in the sale.

Under the Labor Reform, the mere existence of shareholders in common does not imply the existence of an economic group. Additional requisites should be verified case by case by the Labor Court, including the existence of common and integrated interests (*comunhão de interesses* and *interesse integrado*) and their joint operation (*atuação conjunta*) of the relevant companies.

Such changes by themselves, once the Labor Reform is effective, will substantially mitigate the risk of "cross contamination" commented above.

Labor Liability of a Former Shareholder

Article 1,032 of the Brazilian Civil Code limits the liability of the exiting shareholder for obligations of the company to a period of two years as from the date such party ceases to hold corporate interests therein. Due to the absence of provisions regarding this matter in the CLT currently in effect, case law determines that a party formerly entitled to corporate interests in a legal entity may be held liable for its labor obligations stemming from labor relations in effect during the period in which such party was a company stakeholder, regardless of the time elapsed after this party ceases to hold interests in the company.

According to the new rules, former shareholders may be held liable for labor obligations up to two years after departure, and such liability is subordinated to that of the company, in the first place, and of the current shareholders[1].

[1]The exiting stakeholder will be jointly and severally liable with the others when a fraud in the corporate documentation that formalizes the exit is demonstrated.

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Future Perspectives

As another significant innovation, the Labor Reform prevents precedents (*súmulas*) and other statements (*enunciados*) of the Brazilian Superior Labor Court (*Tribunal Superior do Trabalho* - TST) and of Regional Labor Courts (*Tribunais Regionais do Trabalho* - TRTs) restricting rights set forth by, or creating obligations that are not set forth in, statutory law, which will allow for greater predictability to transactions and work as an incentive for foreign investments in the country.

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