Execution of a non-definitive agreement: when is it necessary to disclose a material fact?

Much has been said about the duty of listed companies to disclose material facts. It is one of the main obligations of controlling shareholders and managers, especially of the investor relations officer, and is a constant inspection target by the Brazilian Securities and Exchange Commission (CVM).

In general terms, CVM regulation considers as material fact any act or fact of political-administrative, technical, transactional, or economic-financial character occurred or related to the company's business that may impact the quotation of the securities issued by the company or related to them, the investors' decision to negotiate the securities, and the investors' decision to exercise rights inherent to the condition of holder of securities issued by the company or related to them.

The Brazilian Corporation Law and CVM regulations determine that material information must be immediately disclosed to the market and to the shareholders to prevent insider trading and to make the pricing of traded securities more efficient since shareholders and the market will have access to such information simultaneously.

However, listed companies are frequently in doubt as to whether it is necessary to disclose a material fact due to the execution of a non-definitive material contract, such as a non-binding memorandum of understanding, or a relevant contract that has a real and concrete possibility of being ended.

On this subject, CVM's board understands that an information doesn't need to be definitive for it to be considered relevant. It is possible that non-definitive facts that carry a certain degree of uncertainty are material - that is, assuming it's concrete, the fact may be qualified as relevant.

Investor Relations' assessment on whether to disclose a material fact

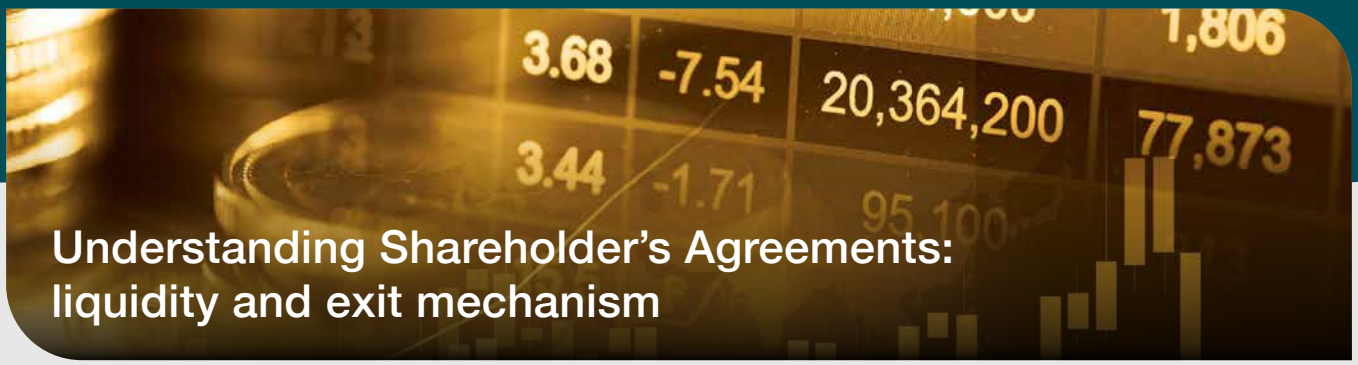
According to the consolidated understanding of CVM's board, what is expected from the investor relations officer when evaluating the need to disclose a material fact is a two-step judgment. The first is about the probability of the act or fact to impact on the decision to trade securities issued by the company. The second is a judgment that involves counterbalancing the magnitude of the potential impact and the likelihood of its occurrence (CVM Sanctioning Proceeding No. RJ2018/6282).

As an exception to the duty to immediately disclose a material fact, CVM regulation stipulates that the secrecy of a material fact may be maintained if its managers or controlling shareholders understand that said disclosure will put legitimate interest of the company at risk.

This exception, however, is no longer applicable (i.e., the mandatory disclosure rule is restored) if the information is beyond the company's control or if there is an atypical oscillation in the quotation, price, or traded quantity of its securities. In these cases, the company shall immediately disclose the material fact.

The text above was published in Portuguese in the Legislação & Mercado section of Capital Aberto on June 22, 2022, and can be accessed through the link below:

https://legislacaoemercados.capitalaberto.com.br/celebracao-de-contrato-nao-definitivo-quando-e-necessario-divulgar-fato-relevante/



Understanding Shareholder's Agreements: liquidity and exit mechanism

When one talks about liquidity and exit mechanisms regarding shareholders' agreement, one seeks to regulate ways for a certain shareholder to leave the company. In other words, a liquidity and exit mechanism is a structure that guarantees to a certain shareholder the right to convert his or her shares into cash in addition to his or her withdrawal from the company.

These structures are quite common in agreements made after an external investment. In this regard, it is possible to come across clauses concerning a put option, registration rights and clawback, which will be detailed below, in addition to tag along and drag along clauses, which have already been subject of another article in our series on shareholder agreements.

Put option

The put option is one of the simplest liquidity mechanisms and can be granted by a shareholder to another shareholder or by the company itself and may contemplate part or the totality of the shares. Thus, if the shareholder who holds the put option wishes to exercise it, he may require the other shareholder or the company, according to the circumstances, to acquire the shares held by him or her as stated in the terms and conditions established in the shareholders' agreement, including the ones related to valuation and the payment method.

As it is a lower cost mechanism when compared to carrying out an initial public offering (IPO) (registration rights clause), for example, the put option is more common in operations involving investment funds since they have a liquidity period for their investments and need to have greater ease and flexibility to sell their shares when the deadline approaches. This mechanism is also common to grant original shareholders the option to withdraw the company in situations in which the investing shareholder considers it essential to remain in the shareholding structure and/or in the company's board for a certain amount of time.

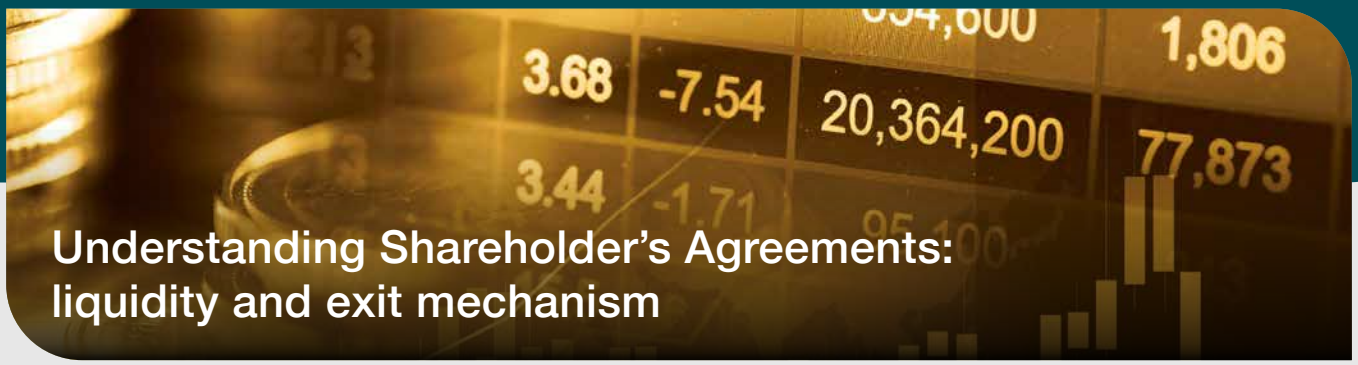
Registration rights

The right to demand an IPO (also known as registration rights) may be granted in favor of a certain shareholder, who may exercise it upon the compliance with certain conditions to be verified within a reasonable period. This type of clause is often found in mergers and acquisitions transactions, especially in the context of private equity investments involving investment funds.

This occurs mainly due to the need to balance the liquidity risks of the operation with the best interests of the new investor, the company, and the original shareholders. This mechanism is known for offering investors a safe way to reduce or liquidate their stake in the company, benefiting from the premiums that are usually paid by the market in an IPO at favorable times for this type of operation.

Clawback

Although they are not considered a liquidity mechanism per se, value recovery clauses are important in the context of divestments to preserve the reaming shareholders' principle of good faith in situations of greater distrust between the parties. These clauses guarantee the shareholder who withdrew from the company the right to claim amounts arising from any increase in valuation of the shares sold after his departure (within a contractually stipulated period), most often due to the sale of control or an IPO.



Understanding Shareholder's Agreements: liquidity and exit mechanism

The importance of liquidity and exit mechanisms

Depending on the nature of the investment or the objectives of the shareholders, the provision of liquidity and exit mechanisms in shareholders' agreements is fundamental, not only as a form of legal security, but also as a strategy to allow a shareholder to leave the company's shareholder structure under pre-established conditions without jeopardizing the performance of the activities or even the continuity of the company.

The text above was published in Portuguese in the Legislação & Mercado section of Capital Aberto on May 09, 2022, and can be accessed through the link below:

https://legislacaoemercados.capitalaberto.com.br/entendendo-o-acordo-de-acionistas-mecanismos-de-liquidez-e-saida/

Deadline to submit the Annual Census of Foreign Capital statement to the Brazilian Central Bank

Between July 1st and August 15th, some entities with foreign capital must submit to the Brazilian Central Bank the Annual Foreign Capital Census statement for the 2021 base year. The filling of the aforementioned statement is mandatory for:

- legal entities headquartered in Brazil that have direct participation of non-residents in their capital stock, in any amount and with net equity equal to or greater than the equivalent of US$100 million on December 31st, 2021;
- legal entities headquartered in Brazil that have a total outstanding balance of short-term commercial credits (payable within 360 days) granted by non-residents equal to or greater than the equivalent of US$10 million on December 31st, 2021;
- investment funds with non-resident quotaholders and with net equity equal to or greater than US$100 million, on December 31st, 2021, through their managers.

The following are exempt from submitting the statement: natural people; the Union, States, Federal District and Counties' administration; legal entities that are borrowers of on lending foreign credits granted by institutions headquartered in the country; and non-profit entities funded by non-residents contributions.

Finally, failure to submit the statement within the deadline, as well as the provision of false, incomplete or incorrect information, may subject those responsible to a fine.

Publication of Letter No. 37 by DREI changes procedural rules for enrollment of members of the board of directors' and officers' residing abroad

On June 20, 2022, the Brazilian National Department of Business Registration and Integration (DREI) published a letter to revoke the need for the following procedures:

- Enrollment of members of the board of directors in the Shareholders and Executive Chart in the company's directory before the Brazilian Federal Revenue (Quadro de Sócios e Administradores – QSA);

- Enrollment of members of the board of directors residing abroad with the Brazilian Individual Taxpayer Registration Number (CPF);

- Presentation of the Basic Entry Document (Documento Básico de Entrada - DBE) when filing corporate acts that include the appointment of officers residing abroad. This is an issue related to the system of the Brazilian Federal Revenue, which, for the time being, will depend on the support of the Boards of Trade to update the information before the Brazilian Federal Revenue.

Letter No. 37 of DREI can be accessed in Portuguese through the link below:

https://www.gov.br/economia/pt-br/assuntos/drei/legislacao/arquivos/oficios-circulares-drei/2022/OFCIOCONJUNTOS-EIN372022ME.pdf