

Distribution and Franchising in Brazil

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Distribution in Brazil

- Distribution agreements (resale) are **not ruled** by any specific law.
- **Broadly** regulated by the Brazilian **Civil Code (“BCC”)**.
- In **writing** or **verbal**. **No registration** is required.
- BCC does **not** provide for **minimum terms** and conditions or **written form**.

Distribution in Brazil

- **No mandatory renewal or termination conditions;**
- Under BCC, it may occur by:
 - (i) **expiration** of the contractual term;
 - (ii) **termination with cause** or due to non-compliance beyond the control of the defaulting party (**force majeure**); or
 - (iii) **unilateral termination without good cause** with **prior notice** of termination, where applicable.

Distribution in Brazil

- Article 473 of BCC: if any of the parties has made **significant investments**, the unilateral termination will only be effective after the agreement has been in force for a **term compatible with the nature and amount** of such investments;
- Agreements containing a **fixed term cannot** be terminated without **just cause**, unless the agreement specifically and expressly provides for;

Distribution in Brazil

- Even in the event that the agreement provides for termination without any cause, the payment of indemnification may be applicable if **insufficient time has passed to recover the investment made;**
- Agreements entered into for an **indefinite time**, the **termination** must also be **preceded by 90** (ninety) **days** prior notice: also, if **insufficient time has passed to recover the investment made, compensation** may be **applicable** (Brazilian case law – 180 days, for long verbal relationships).

Brazilian Franchise Law

- Brazilian Law No. 8,955/94 (the “Brazilian Franchise Law”) governs all franchise relationships that are “established and **operated in the Brazilian territory.**”
- In fact, the Brazilian Franchise Law solely defines franchising and governs the **content of the Franchising Disclosure Document (“FDD”).**

Deadline to Deliver FDD

- Article 4 of the Franchise Law requires that a FDD be **delivered to the prospective franchisee, at least ten (10) days prior to the execution** of any binding document related to the franchise and/or receipt of any **payment by** franchisor;
- The **statute of limitations** for a franchisee to assert a claim of non-compliance **is two years** from the delivery of the FDD.

Consequences of Failure

- A failure by franchisor to provide a prospective franchisee with the appropriate FDD renders the agreement void and gives a franchisee the right to **demand a refund of all amounts paid** by franchisee, plus recovery of **damages**;
- Franchisors tend to be **conservative** in relation to this requirement as the local law provides for a **severe penalty** in the event of failure to comply with this legal obligation.

FDD Content

- (1) A summary of the **background of franchisor**;
- (2) **Balance sheets** and financial statements of the franchisor (two preceding years);
- (3) Description of **all pending lawsuits** involving the franchisor and its affiliated companies, and other franchisees or ex-franchisees relating to the franchise agreement (*this applies to lawsuits filed worldwide*);

FDD Content

- (4) Detailed **description of the** business;
- (5) **Characteristics of the "ideal franchisee"**;
- (6) Requirements regarding the **direct involvement** of the franchisee;

FDD Content

- (7) Specifications regarding: (a) **estimated initial investment** (b) **initial affiliation fee or franchise fee** and (c) **estimated cost** of the facilities;
- (8) **Clear information regarding periodic fees** (royalties; advertising fee; minimum insurance coverage amounts, etc.);
- (9) **Complete listing of all the franchisees and ex-franchisees** within the **last twelve months** (*this includes all international franchisees*);

FDD Content

- (10) With respect to the **territory**: (a) **exclusivity** or a **right of first refusal**; and (b) if the franchisee has the right to sell or render services **outside its territory** or outside Brazil;
- (11) List of **required suppliers**;
- (12) Description of **services and products offered to the franchisee** by the franchisor (supervision; training; franchise manuals; assistance on the selection of the location; layout and architectural plans of the facility; etc.);

FDD Content

- (13) Status of the **licensed trademarks** and patents with the Brazilian National Institute of Industrial Property - INPI;
- (14) Situation of franchisee **after termination** of the franchising agreement, regarding: a) know-how or industrial secrets; and b) non-competition obligations;
- (15) **Draft of the standard franchise agreement**, as well as the preliminary franchise agreement, if any.

Recordal at INPI

- Renders the agreement **effective against third parties**;
- Allows **remittance of royalties** to the foreign franchisor;
- Qualifies franchisee for **tax deduction**;
- Franchisor must have at least **applied for registration** of its trademarks in Brazil, at the INPI;

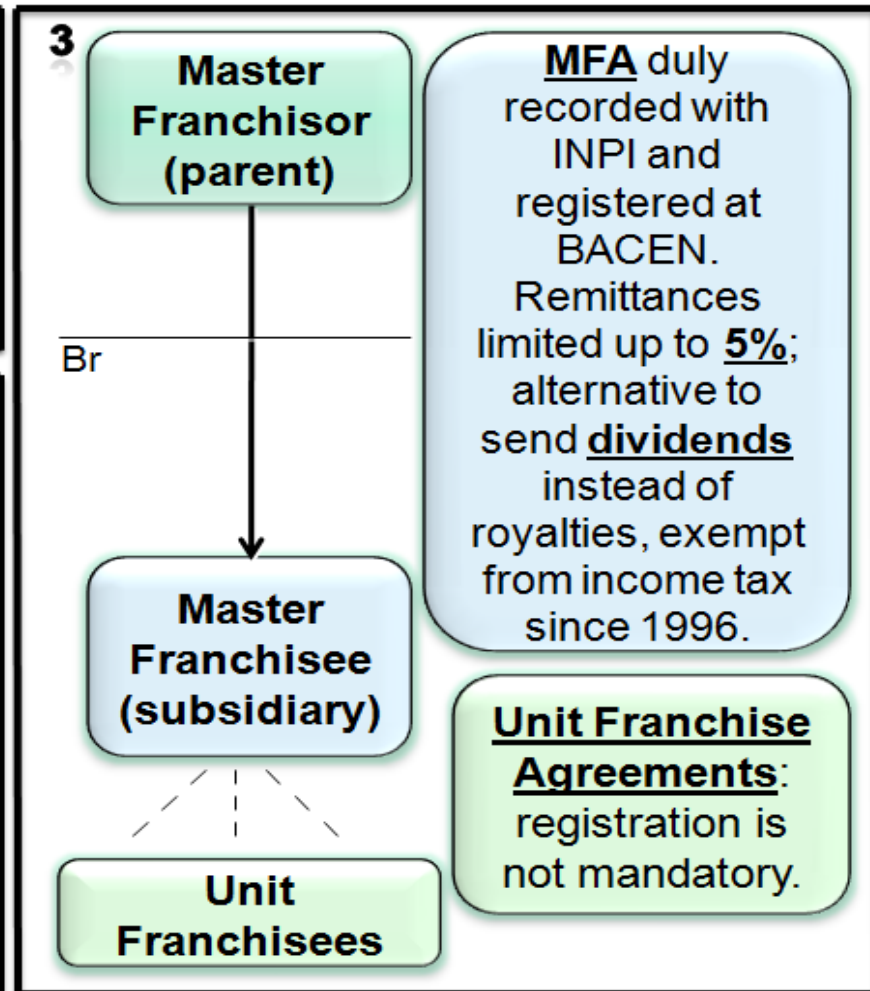
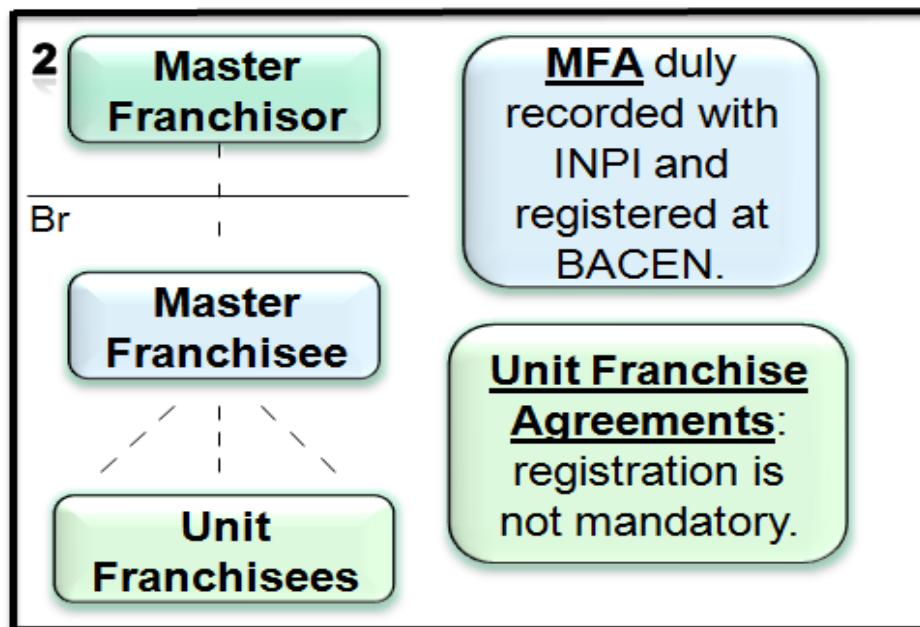
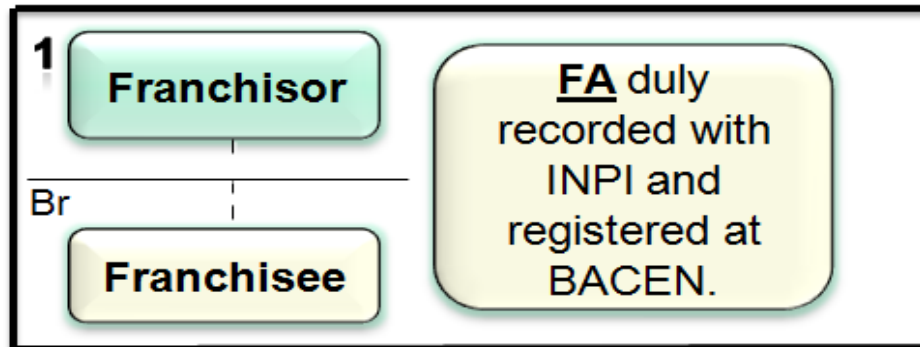
Recordal at INPI

- Payments: the parties may freely set out the remuneration insofar as it stays within the **price commonly practiced in the involved field and in the national and international market**.
- Controlled companies (parent and subsidiary): **payments limited to the corresponding ceiling of fiscal deductibility** (Regulation 436/58), which vary between **1% to 5%** of the net sales price of products, depending on the technology field.

Recordal at INPI and Registration at BACEN

- INPI's Legal term: 30 days - in practice, **50 days** - **Certificate of Recordal** or an office action requesting further details and clarifications regarding the agreement;
- After the Certificate of Recordal is issued, the agreement must be registered with the **Brazilian Central Bank for remittance of payments**. This registration is a very simple procedure and can usually be accomplished in about 2 days.

Franchising Scenarios in Brazil



Choice of Law and Jurisdiction

- The parties are free to **select a foreign law and jurisdiction** to govern the franchise relationship;
- However, there are practical **difficulties toward enforcing foreign decisions** in Brazil (necessary approval by the Superior Court of Justice in Brazil; homologation of foreign judgment” - *exequatur*).

Indemnification for Goodwill

- Recent Court decisions (based on the principle of **fairness** and **unjust enrichment**) have recognized the **existence of local goodwill**, developed through the efforts and expenditures of **franchisees** and **distributors** and granted **compensation** in amounts corresponding to a **part of the developed goodwill**;
- It is common practice to stipulate that the **goodwill**, including the clientele, **belong solely to the manufacturer or licensor**.

Indemnification for Goodwill

- As such agreements should not be considered **adhesion contracts** – if the distributor had the opportunity to **negotiate** its conditions –, provision will likely be taken into consideration by the Courts or especially by arbitrators when deciding such matter.
- taking into consideration several aspects: (i) the **terms** of the agreement; (ii) if the franchisor / manufacturer is the owner of a **well-known trademark**; (iii) if the franchisee / distributor effectively **started and developed** the business; (iv) if the franchisee / distributor has **prior experience** in the business; and (v) if the **clientele** was **attracted** due to their **particular efforts**, etc.

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