SEPTEMBER HAS BROUGHT MORE CLARITY ON THE INTERPRETATION OF PRIVATE AGREEMENTS

Legal uncertainty has been a recurrent concern for those doing business in Brazil. One particularly troubling facet of that problem has been when courts disregard or relativize the content of agreements between private parties on the grounds of imbalance or unfairness. Amendments made to the Civil Code in September in the context of the so-called "Economic Freedom Act" may give some degree of certainty at last.

Until last month, the Brazilian Civil Code had given courts the leeway to apply open-ended legal principles in a way that mitigates express contractual provisions. That has roots in history. The defunct 1916 Civil Code orbited around the concept that contracts must be performed as agreed no matter what; that formalistic approach led in extreme cases to iniquities. In response, the 2002 Civil Code that is currently in force introduced concepts of ethics in contracts and set forth, inter alia, that the parties' intention prevails over the literal meaning of the wording, that contracts must be interpreted and performed pursuant to good faith and that contracts serve a social purpose.

Those are not at all bad rules, but they lack specificity and have opened a can of worms.

Courts at times interpret concrete, express contractual provisions between equally strong parties in light of those principles in a way that completely neutralizes the language of the contract. By doing so they end up releasing parties in breach from their contractual obligations or allowing parties to deliver on their promises in a way that differs from the letter of the agreement. Risks get shifted and allocated to the innocent party as a result.

This picture may change – perhaps drastically. After the amendments made last month, the Civil Code establishes that courts must now expressly take into account objective criteria upon interpreting the scope, meaning and purpose of contractual provisions between private parties.

For instance: the provision must be interpreted in favor of the party who did not draft it (if such party can be identified); the court must take into account the actual behavior of the parties following execution; the parties may set out the applicable rules of interpretation of their deal and if they do the court must observe them; the content of the agreement must take precedence and courts may only revise it and apply different standards as an exception; and absent any evidence to the contrary, the court must assume that the contract has been negotiated and entered into by equally strong parties and must respect the allocation of risks on which they agreed.

While these new rules will need to be battle-tested in some specific cases of business ventures to which some imbalance between the parties is inherent (e.g., franchise agreements or some types of loans), this development has a clear impact on complex, tailor-made business deals. The wiggle room to deviate from the language of the agreement has become smaller.

Ironically, though, history behind this recent legislative change is in itself a tale of legal uncertainty. “The Civil Code enacted in 2002 results from a bill introduced in Congress in 1975. It was amended unilaterally by the Executive in April 2019 by an instrument called “provisional measure” (a type of executive order with immediate effect and one of the requisites of which is urgency). This provisional measure is the so-called “Economic Freedom Act”, which also targets several other business-related topics as discussed in this edition of LS Brazil Outlook.

According to the legislative process, Congress had 120 days to vote whether the provisional measure should be converted into statute, therefore changing the Civil Code and giving greater certainty on the standards to interpret private contracts. Several changes were introduced (and some were dropped) by lawmakers in this process, and resulted in the September law – which, notably, resulted in different amendments to the Civil Code than those contained in the provisional measure.

It is certainly not good omen for businesses when the Executive feels free to change basic laws on private contracts bypassing regular legislative process out of “urgency”, and when Congress, in its turn, opportunistically ends up making different changes to those laws in a hurry. But then again, the end result was positive this time, so Brazilian and foreign investors may be better off just celebrating the good outcome and not asking themselves how we got there.

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