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Transactions in Latin America — legal considerations

By Richard E. Neff

Doing business in Latin America has its challenges, and I have probably seen them all during 30 years of focus on cross-border legal work with Latin American companies and governments. Because of the globalization of the economy and impressive growth by various Latin American countries over the past decade, most notably Brazil and Mexico, the pace of that work has accelerated. But it is not for the fainthearted.

Excessive Formalism. There is a very archaic focus on *formalism* in Latin American legal systems that imbues all transactions (and litigation). From the U.S. perspective, it appears highly wasteful and bureaucratic — and it is. First, in virtually all of the countries, powers of attorney must be granted to local attorneys to take certain actions and enter into certain agreements: e.g., to set up companies, to sign documents, to enter into settlement agreements, etc. These often involve proving that corporate signatories have been granted the right to sign documents and bind the company, legalization and consularization of documents, and obtaining apostilles — all steps that are largely nonexistent in U.S. business. Second, only authorized legal representatives may sign, whose authority has been proved by documentary evidence. In U.S. companies, by contrast, authority is often implicit in being an officer. Third, notaries — an unfortunate holdover from Continental legal systems (who only survive in the Anglo-American system as signature verifiers) — hold great power in Latin America, and create bottlenecks to doing business quickly and efficiently. Fourth, agreements in Latin America often involve pages of declarations identifying the companies involved and their officers by various registration numbers. Fifth, original signatures on agreements are often required in Latin America (despite recent legal changes that would seem to obviate this requirement). And sixth, sometimes to get paid under a contract, the payee is supposed to provide to the Latin American payer a mind-boggling array of government certifications relating to the company, tax payments and employees (something I generally attempt to limit sharply).

Negotiation: Cultural Issues. Negotiating in Latin America is different, for cultural and economic reasons. First, societies like Mexico and Brazil historically have favored monopolization over competition, and in fact, many of the larger companies either have been granted virtual monopolies, are state enterprises, or are privatized state enterprises. Some examples are Telmex in Mexico, Vale and Petrobras in Brazil. These companies often have little respect for the concept of negotiation, taking the position that they have the right to dictate the terms of engagement, a position that U.S. companies doing business with them seldom accept. Therefore, sending back a marked draft of an agreement may be met with hostility. Second, the U.S. concept of redlines and the style of exchanging marked documents — each side taking its turn to accept agreed changes and reflect disputed issues in redline — often is not well established. In Latin America, you never know what you will get back. Often you will get back a clean draft, making it is difficult to discern which of your changes were agreed to and which were rejected. Third, Latin American companies hold fast to penalty clauses, reflecting in part a lack of trust in the legal system. Fourth, a law degree in Latin America generally is an undergraduate degree, so the quality of lawyering is much more varied than one usually sees in the U.S., Canada or the U.K. And fifth, the pace of negotiations can be bizarre; at least a dozen times, I have seen the Latin American side send back revised drafts a year later. Often, if you can wait a long time, you will get far more of your points conceded!

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Penalty Clauses. Contracts in Brazil and Mexico are full of penalty clauses. Sometimes it seems that at least with respect to various technology related licenses and software development agreements, some Brazilian lawyer wrote one template agreement which is now used by all Brazilian companies. There are penalties for delay and penalties for nonperformance. These generally are reflected as a percentage of the contract amount — that is, all amounts paid under the contract. As work under a contract expands, the contract amount is increased by amendment, so that the parties always are aware of the benchmark for calculation of penalties. Sometimes the total amount of penalties is capped, and sometimes it is not and cumulatively can exceed all amounts paid under the agreement. U.S. companies have little tolerance from revenue recognition and equity perspectives for the position that they will be paying their customer or licensee more than their customer is paying for use of their technology. This concept likely grows out of both the "power" dynamic of monopolistic Latin American companies that sets the business tone, and also a lack of faith in very weak legal systems. Instead of waiting years for an unpredictable result from the courts, it is easier to just state in the contract amounts that must be indemnified for perceived wrongs.

Employees. In Latin America, and certainly in Brazil and Mexico, there is great paranoia that the other party's employee who may be performing services at a client site will be classified as that client's employee, triggering multiple tax and benefit requirements. This issue exists in U.S. agreements also, and is usually covered in a relatively simple clause stating that the parties are acting as independent contractors. But in Latin American contracts, there can be pages of text with indemnities dealing with this issue. I have only seen this issue arise once, however, when a rogue lawyer in Colombia claimed he was an employee of one of the U.S.'s most celebrated technology companies.

Taxes. The typical U.S. formulation that the buyer shall pay all taxes, other than taxes on the seller's or licensor's net income, is generally rejected in Latin America. Very often, Latin contracts begin with the proposition that the seller or licensor is responsible for virtually all taxes, whether or not this is the case. At least in Brazil, the impetus for this position seems to be a cumbersome and confusing tax system, where inconsistencies between taxing jurisdictions — e.g., licensed software may be classified as a product at the federal or state level and a service at the municipal level — result in the stronger party trying to pass tax liability to the perceived weaker party in the negotiation. A clause stating that each party will pay the taxes that it is required to pay by applicable law generally helps bridge this tax gap.

Arbitration Clauses. As mentioned, Latin America tends to have very weak court systems. In some countries, judges are poorly paid mid-level bureaucrats, and in most countries, there is considerable corruption in the judicial system. In virtually all Latin American countries, justice moves slowly and there are too many appeals; even the occasional good result can come late and at great cost. This would seem like a natural situation to favor arbitration, but think again. Both Brazil and Mexico have several reasonably regarded arbitration bodies, but company lawyers in both countries tend to reject arbitration in favor of relying on the courts. In part, it is habit, and bad habits die hard. Brazil did not really permit arbitration until 1996, and in Mexico, various court decisions have undercut the effectiveness of arbitral awards. Local lawyers do not seem to trust an option that they do not fully understand, and it is possible that larger Latin American companies believe that they can better control outcomes in the court system.

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