The Legal Framework of Authorised Car Dealerships in Brazil

(including updates on 2016 court decisions regarding differential treatment of dealerships and termination of contract by the manufacturer)

January 2017

by Attorney at Law Christian Moritz
www.lawyer-brazil.de

Introduction

Authorised car dealerships in Brazil are governed by detailed legislation, the so-called *Lei Ferrari*. Besides this special Act, the general provisions of the Brazilian Civil Code apply. The *Lei Ferrari* contains provisions with respect to, *inter alia*, the protection of the dealership's licensed territory, minimum purchase quotas, pricing as between the parties, the dealership's use of the brand name, form and contents of the distribution agreement as well as the legal effects of termination. In recent decisions, the Higher Regional Court of Sao Paulo specified the requirements of equal treatment of multiple dealerships within the distribution network, and the conditions for termination in the event of breach of contract by the dealership.

1. Overview of the Brazilian automotive market

1.1 The automotive industry and Brazil

Brazil and the automotive industry have been considered a perfect couple and success story for decades. Still in 2012, Brazil had broken a national record in its car sales market, with 3.8 million new registrations per year, according to the Federal Association of the Distribution of Motor Vehicles (*Federação Nacional da Distribuição de Veículos Automotores, "Fenabrave"*). Volkswagen alone sold roughly 768,000 new cars in Brazil in 2012. However, the sector went into a tailspin since 2013. According to the Federal Association of Car Manufacturers (*Associação Nacional dos Fabricantes de Veículos Automotores*, "*Anfavea*"), figures have fallen in 2015 to a total of about 2.6 million new vehicles. In 2016, again pursuant to Anfavea, the registration of new cars in Brazil amounts to only about 2.2 million. This signifies a decrease of about 15% compared to 2015. Responsible for this severe drop in sales are the recession of the Brazilian economy, and decreasing real incomes due to rising inflation and unemployment. A glimmer of hope emanates from significantly higher sales of cars by manufacturers such as Audi, Mercedes and BMW in the more premium segment of the market

as well as a favourable exchange rate that is stimulating exports. According to Anfavea, Brazil exported in 2016 520.286 cars, utility vehicles, busses and trucks, in particular to Argentina and Mexico. This signifies an increase of 17.7% compared to the previous year 2015.

1.2 The status quo of car dealerships

Brazil's authorised car dealerships altogether had approximately 380,000 direct employees, and generated a turnover of roughly RS288 billion in 2015 (surveyed in 2014). The first authorised (Ford) dealerships commenced operation in as early as 1920, shortly before those of General Motors. Volkswagen established its distribution network as the first European manufacturer in the early 1950s. According to the Federal Association for the Distribution of Cars (*Federação Nacional da Distribuição de Veiculos Automotores*, "Fenabrave"), 51 car brands have a presence in Brazil today, all of which are members of the Association. As reported by the Association, the number of authorised car dealerships for both imported cars and cars manufactured domestically increased to approximately 7,900 in 2015. Such premium and luxury brands as Mercedes, BMW, Audi, Porsche, Ferrari and Bentley have also discovered the Brazilian market. Audi alone doubled the number of its Brazilian dealerships compared to 2013, with 49 currently part of its network.

1.3 Legal certainty thanks to the *Lei Ferrari*

The *Law for the Authorised Dealing in Cars between Manufacturers and Distributors No. 6.729* of 28 November 1979 is the fruit of negotiations between the Association of VW Dealerships ("ASSOBRAV") and the Federal Association for the Distribution of Cars "ABRAVE" (nowadays "Fenabrave"), that had been ongoing since 1975. The leading framer of the Act was the attorney and then president of "ABRAVE", Renato Ferrari. The name *Lei Ferrari* hence goes back to its instigator and not, as one may conclude prematurely, to the sports car manufacturer of the same name.

The Act comprises 33 articles that regulate, *inter alia*, the protection of the licensed dealership territory, a prohibition on discrimination between dealerships within the network, direct sales by the manufacturer, collective agreements (for the respective brands and categories) as well as the legal situation once the agreement has come to an end. With the *Law Reform Act No. 8132/90*, the Brazilian legislature in the early 1990s altered seven articles of the *Lei Ferrari* and repealed one, namely Art. 14, that had governed profit margins (*margem de comercialização*). Since then, Art. 13 stipulates that dealerships can freely determine their sale prices and are no longer bound by a price fixed by the manufacturer. Further, dealerships may now sell directly to retail customers in other licensed territories without the consent of the manufacturer and the other dealerships in the network, and without having to pass over profits

(Art. 5 § 3). The law reform thereby specifically aimed to increase competition in the market for new cars, which had previously been perceived as insufficient. It is still being debated today how competition between manufacturers and dealerships could be enhanced, for instance through online offers and by further relaxing the protection of licensed territories (permission to advertise across territories).

2. Special features of distribution agreements

Car distribution agreements are regarded as over-regulated because they entail a wide range of special features. Those issues warrant special attention because, in practice, a cursory approach can lead to nasty surprises even in seemingly straightforward situations. Some aspects of the *Lei Ferrari* have already come before the Supreme Federal Court of Brazil. The following sections will explain some of the special features of distribution agreements.

2.1 Protection of the licensed territory

Active marketing (including services) outside of a dealership's licensed territory ((...) *sendo-lhe defesa a prática dessas atividades, diretamente ou por intermédio de prepostos, fora de sua área demarcada*) is expressly prohibited (Art. 5 § 2). Only when a retail customer from a different licensed territory approaches a dealership without prior solicitation, and of the customer's own accord, may a dealership sell directly to that customer (Art. 5 § 3). Since the law reform of 1990, the dealership is no longer required to pass over profits to the dealership in the territory where the customer is resident.

2.2 Minimum purchase quotas

The manufacturer may prescribe minimum purchase quotas, while, in turn, the dealership may limit its inventory to 65% of the monthly allocation of the respective annual quota (Art. 10). Special provisions apply with respect to spare parts and accessories.

2.3 Right of exclusivity in favour of one brand

In relation to the sale of new cars, the parties may agree on exclusivity in favour of one brand (Art. 3 § 1 (b)). However, there are no restraints whatsoever on the dealership concerning the sale of used cars of other brands (Art. 4).

2.4 Resale only to consumers

Dealerships are allowed to sell to consumers (*consumidor*) only. Sales to intermediate wholesalers (*comercialização para fins de revenda*) are generally prohibited (Art. 12). Solely sales between dealerships within the same distribution network are permissible, provided that they do not exceed 10% of the overall sales, or the sale is to an overseas dealership.

2.5 Freedom of pricing of both parties

Since the 1990 law reform, dealerships may freely determine the prices payable by the consumer for cars, spare parts, accessories as well as services (Art. 13). The manufacturer, on its part, is also free in setting the prices payable by dealerships, but must ensure that pricing and payment terms are uniform across its distribution network.

2.6 Direct sales by the manufacturer

In certain circumstances (Art. 15), manufacturers may effect direct sales (*vendas diretas*), for instance to public administrative bodies or the diplomatic corps. This is possible both with or without the involvement of the distribution network.

2.7 Limitations on the contract period

Generally, the contract will remain effective indefinitely (Art. 21 et seqq.). By way of exception, the agreement may be limited to a term of not less than five years when the parties contract for the first time. A contract thus limited will automatically become open-ended where none of the parties gives written notice of cancellation at least 180 days before the expiry of the agreed term.

3. Recent developments in Brazilian court decisions

The distribution agreement may come to an end by way of termination agreement, force majeure, expiry, or cancellation (Art. 22).

3.1 Prohibition on impeding dealerships' independence and discriminating between dealerships

The protection of brand integrity as well as the collective interests of the manufacturer and dealership are important. Specifically, this means that the manufacturer must abstain from impeding the independence of dealerships and discriminating between dealerships with regard to financial burdens and deadlines. To this effect, the Higher Regional Court of Sao Paulo at the beginning of this year ordered "KAWASAKI MOTORES DO BRASIL LTDA" to pay damages in the amount of RS650,000 to a former dealership (*Proceedings No. 1127140-06.2014.8.26.0100*). The latter had cancelled the contract with the manufacturer on grounds of a sharp decline in sales, for which it blamed the manufacturer. As it happened, Kawasaki had established its own dealership in accordance with the *Lei Ferrari*, to which it then advanced significant financial support, and hence a competitive advantage. In the view of the

Court, this constituted a violation of the principle of equal treatment in Art. 16 of the *Lei Ferrari*, and amounted to direct discrimination against other dealerships in the distribution network.

3.2 Termination on grounds not attributable to the innocent party

Either party may, on its own initative (*por iniciativa da parte inocente*), terminate the contract where its legal interests under the *Lei Ferrari*, collective conventions, or the distribution agreement itself have been violated through no fault of the terminating party, or due to factual cessation of business of the other party. Termination will only be available as a last resort (*penalidades gradativas*) where the aggrieved party has first exhausted more lenient measures and sanctions as far as is possible and reasonable. Article 19 of the *Lei Ferrari* specifically envisages the negotiation of a special brand agreement (*Convenção de marca*) between the manufacturer and the dealership. Pursuant to Art. 19, XV, such an agreement must contain a staggered regime of sanctions, compliance with which is a mandatory prerequisite for termination (Art. 22, III) under Art. 22 § 1. Failure to observe these requirements may lead to unexpected outcomes, particularly in seemingly clear situations where one party is falsely supposing a right to immediate termination of the agreement. A decision by the Higher Regional Court of Sao Paulo in late 2015 (*Proceedings No. 2015.0000758421*) in proceedings involving General Motors do Brasil Ltda ("GM") and a dealership illustrates the potential dangers of these provisions. Following a series of established breaches on the part of the dealership, some of which were serious, GM unilaterally declared the contract at an end with immediate effect and claimed damages, which the dealership resisted. Notwithstanding the supposedly conclusive legal position, the Court reprimanded GM for neither having put the dealership on notice nor having claimed damages from it prior to the proceedings. It dismissed GM's objection that no brand agreement whatsoever had been entered into with reference to the rationale of the relevant provision, being the avoidance of arbitrary termination. According to the Court, the respective provisions of the *Lei Ferrari* are to be understood as a binding request on manufacturers to incorporate a staggered system of sanctions into their agreements. The term for giving notice has to be equal to the period of time necessary for the dissolution of legal relations and settlement of pending transactions between the parties. In any event, the term is at least 120 days (Art. 22).

4. Concluding Remarks, Disclaimer and Copyright

„The Brazilian Business Insolvency Act in a Nutshell" forms part of a series of articles on „Introduction to Business Insolvency Law in Brazil". For more information, contact the author by using the email below.

This article is for informational purposes only. It is not intended to be conclusive, or offered as legal advice, nor does it constitute legal advice. Every case turns on its facts and requires

individual legal advice. The contents of this publication are correct to the best of the author's knowledge. All liability for the accuracy and currency of the information supplied is excluded.

www.lawyer-brazil.de
christian.moritz@lawyer-brazil.de