THE NATIONALITY OF BUSINESS ASSOCIATIONS AND THE FEDERAL CONSTITUTION OF 1988

Luiz Gastão Paes de Barros Leães

Professor of Law, University of São Paulo (USP)

I. PRELIMINARY MATTERS

Although the nationality of legal entities has been discussed since the last century, only in this century, and notably after World War II, has it become an important question. This growth in importance is the result of the development of an economy of planetary dimensions, where business activity sprawls over different countries, frequently disregarding national barriers.

Today the prevailing doctrine views the nationality of companies as simply analogous to the nationality of individuals. This doctrinal position is limited to expressing the relationship of legal entities to a certain national legal order, which imposes varying consequences upon them as a function of multifarious facts and circumstances.

The first critic to fix his sights clearly upon this doctrine was Niboyet, in his classic study published in 1927.[1] Niboyet maintained that it was a mistake to apply the concept of nationality to companies. In his opinion, companies do not have nationality; only individuals have nationality. When applied to legal entities, nationality means nothing more than the normative imputation of certain consequences to particular antecedents, as determined by legal systems. In other words, companies have no *political status*, but only an applicable legal system. He, therefore, urged that the doctrine be replaced by legislation. The issue would be limited to establishing the applicable legal regime, and nationality would be no more than a simple reflection of a broader question – that of the subjective ambit of the application of the laws. Nevertheless, the nationality of legal entities remains a hallowed concept, recognized in statutory language, and is still utilized to classify the legal status of companies. Far from being viewed as an anthropomorphic caricature of human beings (for legal entities, in the caustic observation of Samuel Johnson, "have no soul to save and no bottom to kick"), nationality eventually

---

[1] Niboyet, "Existe-t-il vraiment une nationalité des sociétés?," *Revue de Droit International Privé* 402-407 (1927).

becomes the characteristic feature of the received knowledge for problems of conflict of laws.[2]

Viewed in this way, support for the unilateral doctrinal position, which had prevailed for many years, naturally waned. It became conceivable for the nationality of companies to vary in relation to diverse national legal structures. It could even vary within these structures as a function of the specific statute under consideration. In contrast to individuals, where an absolutely privileged bond, such as *ius soli* or *ius sanguinis*, necessarily implies application of a unique national law, the traditional criteria for determining the nationality of companies (such as that of place of incorporation, headquarters or control) can no longer claim general validity. Instead, the nationality of legal entities varies in accordance with diverse legal orders and the types of laws under consideration.

In order to exist legally, every company must be tied to a national legal system. All companies must be constituted under the law of some country and have their internal functions governed thereby. This very same national legal order can, and generally does, characterize firms, *under the identical company law*, as either domestic or foreign, as a function of the effects sought by differing domestic legal provisions. As Rabel emphasizes, the *lex societatis*, the statute that governs recognition of the company's legal existence and regulates its relations with others, should not be confused with the rules that regulate the business activities carried out by the company. A company does not exist merely *interna corporis*, but acts outwardly as a business activity. Hence, a company may be simultaneously cloaked in a dual regime: it may be deemed domestic because it is governed by a certain company law, and at the same time may also be considered foreign for the specific purposes of another statute.[3]

One should distinguish between two conceptual layers of corporate "nationality." One signifies the law under which companies are organized, as determined by the interplay of different national laws. The second represents the regime to be obeyed in the exercise of certain rights within the framework of that same national legal system. In the first case, we are in the field of *conflict of laws*; in the second, in that of the *legal status* of the company to enjoy the rights and prerogatives that different internal laws reserve for domestic and foreign businesses.

These preliminary considerations are set out in order to justify the position adopted by the 1988 Constitution with respect to this problem. In Brazilian law, the nationality of legal entities is now definitely regarded as something that varies in accordance with the nature of the diverse legal effects attributed to it rather than as a unitary and global concept.

---

2 In this same vein, see J. Hamel, "Faut-il parler de 'nationalité' des sociétés cómmerciales?," in *Jus et Lex. Festgabe zum* 70, 365- 371 (Geburtstag von M. Gutzwiller: Basel 1959). According to Niboyet, "nationality" indicates a single bond between the individual and the State. It cannot characterize a company because it is a bond of a political nature. The nationality of a company should not be determined, as happens with individuals, based upon the *lex causae*, but rather based upon the *lex fori*.

3 Fábio Konder Comparato, "Nacionalidade das sociedades," in *Direito Empresarial* 57-64 (1990). See J.P. Niboyet, *Traité de Droit International Privé Français* (Paris 1938), especially Tomes I and II; E. Rabel, 2 *The Conflict of Laws* 151 (1947).

II. BRAZILIAN CORPORATE NATIONALITY: GENERAL CRITERIA

Brazilian law has always maintained a dual posture in the determination of the nationality of companies. Alongside *general criteria* for determining corporate nationality, isolated statutes have always utilized *special criteria* to define the nationality of companies for specific purposes, a subject that will be discussed later.

General criteria for determining corporate nationality are set out in two basic provisions of Brazilian law: (a) Article 11 of the Law of Introduction to the Civil Code, and (b) Article 60 of Decree-Law No. 2.627 of 1940, the former Corporation Law, whose provisions relating to nationality were expressly retained in force by the present Corporation Law.[4] Article 11 of the Law of Introduction to the Brazilian Civil Code provides that "organizations designed for purposes of collective interest, such as companies and foundations, shall obey the law of the State in which they are constituted." The principal paragraph of Article 60 of the former Corporation Law provides that "companies organized under Brazilian law and that have their administrative headquarters in this Country are Brazilian."

A systematic interpretation of these provisions reveals that, even though both deal with the problem of the determination of the "nationality" of legal entities (forgetting for the moment that the civil law does not use this expression, preferring to speak — technically, perhaps more correctly — of the "regulating law"), they display points of divergence.[5] The first is that Articles 60 *et seq.* of Decree- Law No. 2.627 apply to business associations (directly to corporations, secondarily to limited liability companies and by analogy to other types of commercial companies),[6] while Article 11 of the Law of Introduction applies to all legal entities. The second is that the Law of Introduction adopts, as the *exclusive criterion* for the determination of the law regulating legal entities, domestic or foreign, the law under which they are constituted. Article 60 of Decree-Law No. 2.627, on the other hand, utilizes the law of the State in which they are organized and in which they maintain their administrative headquarters as *cumulative criteria*, in order to determine their nationality.[7]

The Law of Introduction speaks of a company's constitution (*constituição*), whereas Decree-Law No. 2.627 speaks of its organization (*organização*), a concept not free from doubt. It has generally been understood, however, that the terms "organize" and "constitute" are synonymous, for the act of constitution is not

---

4 Law No. 6.404 of Dec. 15, 1976, art. 300.

5 See Alberto Xavier, "A distinção entre sociedades nacionais e estrangeiras," in *Direito Tributário e Empresarial* (1982).

6 Secondary application in the case of limited liability companies *ex vi* Article 18 of Decree No. 3.708 of January 10, 1919, and application by analogy in the case of other commercial companies, *ex vi* Article 4 of the Law of Introduction to the Civil Code.

7 See Modesto Carvalhosa, "Nacionalidade das sociedades no direito internacional e no direito interno," *69 Revista de Direito Público* 238- 253 (1984).

exhausted by a mere contractual stipulation. The process must necessarily be completed by acts required for the acquisition or recognition of its legal existence, that is to say, the system of publicity provided for by law.[8]

Because of these *prima facie* diverging positions, doubts arose over whether the provisions of Arts. 60 et seq. of Decree-Law No. 2.627, which date from 1940, had been revoked by Art. 11 of the Law of Introduction, which came later. Today it is well settled that these two legal norms are not conflicting; each prevails in its own distinct ambit. The Law of Introduction makes the place of constitution determinative of the law regulating legal entities. In order to classify them as foreign or domestic, Decree-Law No. 2.627 utilizes the place of their constitution as well as the location of their administrative headquarters.Additionally, the reference in Article 60 to the administrative headquarters, when elsewhere the same statute mentions only headquarters (*sede*) without any modifier, forces us to conclude that Brazilian law requires not simply that the *statutory headquarters* be located in Brazil, but that the *real and effective headquarters* must be in Brazil for a company to be considered domestic rather than foreign. This interpretation, which originated with Trajano de Miranda Valverde (author of the Draft that became Decree-Law No. 2.627), is the same construction that Italian legal scholars have given to the identical expression *sede dell'amministrazione* — used in Article No. 2.505 of the Italian Civil Code. Italian writers regard the administrative headquarters as "the place where the company business is actually organized and managed," as De Gregorio states, or "the place from which stem the volitional impulses inherent in the administrative activity of the company," to use the expression of Simonetto.[9]

The concept of administrative headquarters has been contrasted with *statutory headquarters*, which would be merely a variation on the criterion of nationality based upon the place of incorporation: nationality determined by the place of the headquarters, as set out in the charter, is located. If such were the case, and the criterion of place of incorporation were adopted, the cumulative requirement of the statutory headquarters would be superfluous. Moreover, the place of incorporation criterion is inconvenient, because it permits abuse of the right to choose the regulatory law. The same can be said for the place of headquarters set out in the bylaws. This led the French to employ the concept of *effective headquarters*, used in Art. 3 of the Law of July 24, 1966 on Business Associations, under which *siége social* (company headquarters) is understood to mean *siége réel, effectif et sérieux* (real, effective and serious headquarters).[10]

This interpretation was warmly received by the Convention on the Reciprocal Recognition of Companies and Legal Entities, entered into on February

[8] Egberto Lacerda Teixeira, 1 *Das Sociedades Anônimas no Direito Brasileiro* 73 (1979). Article 16 of the Civil Code requires registration of all companies.

[9] See Valverde, 1 *Sociedades por Ações* 400 (1953); De Gregorio, *Corso di Diritto Commerciale* 375; Simonetto, "Delle società" in *Commentario del Codice Civile* 221 (A. Scialoja & G. Branca eds. 1965).

[10] Article 3 of Law 66-537 states: "Les sociétés dont le siége social est situé en territoire français sont soumises a la loi française. Les tiers peuvent se prévaloir du siége statutaire, mais celui-ci ne leur est pas opposable par la société si le siége réel est situé en autre lieu".

29, 1968, by the member countries of the EEC. It appears in Article 5 as the "place where the central administration is found." According to this criterion, the nationality of companies is to be determined by the law of the place where they have their effective headquarters, which means the place where they have their administration.[11]

Within the Brazilian legal system, the company headquarters of a legal entity formed under private law may be freely chosen in the constituting act.[12] Normally, the headquarters stipulated in the bylaws will coincide with the place where the company has its administration, which is why Article 35 (IV) of the Civil Code states that a company's domicile is the place where its management is to be found. The Civil Code, however, permits selection of company headquarters different from that indicated in the bylaws,[13] in which case the headquarters in the bylaws will not coincide with the place where the legal entity has its management. The administrative headquarters is deemed the effective company headquarters for the effects of attributing nationality to a company.

Effective company headquarters should not be confused with the *siége d'exploitation*, the principal place of commercial activity. This is not always easy to determine and, therefore can not be generally applied, notwithstanding its importance for the effects of tax and bankruptcy law.[14]

Therefore, the cumulative criteria of the place of incorporation as well as that of the company headquarters, adopted by Brazilian law, (*i.e.* a formal criterion supplemented by a substantive one) avoids the inconvenience of the use of any one of the unilateral criteria mentioned above. It grants greater certainty and assurance to the legal statute of the company by detouring around the inconvenience associated with determining corporate nationality in accordance with the criteria of place of incorporation, place of the headquarters, or place of principal business.

Thus, the mere fact that a company incorporated abroad had its actual administrative headquarters in Brazil would not afford it the status of a Brazilian company, since Art. 60 of Decree-Law No. 2.627 adopted a system of *cumulative connections*. This requires that not only must it be headquartered in Brazil, but the company must also "be organized under Brazilian law." Therefore, the above-described company would still be a foreign company in Brazilian positive law. The same conclusion would be reached if a company that had been incorporated in Brazil had its administration abroad. In the absence of either of the two connective elements, whose simultaneous occurrence is necessary for the acquisition of Brazilian nationality, a company must be characterized as foreign.[15]

[11] F. Caruso, *Le Società nella Comunità Economica Europea* (Naples 1969).

[12] Civil Code, Art. 19 (I).

[13] Art. 35 (IV).

[14] In Brazil, Decree-Law No. 7.661 of 1945, art. 7, uses this test to define the forum for hearing bankruptcy claims. Tito Ballarino, "La nazionalità delle società e la condizione delle società straniere," in *I Grandi Problemi della Società per Azioni nelle Legislazioni Vigenti, V, II,* 1574 (1976).

[15] Alberto Xavier, *supra* note 5, at 349 ff.

III. RECOGNITION AND DOING BUSINESS BY FOREIGN COMPANIES

Under Brazilian law, companies that are not both organized under Brazilian law, and with their administrative headquarters in Brazil, are deemed to be foreign. Once a company has been shown to be foreign because of the absence of one of the connective elements, two questions are raised in connection with Brazilian law. First, is whether the company should be recognized as a "collective organization" (whether it is a legal entity)[16] having full capacity, rights and liabilities, even though it was formed under the aegis of a foreign legal system. Second, if recognized by our legal system, what is the permissible scope of the company's activities in Brazil, that is to say, the conditions necessary for it to *do business* within Brazilian territory.

Historically, there have been legal systems that have refused to recognize the existence of foreign companies, even though properly constituted under the laws of their own countries, unless their bylaws were approved by the foreign country.[17] Today, the prevailing international principle is that of the full recognition of foreign companies, and therefore of their capacity to enjoy and exercise their activities, in conformity with their regulating law.

In Brazil, the above-discussed Article 11 of the Law of Introduction to the Civil Code not only determines the criterion for determining the nationality of "organizations for collective interests," but also ordains the *automatic recognition* thereof, with full capacity to use and enjoy their rights within Brazil. Notwithstanding, recognition of the legal capacity of a foreign company is one thing; its establishment or doing business in Brazil is quite another. As a general rule, Brazilian legislation does not require prior governmental authorization for foreign legal entities to invest in the capital of Brazilian companies (Decree-Law No. 2.627, Art. 63), since our law recognizes the existence of foreign companies and the full validity of their rights. This does not, however, permit foreign companies to do business within our territory without governmental authorization. Brazilian doctrine distinguishes between *juristic activity* and *business activity*.[18] Perhaps this language is technically imprecise, but it is sufficiently suggestive to make clear that once the question of the recognition of the foreign company has been affirmatively resolved, the question remains of whether, and to what extent, the foreign company can conduct its business within Brazil.

The right to do business is the dealt with in § 1 of Article 11 of the Law of Introduction to the Civil Code and Article 64 of Decree-Law No. 2.627. The former provides that foreign legal entities "cannot have branches, offices, agencies or establishments in Brazil, until their constitutive documents have been approved

[16] The Law of Introduction speaks of the recognition of "collective organizations", which includes both partnerships and incorporated companies.

[17] With respect to the doing business in Brazil of foreign companies, see Gilberto de Ulhôa Canto, 3 *Temas de Direito* 179 (1964).

[18] *Id.*, at 180 ff.

by the Brazilian government, subjecting these entities to Brazilian law." The latter determines that "foreign corporations or companies, whatever their objectives, cannot do business in Brazil by themselves or through branches, offices, agencies or establishments that represent them without the authorization of the Federal Government; they may, however, be shareholders in a Brazilian corporation, except where expressly prohibited by law."

The scope of the Companies Law is broader, in that it subjects to prior governmental authorization not only the creation of branches, but also the companies themselves doing business in Brazil. Under the terms of Art. 64 of Decree-Law No. 2627, a foreign company can do business in Brazil in two distinct ways: either (a) by itself or (b) "through branches, offices, agencies or establishments that represent it." In the first case, the foreign company acts within Brazil without having any organization of people or assets located there; in the second, it sets up a secondary organization, which the law calls a branch, office, agency or establishment, without distinguishing among these terms. In both cases, although its existence is automatically, *de jure* recognized by Brazilian law, in order to do business in Brazil, it still need specific governmental approval.

IV. BRANCHES AND SUBSIDIARIES OF FOREIGN COMPANIES

Preliminarily, one must take note of the fact that branches, agencies, offices and establishments that represent them, have no legal existence apart from that of the companies of which they are mere extensions (corresponding to *succursales* in French law). Quite different is the situation of *subsidiaries* of foreign companies, which are constituted in Brazil under Brazilian law, even though may be controlled by a foreign legal entity.[19]

The Profit Remittance Law, which regulates foreign capital, defines "subsidiaries of companies with foreign headquarters" as those with "predominantly foreign capital."[20] Decree No. 55.762, which regulates the Law, clarifies the meaning of predominance: "A legal entity formed in this Country, not less than 50% of whose voting capital belongs, directly or indirectly, to a company with foreign headquarters, is deemed a subsidiary of a foreign company."[21] Since they are not legal entities distinct from their parents, branches, offices or agencies of foreign companies (like those of domestic companies) have the characteristics of secondary commercial establishments. Nevertheless, certain aspects of their legal status appear, at first glance, to indicate they are distinct legal entities. Thus the law effectively presumes that with respect to obligations contracted in Brazil the place

[19] "*Subsidiary*" corresponds to "*filiale*" in French law. The present Corporation Law refers to a subsidiary as a "controlled company." Law No. 6.404 of 1976, art. 243 § 2. Alberto Xavier, "Problemas jurídicos das filiais de sociedades estrangeiros no Brasil e de sociedades brasileiros no exterior," 16 *Boletin de Estudos Juridicos do Investimento Internacional* 12 (1980).

[20] Law No. 4.131 of Sept. 3, 1962, art. 42.

[21] Art. 20, sole §. See Herculano Borges da Fonseca, *Regime Jurídico do Capital Estrangeiro 53* (1963).

of a secondary establishment shall be its domicile, without prejudice to the domicile of the parent abroad.[22] The law also provides that the domicile shall be fixed in its own capital destined for operations in Brazil.[23] The law requires branches to have separate accounting[24] and to maintain its own administration, with a permanent representative in Brazil.[25] Lack of any legal existence of branches, however, has other indicators, such as the requirement that the original name be maintained in Brazil, permitting only the addition of "do Brasil" or "para o Brasil".[26] Another indicator is the ability of foreign companies authorized to do business in Brazil to nationalize themselves though a simple change in their by-laws without any change in the company form, keeping their present legal personality.[27] Only for income tax purposes are branches, offices, agencies or representations organized within Brazil deemed legal entities separate from their parents.[28] Subsidiaries of foreign companies, on the other hand, possess a legal existence separate from that of their parents, and are characterized as Brazilian companies. Under the Federal Constitution of 1988, as we shall eventually discuss, however, they are now called Brazilian companies *with foreign capital.*

V. SPECIAL CRITERIA FOR DETERMINING NATIONALITY

Formation and headquarters in Brazil are, thus, the general requirements for determining the Brazilian nationality of companies. In order to perform their activities within Brazilian territory, other preconditions are required, under countless legal statutes, especially those relating to the nationality of *corporate control* or *capital origin*, which place restrictions upon foreign companies or those deemed equivalent thereto.

The Constitution has several provisions dealing with foreign companies.[29] Like its predecessors, the present Constitution provides that the ownership of news media companies of any type including television and radio broadcasting firms, "is restricted to native-born Brazilians or those naturalized more than ten years ago," and prohibits investment by legal entities in their capital, "except for political parties and legal entities whose capital is owned exclusively and nominally by Brazilians" (Art. 222 § 1). In the health care area, "direct or indirect participation

[22] Civil Code, art. 35 § 4.

[23] Decree-Law No. 2.627, art. 64(d).

[24] *Id.*, art. 70.

[25] *Id.*, art. 67.

[26] *Id.*, art. 66.

[27] *Id.*, art. 71.

[28] Alberto Xavier, *Direito Tributário Internacional do Brasil* 221 (1977); Decree No. 85.450 of Dec. 4, 1980 (Income Tax Regulations), art. 96 (II).

[29] Fábio Konder Comparato, *O Poder de Controle na Sociedade Anônima* 363 (2d ed. 1977).

by foreign firms or capital is prohibited, except for cases provided for by law" (Art. 199 § 3).

Exploration for and production of mineral resources and hydraulic energy sources may only be carried out, with federal authorization or concession, "by Brazilians or by a Brazilian company of national capital" (Art. 176 § 1). The new Constitution further provides that "existing Brazilian companies", including companies organized here but having foreign capital, will have four years "in which to comply with the requirements of Art. 176" (Art. 44 of the Transitory Provisions).

Ship owners, operators and captains shall be Brazilian citizens, as shall be at least 2/3 of the crew of national vessels (Art. 178 § 2). Furthermore, coastal and internal shipping "are reserved exclusively for Brazilian vessels, except in the case of public necessity as provided by law" (Art. 178 § 3). The Constitution provides that the law "shall regulate and limit the acquisition or leasing of rural property by foreign individuals or legal entities and shall determine which cases shall require authorization from the Federal Congress" (Art. 190). The Constitution states that a "complementary" law shall set out the conditions for the equity participation of foreign capital in financial institutions and in insurance, pension funds and capital funds, having in mind the special national interest (Art. 192-III (a) and (b).

Several statutes impose restrictions upon the exercise of certain activities by companies whose capital is partly held by foreigners.[30] Thus, financing by the "Federal Treasury and governmental official lending institutions" is restricted to firms, "the majority of whose voting capital belongs to persons not resident in Brazil" or to "branches of companies headquartered abroad."[31] The Brazilian Code of the Air provides that aircraft "may only be entered in the Brazilian Aeronautical Register if they are the property of a Brazilian legal entity, four fifths or more of whose capital belongs to named Brazilians, when (the aircraft) are to be used in air traffic service."[32]

Several laws and decrees require *registration* of all equity shares of determined companies, so as to facilitate governmental supervision of the control exercised by the foreign shareholders of such companies. Thus, registered shares are required for: companies that subdivide rural lots;[33] financial institutions;[34] insurance companies; airline companies in general,[35] as well as trading companies.[36] In all these instances, the criteria of corporate control or the origin of capital are not used as determinants of nationality. According to the legal

[30] *Id.* at 365.

[31] Law No. 4.131 of Sept. 3, 1962, arts. 37 & 39.

[32] Decree-Law No. 32 of Nov. 18, 1966, art. 14 (b).

[33] Decree No. 69.344 of 1971.

[34] Law 4.595 of Dec. 31, 1964, art. 25.

[35] Law 5.710 of Oct. 7, 1971, art. 7.

[36] Decree-Law No. 1.248 of Nov. 29, 1972.

requirements, the determination of nationality continues to be made by the criteria of places of constitution and headquarters. However, they serve as elements to treat companies that exhibit these characteristics as *equivalent to foreign companies.*

This *legal equivalence* is by and large implicit, but express provisions do exist. Thus, for example, in order to make explicit the provisions of Complementary Act No. 45 of January 30, 1969, the statute regulating the acquisition of rural real estate by foreigners domiciled in Brazil or by foreign companies authorized to do business in Brazil, deemed equivalent to a foreign company, for its purposes, any Brazilian legal entity "in which foreign individuals or legal entities have equity ownership of any sort, and these have the majority of their capital abroad and reside or have their headquarters abroad."[37] Indeed, the question of *foreign domicile* assumes special importance in those laws providing that Brazilian companies whose control is exercised abroad are equivalent to foreign companies. Thus, the Profit Remittance Law focuses upon the element of residence, domicile or headquarters of their owner in defining "foreign capital."[38]

In one widely commented law, the Informatics Law, which governs national policy on computers, data processing and communications, control assumed the role of the definitive test of company nationality, rather than being merely one element. For the purposes of this law, *domestic companies* are legal entities constituted and headquartered in Brazil "whose control is permanently, exclusively and unconditionally held, directly or indirectly, by individuals resident and domiciled in Brazil, or by a governmental entity."[39] The Informatics Law defines control with extraordinary breadth. Besides decision-making and technological control, there must be control of capital through the "direct or indirect holding of all capital with actual or potential voting rights, and at least 70% of total capital." Therefore, an informatics company constituted and headquartered in Brazil would still be considered a *foreign company* if it were not "controlled" by Brazilian residents as defined in the Informatics Law.

VI. REFORM PROPOSALS

The variety of circumstances that favor the criterion of control has encouraged a series of proposals to change the system of determining the nationality of companies under Brazilian law. These proposals are aimed at transforming control from a special criterion for corrective or equivalence purposes, into the decisive element in the classification of domestic and foreign companies. The cumulative system used by Brazilian law for establishing nationality (formation and headquarters) has always been criticized as not satisfying the Brazil's interests. Political and economic considerations, notably

[37] Law No. 5.709 of Oct. 7, 1971, art. 1 § 1.

[38] Law No. 4.131 of Sept. 3, 1962, art. 1. See Modesto Carvalhosa, *supra* note 7, at 248.

[39] Law No. 7.232 of Oct. 29, 1984, art. 12.

during periods of war or internal crisis, were used to justify the control test as the best technical parameter for the nationality of companies.

The problems arising from foreign activities during the World Wars and from the confiscation of the property of enemy subjects, especially after World War I, led to laws and courts ignoring fictive legal personality and concentrating on the real *substratum* of firms. Nationality of companies was to be determined not by formal criteria relating to the companies themselves, but by criteria that went to the nationality of their controlling investors or directors. Making control a decisive criterion was a common phenomenon in several countries. French case law during the First World War used the criterion of control to justify confiscation of enemy property with respect to companies both constituted in France and with their administrative headquarters also located in France.[40] In England, the House of Lords deemed a company constituted in England, and therefore formally English, to be foreign because its capital belonged to German subjects.[41] In United States law the control test only came to be used as of the Second World War and intensified during the Cold War.[42] In Brazil, during the last war, the control test was decisive in several statutes provided for expropriation of property belonging to subjects of the Axis powers.[43]

Once hostilities ceased, however, countries generally returned to the criteria of formation and headquarters as determinative of the nationality of companies. As Loussouarn and Bredin asserted, among advances and retreats, the war gave a transitory victory to the control test, but peace reestablished the preeminence of traditional criteria.[44]

In Brazil, however, the criterion of control was never entirely set aside, remaining as a special test in specific instances, and growing in strength as various movements sought to adopt it as the general test for the determination of nationality. One need only mention the draft proposal, submitted during a Symposium on the Reform of Legislation on Corporations, held in 1970 in São Paulo under the auspices of the São Paulo Federation of Industry, which adopted capital origin as the determining factor in the nationality of companies. The proposal was defeated in the full session of Congress. This same proposal came to the Federal Congress as Bill 253 of 1969, which would have given a new wording

[40] Court of Appeals of Lyon, Decision of March 30, 1915, *Dalloz*, 1916.1.45.

[41] *Daimler Co. Ltd.* v. *Continental Tyre & Rubber Co. (Great Britain) Ltd.*, [1916] 2 A.C. 307. English case law went further still in the decision of the Privy Council in 1919, by deeming enemy property a Dutch company, because "all of its business was controlled by German owners."

[42] During the course of the Second World War, the 1941 Trading with the Enemy Act defined an "enemy" for the purposes of the law as "any body of persons (whether corporate or unincorporated) carrying on business in any place, if and so long as the body is controlled by a person who, under this section, is an enemy".

[43] *E.g.*, Decree-Law No. 4.166 of 1942 and its regulating Decree No. 5777 of 1943. During the First World War, we had identical legislation in Brazil, such as Decree No. 3.393 of 1917.

[44] Yvon Loussouarn and Jean Denis Bredin, *Droit du Commerce International* No. 250, p. 267 (1969); Lefebvre D'Ovidio, *La Nazionalità delle Società Commerciali* 134 (1939).

to Article 60 of Decree-Law 2.627, fundamentally changing the criteria thereof and favoring the control test. This bill never became law.[45]

Because of its inherent lack of certitude, control has long been considered to be not the best general criterion for determining the nationality of companies. First, control has both *de facto* and *de jure* aspects, which are not always distinguishable. Furthermore, control can be transferred in less apparent ways than can the transfer of the statutory headquarters. Every time there was a change in the composition of the controlling group, there could be, *ipso facto,* a change of nationality, and consequently of the legal governance of the company. Hence the tendency is to use the control test not as a general criterion, but as a special test for correction or equivalence.[46]

Nevertheless, differentiation of domestic and foreign companies upon the criterion of control has been steadily increasing in Brazil. As has been pointed out above, companies with a majority of foreign capital have been subjected to several restrictions.

VII. HAVE THE RULES UNDER THE CORPORATION LAW CHANGED?

Even though the criteria for nationality provided in Art. 60 of Decree-Law No. 2.627 were expressly retained by the new Corporation Law (Law No. 6.404 of 1976, Art. 300), some writers have maintained that the Corporation Law introduced a new concept of a Brazilian corporation for certain areas, and that it favors the control test rather than the criteria of place of constitution and headquarters.[47] This is because Article 265 § 1 of the Corporation Law requires that any company which controls or commands a group of companies must be Brazilian, and the sole paragraph of Article 269 declares that, for the purposes of determining the "nationality of the control of the group", the phrase "under Brazilian control" means that the controlling or commanding company be, in turn, under the control of: (a) individuals resident or domiciled in Brazil; (b) governmental legal entities; or (c) a Brazilian company or companies which are directly or indirectly under the control of the persons or entities stated above.

Nonetheless, there are two levels of nationality to be considered in these provisions. Article 265 treats the nationality of the controlling company; Article 269 treats that of the control of such company. Under the terms of Article 265, the company controlling a group must be domestic, using the general criteria of Article 60 of Decree-Law No. 2.627: constitution and headquarters. Nothing in this article authorizes use of any other criterion. Article 269 only requires that the agreement forming the group declare its nationality (item VI), deeming to be under Brazilian

[45] Cd. Luiz Mélega, "Nacionalidade das sociedades por ações", 33 *Revista de Direito Mercantil* 127 (1979).

[46] Niboyet, *supra* note 3, at vol. 2, nn. 75 *et seq.*

[47] *E.g.*, Jacob Dolinger, "A sociedade anônima brasileira — Critério determinador de sua nacionalidade," 23 *Revista de Direito Mercantil* 65 (1976).

control any group whose controlling company (which must be Brazilian under the terms of Art. 60 of Decree-Law No. 2.627) is under Brazilian control, applying the criteria set out in the sole paragraph of Article 269.[48]

Thus, a group of companies in which the commanding company, albeit domestic, is under the direct or indirect control of foreigners, will be deemed to have foreign control. This is not so say, however, that the criterion of control has been adopted for the classification of the Brazilian company. The law merely establishes that the *nationality of the control* of the controlling company will be determined by the nationality of the those who control it, determining the *nationality of the group of companies.*

Is the same way, in its chapter relating to wholly-owned subsidiaries (another innovation), the law, by providing that such a company shall always have as its sole shareholder a Brazilian company (Art. 251) does not alter the general system, since the nationality of the controlling company is determined by the concept of Art. 60 of Decree-Law 2.627. There are no special criteria proposed for this concept in this context. As is the case with Article 269, where no special criteria are fixed, the law remits its interpreter to the general rule on the nationality of companies.[49] In short, Law No. 6.404 did not alter the general criteria for the determination of the nationality of companies. It is the 1988 Constitution that has started these movements for change.

VIII. THE 1988 CONSTITUTION: THE TRIUMPH OF CONTROL

The Federal Constitution of October 5, 1988, definitively sanctioned the dualistic system of determining company nationality, in two separate contexts: that of domestic conflict of laws, and that of the enjoyment of rights under the aegis of the same system of laws. In the first case, the company's headquarters and formation are the elements determining its nationality; in the second, the nationality of the controller prevails. Control is no longer regarded as an exceptional corrective criterion, but rather as a general criterion, with respect to the enjoyment of rights under a law.

In Article 171, the Constitution distinguishes two categories of domestic businesses, one generic and the other specific: (a) the *Brazilian company*; and (b) the *Brazilian company with national capital.* A Brazilian company, *tout court*, is one "constituted under Brazilian laws that has its headquarters and management in the Country" (Art. 171-I). A Brazilian company with national capital, in turn, "is one whose effective control is permanently held, either directly or indirectly, by individuals domiciled and resident in the Country or by entities of domestic public law" (art. 171-II).

"Effective control", says the Constitutional text, is to be understood as "the ownership of a majority of its voting capital and the exercise, both in fact and in law, of the decision-making power to manage its activities." (Art. 171-II).

[48] Fábio Konder Comparato, *supra* note 29, at 367-68.

[49] Paulo Roberto Costa Figueiredo, *Subsidiária Integral* 79-80 (1984).

Therefore, if the effective control of a Brazilian company is held, directly or indirectly, by individuals or legal entities resident, domiciled or having their headquarters abroad, one must infer that this company will be deemed a *Brazilian company with foreign capital.*

The determination of effective control, for the purpose of classification of a company as having national or foreign capital, is different from that provided in Law No. 6.404 of 1976. According to the provisions of Articles 116 and 243 § 2 of Corporation Law, a controller is a natural person or legal entity that is the owner of equity rights which permanently guarantee it the majority of votes in the decisions of the shareholders' meetings, and the power to elect the majority of the officers and directors, so long as it actually uses this power to manage the company. It does not, as does the Constitution, require holding a majority of the voting stock in order to find control, but only the majority of votes in the shareholders' meetings. In this way it implicitly recognizes the phenomenon of minority control, which the Constitution ignores.[50]

Once effective control has been defined as majority control, the complementary prerequisite of the exercise of decision-making power hardly seems relevant. As the author has stated, "Under this type of majority control, however much the controller may pretend to be uninvolved in company business, he cannot avoid the fact that the power to command is exercised in his name, or by delegation from him, which is the same thing." Additionally, in speaking of "the exercise, both in fact and in law" of the decision-making power, the constitutional text forgets that exercise is a fact and not a possibility, so that the phrase "the exercise in law" of the decision-making power, masks an inherent contradiction. By demanding the exercise both in fact and in law of the decision-making power in order to classify a company as having national capital, the Framers must have sought to emphasize that the domination of the Brazilian majority must be both formally and actually exercised.

The legal consequences of these distinctions still depend upon future statutes, but the Constitution has already authorized the granting of *privileged treatment* to Brazilian companies with national capital. (Art. 171 §§ 1 & 2). This brings the law governing Brazilian companies with foreign capital closer to that governing foreign companies authorized to do business within Brazil, through governmental approval. This privileged treatment may be of three types: (a) the conceding of temporary benefits to develop activities considered strategic for national defense or essential to the development of the country, (b) the creation of reserved markets in sectors deemed essential to national technological development, and (c) preferential treatment in the acquisition of goods and services by the Government.

The question of the nationality of companies thus has become not simply one issue within international conflict of laws. Instead it has become a central chapter of the body of rules that the French call "*droit des étrangers*" and the Germans "*Fremdenrecht*", which still awaits a systematic treatment.[51]

---

[50] Comparato, *supra* note 29, at 37.

[51] Tito Ballarino, *supra* note 14, at 1588.