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Legal Framework for STARTUPS

The advance of innovative entrepreneurship

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BRAZILIAN INNOVATION ECOSYSTEM

In the last few years, Brazil has been a fertile ground for the emergence of businesses, fostering an ecosystem of innovation and entrepreneurship.

According to StartupBase consultancy, there are at least **13,400** startups in Brazil

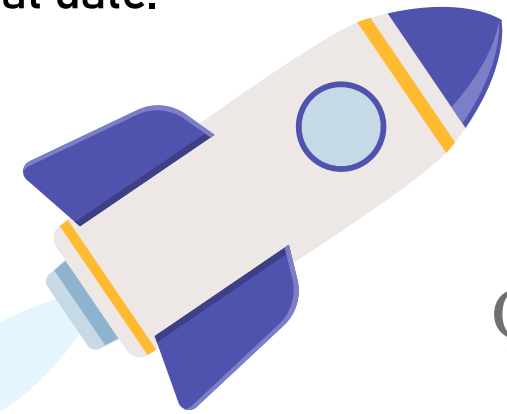
Brazil is in the top ten countries that have the highest number of "unicorn startups," i.e., innovative companies valued at over **1 billion dollars.** In the national scene, currently, unicorn companies number **16.**

While the startup market is heated, the legal universe presents challenges. Disruptive and innovative businesses pose a series of risks for investors, as many of these activities are not yet regulated by law.

THE LEGAL FRAMEWORK FOR STARTUPS (LFS)

To contain **legal uncertainty and boost the growth of the country's ecosystem**, entrepreneurs, parliamentarians, lawyers, and associations, among other stakeholders, participated in the discussion of Supplementary Law Project (PLP) No. 146/19, known as the "Legal Framework for Startups" (LFS), since its publication in 2019.

These efforts resulted in Supplementary Law No. 182, which was published on **June 2, 2021**, in the Federal Official Gazette, which comes into effect **90 days** after that date.



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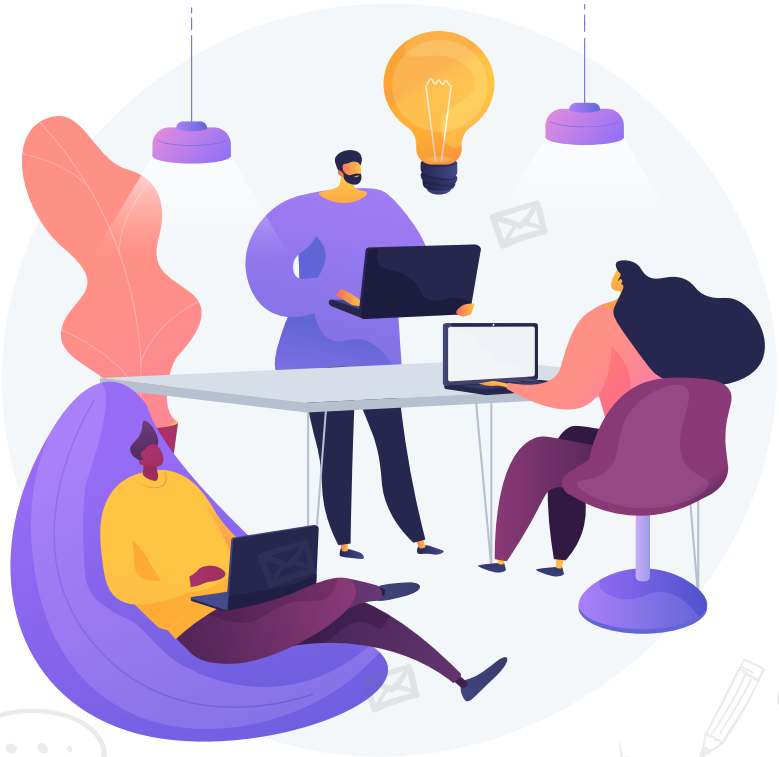
Article 3 of the Legal Framework sets out a list of nine principles that should guide its application and interpretation. **Among the most important principles are:**

- encouraging innovative entrepreneurship with legal certainty and contractual freedom
- modernizing the Brazilian business environment
- fostering the generation of qualified jobs
- improving public policies aimed at entrepreneurship and fostering cooperation between the public sector and private initiative
- encouraging government procurement of innovative solutions
- promoting competitiveness, internationalization and attracting foreign investment

Thus, the main objectives of the Legal Framework are **creating more favorable conditions for the startups**, promoting greater legal certainty for investors and establishing rules for differentiated treatment for these companies, helping their growth and expansion of the sector in the Brazilian market.



In the next few pages, you can learn more about the main points of the Law.

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CORPORATE ASPECTS OF THE LFS

Startup framework

Mandatory criteria + Alternative requirements

What are the mandatory criteria?

- Individual Entrepreneurs / EIRELI[1] / Limited Companies / Corporations / Cooperatives / General Partnerships
- Having been organized for up to 10 years - CNPJ (National Corporate Taxpayer's Register) registration
- Which applies innovation to the business model or to products / services
- With gross revenue of up to BRL 16 million in the previous calendar year, regardless of the corporate form has been adopted

NOTE: If the startup has been incorporated for less than 12 months, it must be considered the calculation of BRL 1,333,334.00 multiplied by the number of months of activity in the previous calendar year.

[1]Individual Limited Liability Company

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Alternative Requirements

Declaration, in the constitutive or amending corporate act, of the use of innovative business models to generate products or services[2]

or

Inclusion in the special regime of Inova Simples (Simplified Special Regime), the Brazilian government's startups incentive program[3]

[2]According to item IV, Article 2, Law 10,973, of December 2, 2004
[3]According to Article 65-A of Supplementary Law No. 123/2006

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Making corporate requirements and bureaucracies more flexible

Composition of the executive board of S/A (Corporations): reduction from at least two to just one administrator. Article 143 of Law No. 6,404/76 (Brazilian Corporations Law). This flexibility is adjusted to the reality of startups, since 49%[4] are usually composed only by the founding partners.

Changing parameters so that privately held corporations can

I. make the publications ordered by the Brazilian Corporations Law electronically;[5]

II. replace the corporate books[6] with mechanized or electronic records; and

III. freely establish the distribution of dividends as approved at the General Meeting, if the Articles of Incorporation are silent in this regard, without the startup having to apply the rules of Article 202 of the Brazilian Corporations Law.

Before the LFS: flexibility for companies with Owners' Equity below BRL 10 million and up to 20 shareholders.

With the LFS: companies with annual gross revenue up to BRL 78 million, regardless of the number of shareholders.

[4]Source: Abstartups, 2017
[5]Article 294 of Law No. 6.404/76 (Brazilian Corporations Law)
[6]Article 100 of the Brazilian Corporations Law

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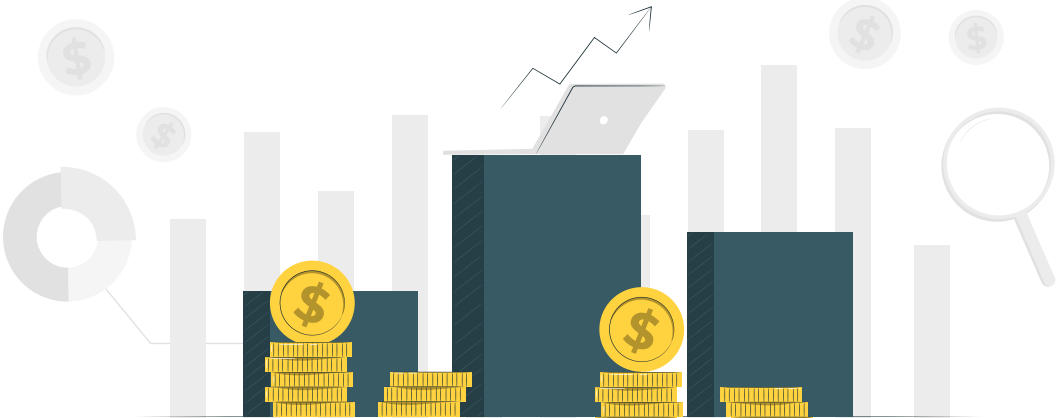
Investment Instruments

The contributions made, by an individual or legal entity, through the following types of investments, may or **may not** result in **holding interest in the startup's capital**:

- Unit of Ownership/Share Subscription Option Agreement
- Unit of Ownership/Share Option Agreement
- Convertible Bonds, according to the Brazilian Corporations Law
- Loan Agreement Convertible into equity interest
- Structuring of Unincorporated Joint Venture
- Angel Investor Agreement, according to Supplementary Law No. 123/2006
- Other capital contribution instruments in which the investor is not formally a member of the company



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Access to the Capital Market for smaller companies

Determination by the CVM (Securities Commission) to regulate simplified conditions to allow the access of smaller companies (annual gross revenue under BRL 500 million) to the capital market.

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Angel Investor: figure that has already appeared in Article 61-A of Supplementary Law 123/2006 in regulation of the Participation Agreement.

LFS recognizes that the angel investors contributions in startups do not form part of its capital, and, therefore, such investors will not be considered members.

LFS expands the concept to permit that, in addition to individuals and legal entities, an investment fund[7] can also be considered an angel investor.

LFS reinforces that the angel investors will not have the right to manage or vote in the company's administration, but allows them to participate in the management in an advisory capacity and have access to the accounts, inventory, balance sheets, accounting books and cash position of the startup.

[7]To be regulated by the Brazilian Securities Commission - CVM

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INVESTMENTS IN R&D AND INNOVATION

Investments arising from regulatory obligations* may be made with contributions to startups through:

- Endowment funds
- Private Equity Investment Funds
- Programs aimed at financing, accelerating and scaling startups, managed by public institutions. **

*grants or delegates signed through regulatory agencies.
**public companies focused on developing research, innovation and new technologies, university foundations, development banks that seek to develop technology-based companies, entrepreneurial ecosystems and encourage innovation.

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Investments in R&D and innovation do not apply to the minimum legal or contractual percentages

FIP (Private Equity Investment Fund), endowment fund or the public institution that receives funds: issuing certificate for companies to prove compliance with legal or contractual obligations to invest in research, development and innovation

Validation of compliance with legal or contractual obligations: subject to compliance with rules defined by the sectorial entity responsible for supervising such obligations

Later regulation: accountability of the FIP, endowment fund or the public institution that receives funds and the supervision of legal or contractual obligations

GOVERNMENT CONTRACTING

The Legal Framework for Startups creates specific bidding rules for the contracting of innovative solutions by the Government.

The new Law sets forth two phases of contracting:

- **First phase:** the Government presents the problem to be solved and the expected results.
- **Second phase:** a specific bidding procedure is established for hiring startups.

CPSI

After approval of the result of the bidding procedure, the Government may test the innovative solutions through a Public Contract for Innovative Solution (CPSI)

Amount: up to BRL 1.6 million

Term: up to 12 months, extendable for an equal period

After the end of the CPSI, there may be a 3rd stage in the contracting: **the Government can enter into a contract with the startup** to supply previously tested innovative solutions, without the need for a new bidding process.

Term: up to 24 months, extendable for an equal period.

In addition, specific bidding rules were established for contracting with the Government containing the possibility of waiving the

I provision of guarantee for contracting;

II documentation relating to legal qualification;

III documentation relating to technical and economic-financial qualification; and

IV documentation relating to fiscal good standing, except for social security.

Possibility of prepayment of the contract installment to enable the startup to implement the initial stage of the project.

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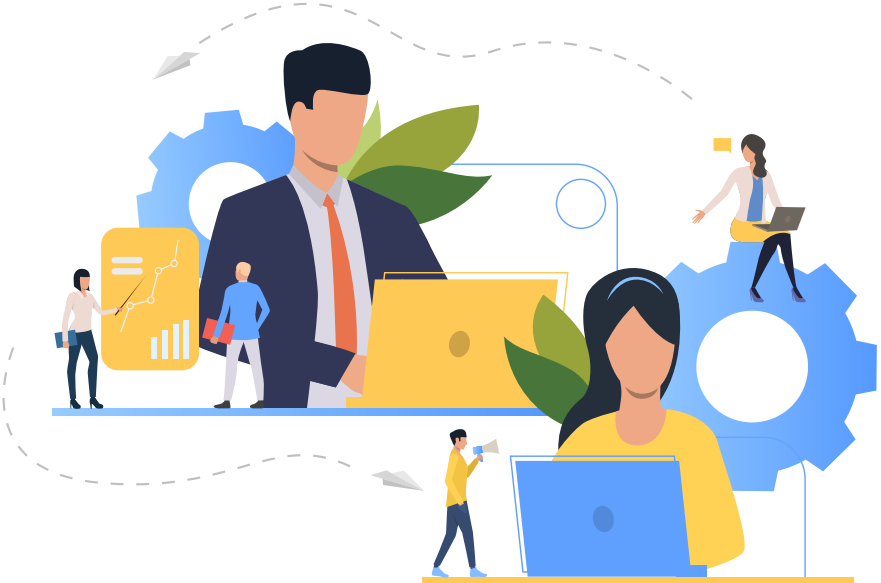
REGULATORY SANDBOX

What is it?

The Regulatory Sandbox is an environment that enables innovative ideas not yet regulated by the Government to be tested. Companies can test their solutions in a controlled way, avoiding any damage.

Through the Regulatory Sandbox, **startups will have more freedom to act before Government bodies responsible for regulating the sector.** Thus, regulatory agencies may suspend the requirements pertaining to the sector until to prove the viability of the business and its technical capacity for execution, among others.



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Therefore, the Regulatory Sandbox allows, for example, Anvisa, ANEEL, ANTT, and others regulatory agencies, **to establish simplified procedures and avoid regulatory sanctions**, for a determined period, for these companies to may test their technologies and business in the market.

As set forth in the LFS, bodies or entities responsible for regulation may establish individually or in joint cooperation:

I criteria for selection or qualification of the startups that will be regulate

II the time period and scope of the incidence suspension of regulatory rules

III the standards that will be covered

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credits

Partners

José Roberto Opice Blum
Renato Opice Blum
Marcos Gomes da Silva Bruno
Rony Vainzof
Camilla Jimene
Caio César Carvalho Lima
Danielle Serafino

Legal content

Marcella Costa
Gisele Karassawa
Ana Catarina de Alencar

Editorial coordination

Bruno Toranzo

Review

Rony Vainzof
Caio Lima
Bruno Toranzo
Yasmin Brandão

Art and layout

Paola Cosentino

Intern

Lucas Fernandes

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