Insolvency and Corporate Reorganisation **Report 2016**

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Section 1: PROCESSES AND PROCEDURES

1.1 What reorganisation and insolvency processes are available for debtors in your jurisdiction?
The Brazilian Bankruptcy Law provides three alternatives for debtors:

(i) judicial reorganisation – reorganisation proceedings before a bankruptcy state court;
(ii) extra-judicial reorganisation – an out-of-court settlement; and,
(iii) bankruptcy.

Judicial reorganisation is the Brazilian equivalent of Chapter 11 of the US Bankruptcy Code. The debtor files a petition before the Bankruptcy Court and if all the formal requirements set out in law are fulfilled, the processing of the judicial reorganisation is granted. The main aspects of a judicial reorganisation are:

(i) a 180-day automatic stay;
(ii) debtor in possession as a rule – the management may be replaced in cases of fraud, mismanagement, crimes and so on;
(iii) four classes of creditors in the creditors' meeting (labour, secured creditors, unsecured creditors and creditors defined by Brazilian law as 'micro' or 'small' entities);
(iv) nomination of a trustee to assist the court; and,
(v) deliberation of the reorganisation plan in a creditors' meeting that will vote and approve the plan.

The extra-judicial reorganisation is basically an out-of-court negotiation and settlement entered into by the debtor and creditors. The settlement may or may not be submitted to the Bankruptcy Court for homologation. The main advantage of homologation is that the plan will oblige all creditors. It resembles at the earlier stages the pre-packaged bankruptcy of the US Bankruptcy Code. However, in the Brazilian case, the court's approval terminates the proceedings and has essentially contractual effects. The extra-judicial reorganisation is rarely used in Brazil.

Bankruptcy consists of liquidation proceedings before the Bankruptcy Court. A trustee is nominated to organise and verify the creditors' claims, liquidate assets, and investigate potential crimes and fraud.

1.2 Is a stay on creditor enforcement action available?
If the request for processing the judicial reorganisation is granted, there is an automatic stay of 180 days. The stay suspends the limitations period and the course of actions against the debtor, except for tax and labour claims, and claims that seek indemnification of unliquidated amounts. Even though such actions may proceed, only tax claims are enforceable within this period.

According to the Brazilian Bankruptcy Law, the automatic stay cannot be extended. However, there are precedents allowing such an extension until the deliberation of the plan by the creditors' meeting.

The automatic stay also applies in the case of bankruptcy adjudication.

1.3 How could the reorganisation and/or insolvency processes available in your jurisdiction be used to implement a reorganisation plan?
Judicial reorganisations may be used to stay for 180-day enforcement actions and negotiate a plan of reorganisation with creditors. This plan may provide for:

(i) the renegotiation of debt values;
(ii) the renegotiation of payment conditions;
(iii) the sale of assets;
(iv) a capital increase;
(v) the sale of business sectors; or,
(vi) replacement of management, and so on.

Tax claims are excluded from the judicial reorganisation. However negotiation with employees, financial institutions and other creditors may provide effective ways for financially troubled debtors to avoid becoming bankrupt, preserving the entity, its business and the interests of stakeholders.

1.4 How can a creditor or a class of creditors be crammed-down?
A class of creditors that objects to the reorganisation plan may be crammed-down if the following conditions are met:

(i) approval in the creditors' meeting by creditors holding more than 50% of the credit value, regardless of the class in which they participate;
(ii) approval by at least two classes of creditors, according to the requirements set forth in the Bankruptcy Law (more than 50% of credit value and more than 50% of the creditors – except for the labour class, whose votes are calculated per person despite the value of each credit); should the creditors' meeting have only two classes of creditors, approval in only one class is required;
(iii) approval in the class that will be crammed-down by at least one-third of creditors (both in terms of credit value and individuals); and,
(iv) prohibition of unfair discrimination in the class that rejected the plan. Brazilian law does not provide for the 'fair and equitable' requirement of US bankruptcy law.

1.5 Is there a process for facilitating the sale of a distressed debtor's assets or business?
The Brazilian Bankruptcy Law stipulates that after filing for the judicial reorganisation a debtor in possession may only sell fixed assets if the utility of the sale is proved, and this must be approved by the creditors' committee and by the court.

Besides that general rule, the plan of reorganisation may provide for sales of assets as a recovery measure for the debtor. If the plan is approved and the judicial reorganisation is granted by the Bankruptcy Court, no further court approval is required for the sale of assets. However, a secured creditor's lien on certain assets must be respected so that the sale of the assets in a judicial reorganisation must be approved by the affected secured creditor.

In the bankruptcy proceedings, the Bankruptcy Law provides that the liquidation of assets will observe the following order:

(i) sale of the entity itself as a whole;
(ii) sale of branches or business divisions of the entity;
(iii) sale of assets related to certain business activities, branches or divisions; or,
(iv) sale of assets individually.

The Bankruptcy Code requires an auction process. The buyer of the assets will not be subrogated into the debtor's liabilities and debts according to the Brazilian Bankruptcy Law.

1.6 What are the duties of directors of a company in financial difficulty?

The duties of the directors of a company in financial difficulty are the same as those that apply if the company was not in difficulty. The same duties set out in the Brazilian Civil Code and in law number 6.404/76 (Company's Law), such as fiduciary, loyalty and information duties, also apply in judicial reorganisation and bankruptcies. The Brazilian Bankruptcy Law provides specific duties to be observed in such proceedings: assisting the court and the trustee; providing information, documents and financial statements; and several other obligations. In addition, specific conduct is considered a bankruptcy crime (such as failure to maintain the accountancy books or to present information requested by the court and fraudulent acts).

If insolvency becomes inevitable, it is recommended that the company files for bankruptcy instead of ceasing its activities on an irregular basis. Brazilian case-law considers that failure to do so is cause for holding the administrators liable for the companies' debts.

1.7 How can any of a debtor's transactions be challenged on insolvency?

There are two alternatives:

(i) revocatory action – an action brought by any creditor to annul a debtor's transaction that increased the debtor's insolvency; and,
(ii) action to declare ineffective certain transactions that are deemed harmful to the estate by the Bankruptcy Law.

The revocatory action is predicated on fraudulent behaviour of the debtor and the counterparty of the transaction, causing damage to the estate. Meanwhile, the second action is grounded on acts *per se* considered ineffective by law based on the assumption that these acts, regardless of the parties' intention, injure the estate and accelerate the insolvency. Examples include: payment of debts before the maturity date; payment of debts in conditions not contractually agreed; providing the debtor's assets as security for certain debt; and, renouncement of the debtor's rights. If these acts were performed within a period preceding the bankruptcy adjudication day, the Brazilian Bankruptcy Law considers them ineffective.

1.8 What priority claims are there and is protection available for post-petition credit?

Some claims in bankruptcy proceedings are paid with absolute priority. In general, these are debts that originated in the course of the judicial reorganisation or bankruptcy or claims for restitution of assets that were unduly seized in the bankruptcy proceedings. Amounts paid in advance in relation to certain foreign exchange contracts for exports may also be claimed with priority.

Further, the Brazilian Bankruptcy Law specifies rankings for claims, which require them to be paid in the following order:

(i) labour claims of up to 150 minimum wages and claims related to work accidents;
(ii) secured claims up to the collateral value. (A secured creditor, however, cannot enforce its security in bankruptcy proceedings; the security asset will be liquidated and the creditor will be given preference to receive priority payment, after the labour class, up to the asset's liquidated value. In a judicial reorganisation a secured creditor's lien on certain assets must be respected and may be enforced after a few requirements are met);
(iii) tax claims;
(iv) privileged claims according to various Brazilian laws;
(v) unsecured claims;
(vi) subordinated claims; and,
(vii) equity.

According to Brazilian law, all debts must be included in the bankruptcy proceedings (pre-petition and post-petition). Creditors that were not listed by the debtor or the trustee in the bankruptcy filings must file their claims to be included in the general list of creditors and receive distributions. If not included in the bankruptcy proceedings, post-petition creditors lose the right to receive payments after the liquidation of the debtor's assets and will still be eligible for discharge at the end of the bankruptcy proceedings. If the claims are not filed on time they are considered late claims (*habilitações retardatárias*) and the creditors lose the right to vote in creditors' meetings and to be included in distributions that have already taken place in the bankruptcy proceedings.

All debts must also be included in the reorganisation proceedings, even those that have not yet reached their maturity date. Debts originating after the filing for reorganisation are not subject to the reorganisation plan and must be paid according to the contractual terms.

1.9 Is there a different regime for credit institutions and investment firms?

Financial institutions in Brazil are not allowed to ask for judicial or extra-judicial reorganisation under the Bankruptcy Law.

In the case of financial difficulties or insolvency, these institutions are subject to administrative proceedings before the Brazilian Central Bank (Law number 6.024/74 and *Decreto-lei* number 2.321/1987). The Central Bank may nominate an administrator to manage the institution in the case of financial difficulties originating from mismanagement or fraudulent conduct, for example, or may liquidate the institution. If several requirements are met, the liquidation may be converted into bankruptcy proceedings before the Bankruptcy Court.

Section 2: INTERNATIONAL/CROSS-BORDER ISSUES

2.1 Can reorganisation or insolvency proceedings be opened in respect of a foreign debtor?

The Brazilian Bankruptcy Law adopts the territoriality principle and provides no solution for international/cross-border issues. The Law allows Bankruptcy Courts to process only the reorganisations and bankruptcies of Brazilian branches of international entities. It is limited to obligations undertaken in Brazil and can reach only assets located within Brazilian borders. However, since Brazil is becoming a much sought-after destination for foreign investors and multinational corporations, case-law may be forced to review the legislation. There is one precedent from the Rio de Janeiro Court of Appeals in the reorganisation of OGX where the lower court decision denying the inclusion in the reorganisation proceedings of two overseas subsidiaries of OGX was overruled.

2.2 Can recognition and assistance be given to foreign insolvency or reorganisation proceedings?

The new Brazilian Civil Procedure Code provides for international assistance measures. It is also possible to seek the homologation of foreign decisions.

Section 3: OTHER MATERIAL CONSIDERATIONS

3.1 What other major stakeholders (such as governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

In general, creditors have a material impact on the outcome of the reorganisation because they must approve the plan. Since failure to approve automatically leads to bankruptcy, the negotiation with creditors is one of the most relevant aspects of the process. Government and regulatory institutions have an important impact on businesses that depend on concessions from the government (the electricity and telecommunications sectors, for example), but their influence on concessionaires' activities usually takes place before any reorganisation proceedings. These are rare in these business sectors.

Section 4: CURRENT TRENDS

4.1 Outline any bankruptcy and reorganisation trends specific to your jurisdiction

The Brazilian Superior Court of Justice continues to consolidate case-law to decide disputes arising from the Brazilian Bankruptcy Law (Federal Law number 11.101/2005). These include: the creditor's right to seek enforcement against guarantors; the submission of some secured creditors to reorganisation proceedings; and, the enforcement of collateral in reorganisations.

Cross-border issues have increased in recent years (for example, how to deal with Brazilian subsidiaries abroad, bonds issued by Brazilian companies, and so on). These issues demand solutions from Brazilian courts that were not contemplated in the Bankruptcy Law.

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