Brazil

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SECTION 1: Market overview

1.1 What have been the recent bankruptcy and reorganisation trends or developments in your jurisdiction?

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Law 11,101 dated February 9 2005 (the Bankruptcy Act) continues to be the most important statute on insolvency. Rescue continues to be favoured over liquidation, and reorganisations continue to be heavily favoured over pre-packs among available rescue mechanisms.

Several large entities have chosen to deal with their creditors out of court, as banks have been more flexible and willing to reschedule debt maturity dates and enter into standstill agreements than in the past.

Publicly-traded telecom carrier Oi, with debt in excess of R$65 billion ($21 billion), made the largest-ever Brazilian insolvency filing. Oi's struggles stem from factors ranging from bad M&A deals to regulatory hurdles by telecoms watchdog Anatel. This is a very complex matter that also involves aspects of cross-border insolvency (with non-main proceedings in the UK, US, Netherlands and Portugal).

The real estate industry has been severely affected by poor macroeconomic conditions, translating into low credit availability, retraction in the number of new enterprises and a surge in early terminations of purchase agreements by buyers. Publicly-traded property developers and high-rise building constructors Viver and PDG have petitioned for reorganisation. These cases have garnered a lot of public interest because delays in ongoing construction works could affect thousands of buyers.

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About the author

Angela Paes de Barros Di Franco heads Levy & Salomão's dispute resolution group. She has litigated numerous matters in over 20 years at the firm, and she has tried hundreds of cases to final verdict. She has resolved many cases through alternative dispute resolution forms, such as arbitration. Her clients include Brazilian and international corporations. She has handled matters as diverse as shareholder actions, tax litigation, intellectual property claims, commercial contract disputes, land use, environmental protection matters and debt recovery. Her cases include both straightforward actions to enforce judgments and complex multijurisdictional matters. She also represents clients before administrative agencies, such as the Central Bank and the Appellate Council of the National Financial System. Her appellate litigation experience includes bringing several cases before Brazil's highest court.

She served the São Paulo State Court System as a mediator and is a featured lecturer on alternative dispute resolution in Brazil. Appointed by her peers to serve as an arbitrator or mediator in several cases, she has been listed among the world's leading dispute resolution practitioners by Chambers & Partners, The Legal 500 and Best Lawyers.

1.2 Please review some recent important cases and their impacts in terms of precedents or shaping current thinking.

Courts have reaffirmed the principle of preservation of the business (article 47 of the Bankruptcy Act) to the detriment of creditors' freedom to oppose rescue.

The Superior Court of Justice (STJ) has found that the majority may vote to suppress security over an asset and bind the relevant secured creditor (article 50, §1, of the Bankruptcy Act sets forth that consent by the creditor is required).

The São Paulo State Court of Appeals (TJSP) entered two important opinions in the Schahin matter: first, that votes by syndicated banks against the plan were deemed abusive and disregarded on the grounds that the debtor is still generating revenue and immediate liquidation would only favour the banks to the detriment of workers; and second, that funds who had bought a claim to which contractual step-in rights were attached must be deemed indirect controlling shareholders of debtors and may not vote the restructuring plan.

The Rio de Janeiro State Court of Appeals (TJRJ) found that Abengoa is allowed to present a consolidated plan, to be voted by creditors to each debtor at separate meetings; this is a middle-ground approach to substantive consolidation.

SECTION 2: Processes and procedures

2.1 What reorganisation and insolvency processes are typically available for financially troubled debtors in your jurisdiction?

The Bankruptcy Act contemplates three types of processes.

- A judicial reorganisation (*recuperação judicial*) is a debtor-in-possession (DIP) proceeding. An automatic stay applies; a court-appointed administrator oversees the conduct of business; the debtor presents a restructuring plan and this plan is voted by creditors at a meeting; creditors are divided into up to four classes (labour/employment, secured debt, unsecured debt, small-sized enterprises); and claims are novated as a result of approval.
- In a pre-pack (*recuperação extrajudicial*), the debtor strikes a deal with creditors out of court and then may submit it for court homologation. The deal may contemplate unsecured claims, secured claims or both (tax and labour/employment claims are excluded). If the deal encompasses more than 60% of the claims and is submitted to the court, then it binds the remaining claims if it is homologated. The proceedings end upon homologation and there is no further interference with debtor's activities.
- In a liquidation (*falência*), the debtor is removed from management of the business immediately upon adjudication and an administrator is appointed to manage the estate. The administrator finds and sells all assets of the estate and then uses the money to pay the estate's creditors according to a ladder of priorities.

Personal bankruptcy (*insolvência civil*) is regulated by Law 5,869 dated January 11 1973 and is rare.

See Section 2.9 for rules applicable to financial institutions.

2.2 Is a stay on creditor enforcement action available?

A statutory 180-day stay is triggered upon the court accepting the petition for reorganisation. Courts grant extensions on a case-by-case basis, usually for an additional 60 or 90 days (some precedents have allowed the stay to remain in force until the plan is voted), provided that the debtor has not caused the proceedings to drag. Courts may prevent a creditor from enforcing collaterals at any time if the underlying assets are essential for the business (for example, seizing production line machinery).

The TJSP has found that automatic stay also applies to pre-packs notwithstanding article 161, §4, of the Bankruptcy Act to the contrary.

As a rule, creditors may not pursue claims over the course of liquidation.

2.3 How could the reorganisation and/or insolvency processes available in your jurisdiction be used to implement a reorganisation plan?

A non-exhaustive list of measures that restructuring plans may contemplate is as follows: a debt renegotiation (including rescheduling, haircuts and grace periods, among other mechanisms); the sale of assets, either piecemeal or bundled as autonomous business units; payments in kind; corporate mergers and spin-offs; and capital increases and DIP financings.

Although claims not affected by reorganisation (such as taxes) are usually very sizeable, negotiation with unions, banks and trade creditors may provide effective ways for debtors to avoid liquidation, thereby preserving the business and the interests of stakeholders.

2.4 How can a creditor or a class of creditors be 'crammed-down'?

As a rule, each existing class of creditors must approve the restructuring plan, as follows:

- labour/employment: creditors in attendance (headcount), regardless of claim value in attendance;
- secured debt: headcount plus claim value;
- unsecured debt: headcount plus claim value; and
- small-sized enterprises: headcount, regardless of claim value.

Dissenting creditors and classes may be crammed-down if the plan has been approved cumulatively by more than half of the global claim value in attendance, at least two classes and more than a third of each class that has rejected the plan.

On top of statutory cram-down, the TJSP and the TJRJ have occasionally scraped "abusive" votes, in the sense that creditors failed to provide convincing reasons why liquidation would be a better overall alternative to rescue. These precedents basically found that creditors' selfish interests may be trumped by the principle of preservation of business for generation of revenues to pay workers and taxes. The STJ has not yet addressed the matter.

2.5 Is there a process for facilitating the sale of a distressed debtor's assets or business?

A debtor under reorganisation may only sell fixed assets as contemplated in the approved plan, or if the court finds that the sale is useful for the business. Assets may be bundled together and sold as a standalone business unit; if the unit is sold through a court-supervised auction, buyer will not be liable for prior debts.

There is a preferential order for sale of assets on liquidation: transfer of the whole business; separate transfer of each branch and business unit; sale of assets that comprise a specific branch or unit; and piecemeal asset sale. Auction is mandatory. The winning bidder is not liable for prior debts.

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Rafael Zabaglia is a senior associate in the firm's dispute resolution and business restructuring practices, and he also has extensive experience in transactional matters. Zabaglia has been lead trial counsel on many cases and has also represented clients in appeals to Brazil's highest federal and state courts. He has handled disputes involving aviation products liability, distribution agreements, M&A deals and other corporate arrangements, enforcement of judgments, reorganisation and liquidation of businesses in financial distress, and class actions brought in the name of the people by private petitioners or the public prosecutor. He also counsels clients on risk assessment related to potential and outstanding litigation.

Zabaglia worked for almost two years in the firm's M&A and corporate practice and has been seconded to Morrison & Foerster, New York office, where he worked at the M&A and corporate practice for almost one and a half years. Zabaglia has been listed among the top litigation practitioners in Brazil by Chambers & Partners global and local rankings. He holds a bachelor of laws from the Universidade de São Paulo and a specialist degree in organisational management and human resources from the Universidade Federal de São Carlos.

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

Directors' duties under Law 10,406 dated January 10 2002 (the Civil Code) and Law 6,404 dated December 15 1976 (the Corporations Act) are generally the same whether or not the company is in financial difficulty. The Bankruptcy Act imposes additional duties (for example, assisting the court and the administrator and providing information and financials periodically).

Directors are not statutorily required to call a shareholders' meeting, ask for capital contributions or make an insolvency filing in case of distress. However, they may be held personally liable for the business debts in case of an irregular shutdown (ceasing to do business and pay creditors and taxes without formal winding-up).

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

Preferential transfers are prohibited on liquidation. The administrator, the public prosecutor or any creditor may sue to void transactions the objective of which is to harm creditors' interests (*ação revocatória*); claimants must prove that the debtor and the counterparty to the transaction had a fraudulent intent and that the estate suffered losses as a result of the transaction. They may also petition to the court, or sue, to render certain transactions within the suspect period ineffective (for advance repayment of debt, repayment of outstanding debt in noncompliance with the contract or granting of new security for prior debt); the suspect period is usually the 90-day period prior to the petition for liquidation (or for reorganisation later converted into liquidation, as the case may be); it is not necessary to prove fraudulent intent.

Also, the judicial administrator, the public prosecutor or any creditor may at any time seek to have any claims excluded from liquidation or reorganisation, or modified in their nature or value, on the grounds of falsehood, wilful misconduct, fraud and simulation.

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

Taxes, claims secured by the fiduciary transfer of assets (*alienação fiduciária*), and certain credit arrangements like title retention sales and closed-end leases are not affected by reorganisation; they are de facto super-priority claims. All labour/employment claims must be paid no later than one year after approval of the plan. There is no other statutory priority on reorganisation since payment is made to each class of creditors per the plan. The plan may contemplate unequal treatment among creditors within the same class if there is economic reason to do so (for example, creditors who continue to trade with debtor may have their pre-petition claims be paid ahead of other claims).

Claims are divided into tiers on liquidation, according to a ladder of priorities that is roughly as follows: labour/employment; secured debt; tax; construction liens, mechanic's liens and alike; unsecured debt; administrative, criminal and tax fines; equity and other subordinated debt. Payments are allocated among creditors pro rata within each tier. Administrative expenses, claims for restitution of assets (including fiduciary transfers) and DIP financing during prior unsuccessful rescue proceedings are super-priority claims and must be paid without proration and with any immediately available funds.

Post-petition claims are protected from the effects of insolvency, must be repaid on their maturity dates and are super-priority claims both on reorganization and liquidation (articles 67 and 84, item V, of the Bankruptcy Act).

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

Financial institutions, insurers, pension funds and credit cooperatives are not allowed to file for reorganisation or pursue a pre-pack.

Distressed financial institutions may be subject to administrative proceedings before the Brazilian Central Bank (Law 6,024 dated March 13 1974 and Decree-law 2,321 dated February 25 1987). An administrator is appointed to either manage the business temporarily (*regime de administração especial temporária*), intervene to suspend its activities for up to 12 months (*intervenção*) or liquidate it (*liquidação extrajudicial*). If several requirements are met, administrative liquidation may be converted into court liquidation.

Security dealers are also subject to administrative proceedings overseen by the Central Bank.

SECTION 3: International/cross border issues

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

Brazil has not adopted the UNCITRAL Model Law on Cross-Border Insolvency, and the Bankruptcy Act does not contain any cross-border rules. Upon ruling on Oi, OGX, OAS and Tonon, local courts have established their jurisdiction over foreign debtors as long as these are functionally part of a corporate group the centre of main interests of which is Brazil. In practice, special purpose vehicles incorporated abroad to issue bonds can get court protection in Brazil first and then seek protection/assistance abroad through foreign non-main proceedings.

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

Foreign decisions may only be enforced in Brazil if and after the STJ validates them. Due process of law applies, so the party against whom the decision was entered must be served process and may file a defence on the grounds that the decision violates Brazilian public policy. This could be a lengthy process.

Law 13,105 dated March 16 2015 (Code of Civil Procedure) broadly provides for generic international assistance measures. There is no law on requests for assistance from foreign bankruptcy courts in what should otherwise be deemed foreign main proceedings. Brazilian courts are free to act as they deem appropriate. For instance, the Oi lower court has recently allowed the court-appointed administrators of two Dutch subsidiaries to join the proceedings only as representatives of the relevant creditors but not to practice any act of management (despite the fact that this is their role under Dutch law).

SECTION 4: Other material considerations

4.1 What other major stakeholders could have a material impact on the outcome of the reorganisation?

The outcome of reorganisations depends upon negotiation between debtor and its largest secured and unsecured creditors, since the rejection of the plan causes immediate conversion into liquidation. Negotiation with workers and unions is usually not as important because conditions for payment of labour/employment claims are largely predetermined by Article 54 of the Bankruptcy Act.

The government and its different agencies only interfere with reorganisation in regulated sectors. The government has been especially proactive with respect to Oi through Anatel, the federal accountability office (*Tribunal de Contas da União*) and the Ministry of Science, Technology, Innovation and Communications.

SECTION 5: Outlook 2017

5.1 What are your predictions for the next 12 months in the corporate reorganisation and insolvency space and how do you expect legal practice to respond?

The government has commissioned a review of the Bankruptcy Act. Work is underway and we expect lawmakers to address substantive consolidation, set-off and netting, cross-border insolvency and submission of tax claims and fiduciary transfers to reorganisation. Also, a Commercial Code bill which addresses cross-border insolvency is under consideration in Congress and might be taken to vote soon.

We expect courts to further discuss the criteria to accept substantive consolidation and to disregard abusive creditors' votes. Oi will make headlines given the interaction between Brazilian and Dutch jurisdictions and the anticipated showdown between shareholders and bondholders at the creditors' meeting. The PDG matter will also be relevant; its subsidiary PDG Securitizadora was the first securitisation vehicle of its kind to ever file for insolvency in Brazil and investors are likely to dispute the filing in light of certain sophisticated regulations of real estate-backed securities.

Although the economic forecast is not as grim as 2015 and 2016, we expect a few high-profile filings. Effects of large-scale corruption probes like Operation Carwash and Operation Greenfield will continue to be felt across the market and cause companies to seek court protection, sell assets or restructure their indebtedness out of court. Brazil will continue to draw attention from investors specialised in distressed assets.