Insolvency and Restructuring in Brazil

*By Felsberg e Associados**

1. Legislation: - What legislation is applicable to bankruptcies and reorganizations?

In Brazil, bankruptcy proceedings are governed by Decree-Law No. 7.661 of June 21, 1945, otherwise referred to as the "Bankruptcy Law".

2. Excluded Entities: - What entities are excluded from bankruptcy proceedings and what legislation applies to them?

Under the Bankruptcy Law only certain entities termed to be merchants are eligible for bankruptcy protection. Merchant is defined as a natural person or legal entity that engages in commerce in its usual course of conduct. Entities not encompassed under the legal definition of merchant are not eligible for bankruptcy and are termed civil persons under Brazilian law.

In general terms, bankruptcy in Brazil is the procedure whereby a merchant (usually a corporation or a limited liability partnership) is liquidated, if and when such merchant becomes insolvent and is not able to reorganize in accordance with formulae established by statutory law. If the debtor entity does not fit into the definition of merchant, then its creditors must look to alternative methods by which to collect on the outstanding debts. Thus, any person not fitting the legal concept of merchant is excluded from being subject to bankruptcy and from seeking remedy under the bankruptcy laws. For those cases, the Brazilian Civil Code provides for civil insolvency procedures, which are, in many respects, similar to the bankruptcy proceedings.

Notwithstanding the foregoing, some merchants, according to Brazilian law, are totally excluded from bankruptcy proceedings, such as private and public joint stock companies ["sociedades de economia mista"] (incorporated in part with Government capital - art. 242 Law No. 6404/76, as amended by Law No. 9457/97) and insurance companies (art. 26 of the Decree-law n. 73/66). Moreover, under Law No. 6024/74 financial institutions are subject to their own insolvency procedures albeit bankruptcy may be a potential end result in very rare cases.

As provided under the Bankruptcy Law, the following persons have the legal capacity to petition for bankruptcy:

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a) the creditor of a civil obligation, a commercial, labor or tax debt, or of a clearly legal obligation taken from the accounting books;
b) the debtor himself (voluntary bankruptcy – Bankruptcy Law, art. 8);
c) the surviving spouse, the heirs and the administrator, upon the bankruptcy of the estate;
d) the partner or shareholder.

3. Secured Lending and Credit (Immovables): - What are the principal types of security devices that are taken on immovable (real) property?

The principal types of security devices that are taken on immovable (real) property, in Brazil, are:

Mortgage ("hipoteca") : This is a contract by public instrument, duly registered with the proper real estate registry, by which a real property is used as security for the repayment of a loan/debt, some times the purchase price of the real property itself. In the event debtor is unable to discharge the mortgage such property does not revert to the creditor in satisfaction of the loan/debt, but must be sold in a public auction and the proceeds of such sale are paid to the creditor. Contractual provisions that allow the mortgagee to take possession of the mortgaged property in case of a mortgagor's default are null and void.

Chattel Mortgage ("alieniação fiduciaria") : This is a legal instrument, which conveys a property interest, generally as security for a debt such as the purchase price of the property as collateral. In this instrument the debtor retains possession of the property while the creditor retains title until satisfaction of the debt. This is generally used for personal property, however Brazilian legislation has recently permitted its applicability to real property in order to grant to the creditor rights of repossession in case of default.

4. Secured Lending and Credit (Movables): - What are the principal types of security devices that are taken on movable (personal) property?

The principal types of security devices that are taken on movable (personal) property, in Brazil, are:

Pledge ("penhor"): A deposit of personal property belonging to and delivered by a debtor as security for a debt until such debt is repaid. Brazilian law also prohibits a lender of pledged assets from taking possession of said assets in case the borrower defaults according with the article

765 of the Civil Code. In this case, the pledged assets will have to be seized, and thereafter sold at a public auction by order of the court.

Chattel mortgage: This is a legal instrument, which conveys a personal property interest, through a fiduciary sale, generally as security for a debt such as the purchase price of the personal property. In this instrument the debtor retains possession of the property as collateral while the creditor retains title until satisfaction of the debt. Other ways of securing transactions consist of structuring deals as conditional sales or finance lease transactions.

5. Unsecured Credit: - What remedies are available to unsecured creditors (e.g. seizures, attachments, judgments, etc.)? Are the processes difficult or time consuming? Do any special procedures apply to foreign creditors?

Unsecured creditors may file ordinary law suits to collect their credits. For specific situations, the courts may grant protection to creditors which may consist of injunctive relief, temporary restraining orders and even under exceptional and well defined circumstances, the seizure of property. Under the bankruptcy laws there is no specific remedy available to unsecured creditors. Their only option is to register their credits with the bankrupt estate and look to the distribution of dividends once the secured creditors have been satisfied.

The applicable law (Decree-Law No. 7661/45) does not differentiate in its treatment of domestic and foreign creditors, except that foreign credits must have their value converted into Brazilian currency on the date of the bankruptcy or on the date a concordata (a legal moratorium of unsecured credits) is granted.

6. Courts: - What court(s) are involved in the bankruptcy process? Are there restrictions on the matters that the court(s) can deal with?

The administration of a bankruptcy proceeding is the sole purview of a single court. A bankruptcy proceeding will be filed with the state court of the registered headquarters of the debtor. . If the officers or directors reside outside the court's administrative region, the court can exercise jurisdiction over them by a commission (*precatória*), if they reside in Brazil, or by a rogatory letter (*carta rogatória*) if they reside abroad.

As described above, the court will appoint a trustee (“síndico”) to manage the bankrupt estate/company. All the actions of the “síndico” are directed and supervised by the bankruptcy judge. Therefore, the court’s involvement has exclusive jurisdiction and is absolute in all the affairs of the bankruptcy, including appraisals, sales of assets, etc.

In the event that a "concordata"[1] is brought rather than a bankruptcy proceeding, the debtor retains the right to administer its business, and may continue to run it under the supervision of an inspector ("comissário"), who similarly to a "síndico" will be appointed by the court from among the major creditors.

7. Voluntary Liquidations: - What are the requirements for a debtor to commence a voluntary liquidation of its business? What are the effects of the commencement of the liquidation?

The shareholders of a corporation or the quotaholders of a limited liability partnership may at any time decide to dissolve, as a whole or in part, a business entity. Once such a resolution is adopted, the company goes into voluntary liquidation, under the helm of a trustee (liquidante) appointed by the equity holders. The trustee shall pay all debts pro-rata and proportionally, respecting the preferred creditors rights. Debts which are not due on the date of liquidation shall be paid at a discount at normal bank rates. Once all debts have been paid and the remaining assets have been distributed to the equity holders, the trustee shall extinguish the company. A debtor who is unjustifiably in default as to his obligations has the duty of petitioning for his voluntary bankruptcy within 30 days from the maturity of the legally enforceable obligation, under penalty of forfeiting his right to petition for reorganization ("concordata").

8. Involuntary Liquidations: - What are the requirements for creditors to successfully place a debtor in involuntary liquidation? What are the effects of the commencement of the liquidation?

The most important requirement to place a debtor in involuntary liquidation is to legitimately hold an unpaid instrument which allows a creditor to execute a debtor and which has been protested. If a creditor files a valid bankruptcy claim, the debtor must pay or deposit the amount claimed in 24 hours of receipt of the proper summons, or the judge will declare him bankrupt. Once such a decision is handed down by the judge, a trustee will be appointed to take over the bankrupt estate and manage the involuntary liquidation, usually closing the business of the bankrupt company. The law lists six other situations which characterize insolvency and which allow a creditor to file for bankruptcy (art.2 of law 7661).
The effects of a bankruptcy decree are determined under Title II of Decree-Law No. 7661/45. Every creditor must present documentary evidence regarding its credits to the Bankruptcy Judge (who has jurisdiction to decide upon every matter concerning the bankrupt estate). Every previously existing lawsuit and collection action pertaining to the rights and interests of the bankrupt estate are stayed, with the exceptions provided for in items i and ii of Article 24 of Decree-Law No. 7661/45.

[1] This is basically similar to a Chapter 11 bankruptcy under United States law. It should be noted that some companies are specifically barred from filing a "concordata": these include financial institutions; airlines or firms that are part of the airline industry; insurance companies; or cooperatives.

All of the bankrupt's debts are declared immediately payable.

Bilateral agreements cannot be terminated on account of the bankruptcy, and enforcement thereof may be carried out by the trustee if he deems it beneficial to the bankruptcy estate.

9. Voluntary Reorganizations: - What are the requirements for a debtor to commence a financial reorganization? What are the effects of the commencement of the reorganization?

Reorganization proceedings apply only to unsecured creditors (“quirografários”).

Brazilian law allows a bona fide entity engaged in trade or business, whose incapacity to satisfy its liabilities is of a temporary nature, to avoid bankruptcy by petitioning for a concordata, provided that:

- the entity has assets which exceed 50% of its liabilities.
- The entity has registered or filed the documents and books necessary for the regular exercise of its business with the commercial registry;
- the entity has not failed to apply for protection within the prescribed period;
- the entity's administrators have not been convicted for any bankruptcy offense, theft, robbery, fraud, smuggling or other similar crime; and
- the entity has not, within the prior five (5) years, petitioned for “concordata” or failed to comply with the terms of an earlier “concordata”.

If the entity fails to comply with its obligations in the “concordata” proceeding, then the “concordata” may, at any time, be transformed into a bankruptcy.

The law provides for two different types of “concordata”: the “preventive concordata” and “suspensive concordata”, the later one to be filed on behalf of a bankrupt estate which could be restructured in order to recommence operations.

10. Involuntary Reorganizations: - What are the requirements for creditors to commence an involuntary reorganization? What are the effects of the commencement of the reorganization?

In Brazil reorganization is a right vested in the merchant debtor. It is a "legal benefit" which consists in the partial discharging or extension of the maturity of the liabilities assumed by a merchant. The purpose of the reorganization is to safeguard such merchant against the consequences of a bankruptcy, whether by avoiding declaration thereof or suspending its

effects. The debtor, under such proceeding, does not forfeit the administration and the right to dispose of his properties. Therefore, there are no involuntary reorganizations in Brazil.

The debtor, by filing a concordata, may obtain i) a 50% reduction of its obligations towards non-secured creditors for cash payment; ii) a payment extension whereby non-secured creditors are paid 2/5 of their credits after 12 months and the balance in 42 months; iii) other reductions or extensions discussed below.

11. Doing Business in Reorganizations: - Under what conditions can the debtor carry on business during a reorganization? What conditions apply to the use and sale of assets, the availability of credit, the position of creditors who supply goods or services after the filing? What are the roles of the creditors and the Court in supervising the debtor's business activities?

The Brazilian legal system regarding reorganization and bankruptcy clearly defines the rules concerning creditors' rights as well as the rights and duties of the insolvent business. Depending on the circumstances, an entity in Brazil undergoing financial difficulties can be subjected to one of three separate proceedings: insolvency, bankruptcy, or "concordata." Generally speaking, the first two result in all debts being accelerated, all assets being collected and sold to pay the creditors, and the business being liquidated, whereas the "concordata" proceeding allows the entity to continue conducting business under judicial supervision while it pays its unsecured creditors in accordance with the applicable law. Sale of assets must be allowed by the court after hearing the inspector ("comissário") and the Public Attorney. The sale or transfer of a business unit or of all business units requires the consent of all unsecured creditors. In actual practice, companies in concordata have no credit available to them, although creditors who supply goods or services (or even loans) after the filing are not affected by the concordata. In any event, during the *concordata*, the entity may only give secured guarantees with previous authorization from the court. As stated above, creditors are represented by the inspector ("comissário") who has the legal obligation to audit the business in concordata and supply the court with the documentation required by law.

The Bankruptcy Law institutesa two-year moratorium on the payment of all unsecured debts. Because the concordata proceeding (moratorium) applies only to unsecured creditors ("quirografários"), secured creditors are not restricted from enforcing or collecting on their debts.

The law provides for two different types of "concordata": the "preventive concordata" and "suspensive concordata."

a. Preventive Concordata

A preventive concordata is the most common type of concordata and is applied for *prior* to the filing of a petition of bankruptcy. To qualify, the entity must prove that it has carried on business regularly for more than two (2) years; it possesses assets worth more

than one-half (½) the amount of its unsecured liabilities; and it has neither been declared bankrupt nor have there been any documents filed protesting the entity's failure to pay a debt.

b. Suspensive Concordata

The other kind of "concordata" provided in Brazilian Bankruptcy Law is the "suspensive concordata", which allows an entity involved in a bankruptcy proceeding to have its bankruptcy suspended by asking the bankruptcy court to grant a "suspensive concordata".

These options are available only under the legal hypothesis on which is possible to reorganize the insolvent business.

12. Stays of proceedings/moratoria - What prohibitions against the continuation of legal proceedings or the enforcement of claims by secured and unsecured creditors are imposed by legislation or court order in (a) liquidations and (b)reorganisations? In what circumstances can secured or unsecured creditors obtain relief from such prohibitions?

Brazilian bankruptcy law does not have a "standstill" period during which all creditor can get together in order to agree on a plan which would permit maximum recovery of credits.Nonetheless, the concordata which consists of a judicial moratorium on usecured debt, allows an immediate stay of all actions and claims presented by unsecured creditors.

If bankruptcy (liquidation) is declared, most proceedings against the debtor are suspended in order to achieve par conditio creditorum (equal treatment among creditors).

13. Set-off and netting - To what extent are creditors able to exercise rights of set-off or netting in a liquidation or in a reorganisation? Can creditors be deprived of the right of set-off either temporarily or permanently?

The Bankruptcy Law, allows for set-off and netting, provided certain requirements are met: the reciprocal debts must be legal due and certain. Debts which are accelerated due to the bankruptcy are considered due for all legal purposes.

14. Post-filing credit - Does your country's insolvency system allow a debtor in (a) a liquidation or (b) a reorganisation, to obtain secured or unsecured loans or credit? What priority is given to such loans or credit?

According to Article 46 of the Bankruptcy Law, claims assigned after the company became insolvent or after the bankruptcy was declared. Tax claim are not subject to set off in insolvency proceedings.

15. Successful Reorganizations: - What features are mandatory in a reorganization plan? How are creditors classified for purposes of a plan and how is the plan approved?

The purpose of the "concordata" is to safeguard the merchant against the consequences of the bankruptcy, either by avoiding declaration thereof ("concordata preventiva") or suspending its effects ("concordata suspensiva"). A "concordata" will be deemed fully complied with if the merchant fulfills the obligations assumed upon being granted such benefit, within the term allowed (no more than 2 years).

16. Unsuccessful Reorganizations: - How is a proposed reorganization defeated and what is the effect of the plan not being approved? What happens if there is default by the debtor in performing an approved plan?

The "concordata" may be denied by the judge or cancelled at any moment by him, after a petition for termination has been filed against the concordata. Court decisions that deny or cancel a "concordata preventiva" entail the declaration of the bankruptcy of debtor. On the other hand, decisions that deny or cancel a "concordata suspensiva" entail the re-initiation of the bankruptcy proceeding of debtor.

17. Bankruptcy Processes: - During a bankruptcy case, what notices are given to creditors? What meetings are held? What committees are or can be formed? Can creditors initiate proceedings to pursue remedies against third parties or changes in the administration of the case?

Under Decree-Law No. 7661/45, a creditor can request the commencement of the bankruptcy proceeding. According to Articles 122 and 123, the creditors can request the calling of a meeting to discuss how the assets are to be sold in order to pay the credits.

Article 104 provides for the possibility of creditors requesting the initiation of an investigation of the estate trustee, especially if a final report is not rendered.

Anyone can file a complaint against the trustee, which must be evaluated and investigated. A filed complaint may potentially result in the dismissal of the trustee if the facts so warrant it. The trustee has legitimacy to represent the bankrupt estate and initiate litigation against third parties, although any creditor could file a law suit to void fraudulent transactions if the trustee does not do so within the time frame established by law (art.55 of law 7661/45).

18. Claims and Appeals: - How is a creditor's claim submitted and what are the applicable time limits? How are claims disallowed and how does creditor appeal a disallowance?

The judge determines a time limit that varies between 10-20 days in which creditors must present their documentary evidence in support of their credits. The trustee and the bankrupt

estate are tasked with informing the court of the validity of the claims. The court will decide on each claim, and this decision is subject to appeal to the higher court. A creditor who has not declared his credits during the time limit established by the courts may do so any time thereafter, but as a consequence, such delinquent creditor will only participate in the dividends distributed after his claim has been accepted by the judge.

19. Priority Claims: - What are the major (a) governmental and (b) non-governmental privileged and priority claims in liquidations and reorganizations? Which priority and privileged claims have priority over secured creditors?

The court will draw up a general list of the creditors, and their claims will be listed in the following order of priority:

1. Compensation for accidents at work (§ 1 of art. 102 of the Bankruptcy Law, as restated by Law No. 3726, of February 11, 1960 and Law No. 8213 of July 24, 1991 and Decree No. 611 of July 21, 1992);
2. Labor and social security credits (art. 102 of the Bankruptcy Law, of June 21, 1945, as restated by Law No. 3726, of February 11, 1960, and art. 499, § 1 of the "CLT", as restated by Law No. 6449, of October 14, 1977; art. 157 of Law No. 3807, of August 26, 1960, as restated by Decree-law No. 66, of November 21, 1966 and art. 1 of Law No. 6830 of September 22, 1980);
3. Tax credit (art. 5 of Law No. 6830, of September 22, 1980; art. 186, 187 and 188 of the National Tax Code , Law No. 5172 of October 25, 1966);
4. Burdens and debts of the bankrupt estate (art. 124, §§ 1 and 2 of the Bankruptcy Law);
5. Creditors holding security interests (art. 102 of the Bankruptcy Law, item I);
6. Creditors with special privileges (art. 102 of the Bankruptcy Law, item II);
7. Creditors with general privileges (art. 102 of the Bankruptcy Law, item III);
8. Unsecured creditors (art. 102 of the Bankruptcy Law, item IV).

Having absolute precedence over the payment of any of the above-listed claims, however, will be the payment of the fees for the administration of the insolvency proceeding.

17. Distributions: - How and when are distributions made to creditors in liquidations and reorganizations?

In bankruptcy proceedings distributions occur during liquidation, which is the objective of the the proceeding. The liquidation has two objectives: realization of the assets by selling the seized properties and payment of the liabilities, thus paying off the qualified creditors, according to the nature of their credit and the availability of the bankrupt estate.

In "preventive concordata" proceedings, the entity must offer creditors payment of at least 50% (fifty percent) of their claims at sight, or it must offer payment of 60, 75, 90 or 100% (sixty, seventy-five, ninety or one hundred percent) of their claims within 6, 12, 18 or 24 (six, twelve, eighteen or twenty-four) months, respectively. In the case of an 18 or 24 (eighteen or

twenty-four) month “preventive concordata”, at least 40% (forty percent) of the debt must be discharged the first year.

In "suspensive concordata" proceedings, though, the entity must offer its unsecured creditors payment of at least 35% (thirty-five percent) of their claims at sight, or 50% (fifty percent) within a maximum period of two (2) years and at least 40% (forty percent) of the debt must be discharged the first year. The other rules for “preventive concordata” also apply to “suspensive concordata” insofar as appropriate.

21. Voidable Transactions: - What types of transactions can be annulled or set-aside in bankruptcies and what are the grounds? What is the result of a transaction being annulled?

The Bankruptcy Law considers certain acts performed by the bankrupt before the bankruptcy as non-operative as to the bankrupt estate. Such acts do not produce any legal effects as to the bankruptcy estate. They are not void or voidable acts, but non-operative ones. Consequently, they do not produce any effects on the bankruptcy estate.

Such non-operative acts are described in art. 52 of the Bankruptcy Law. In such cases, whether or not the bankrupt has acted with malicious intent, the act is deemed non-operative.

Here are some examples of non-operative acts provided by law:

1. payment of the debt within the legal term set for this purpose in the decision which declared bankruptcy , except in the cases provided by law;
2. security interests provided within the legal term for bankruptcy proceedings as regards the liability assumed before such period;
3. donations made in the two years prior to the declaration of the bankruptcy;
4. waiver of inheritance made in the two years prior to the declaration of the bankruptcy;
5. sale of the commercial premises without the consent of all creditors.

Under Article. 53 of the Bankruptcy Law, any fraudulent act which is performed with the intent of harming creditors is also voidable. The consequences of performing a non-operative or voidable act is that the parties must be placed in the same position that they were in before the occurrence of such an act and if this is not possible, an obligation to pay for damages arises, which could be charged to the third party who participated in such act.

22. Directors and Officers: - Do corporate officers and directors have personal liabilities for any pre-bankruptcy actions or for particular types of claims? Can they be subject to other sanctions for other reasons?

22.1 Liability System

As a general rule, officers and directors are not personally liable for obligations incurred in the corporation's name by virtue of administrative acts performed in the normal course of business.

Exceptions to this rule are stated by Decree 3.708, of 01.10.1919 (Limited Liability Companies Law), article 10, and by Article 158, Law No. 6404 of 15.12.1976 (Corporation Law), which provide that corporate officers and directors are personally liable when: "(I) within the scope of their powers, they act recklessly, negligently, below the accepted standard of competence for a corporate director or fraudulently; or (II) "ultra vires", which in both cases they may be held personally liable for damages caused by their acts.

Under section I above, the managers will only be held liable for damages if it is proven that they acted recklessly, negligently, incompetently or fraudulently. In this case the company will be held liable for damages to third parties caused by the acts of its managers. However, it will have the right to file suit against them in order to recoup its losses.

Under section II above, an officer or director will be held strictly liable for their "ultra vires" acts regardless of whether they were negligent or fraudulent. In principle, a company is not liable for the "ultra vires" acts of its managers. However, if the damaged party was acting in good faith, the corporation may be held liable.

With regard to the above, as stated in article 159 of Corporation Law, subsequent to a finding of liability, a corporation, any of its shareholders or an injured third party may bring suit against the responsible director in an attempt to recoup its losses.

a) Breach of Fiduciary Duty to Creditors or Wrongful Trading

Paragraphs 1 through 5 of article 158 of Corporation Law establish additional rules in connection with the joint and several and individual liability of corporate directors. Liability deriving from illegal acts is distinguished from liability arising from a failure to carry out duties and obligations in connection with the regular functioning of the company, as follows:

b) Liability for illegal acts

A director is not responsible for the illegal acts of other directors, unless he conspires with them or is deemed negligent in regard to the discovery of their illegal acts or, having knowledge of wrongdoing, fails to attempt to impede it.

Members of corporate bodies, such as the Board of Directors, participating in joint decisions in accordance with the company's By-laws, will incur joint and several liability.

c) Liability for damages resulting from a failure to carry out corporate duties and obligations

The directors are jointly and severally liable for damages resulting from a failure to carry out their duties and obligations in connection with the regular functioning of the company, even if each director is not responsible for the performance of all duties. Thus, for

example, the failure to produce and publish annual balance sheets, which may impair the normal functioning of the company, may result in joint and several liability of the directors.

However, in the case of public companies, directors will only be liable for damages resulting from a failure to perform their individual duties in accordance with the company By-laws.

In any event, a director who learns of the existence of a failure on the part of a current or former director to perform his corporate duties, must communicate this fact to the Shareholders at a general meeting in order to exonerate himself of liability for damages caused as a result of the director's failure to act.

In addition, as to the directors of public companies, the Securities and Exchange Commission has the authority to impose administrative penalties, by means of administrative hearings, appealable to the National Monetary Council, such as warnings, fines, and the suspension or disqualification of directors. With respect to directors of financial institutions, the Central Bank possesses similar authority to issue warnings and to impose fines, suspensions and disqualification.

22.2. Liability in Bankruptcy

There is not a special Liability System in the event of bankruptcy.

Article 6 of Decree-Law n. 7661/45 (“Bankruptcy Law”) states that, if the company has the bankruptcy declared, in general the managers are not personally liable for obligations incurred in the corporation's name by virtue of administrative acts performed in the normal course of business, provided the exceptions herein.

The sole provision related to managers' liability in Bankruptcy Law establishes that if they are personally liable, according to general rules, their personal liability will be taken into account by an ordinary process in the bankruptcy jurisdiction.

22.3. Criminal Liability System

Certain acts practiced by corporate administrators are defined as crimes in the Criminal Code and are punishable by imprisonment and/or fines. Thus, it is considered a crime to: a) make false assertions as to the financial status of the company or to fraudulently hide facts related to that status, in a report, balance sheet, communication to the public or to a shareholder; b) promote the false quotation of shares by means of artifice; c) use corporate assets, without the prior authorization of the shareholders, for personal benefit or for the benefit of third parties; d) obtain the approval of minutes or opinions through collusion with the shareholders; etc.

The nonpayment and misappropriation of taxes will also result in criminal liability of corporate directors, administrators and managers. The same is true for the misappropriation of social security taxes.

22.4. Criminal Liability in Bankruptcy

In addition to the laws contained in the Criminal Code, various other laws specifically address the criminal liability of corporate administrators.

One of them is Law No 1521/51 ("crimes against the public economy"), which determines that administrators may be found criminally liable for committing crimes such as the falsification of registrations, reports and other data for the purpose of withholding profits, dividends or bonuses or in order to misappropriate funds from the technical reserve.

Another law is Law No 4137/62 ("abuse of economic power"), which establishes that administrators are criminally liable for the corporation's abuse of economic power.

Bankruptcy Law states that, in the event of declaration of bankruptcy, the corporation's directors and administrators will be identified with the debtor and bankrupt party for criminal purposes. Among the possible acts which may be charged as crimes in connection with a petition for bankruptcy are: (i) the use of destructive means to obtain resources and to delay the declaration of bankruptcy, such as the realization of sales, at prices below current market value, during the 6 months prior to filing for bankruptcy; (ii) failure to keep required books or their late, defective or unclear completion; (iii) fraudulent acts, prior or subsequent to declaration of bankruptcy, for the purpose of obtaining unfair advantage, to the prejudice of the creditors; (iv) accelerated payment of certain creditors to the prejudice of others; (v) recognition of false or simulated credits.

With regard to administrative duties, both the courts and legal scholars have established the general rule that negative facts, resulting from acts of omission or failure to act, even if not the result of joint deliberation, will result in joint and several liability of the administrators. However, the existence of positive facts, resulting from the intentional acts of an individual administrator, will give rise to liability limited to the individual actor. Finally, either negative or positive facts, which result from joint deliberations, will give rise to joint and several liability except as to those individuals who expressly object.

The courts have tended to find no liability if an individual was not participating in the administration of the corporation at the time of a crime's occurrence. New administrators, who learn of the existence of former or continuing criminal acts committed or initiated prior to their entry into the corporation, must inform the shareholders accordingly in order to exonerate themselves of liability.

Under Brazilian law, a legal entity usually can not be held criminally liable, however the Bankruptcy Law does provide for the criminal liability of such an entities' legal representatives (directors, officers, administrators, managers or liquidators).

Bankruptcy crimes are provided for in articles 186 to 190 of the Bankruptcy Law.

22.5. Piercing the Corporate Veil

Brazilian Law provides for the separation of assets and liabilities between corporate entities and their principals/shareholders. Therefore, the assets of a principal/shareholder in a company undergoing bankruptcy are in theory separate and thus protected from the company's creditors.

Let's consider as an example the two main kinds of companies currently adopted in Brazil: the limited company and the joint stock company. In the case of the limited company, the partners are liable as sureties as well as jointly and severally liable for the company's debts up to the value of its capital, but only if the capital is not fully paid up. In case of the joint stock companies, the shareholders liability is more restricted than the liability of the partners of the limited companies. The liability of each shareholder is limited to the issue price of the shares subscribed or acquired.

However, the rule of separation between the net worth of the company and that of the partners or shareholders, and consequently the limitation of their liability for the company debts, is not absolute. Exceptions exist when for instance the legal entity is being utilized for fraudulent purposes or solely for the personal benefit of the partners.

The possibility of such fraudulent practices led to the development of the theory of "piercing the corporate veil", also called the disregarding of the legal entity doctrine. This theory states that if the recognition of the corporate fiction will result in an injustice or in consequences injurious to the public, such fiction will be disregarded and the principals/shareholders dealt with as justice dictates. In this circumstance, the principals would be liable as if the corporate entity did not exist: directly, joint and several and unlimitedly. Thus, the corporate entity will not be recognized when to do so will defraud creditors, evade existing obligations, circumvent a statute, justify fraud, defend crime or defeat the public interest.

Examples of cases in which the corporate veil has been pierced are; (i) the irregular dissolution of a company, (ii) the intermingling of the company's assets with that of its sole shareholder and administrator, (iii) the carrying out of activities incompatible with the corporate purposes and (iv) the company being under the absolute control of just one partner, who performed acts of fraud, among other examples.

In a bankruptcy situation, the above rules are also applicable in determining when creditors would be able to go after the principals behind a corporate entity. However, it is worth noting that according to Article 5 of the Bankruptcy Law, the principals which are deemed liable for corporate debts are not individually subject to the effects of the company's bankruptcy, but they are subject to other legal effects that may be brought about by the bankruptcy. In other words, the principals will not be declared bankrupt but may be held responsible for the company's debts depending on the corporate form and their resulting level of liability.

23. Creditor Enforcement: - Are there processes by which a business can be liquidated outside of the bankruptcy process (e.g., by seizure by a creditor)? Outside of court proceedings? How are these processes carried out and what are the consequences?

In general terms, bankruptcy in Brazil is the forced liquidation of an insolvent merchant. If the debtor entity does not fit into the definition of merchant, then its creditors must look to alternative methods by which to collect on the outstanding debts. Thus, any person not fitting the legal concept of merchant is excluded from being subject to bankruptcy and from seeking remedy under the bankruptcy laws. For those cases, the Brazilian Civil Code provides for civil insolvency procedures.

Civil insolvency proceedings also take place in the courts, and both proceedings can result in the liquidation of the debtor's assets.

Except for i) voluntary liquidation and ii) the system enacted to liquidate financial institutions through the Central Bank of Brazil (Law 6024) and other similar laws, there are no out of court proceedings to liquidate businesses.

24. Informal Restructurings: - Can a restructuring be carried out without formal proceedings? If so, how are such restructurings implemented?

The answer is no. In Brazil informal restructuring (extra-judicial "concordata") is not permitted and the steps normally associated with informal restructuring may be deemed sufficient for a declaration of bankruptcy by a judge. However, in practical life, banks and other creditors often use corporate engineering and creative thinking to reach results which allow companies to be restructured. Certain investment banks have developed techniques to acquire, merge, spin-off and reorganize the activities of entire business sectors which come under economic hardship.

25. Corporate Procedures: - Are there corporate procedures for the liquidation or dissolution of a corporation? How do such processes contrast with bankruptcy proceedings?

In Brazil, the dissolution and liquidation of a corporation occurs by decision of its equity holders who designate a trustee to sell the assets, pay the debts and distribute what is left over. After liquidation, the trustee will extinguish the corporation.

26. Conclusion of Case: - How are liquidation and reorganization cases formally concluded?

Both bankruptcy and concordata are judicial proceedings, thus they require a final judicial sentence in order to be terminated.

Except in the case of *force majeure,* the bankruptcy proceeding should be formally terminated by a court order two (2) years after the date on which the bankruptcy was declared, which never happens in actual practice. Apart from the other methods of discharging debts referred to in the law, the entity's liabilities are automatically extinguished five (5) years after

termination of the bankruptcy proceeding, provided that the entity has not been convicted of any bankruptcy offense. If it has been so convicted, its liabilities are not discharged for ten (10) years. The court order discharging the entity will authorize it to carry on trade or business, unless it has been found guilty of a bankruptcy offense or is awaiting the outcome of proceedings brought as a result of such an offense. In other words, the shareholders or quotaholders, as the case may be, will decide what happens with the remaining shell: it may be dissolved and extinguished or it may engage in business if sufficiently capitalized.

A negative judgment as to a petition for preventative concordata results in the debtor being declared bankrupt, while in the case of a suspensive concordata it results in the resumption of the debtor's bankruptcy proceeding.

27 UNCITRAL Model Law - Is the adoption of the UNCITRAL Model Law on Cross-Border Insolvency under consideration in yourcountry? If so, what is the present status of this consideration?

Brazil has not adopted the Uncitral Model Law on Cross-Border Insolvency. As a reform of the existing law is contemplated, specialists are currently proposing the adoption of the UNCITRAL model law into the new Brazilian Insolvency Laws.

28. International Cases: - What recognition or relief is available concerning an insolvency proceeding in another country? How are foreign creditors dealt with in liquidations and reorganizations? Are foreign judgements or orders reorganized and in what circumstances? Is your country a signatory to a treaty on international insolvency or on the recognition of foreign judgments?

Brazilian law does not discriminate against foreign creditors; they are entitled to be included in a list of creditors for the Brazilian entity the same as a Brazilian creditor and can be represented by a Brazilian lawyer, provided that the appropriate authority is given to such lawyer in a duly executed power of attorney, which must be notarized, “legalized,” translated in Brazil by a sworn translator, and then registered with the appropriate Registry of Titles and Documents.

Another formality that may affect a foreign creditor is that all foreign signatures (*i.e.*, one that was not signed in Brazil) on any document that needs to be submitted to a Brazilian court must be notarized in the country of such signatory and then “legalized” at the nearest Brazilian Consulate’s office. Moreover, if the documents are drafted in a language other than Portuguese, they must be translated in Brazil by a sworn translator prior to being registered with the appropriate Registry of Titles and Documents the (“Cartório de Títulos e Documentos”).

However, in order to file a petition in bankruptcy, the creditor who is not domiciled in Brazil, by virtue of art. 9, item III, "c", of the Bankruptcy Law, must provide an amount in escrow corresponding to the costs and payment of compensation for damages and losses should the claim be denied on account of its malicious nature (art. 20).

In addition, until there is a final decision to be rendered, it is possible to file for injunctive relief or temporary restraining orders, or even repossession law suits in order to protect property which belong to bankrupt estates located outside of Brazil.

The recognition ("homologation") and enforcement of a foreign judgment in Brazil requires that certain conditions be fulfilled, which include that:

(1) the judgment was rendered by a court of competent jurisdiction (both personal jurisdiction and subject-matter jurisdiction) in the awarding country;

(2) the defendant had been properly served notice of the proceedings;

(3) the judgment is final in the awarding country and not subject to any appeals;

(4) the judgment does not offend Brazil's notions of sovereignty, public policy or morality; and

(5) the judgment has been consularized by a competent Brazilian consular authority and then translated into Portuguese by a certified translator in Brazil.

The second condition listed above is one of the most frequently contested requirements for the "homologation" of a foreign judgment against a defendant domiciled in Brazil. Since Brazil is not a party to the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters of 1965, service of process must be accomplished in accordance with Brazilian law. Therefore, the appropriate method for properly serving process on a Brazilian domiciled individual is by a Rogatory Letter (Brazil is a member of the Interamerican Convention on Letters Rogatory, which was signed in Panama on January 30, 1975, and ratified by Brazil on December 27, 1995).

Any other method of serving a Brazilian domiciled defendant will render the eventual foreign judgment unenforceable in Brazil. Unfortunately this is a lengthy process often dragging on for months. There is one exception to this rule: where the defendant has accepted the jurisdiction of the foreign court by voluntarily appearing and defending the claim.

The foreign judgment itself should also be submitted by means of a Rogatory Letter, authorized by the respective court where the suit is filed, should be forwarded to the Brazilian Supreme Court (*Supremo Tribunal Federal – "STF*") for the issuance of an *exequatur* (an authorization granted by the STF permitting the execution of a foreign judicial act in Brazil). Before the issuance of the *exequatur*, the subject party shall have a 5-day period in which to challenge it.

Once the *exequatur* is issued, the STF shall forward it to the federal court of first instance nearest the defendant's domicile for the implementation of the Rogatory Letter. Once implemented the Rogatory Letter shall be returned to the US court.

It must be noted that a sworn translator must translate all documents in connection with the Rogatory Letter into Portuguese. Such documents must also be notarized and consularized.

29. Pending Legislation: - Is there any new or pending legislation affecting domestic bankruptcy procedures, international bankruptcy co-operation or recognition of foreign judgments and orders?

Yes. There is pending legislation that has been under discussion at the Brazilian National Congress since 1993. It is the bill of law n. 4.376-A, which establishes a new bankruptcy law. The idea is to create a system that is more effective in protecting and stimulating the restructuring of the business. Also, within MERCOSUL new arrangements have been proposed but not formalized.

30. Hot Topics and Trends: - What are currently the most active or significant issues in the bankruptcy area and what major trends are developing?

Once bankruptcy proceedings have been concluded and all the top-tier creditors are paid (meaning specifically, the full payment of the bankruptcy administration costs as well as all labor, tax and social security claims), there are almost never funds left over to be distributed, even among the secured creditors. In addition, tax and labor issues consume long periods of time to be resolved and this delays the final liquidation of the bankrupt estate. Finally the time frame required by existing procedures to sell the assets of the bankrupt estate, tend to reduce dramatically the value of such assets. Our office has been recently asked to draft an amendment to the existing bankruptcy law which hopefully will render it more effective. If some of the ideas we included in this draft are finally adopted, we hope to have a better version of the Brazilian Bankruptcy law in the near future.

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