The insolvency scenario in Brazil: Certain relevant issues

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Being one of the larger economies of the world, Brazil has suffered the impact of international as well as national crises. For the insolvency sector, many issues of importance have been discussed at different levels of government and litigated in court. This article will discuss some of these issues.

The Probability of the UNCITRAL Model Law being approved in Brazil in 2019

Proposals are under way in the National Congress for a reform of the Insolvency Law (LFRE). Bill of Law nr. 10.220/2018, tabled in May 2018 by the Administration, adopts, among other provisions, the model law on cross-border insolvencies of the United Nations Commission on International Trade Law (UNCITRAL).

After almost 15 years in effect, expectations in relation to reforms in the LFRE are high, considering that several provisions no longer meet the current needs of the business world.

The absence of specific legislation in the international area has led Brazilian courts to apply current Brazilian law to cross-border conflicts, considering the rise in the number of cases of insolvency that cross national borders. Legal certainty and recognition of foreign insolvency decisions, however, have been subject to vagaries inconsistent with the requirements of modern inter-dependent economies.

With the intention of overcoming this legislative gap, the Bill contains a chapter dedicated to international insolvency and proposes the adoption of the UNCITRAL rules, created in 1997, with the purpose of providing greater strength to nations in their ability to resolve cases involving insolvency of transnational nature.

In addition to the general provisions relating to international insolvency, the Bill also presents specific rules concerning access to Brazilian jurisdictions by foreign representatives; the equal standing of the rights held by foreign and Brazilian creditors in insolvency processes; provisions addressing requests to Brazilian judges for recognition of foreign processes; the cooperation between foreign authorities and representatives; and specific regulations for processes running concurrently in Brazil and overseas.

Despite the positive changes proposed, several legal experts have expressed their concern in relation to certain alterations addressed in other chapters of the Bill, especially the increase of the prerogatives conferred on the tax authorities in insolvency proceedings. In addition, the Bill addresses matters which are efficiently addressed by current legislation and case law and do not require change.

These difficulties may jeopardise the approval of the Bill in the 2019 legislature and delay the adoption of the Model Law.

The representation of bondholders in the General Meetings of Creditors and the individualisation of their credits

The raising of financial resources through the issuance of trade currency on the international markets has become common practice in Brazil since the 1990s. According to available data, hundreds of billions of US dollars has been raised by companies or government entities in the past few years through the issuance of fixed income securities, including bonds, medium-term notes and securitisation transactions.[1]

Brazilian case law permits bondholders to be represented by their indenture trustees or to individualise their right to vote on the credits involved in an insolvency proceeding.

As an example, in the restructuring of the OGX Group,[2] the 4th Commercial Court of Rio de Janeiro approved the adoption of a procedure

proposed by the trustee, by means of which the bondholders could opt to individualise their proofs of claim to vote on the judicial reorganisation plan during the general meeting of creditors. The same happened in the Oi,[3] Rede[4] and Aralco[5] cases, amongst others.

In 2015, the '*II Jornada de Direito Comercial*' approved Statement nr. 76, which established that "in the cases of issuance of debt securities by a company under reorganisation, in which there exists a fiduciary agent or similar figure representing a collective group of creditors, it is the responsibility of the fiduciary agent to exercise the vote at the general meeting of creditors, under the terms and by means of the authorisations provided in the issuance deed, subject to the power of any final investor to file with the judicial reorganisation court a request for the break-up of the right to a voice and a vote at a general meeting to exercise such individually, solely by means of judicial authorisation."

The foreclosure of credits which are not subject to a court reorganisation

Creditors that hold title to assets or rights which were granted by an insolvent company as security are, in principle, not affected by an insolvency filing and are therefore authorised to enforce their rights[2].

Courts have, however, been resistant to applying this rule, in its strictest sense, whenever the enforcement of such rights during the stay period could jeopardise the reorganisation of the insolvent company. Several theories have emerged to justify this position, amongst which are the "essentiality" of the asset, the lack of "individualisation" of the credit, the recognition that the acceleration clause of such a debt is subject to the filing, or even the partial enforcement of the rule.

Although the STJ has positioned itself, in an isolated decision, as being contrary to such flexibility, the Court of Appeal of São Paulo (AgInt nr. 22369790) recently recognised that a creditor may not remove its security if it is essential to the debtor's activities.

These matters are being discussed at all levels in the state courts and a final definition has yet to be handed down by the Superior Court of Justice in Brasilia.

Government credits against companies under judicial reorganisation

Law 11.101/05 establishes that the processing of judicial reorganisation shall not suspend the course of tax enforcements[6] filed against the debtor (art. 6, §7) and, in parallel, the National Tax Code (art. 187, lead paragraph) excludes tax credits from any insolvency proceeding.

Thus, in relation to tax credits there can be no doubt: these are not subject to the judicial reorganisation proceedings and the foreclosure may proceed in the specialised courts in which they have been filed. Only the enforceable acts designed to constrict or expropriate the assets of a company under judicial reorganisation must be previously submitted to the proper restructuring court.[7]

However, government non-tax credits, have received different treatment by the courts, because statutory law is not clear in this respect.

In the Celpa and Oi[8] (0057446-63.2017.8.19.0000) cases, penalties imposed by their respective regulators have been classified as unsecured credits in insolvency proceedings. Yet in the Viracopos case, according to the Court of Appeal of São Paulo, these same credits were treated as tax credits, overturning a contrary decision made by the lower court.

It is important to stress, however, that the Higher Courts have still not made their position clear with respect to this issue, and there is a recent precedent from São Paulo recognising that a public credit arising from contractual non-compliance should be subject to the judicial reorganisation of the Libra Group.

Credits in foreign currency within the judicial reorganisation

The Brazilian Insolvency Law establishes that, in the general meetings of creditors, for decisions on any matters that are incidental to the judicial reorganisation proceeding, the creditor's vote shall be proportional to the sum of their credit (art. 38, lead paragraph). In relation to the decisions for approval or rejection of the judicial reorganisation plan, this regulation also applies for the purposes of calculating the quorum for all the classes of credits, except for the credits from classes I (labour) and IV (micro-companies

and small companies), the quorums of which are calculated by a simple majority of the creditors present, regardless of the value of their credits (art. 45, §2º).

But if the creditors belonging to other classes that are not I or IV (that is, the holders of in-rem guarantees [class II] and unsecured creditors [class III]) vote, in all cases, the issue rests upon how foreign-denominated credits should be treated, given the natural fluctuation in exchange rates.

The sole paragraph of article 38 regulates the matter, establishing that, in judicial reorganisation procedures, for the exclusive purposes of voting at the general assembly, the credit in foreign currency should be converted into local currency using the exchange rate on the eve of the date upon which the meeting takes place. However, the law does not define the rate that should be applied to this conversion.

There exist different interpretations on this matter in legal doctrine. For some, considering that the currency has a sale price and a purchase price, the conversion should be performed in accordance with the currency sale price. The best understanding, however, seems to be that defended by other scholars, who suggest the equity criteria applicable in Brazilian law to overcome the legal gaps, defending that an average market rate should be applied, such which corresponds to the average sum falling between the purchase rate and the sale rate.

In relation to the payment conditions, the current Insolvency Law is favourable to a debt expressed in foreign currency: the legislation establishes that the exchange rate variation shall be the parameter of indexation of the liability, unless the amounts owed should come to be otherwise determined by the creditor (art. 50, §2). In other words, unless the foreign currency creditor expressly agrees to the provision of the judicial reorganisation plan that alters the parameters of the calculation of their credit when payment is effectively made, the rate of conversion should necessarily be observed as a parameter for the establishment of their credit.

The abovementioned issues are but a few of those which are being discussed by the legal and business community, as well as in our courts and universities. They reflect the vibrant atmosphere in which insolvency matters are being dealt with in this country. For all those involved in insolvency matters in Brazil – creditors, debtors, consultant, lawyers, professors and legal scholars – there is a common link, which could be summarised by the expression "never a dull moment".

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Notes:

1. <http://portal.anbima.com.br/informacoes-tecnicas/boletins/mercado-de-capitais/Documents/BoletimMK_201508.pdf>
2. In re OGX, Case nr. 037762056.2013.8.19.0001, 4th Lower Commercial Court of Rio de Janeiro.
3. In re Oi S.A., Case nr. 0203711-65.2016.8.19.0001, 7th Lower Commercial Court of Rio de Janeiro.
4. In re Rede Energia, Case nr. 0067341-20.2012.8.26.0100, 2nd Lower Commercial Court of São Paulo.
5. In re Aralco, Case nr. 1001985-03.2014.8.26.0032, 2th Lower Civil Court of Araçatuba.
6. Judicial process of foreclosure for satisfaction of a tax or non-tax debt.
7. On the other hand, the debtor should present a certificate of good tax standing when requesting ratification of its judicial reorganisation plan, precisely so that its restructuring, although having an impact on the charging of the tax credits, does not end up providing defence for those under restructuring against their tax creditors.
8. Court of Appeals of Rio de Janeiro, Interlocutory Appeal n. 0057446-63.2017.8.19.0000 (2017).

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