



Cross-Border Restructurings in BRAZIL

Adoption of insolvency proceedings and staff restructuring measures

The Brazilian economy is in deep water: after years of prosperity on the back of high commodity prices combined with an ever growing middle class leading to high domestic consumer demand, GDP flatlined in 2014 (+0.1%). Especially the propensity to invest was on a very low level, with less than 18% of GDP. At the same time, the scandal involving Petrobras, its suppliers and the political establishment unsettles not only Brazil and its entrepreneurs and the population but the whole region and international investors as well. Christian Moritz (Felsberg Advogados, São Paulo) and Dr. Alexander Verhoeven (WELLENSIEK) comment on the relevance of these recent developments for German companies.

Some 1.200 German companies are doing business in Brazil under the conditions of a volatile (emerging) market – do you see first signs for an intensifying crisis?

Verhoeven: Well, the dominant topic at the moment is the scandal at Petrobras and its disastrous effects on the Brazilian economy: a) the currency (Real) has depreciated significantly against the Dollar (up to an 11-year low), b) the economy is trapped in a state of stagnation because many of Petrobras' suppliers are involved in the scandal; one by one getting into financial distress themselves and c) at the same time politicians (especially the ruling coalition) are losing the backing of the population, businesses and investors alike because of their involvement in the investigations of the public prosecutor's office. It should be outlined, however, that a decline in the Brazilian overall economic data had already been in the making before Petrobras.

What exactly are the reasons for these negative developments – do you see signs for hope?

Verhoeven: The surge in commodity prices lead to a sudden rise in economic growth for the Brazilian market and

other emerging markets. Unfortunately the steady revenue stream stemming from this economic boost was not used to fund much needed new infrastructure projects or to stimulate diversification of domestic industries. In consequence the aforesaid negative economic status quo is also the outlook for the near future; a budget deficit combined with the introduction of a fiscal austerity policy will not make it easier for the economy to bounce back on a growth path. However, a gleam of light comes from the labor market with a comparatively low unemployment rate of about 5 %, signaling a steady and strong consumer demand on domestic markets.

What are the biggest risks of liability when a Brazilian subsidiary enters a state of distress?

Moritz: Particularly in an insolvency scenario the liability of directors and shareholders as well as of other group members (including their shareholders) becomes a factor to be aware about. In theory, Brazilian companies in the legal form of a sociedade limitada or a sociedade em ações (comparable with the German GmbH or AG respectively) are granted exclusion of liability of its shareholders and directors. But in fact Brazilian law offers a

long-standing tradition in lifting the corporate veil of such companies (i.e. case law and statutory law from fields such as labor law, tax law, environmental law, anti-trust law and product liability law). This goes to show that the Brazilian piercing the corporate veil practice goes above and beyond the rather restrictive cases known under German jurisdiction. Claims deriving from such direct liability against shareholders of an insolvent company have to be brought to the competent insolvency court separate from the insolvency proceedings.

What kind of proceedings does Brazilian insolvency law offer?

Moritz: The recuperação judicial, introduced in 2005, and the traditional falência are by far the most important proceeding types. The recuperação judicial proceeding might be seen as a mixture of the German insolvency plan proceedings (in combination with debtor-in-possession, "Schutzschirmverfahren"), the French redressement judiciaire and the US Chapter 11 proceedings. Whereas the falência proceeding is the pendant to the German insolvency proceeding and the French liquidation judiciaire.

In Germany directors of a company in distress always need to be aware about their obligatory duties to file for insolvency – do such obligatory reasons exist under Brazilian law?

Moritz: Pursuant to the Brazilian insolvency code a company in financial distress needs to file for insolvency if it deems the criteria for a restructuring under the recuperação judicial proceedings are not met. However, the legal consequences for not complying with this statutory obligation remain unclear; damage claims from creditors on the grounds of a late filing for insolvency have not occurred so far in court history.

How do Brazilians handle situations of distress in general and how should companies react from a German perspective?

Verhoeven: Brazilians are used to handle things with a certain ease and normally do find ways to simply sidestep problems. In principle (especially in everyday situations) this is a positive characteristic. In business and legal affairs however it leads to a certain inconsistency which makes it hard to assert legally binding agreements (both, in and out-of-court). Primarily the long duration of legal proceedings is not feasible for companies and their advisers. That applies especially to exceptional circumstances, such as distressed or insolvency scenarios.

What are potential pitfalls under Brazilian labor law when it comes to lay-offs or other measures to adapt the workforce?

Moritz: First you need to consider that mutual agreements with employees or unilateral declarations of employees will not necessarily bear up in a court proceeding. Other than under German law the Brazilian labor law does not provide, out-of-court, for a legally binding way to get contractual or statutory rights of employees waived. Without professional advice the risk for damage or compensation claims arising out of a dismissal of staff is high. The same applies to the outsourcing of staff (e.g. in the cleaning, IT or private security business). In certain cases the principal can be held liable for labor law and social security obligations of the agent vis-à-vis his staff. The principal should insist on the issuance of a clearance certificate with respect to labor compliance.

What positive aspects does Brazilian labor law provide for companies undergoing a restructuring process?

Moritz: From a German point of view the process of dismissal of staff is quite flexible. A proper notice of termination does not need to be justified by a social, operating or conduct related cause (as under German labor law). As long as certain compensation payment rules and notice periods are observed a contract can be terminated without giving any reasons. Also there is no need for selection based on social criteria (e.g. a company dismissing staff does not have to take into account the age, length of service and extent of support obligations of the employees).

What about mass redundancies?

Moritz: There is no statutory rule providing for such measures. However it is widely recognized by the courts that mass redundancies are legitimate under certain circumstances. In 2009 (during the financial crisis) the labor courts of the state of São Paulo rendered a set of precedent rulings; in these cases the courts have nullified the mass redundancies in question (e.g. from Embraer), but only on the grounds of a violation of the (unwritten) principle of proportionality. For companies considering a mass redundancy in a restructuring this means that in addition to the obligatory FGTS-Compensation the costs for extra compensations and negotiations with the unions

involved (about potential alternative solutions) have to be considered.

Among German entrepreneurs seem to persist a notion that in Brazil the rule of law and its enforcement are less complicated (in other words: adhered to less rigidly) – what is your practical experience from daily (business) life?

Verhoeven: The very opposite is true. The Brazilian legal system is known, among domestic and international investors alike, for its complexity. The same goes for its massive bureaucratic apparatus. Companies doing business in Brazil are often confronted with an impenetrable web of statutory and governmental rules and procedures/proceedings. This leads to considerable liability risks that need to be mitigated by the timely assignment of professional advisers.

How does the ideal cooperation in this context look like?

Verhoeven: Ideally the local advisers – assigned for special tasks, e.g. the dismissal of the director of a local subsidiary – work in close collaboration with an external project manager (ideally with a legal background) who can bring together the loose ends between management of the company and the persons involved locally. This way the company can save valuable resources.

*Many thanks for the interesting conversation,
Mr Moritz and Dr. Verhoeven.*

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