CROSS-BORDER INSOLVENCY

in Brazil, Germany and Russia

Dear Reader,

Brazil is the seventh largest economy in the world and the largest in Latin America. On the one hand, several multinational companies have established and continue to establish subsidiaries and to invest in Brazil. On the other hand, Brazilian companies increasingly operate abroad having assets, debtors and creditors located across the globe. In view of the current difficult economic situation in Brazil, the increase of international trade and investment flows may give rise to complex cross-border insolvency situations which are not addressed by the Brazilian domestic legislation or consistent court practice, as for instance creditor discrimination in the course of parallel multi-jurisdictional proceedings.

Russia faces similar challenges. Companies doing business with Russian counterparts or operating in the country through a Russian subsidiary should be mindful of certain requirements related to Russian bankruptcy law. Germany, at its turn, looks at a record low of corporate bankruptcies, at the same time being praised for its efficiency in resolving insolvencies, e.g. ranked 3rd globally by the World Bank Group. For debtors with business ties to Germany, the treatment of foreign insolvency cases by German courts may be of substantial interest.Against this background, in the current issue of our newsletter, we look into the main cross-border insolvency challenges in Brazil and Russia as well as into the specific case of recognition of Brazilian court-supervised reorganization and liquidation proceedings in Germany.

We hope you enjoy the reading!

Yours sincerely,

Holger Alfes, Alexander Liegl & Luiza Saito Sampaio

Brazil

Current economic scenario and insolvency in Brazil

After one decade of economic and social progress, Brazil is expected to face a reduction of its real GDP by 1 per cent this year, according to the latest IMF projections. Among other things, low commodity prices and austerity measures could continue to hamper economic prospects in the next year.

Brazil's medium-term outlook will depend on the success of the on-going economic measures to return to growth including rebalancing public finances and investing in infrastructure.

Currently increasing energy costs and taxes combined with reduced private consumption impose financial difficulties to companies. This is aggravated by hiking interest rates, which in turn increase financing costs.

As a consequence, a record number of insolvency filings in the first half of 2015 has been released by Serasa, a leading Brazilian credit research firm. 492 court-supervised reorganization filings have been recorded during this time period. This represents the highest mark since the Brazilian Bankruptcy and Restructuring Law of 2005 ("BBRL") entered into force. The number of bankruptcy filings amounted to 798 in the same period.

Experts anticipate that insolvency risk scenarios for most industrial segments shall remain sensitive. In general, such risks should increase in capital-intensive sectors such as in the automotive and transport segment, in construction, distribution and in the oil and gas sector.

Brazilian Bankruptcy and Restructuring Law

The BBRL provides for three insolvency mechanisms for distressed entities:

(i) out-of-court reorganization (*recuperação extrajudicial*);

(ii) court-supervised reorganization (*recuperação judicial*); and

(iii) court-supervised liquidation (*falência*).

The BBRL was largely inspired by the US Bankruptcy Code and was enacted for the purpose of improving court-supervised reorganization and liquidation proceedings in Brazil.

Moreover, the BBRL is based on the territoriality principle, which implies a plurality of insolvency proceedings when the debtor has center of activities and assets in more than one country. Multi-jurisdictional insolvency proceedings, however, have not been regulated by the BBRL. As a result, one should be mindful of the main cross-border challenges faced by companies involved in international insolvency cases with Brazilian exposure.

Main cross-border challenges

Pursuant to Article 3 of the BBRL, the court in which the debtor's principal place of business (*principal estabelecimento*) is located has jurisdiction over insolvency proceedings. Since foreign main and ancillary proceedings are not recognized in Brazil, in the case of a multinational group of companies undergoing a foreign restructuring process, independent proceedings governed by Brazilian law have to be filed in Brazil to address the insolvency of the Brazilian group company.

Furthermore, the BBRL does not contain any rules with respect to international coordination among courts in multi-jurisdictional insolvencies. Therefore, cooperation with foreign courts is to be conducted on a case-by-case basis. This was possible, for example, in the insolvency proceedings of Parmalat and of the Brazilian airline company Varig.

Noerr Brazil Desk

Embedded in a leading European law firm, the Noerr Brazil Desk provides advice and support to Brazilian companies wishing to invest or already conducting business in Germany and Central and Eastern Europe (CEE) countries, as well as to European companies having an established presence in Brazil or contemplating entering the Brazilian market.

We work as a gateway to a comprehensive range of legal advisory services and tax solutions offered by our firm in Germany and CEE. In Brazil, we rely on a network of experienced "best friends" law firms.

Consisting of Brazilian and German qualified lawyers, the Noerr Brazil Desk team offers its clients:

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Another relevant challenge refers to the recognition of foreign judgments in Brazil. The enforcement of a ruling issued by a foreign court relating to, for instance, debt recovery in Brazil must be submitted to the Brazilian Superior Court of Justice (*Superior Tribunal de Justiça*) for the issuance of an *exequatur* provided that certain conditions set forth in Brazilian procedural law are met.

It should be emphasized that such a recognition is not possible in cases of absolute and exclusive Brazilian jurisdiction, which include, for instance, disputes over real estate property located in Brazil (even if the principal place of business of the insolvent company is located abroad).

Finally, with respect to procedures applicable to creditors domiciled abroad, there are some specific rules to be observed, including the obligation to provide collateral for the court fees and indemnification in order to file an application for a Brazilian debtor's bankruptcy and the mandatory conversion of debts in foreign currency into Brazilian Reais.

Germany

Recognition of Brazilian reorganization and insolvency proceedings in Germany

After a ground breaking decision of the German Federal Court of Justice (*Bundesgerichtshof*, "BGH") in 1985, German insolvency law effectively turned from territorialism towards universalism. In 1999, the universalist approach, i.e. general recognition of foreign insolvency cases, became statutory law in Germany. This law applies to proceedings in any foreign jurisdiction without the need for reciprocity or any international treaty. The only positive prerequisite for the general recognition is that the foreign case is an insolvency case within the meaning of § 343 German Insolvency Code (*Insolvenzordnung*, "InsO").

Based on this rule, in August 2011 the Labor Court of the State of Hesse (*Hessisches Landesarbeitsgericht*, "LAG Hessen") granted comity to Brazilian court-supervised reorganization proceedings over Varig (case no. 5 Sa 1548/10). Lacking relevant treaties between Brazil and

Germany, the LAG Hessen applied the § 343 InsO-test, holding that the Brazilian court-supervised reorganization proceedings are insolvency proceedings within the meaning of this section. Consequentially, the LAG Hessen accepted the automatic stay imposed by Brazilian law and refused to rule on the merits of a suit filed against the debtor in Germany.

The claimant (an employee of the airline in Germany) appealed, continuing to pursue his claim for outstanding salary and redundancy compensation. In the meantime, the court-supervised reorganization in Brazil was converted into a bankruptcy case. The German litigation moved on to the Federal Labor Court (*Bundesarbeitsgericht*, "BAG"), which considered at length the essentials of both the Brazilian court-supervised reorganization and the bankruptcy proceedings and held that both meet the basic standards of German insolvency proceedings (decision dated 18 July 2013, case no. 6 AZR 882/11).

The BAG concluded that the Brazilian proceedings generally serve the purpose of equitable satisfaction of creditors' claims and are supervised by the courts. It also pointed out that Brazilian law provides for sufficient safeguards for an equitable distribution, such as the stay of litigation and enforcement measures. Furthermore, the BAG held that the debtor-in-possession restructuring under Brazilian law does not preclude recognition, pointing out that the concept of "self-administration" has been implemented into German insolvency law in 1999 (concurring with a prior decision of the BGH regarding the US Chapter 11 proceedings under the US Bankruptcy Code).

Against this background, the BAG concluded that the German litigation against the debtor was stayed. Such stay came into effect at the latest upon conversion into bankruptcy, since § 352 InsO provides for a stay of litigation when the standing shifts from the debtor-in-possession to the court appointed administrator (Article 76 of the BBRL), regardless of whether the foreign law itself provides for a stay resulting from such shift or not.

Briefly addressing a (negative) element of § 343 InsO, the BAG held that since the debtor's seat was in Brazil, from a German perspective, Brazilian courts rightfully assumed their international jurisdiction over the debtor's restructuring, so that recognition may not be denied on the grounds of improper jurisdiction. This element may become particularly relevant in cases of "forum shopping", e.g. when a Brazilian business files for a Chapter 11 reorganization in the US.

The decision of the BAG demonstrates that the question of recognition of Brazilian proceedings and the benefits coming with it (comity being granted to decisions facilitating the proceedings) may be considered as settled in Germany. This is particularly important since under German law no special petition for recognition (such as under Chapter 15 of the US Bankruptcy Code) is possible and the comity question may be raised in any litigation de novo.

The fundamental public policy exception of § 343 para. 1 sentence 2 InsO shows, however, that comity is anything but absolute. In a decision dated 27 February 2007 (case no. 3 AZR 618/06), the BAG ruled that although the US Chapter 11 passes the § 343 InsO-test (in 2009, the BGH concurred with this opinion on occasion of a patent litigation), leaving the relief from the automatic stay within the powers of the US Bankruptcy courts in case of an employee's complaint against dismissal termination would violate German fundamental public policy. The BAG held that given the constitutional protection of employment under Article 12 of the German Constitution and the urgency of the matter, the claimant could get relief from the American automatic stay by formally resuming German litigation in accordance with German procedural rules, regardless of any limitations provided by the US bankruptcy law. It appears likely that the BAG would have come to a similar result in a Brazilian insolvency case.

In summary, Brazilian debtors may rely on comity to be granted by German courts to Brazilian court-supervised reorganization and bankruptcy decisions. However, despite general recognition, where the provisions of the BBRL are considered to be in conflict with fundamental principles of German law, in particular basic constitutional rights, local stakeholders still may obtain protection. This needs to be taken into account in reorganizations of businesses with connections to Germany.

Russia

Increasing number of insolvency proceedings in Russia

Currently the Russian economy is facing an on-going financial crisis. Many Russian banks have lost access to European and US financial instruments and were constrained to take a tough line in relationships with their debtors in Russia. Furthermore, the Russian economy, which is dependent on the export of natural resources, is highly affected by the low price for crude oil. An effect of the crisis was the collapse of the Russian Rouble in the end of 2014 which has deepened the economic difficulties.

In the given context, the quantity of initiated insolvency proceedings has essentially risen. According to information of the Unified Federal Register of Bankruptcy in Russia, the number of bankruptcy proceedings in the first half of 2015 has grown by 15 per cent compared to the same period of 2014 and reached the amount of 7,658 legal entities considered by courts as bankrupt. Subject to bankruptcy proceedings are mainly businesses in the spheres of trade, construction, real estate and in the process industry.

Russian Bankruptcy Law

The Russian Bankruptcy Law ("RBL") provides for four legal entity bankruptcy procedures (excluding banks, state corporations and funds which are subject to specific regulations):

(i) supervision (*наблюдение*);

(ii) financial rehabilitation (*финансовое оздоровление*);

(iii) external management (*внешнее управление*); and

(iv) bankruptcy liquidation procedure (*конкурсное производство*).

The above mentioned bankruptcy proceedings are supervised by the Russian state court which is responsible for the location of the legal entity's main place of business ("Supervising Court") . In addition, the bankrupt legal entity and its creditors may agree on out-of-court financial restorations and settlement agreements.

Main cross-border challenges

The RBL applies only to the bankruptcy of Russian legal entities. The COMI-principle (Center of Main Interests, i.e. principal place of debtor's business) employed by the US Bankruptcy Code and the European Insolvency Regulation is not recognized by the RBL.

Similarly as in Brazil, foreign creditors have the same legal status as local creditors. However, Brazilian creditors have to submit all documents to the Supervising Court either in Russian or accompanied by a notarized translation into Russian. Brazilian public documents (including documents notarized in Brazil) must be legalized by the Russian consular authorities or by the Russian Ministry of Foreign Affairs. Furthermore, creditors' claims indicated in a non-Russian currency will be converted by the Supervising Court into Russian Roubles.

Multi-jurisdictional bankruptcy procedures in Russia

The RBL neither provides for rules on the coordination of multi-jurisdictional insolvency procedures nor is there an established practice applied by Russian courts in this regard. However, as the Russian professional organizations of insolvency administrators are obliged to international cooperation with the professional organizations of insolvency administrators of other jurisdictions there are good chances that rules on international coordination will be enacted in future.

Based on the principle of reciprocity, Russian courts recognize decisions of non-Russian courts which declare businesses bankrupt under the relevant jurisdiction. In particular, there are positive decisions on the recognition of German, English and Swedish courts. At this moment, there is no court practice on recognition of decisions of Brazilian state courts in Russia. However, we are not aware of actions taken by Russian courts in respect of non-Russian bankrupt businesses' property located in Russia. Currently, the Russian Federation is not a party to any international treaty on the recognition of decisions declaring non-Russian businesses bankrupt.

Brazilian creditors are entitled to apply for the registration of claims against a bankrupt Russian legal entity to the relevant Supervising Court. If a Brazilian creditor has obtained a decision by a Brazilian or other non-Russian state court ordering the bankrupt Russian legal entity to make payments, it may apply to the Supervising Court for recognition of such decision. A recognition is possible if there is a treaty for legal assistance between Russia and the respective court's state. If no such a treaty applies (which is the case regarding Brazil and most Western countries), the basis for a recognition may only be the principle of reciprocity. If, in general, a recognition is possible, the Supervising Court may refuse the recognition only if the foreign decision conflicts with the public order of the Russian Federation or certain imperative procedural principles and statutory requirements.

Finally, foreign creditors may seek recognition by the Supervising Court in Russia of arbitral awards issued in a New York Convention member state (e.g. Brazil and most Western countries).

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