Insolvency and Arbitration in Brazil: One More Step Ahead

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On 24 December 2020, the New Brazilian Insolvency Act ("NBIA" – a slight misnomer, as the Act is in fact an amendment to an existing statute) was published in the *official Brazilian gazette*. The act implements important modifications in the field, including a few related to arbitration, which came into force on 23 January 2021.

Arbitration and insolvency[fn]The terms 'insolvency', 'judicial reorganisation', and 'bankruptcy' are often used loosely to describe any kind of financial failure. In this article, for the sake of convenience, I use the term 'insolvency' to describe the legal proceedings where a court declares that a company is insolvent and can no longer pay off their debts, issuing a winding-up order. The term 'judicial reorganisation' is dedicated to cases where the debtor applies to court seeking to save its business and discharge its debts by entering into a reorganisation plan approved by its creditors and by the court. I don't use the term 'bankruptcy', as in many jurisdictions it only applies to individuals, and not companies.[/fn] are two separate worlds governed by different policies. On the one hand, arbitration aims to enforce party autonomy and ensure that the winning party gets what it deserves, regardless of the impact of the arbitral award on third parties. On the other hand, insolvency is an attempt to rescue a viable business and/or return productive resources to the market, balancing the interests of the insolvent party with the interests of creditors and other stakeholders.

Unsurprisingly, these policies sometimes clash, and different legal systems have come up with a variety of solutions, often causing complex issues in cross-border disputes. In general, the complexity resides on the lack of specific legal provisions dealing with (i) the arbitrability of insolvency issues, (ii) the effects of insolvency proceedings on arbitration agreements, and (iii) the effects of insolvency proceedings on ongoing arbitrations.

The NBIA expressly deals with the two latter issues. This post briefly explains (i) the relevance of the new legal provisions in the context of a global economic crisis, and (ii) the impact of insolvency on arbitration agreements and ongoing arbitrations in Brazil according to the new legislation (highlighting, when appropriate, precedents from the Superior Court of Justice – "STJ" – on the topics).

Well-timed modification

The global economy is in crisis. In April 2020, the IMF indicated that 2020 would see the worst global economic contraction since the Great Depression of the 1930s. In December 2020, the OECD reported that global GDP had decreased 4.2% in the last year as the result of the pandemic (Statista puts the figure even higher, at 4.5%).

In Brazil, the number of winding-up petitions filed in July 2020 increased 28.9% in comparison to July 2019. In the same period, the number of petitions seeking judicial reorganisation in the country jumped to 82.2% in contrast to July 2019.

Needless to say, the huge economic crisis the COVID-19 pandemic caused, and the boost in numbers of insolvency proceedings will likely bring a renewed focus on the topic of 'arbitration & insolvency' in 2021. This will require businesspeople, lawyers, arbitrators, and arbitral institutions to use all their creativity in designing the most reasonable legal solutions.

In this sense, the NBIA is a well-timed initiative which will bring more certainty and predictability to arbitrations seated in Brazil and/or to arbitrations involving at least one party headquartered in the country.

Insolvency, judicial reorganisation, and arbitration under the NBIA

As previously discussed here, the original text of the Brazilian Insolvency Act did not mention the words “arbitration” or “arbitral”, which was not a particularity of the country as this lack of provisions regarding arbitration is a common feature of many insolvency laws across the globe. In contrast, the NBIA now registers these words five times. This post explores three of these uses.

According to the new paragraph 9 of s. 6, “the commencement of a judicial reorganisation proceeding or the issuance of a winding-up order will neither permit the trustee/liquidator to discharge the arbitration agreement, nor prevent arbitrations from starting or continuing”.

The new provision reinforces what legal scholars[fn]For a comprehensive analysis of the academic works, see MONTEIRO, Andre Luis. FICHTNER, Jose Antonio. MANNHEIMER, Sergio. Teoria geral da arbitragem. Rio de Janeiro: Forense, 2019, p. 426-490.[/fn] and case law had already supported: a pre-existing arbitration agreement is not discharged by the commencement of judicial organisation proceedings or by the issuance of a winding-up order. Unlike other jurisdictions, in Brazil trustees/liquidators do not have the power to discharge pre-existing arbitration agreements based on these facts. Also, it is not necessary to seek court permission to enforce pre-existing arbitration agreements against an insolvent party. Everything stands as it was.

In addition, neither creditors nor insolvent parties are prevented from commencing or continuing arbitrations after the beginning of judicial reorganisation proceedings or after the issuance of winding-up orders. Moreover, courts cannot stay ongoing arbitrations exclusively based on these facts. The STJ had already adopted this understanding in the case *Hornbeck v Astromarítima* (2018). Then, it seems like the NBIA simply turned the existing case law into a legal provision.

This provision also makes clear that the commencement of judicial reorganisation proceedings or the issuance of a winding-up order do not turn the claims made against the insolvent party into inarbitrable matters. Logically speaking, if the arbitration is not stayed and, therefore, it can commence or continue, it follows that the subject matter does not become inarbitrable.

In cases where an insolvency court has rendered a winding-up order, the new s. 22(iii)(c) establishes that the concerned trustee/liquidator will “take on the representation of the estate in extrajudicial matters, court proceedings, and

arbitrations." This provision clarifies that, from the issuance of the winding-up order, the trustee/liquidator will assume the legal representation of the estate, which means he/she will be able to hire/replace lawyers, discuss potential settlements etc., including in arbitration proceedings. As this replacement may take some time, it is fair for the arbitral tribunal to stay the ongoing arbitration for a reasonable period of time, for instance, 60-90 days.

Last but certainly not least, the NBIA has adopted the 1997 UNCITRAL Model Law on Cross-Border Insolvency,[fn]*See* ARAUJO, Nadia de. SPITZ, Lidia, "A insolvência transnacional na nova Lei de Falências."[/fn] but with a few important distinctions. Based on subparagraph 1(a) of Article 20 of the Model Law, the UNCITRAL Guide to Enactment and Interpretation of the Model Law states that "by not distinguishing between various kinds of individual action, (the provision) also covers actions before an arbitral tribunal" and, therefore, "article 20 establishes a mandatory limitation to the effectiveness of an arbitration agreement,", i.e., arbitrations are also subject to the automatic stay provided for this provision.

This is not the approach that the NBIA takes. Paragraph two of s. 167-M states that, in spite of the recognition of the main foreign insolvency proceeding, "it does not affect the creditors' right to commence or continue any court proceedings or arbitrations seeking a monetary award against a debtor, except when it involves executive measures against the debtor's assets, which will keep stayed". In other words, the effects of main insolvency proceedings taking place abroad do not prevent the creditor from commencing or continuing arbitrations against the insolvent party in Brazil. In practical terms, only measures against the debtor's assets (freezing orders, search and seizure orders, orders for sale, etc.) should be suspended under this scenario.

The NBIA does not deal with the arbitrability of core-insolvency-issues, but the STJ's case law is clear on that arbitral tribunals do not have powers to grant winding-up orders, for example. Consequently, as decided in *Jutaí 661 v PSI* (2013) and *Volkswagen v Metalzul* (2018), a pre-existing arbitration agreement does not prevent the creditor from filing a winding-up petition in the insolvency courts. Also, as decided in *Galvão Engenharia v. Clark* (2017), *Hornbeck v Astromarítima* (2018), and *Oi v Bratel* (2018), arbitral tribunals do not have powers to deal with an insolvent party's assets (they cannot, for example, issue freezing orders, search and seizure orders, orders for sale, etc.).

Conclusion

The NBIA has come into play at a pertinent moment and it adopts an indisputably arbitration-friendly approach. Hopefully, the new legislation can serve as an inspiration for more studies in this field and, also, for other countries' legislative works.