



Protection of Creditors' Rights under Brazilian Law

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February 2014

Introduction

Under Brazilian law, as in the vast majority of the world's legal systems, the assets of the debtor, and only its assets, are the guaranty for the payment of its debts (in this regard, Art. 591 of the Brazilian Code of Civil Procedure).

In some cases, this may lead a debtor to dispose of its assets with the purpose of avoiding to pay for its debts. Thus, at a given point in time, the debtor becomes insolvent and no longer capable of satisfying its payment obligations towards his creditors.

Fraud against Creditors

A fraud against Creditors occurs when, on one hand, a debtor deliberately and consciously disposes of its assets to the prejudice of its creditors while being insolvent or becoming insolvent with such act (objective criterion, also called "*eventus damni*" = damage) and, on the other hand, the buyer or grantee of the assets is aware of the state of insolvency of the debtor, but plots with it the fraud (subjective criterion, also called "*consilium fraudis*").

In case the defrauding transaction consists in a gratuitous act or in the remission of a debt, the subjective criterion is not required. In this case, the "*eventus damni*", i.e., the damage is sufficient to configure the fraud.

The fraud against creditors, once verified, may be annulled by means of a revocatory action, the so-called paulienne action, proposed by the creditor affected by the fraudulent act. The revocatory action may be proposed against the insolvent debtor or against third parties, which acted in bad-faith. The damage caused to the debtor must be proven. The potential damage is not sufficient.

The statute of limitations for the proposal of such revocatory action is of 4 (four) years counted from the date of practice of the act.

It is necessary that the credit be previous to the disposal, i.e., that the affected creditor had already been a creditor when the fraudulent disposal of assets was made. However, there is jurisprudence of the Higher Court of Justice (STJ) to the effect that, exceptionally, a disposal of assets in relation to a later credit may characterize the fraud, if the defrauding transaction was, as such, figured out in advance.

The fraud against creditors is an institute of material law and is provided for in Articles 158 through 165 of the Brazilian Civil Code.

Fraud against Foreclosure

Similarly to what occurs in case of fraud against creditors, a fraud against foreclosure may be alleged by creditors when, at the time of disposal or burdening of the assets, the debtor had a pending claim against it capable of rendering it insolvent.

However, differently from the fraud against creditors, the fraud against foreclosure is an institute of procedural law provided for in Art.593 and its items of the Brazilian Code of Civil Procedure.

It is alleged incidentally, in the course of another action, usually, but not necessarily, a foreclosure action. It may further be alleged when there is pending claim against the debtor based on "*in rem*" rights in relation to the disposed or burdened asset.

In case the asset is linked to the defrauding action through a right "*in rem*", no further proof is required to demonstrate the fraud against foreclosure. If there is no such link, it is necessary to demonstrate the "*eventus damni*", i.e., the insolvency of the debtor caused by the disposal or burdening of the asset.

In the fraud against foreclosure, the act of disposal or burdening is not null, but ineffective in relation to the creditor and the foreclosure action, remaining valid between the disposing party and the receiving party.

It should be noted that the fraud against foreclosure is considered an act practiced in prejudice of the dignity of the Justice (Brazilian Code of Civil Procedure, Art. 600, I), since it retrieves from the incidence of the judicial power the object of the judicial constriction.

Thus, it receives a more severe treatment from the law, if compared to the fraud against creditors. It subjects the debtor to the (possibility of) imposition of a fine not to exceed 20% of the updated value of the debt under foreclosure, for the benefit of the creditor, and is provided for in Art. 179. of the Brazilian Criminal Code, amongst the crimes against the Administration of Justice.

The fraud against foreclosure may be alleged at any time, incidentally, in the course of an action against the debtor, which has disposed or is disposing of its assets in violation of the law.

Considerations in Regard to Bankruptcy

In case of bankruptcy, the law has established the term of up to 90 days counted from (i) the date of request of bankruptcy, (ii) the date of request of judicial recovery, or (iii) the date of the first protest for lack of payment against the debtor (with exclusion of the cancelled protests), as the legal term of the bankruptcy, i.e., the date as of which the debtor is, legally, considered bankrupt. The referred 90-day-period is a maximum, which may be reduced by the judge.

Any payment carried out during the legal term is ineffective and void in relation to the bankruptcy estate. Likewise, any act practiced by the debtor without compensation, within the period of two years before the declaration of bankruptcy is ineffective and void in relation to the bankruptcy estate.

Such ineffectiveness may be declared by the judge, alleged in defense, requested by means of the proper legal action or, incidentally, in the course of the bankruptcy.

The proper legal action referred to in the previous paragraph is the revocatory action provided for in the Brazilian Bankruptcy Law (Law 11.101/05), in its Arts.129 through 138. It may be proposed by the judicial administrator, by any creditor or by the Public Prosecutor within the period of 3 (three) years counted from the declaration of bankruptcy.

The revocatory action may be proposed (i) against all that took part in the legal act or which have been paid, guaranteed or have profited from the act; (ii) against the third parties which acquired assets from the debtor, if they had knowledge of the intention of the debtor to damage creditors; and (iii) against the heirs or legatees of the persons/entities mentioned under items (i) and (ii) above.

The decision which judges favorably on the revocatory action will determine the return of the disposed assets, together with its accessories, or of their market value increased by damages, to the bankruptcy estate.

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