

International Insolvency Institute and Fordham University School of Law

**Sixth Annual International Insolvency Conference
Committee on Corporate and Professional Responsibilities in Bankruptcy**

“Saving the going concern: must the crew abandon the ship ?”

What changes would you like to see in your local law on Officers and Directors obligations to increase the prospects of the rescue/reorganization of Multi-National Corporate Groups ?

New York - 2006

BRAZILIAN LAW

A. CURRENT SITUATION OF THE LIABILITY OF COMPANY OFFICERS AND DIRECTORS

1. Liability in general. The Corporation Law (“Lei das Sociedades Anônimas”) holds directors and officers equivalent for the purposes of fixing of liability. Thus, members of the Board of Directors or of the Audit Committee have the same duties and responsibilities as officers. In principle, officers and directors of Brazilian companies are not personally liable for any obligations incurred on behalf of companies by virtue of the performance of regular management acts during the ordinary course of business. In this case, the company is liable on its own, and may not bring a suit against the director or officer in order to recover its losses.¹

However, they are personally liable for the damages caused by their acts, whether performed in a fraudulent manner or due to negligence, or, further, in violation of the law or the corporate bylaws of the company. On the other hand, officers and directors are not liable for the illegal acts committed by other officers and directors, except when conniving therewith, when neglecting to disclose such acts or if, being aware of such acts, they fail to take the necessary steps to prevent the performance thereof

Dissident officers and directors who cause their dissent to be recorded in the minutes of the meeting of the administration body or, when this is not possible, immediately apprise the administration body, audit committee, if in operation, or general meeting of their dissent are exempt from liability. Officers and Directors are jointly liable for the losses caused by virtue of failure to discharge the duties imposed by law to ensure the normal operation of the company, even when such duties, in accordance with the corporate bylaws, are not the responsibility of all the officers and directors.

¹ Law 6.404/76, article 158 Law 10406/2002 (Civil Code), articles 47 and 1.015.

Nevertheless, the directors will not be liable for the acts of officers that have been concealed from the directors, or that are of difficult or impossible ascertainment within the normal situations of the company. In this case the liability of the Directors cannot be presumed.

There is no way of imposing liability on the directors for the act of an officer that displays incompetence. However, the directors will be liable for the election of an unfit officer, when the knowledge of his unfitness is possible, through the verification of commercial or judicial information. Omission in deposing the officer elect, following verification of his incompetence or unfitness, renders the directors liable for the damages caused to the company or to third parties.

The Civil Code of 2002 also established stricter rules for the liability of officers and directors for the acts performed in the administration of certain business dealings, even if negligence or fraud are not verified, i.e., the officer or director, in these cases, may be strictly liable for the damage caused, even if he did not have the intention of causing it and did not act with negligence, imprudence or malpractice.

The Officers and Directors shall obey the following duties/obligations:

(i) Duty of care. The Officers and Directors shall employ the care and diligence that any active and honest man employs in the administration of his business.

(ii) Purpose of powers and ultra vires. The officers and directors shall exercise the powers that the law and corporate bylaws confer on them for the attainment of the objectives and in the interest of the company, observing the requirements of public welfare and the social function of the company.

(iii) Duty of Loyalty. Officers and Directors shall serve the company with loyalty, protecting its rights and interests.

(iv) Duty of avoiding conflicts of interest. Officers and Directors are prohibited from participating in any corporate resolution or operation in which they have an interest that is

conflicting with the interest of the company, and shall inform the other officers and directors in respect of the nature and extent of their interest.

(v) Duty of confidentiality. The officers and directors of publicly held companies shall maintain confidentiality over any information that has not yet been disclosed for the knowledge of the market, obtained by reason of the position and capable of influencing the quotation of securities, and are prohibited from using the information to obtain advantage for themselves or for others through the purchase or sale of securities. Moreover, they shall take care for the violation of this duty not to occur through subordinates or third parties of their trust.

(vi) Duty to inform (disclosure). This duty applies specifically to the Officers and Directors of publicly held companies, who, at the time of their taking of office, are obligated to disclose to the annual general meeting the securities issued by the company, of which they are owners, as well as inform the benefits, advantages, and any other material acts or facts in the activities of the company, and that might influence the quotation or trading of their securities issued. In addition, they are obligated to immediately inform CVM (Brazilian Securities Commission, equivalent to the US SEC) and the Stock Exchange or entities of the organized over the counter market, the modifications in their shareholder positions in the company. In this regard, it can be seen that the regulations issued by CVM include, in many aspects, similar rules to those contained in the Sarbannes-Oxley Law.

(vii) Liability of officers and directors of financial institutions. Financial institutions are regulated by specific legislation², which also disciplines the consequences of the respective insolvency. The officers and directors will be liable, at any time, for the acts that they have performed or failed to perform.

The officers and directors of financial institutions are jointly liable for the obligations assumed by such institutions during their term of office, until they are fulfilled. Nevertheless, this joint liability is limited to the sum of the losses caused.

² Law 6.024, of March 13, 1974

The immediate effect, for the officers and directors, consists of the suspension of the position, in the event of intervention, or in the loss of the position, when out-of-court liquidation or bankruptcy occurs. In other words, in any of these situations, the officers and directors are no longer accountable for the Administration of the financial institution, which is assumed by the intervenor, liquidator or trustee in bankruptcy.

As a consequence of the suspension or loss of position, all the property of the former officers and directors are inalienable until the determination and final liquidation of their liabilities, to guarantee the payment of the creditors of the institution under the intervention regime, out-of-court liquidation or bankruptcy, if this institution does not have sufficient assets to cover its debts.

2. **Judicial consummation of liability.** The law determines a suit to be brought by the company against the officer or director (derivative lawsuit), seeking the reimbursement of the losses caused, as well as the appropriate suit to be brought by the shareholder or third party directly affected by the act of the officer or director. In the case of a suit that is proper for the company not being brought within the legal term, any shareholder may bring it. On the other hand, if the general meeting resolves not to bring the suit, shareholders representing 5%, at least, of the capital stock, will be entitled to bring the derivative lawsuit, seeking to indemnify the company for the damage that it suffered directly and the shareholders, indirectly.

3. **Tax liabilities.** Although the Officer and Director act on behalf of the Company, the latter is responsible for the payment of taxes. Consequently, the Officers and Directors will not be personally liable, unless the default results from management acts performed with violation of the law, or with excessive powers, i.e., in an abusive manner. This is liability by substitution.

4. **Social security liabilities.** The law establishes that the officers are jointly and secondarily liable with their personal property, in respect to default of obligations with the Social Security Authority, due to fraud or negligence.

5. **Labor liabilities.** There is no express rule in Brazilian law regarding the liability of officers and directors for labor liabilities. However, in general terms, the Brazilian courts have

developed case law according to which the corporate veil is removed and the officers and directors considered strictly liable for the labor liabilities of the companies that they administrate. Officers and Directors can have their personal property seized as a guarantee for labor liabilities of the company.

6. **Damages to the consumer.** The law determines disregarding the corporate entity when, in detriment to a consumer, there is abuse of a right, excessive power, violation of the law, fact or unlawful act or violation of the corporate bylaws or articles of incorporation, and also when there is bankruptcy, the state of insolvency, close down or inactivity of the legal entity caused by mismanagement.³

7. **Antitrust law.** The Officers and Directors may be considered strictly, individually and jointly liable with the Company for damages resulting from the violation of certain rules of the antitrust law.⁴ Moreover, the corporate entity of the person responsible for the violation of the economic order may be disregarded when there is abuse of law, excessive power, violation of the law, fact or unlawful act or violation of the corporate bylaws or articles of Association on the part thereof. This disregarding will also occur when there is bankruptcy, the state of insolvency, close-down or inactivity of the legal entity caused by mismanagement⁵

8. **Environmental law.** Officers and Directors may be considered strictly, individually and jointly liable with the company, for losses resulting from the violation of certain rules of the environmental protection legislation⁶, with the disregarding of the corporate entity whenever it represents an obstacle to the reimbursement of damages caused to the quality of the environment⁷.

³ Art. 28 Law 8.078/90.

⁴ Law 8.884/94, arts. 20 and 23.

⁵ Law 8.884/94, art. 18.

⁶ Law 9.605/98, art. 2.

⁷ Law 9.605/98, art. 4.

9. **Determination of liability in insolvency.** During the judicial reorganization proceeding, the officers and directors are maintained in the conduct of the business activity, except if any of them have been convicted for a bankruptcy crime, acquisitive offense, offense against the public interest or the economic order, have acted with felonious intent, simulation or fraud against the interests of creditors, or have engaged in any of the following conducts:

- (i) incurred manifestedly excessive personal expenses in relation to his asset situation;
- (ii) incurred unjustified expenses due to their nature or magnitude, in relation to the capital or kind of business, the movement of operations and other analogous circumstances;
- (iii) unjustifiably decapitalize the company or conduct operations that are detrimental to its regular operation;
- (iv) simulate or omit credits upon presenting the list referred to in item III of the **main provision** of art. 51 of this Law, without a relevant lawful reason or support of a judicial decision⁸;

The law establishes that, regardless of the realization of the asset and evidence of its insufficiency to cover the liability, the personal liability of the officers and directors for negligence or willful misconduct in the discharge of their duties will be ascertained by the Judge of the bankruptcy himself⁹. The private property of the officers and directors, in a sum that is compatible with the damages caused, may become inalienable until the judgment of the liability suit.

10. **Insurance as a means of protecting the assets of the Officers and Directors.** In view of the possibility of the officers and directors being considered liable by virtue of the performance of the company's management acts, the Brazilian legal system admits civil liability insurance, known as D&O (Directors and Officers Insurance). However, it is deficient in respect of liability insurance to protect officers and directors while they act for a company in a

⁸ Law 11.101/2005, art. 64

⁹ Law 11.101/2005, art. 82

financial crisis situation. Technically, these insurance policies are permitted, but, in practice, are very rarely used.

In many cases, such insurance is already part of the hiring policy of companies, which bear their costs, and many officers and directors stipulate the prior contracting of insurance by the company as a condition for their taking of office.

11. Criminal Liability. Officers and Directors may be sued for violation of the rules of the Penal Code, legislation that disciplines the Capital Market¹⁰, Consumer Protection Code¹¹, environmental legislation¹², antitrust legislation¹³, the law that disciplines intellectual property¹⁴ and, also, for the performance of acts characterized in the Company Reorganization and Bankruptcy Law¹⁵, which considers the commitment, before or after the decision that decrees bankruptcy, grants judicial reorganization or ratifies out-of-court reorganization, of a fraudulent act that results or may result in losses to creditors, with the purpose of obtaining or ensuring an undue advantage for oneself or for others a crime. The penalty of confinement, of 3 to 6 years and a fine applies. The penalty is increased by one sixth to one third, if the party: I – prepares the accounting records or balance sheet with inaccurate data; II – omits entries in the accounting records or balance sheet that must be included therein, or alters authentic accounting records or balance sheet; III – destroys, erases or adulterates accounting or business data stored in a computer or computerized system; IV – simulates the composition of the capital stock; V – totally or partially destroys, conceals or mutilates the mandatory bookkeeping. The penalty is increased by one third to half if the debtor maintained or transferred funds or amounts concomitantly to the bookkeeping required by the law¹⁶.

¹⁰ Law 6.385/76, arts. 27C to 27F.

¹¹ Law 8.078/90, arts. 61 to 80

¹² Law 9.605/98

¹³ Law 8.884/94, arts. 20 to 27

¹⁴ Unfair competition crimes set forth in art. 195 of Law 9.279/96.

¹⁵ Law 11.101/2005

¹⁶ Law 11.101/2005, art. 168.

It is also a crime to withhold or omit information or provide false information in a bankruptcy, judicial reorganization or out-of-court reorganization proceeding, with the purpose of leading the judge, District Attorney's Office, creditors, the general meeting of creditors, the Committee or judicial trustee into error, as well as to perform, before or after the decision that decrees bankruptcy, grants judicial reorganization or ratifies an out-of-court reorganization plan, an act of disposition or encumbrance of assets or that generates an obligation, designed to favor one or more creditors to the detriment of the others¹⁷.

The following conducts are also defined as crimes: appropriate, misappropriate or conceal assets owned by the debtor under judicial reorganization or by the bankruptcy estate, including acquisition by a designee; failure to prepare, record in the accounts or certify, before or after the decision that decrees a bankruptcy, grants judicial reorganization or ratifies an out-of-court reorganization plan, the mandatory bookkeeping documents¹⁸.

It is important to mention that in the bankruptcy, judicial reorganization and out-of-court reorganization of companies, the officers and directors, *de facto* or *de jure*, are held equivalent to the debtor or insolvent entity for all criminal purposes arising from the Law, to the extent of their culpability¹⁹, whereas it is certain that the decisions that decree the bankruptcy, grant judicial reorganization or out-of-court reorganization are objective conditions for punishability of the criminal offenses defined in the law. The following are effects of conviction for a crime set forth in the said law: (i) disqualification to engage in business activity; (ii) impediment to exercise a position or function on a board of directors, board of executive officers or management of companies subject to the law; (iii) the impossibility of managing a company for a term of office or by *negotiorum gestio*.

The aforesaid effects are not automatic, and shall be stated and substantiated in the decision, and will persist for up to five (5) years after the extinction of punishability but may cease earlier by criminal rehabilitation.

¹⁷ Law 11.101/2005, arts. 171 and 172

¹⁸ Law 11.101/2005, arts 173 and 178

¹⁹ Law 11.101/2005, art. 179.

B. SUGGESTIONS FOR THE IMPROVEMENT OF THE LIABILITY SYSTEM OF OFFICERS AND DIRECTORS OF COMPANIES

12. Introductory observations. Needless to say, companies only exist if there are people to found them, direct them, provide them with capital, and work for them. And in order for the enterprise to be successful, accomplishing its objectives, it is of vital importance that there is a balance in respect of the rights and obligations of these various stakeholders, which balance shall result from the existence of legal certainty as to the guarantee of the limitation of the various liabilities.

Hence, the suggestions that I make for the improvement of the liability system of company officers and directors take three distinct aspects into account: (a) with respect to civil liability; (b) with respect to criminal liability and (c) with respect to enforcement.

13. Civil liability. In respect of the civil liability of officers and directors, permit me to make some prior considerations, to then, suggest some changes.

14. Duties of company officers and directors before the creditors. Bearing in mind the tendency manifested over the last fifteen years or so, on the part of an expressive number of U.S. courts, in the sense that fiduciary duty exists of company officers and directors toward creditors, as from the moment in which the company is in the vicinity of insolvency²⁰, it is

²⁰ Note, however, that in the judgment of the *Production Resources Group, L.L.C. v. NCT Group, Inc.* case, 863 A.2d 772 (Del. Ch. Nov. 17, 2004), Vice Chancellor Strine, of the Court of Chancery of Delaware, observed that in a ruling that was considered a landmark decision on the matter, handed down in 1991 in the *Credit Lyonnais [Credit Lyonnais Ban Nederland, N.V. v. Pathe Communications Corp.]* case, 1991, WL 277613 (Del. Ch. Dec. 30, 1991)], the assertion that the universe of beneficiaries of the fiduciary duty of the officers and directors is expanded, in order to include the creditors of the company, in case the latter is insolvent or is in the vicinity of insolvency, is aimed at constituting a shield, with the purpose of protecting the officers and directors in relation to the claims formulated by the shareholders, on the basis of the allegation of acting very conservatively in the administration of the company's business. Moreover, although there are contrary opinions, Vice Chancellor Strine asseverated that the

interesting to examine if it would be necessary for the Brazilian corporation law to establish that, in the same circumstances, the duty of loyalty of a company's officers and directors toward its creditors would survive. In other words, if the law should declare that, in the event of the proximity of insolvency and during same, the officers and directors would assume duties not only toward the company, but toward the creditors, whereupon the officers and directors would have to act in accordance with the best interests of the creditors.

In the common law, the fiduciary duty has its roots in the trust fund doctrine, according to which the assets are maintained in a trust by the fiduciaries, to the benefit of the *true owners*. Accordingly, the assets of an insolvent company (regardless of whether its bankruptcy has been requested or not) constitute a trust fund to the benefit of its creditors. The civil liability due to the breach of these legal obligations constitutes a strong incentive to officers and directors of companies with financial problems in the sense of avoiding taking unreasonable risks, with a view to restoring their financial health.

I understand, nevertheless, that there is no need to establish a fiduciary duty of the officers and directors in relation to the creditors of the company, even when the latter is insolvent or close to insolvency (in the vicinity of insolvency). In reality, the fiduciary duty theory adds nothing in substantial terms that is not already provided for in the Brazilian corporation legislation in terms of the liability of officers and directors. It is sufficient, for such, to invoke the duty of care in order to impose liability on the officers and directors that act beyond the required legal standards. The creation of a fiduciary duty would imply overly extending their liability, which would certainly generate a counterproductive effect in the business environment, bearing in mind the added cost that this would represent for the companies (and, consequently, for society).

decision in the *Credit Lyonnais* case did not create a new set of duties for the officers and directors directly in favor of the creditors, besides those already existing in relation to the company. Without going into a complex analysis of the above assertion constituting "holding" or "obiter dictum" – insomuch as this task is unnecessary for the scope of this work--, I agree with the understanding of Vice Chancellor Strine, insofar as the assertion made in the decision handed down in the *Credit Lyonnais* case, in a footnote is that "At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise".

In addition to the duty of care, creditor interests are protected by the legal provisions that render null and void, in relation to the bankruptcy estate, a series of acts performed within the legal term of the bankruptcy, whether or not the contracting party is aware of the economic-financial crisis condition of the debtor, whether or not it is the intention of the later to defraud the creditors. These acts consist of the payment of debts not yet due; the payment of debts other than in the manner set forth in the contract; the establishment of guarantees in relation to previously incurred debts, the performance of acts on a gratuitous basis, up to two (2) years before the decree of bankruptcy; the sale or transfer of the establishment, done without the express consent or payment of all the creditors, existing at that time, if sufficient assets do not remain for the debtor to pay off its liabilities, except if, within the period of thirty (30) days, there is no opposition from the creditors.

Moreover, the acts performed with the intent to injure creditors in which fraudulent collusion between the debtor and third party contracting therewith and the actual loss suffered by the bankruptcy estate are evidenced may be revoked (avoidance). The revocation suit will run before the bankruptcy judge and shall be brought by the trustee, by any creditor or by the District Attorney's Office within the period of three (3) years from the decree of bankruptcy. The sentence that judges the revocation suit valid will determine the return of the assets to the bankruptcy estate in kind, with all the accessories, or the market value, plus losses and damages. The judge may, at the request of the plaintiff of the revocation suit, order, as a preventive measure, pursuant to the civil procedural law, the sequestration of the assets removed from the assets of the debtor that are in the possession of third parties.

In actual fact, the fiduciary duty of the officers and directors exists toward the company and this does not change on the dependence of the alteration of its financial condition. The interests of the company should not be confounded with the interests of the creditors or of other stakeholders. The fiduciary duty of the directors and officers does not change when the company finds itself in the nebulous vicinity of insolvency²¹. The creditors do not need the protection of a "fiduciary duty", because they have other legal remedies at their disposal.

²¹ Vice Chancellor Strine refers to the "metaphysical boundaries of the zone of insolvency" (according to the monocratic decision in *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. Nov. 17, 2004))

On the other hand, this “fiduciary duty” would present a series of problems, among which that of no less importance consisting of fixing the moment from which it would begin to exist. Moreover, it is difficult to explain in what way it differs from the currently existing protective rules and, thus establish who would have standing to bring the suit.

Although the affirmation that the interests of creditors grow in relevance to the extent that the company’s finances deteriorate is logical, and notwithstanding the fact that the fiduciary duty of the officers and directors exists toward the company, and not in favor of a singular group of stakeholders, it is lawful for the creditors to sustain, with basis on the duty of care, that the officers shall act in a manner that is compatible with the economic reality in that the interests of the creditors are thereby exposed to a greater risk, as from the moment in which the company starts to face financial problems.

One should not, moreover, overlook the fact that the law, when referring to the duty of loyalty of the officers and directors toward the company, shall be interpreted broadly, in order to include in this concept the interests of a more extensive spectrum of stakeholders, including not only the shareholders, but also the employees, suppliers, creditors, consumers, government and even the environment, for this entire “community of interests” is relevant for the existence and preservation of the enterprise and, therefore, of the company.

On the other hand, as previously mentioned, Brazilian law is express in the sense that the officer and director are not personally liable for the obligations that they incur on behalf of the company and by virtue of a regular management act²². Moreover, it is also clear when expressing that the officer and director are not liable for the unlawful acts of other officers and directors, except when conniving therewith, when neglecting to disclose such acts or if, being aware of such acts, they fail to take action to prevent the performance thereof. Dissident officers and directors who cause their dissent to be recorded in the minutes of the meeting of the management body or, when this is not possible, immediately apprise the management body, audit committee, if in operation, or general meeting of their dissent are exempt from liability²³.

²² Law 6.404/76, art. 158.

²³ Law 6.404, art. 158, paragraph 1.

When dealing with a liability suit against the officers and directors, for the losses caused to the assets of the company, the law grants standing to the latter, and authorizes the filing of a derivative lawsuit by any shareholder, in case the judicial remedy is not requested within the period of three (3) months from the resolution of the general meeting. It also permits it to be brought by shareholders representing at least five percent (5%) of the capital stock²⁴.

Though observing that the derivative lawsuit does not exclude the applicable suit for the shareholder or third party directly affected by the act of the officer and director, the law is express in the sense that the judge may recognize the exclusion of the liability of the officer and director, once convinced that the latter acted in good faith and with a view to the interests of the company²⁵.

Besides, the officers and directors who, in good faith, based themselves on the reports of professionals, such as lawyers, economists, accountants and other experts, will be considered, presumably, exempt from liability for the result of their actions. One can sustain, therefore, that officers and directors enjoy the benefit of the business judgment rule, the U.S. doctrine that sustains that the courts shall avoid second guessing on the application of business expertise to the considerations involved in the decision-making process of a company²⁶.

Given the foregoing considerations, my understanding is that, in Brazilian law, the interests of the various stakeholders of a company are sufficiently protected, verifying a reasonable balance in respect of the protection of the interests of the shareholders, creditors and officers and directors, wherefore there is no need for any alteration in the law in this aspect.

15. Obligation to request judicial protection within a certain period. Another attractive idea, in principle, is the one of establishing that, in case of insolvency or excessive

²⁴ Law 6.404, art. 159, paragraphs 1 to 5

²⁵ Law 6.404/76, art. 159, paragraphs 6 and 7.

²⁶ Note that the decision in *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. Nov. 17, 2004) affirmed the applicability of the business judgment rule as defense in suits brought by the creditors of an insolvent company, in the same way as this defense is admissible in suits brought by the shareholders. It is important to note, however, that the U.S. courts disagree with respect to the applicability of this rule to decisions taken by officers and directors of insolvent companies or that are in the zone of insolvency. While some courts applied the rule (See *Ángelo Gordon & Co., L.L.P. v. Allied Riser Comm. Corp.*, 805 A.2d 221, 229(Del. Ch. 2002), others affirmed its inapplicability (See *Unsecured General Creditors Committee v. General Homes Corp.*, 199 B.R. 148, 151-152 (S. D. Tex. 1996).

indebtedness, the company's administration shall request the appropriate injunctive relief within a certain period, and, in case of non-compliance, the officers and directors shall be considered liable before the creditors for the losses caused by the delay. Evidently, these situations should be examined on a case-by-case basis by the judge, and an officer or director may be relieved of liability if he demonstrates that the fault was not due to negligence on his part.

However, for reasons similar to those mentioned in the previous item, I understand that the cost/benefit relationship of the introduction of this discipline is negative. In effect, it is repeated, it is very difficult, in certain cases, to fix the moment from which the insolvency is verified. Moreover, this duty would represent an incentive for the officers and directors to stop seeking other possible solutions to avoid the situation of the company's financial difficulty.

16. Legal discipline of disregarding the corporate entity. Even before the possibility of disregarding the corporate entity being formalized by various laws (consumer, environmental, economic order), culminating with its introduction in the Civil Code of 2002, this institution was already being applied by some Brazilian courts, often with haste and unfamiliarity with the true reasons that authorize a judge to pierce or lift the corporate veil.

As is a well known fact, the purpose of the institution in question is to prevent partners and/or officers or directors of a company, who make abusive use of the corporate entity, by means of deviation of the ultimate objective or equity confusion, from enriching unjustly or injuring third parties that contract therewith.

In such situations of the abuse of corporate entity, characterized by equity confusion or deviation of the ultimate objective, it is just to pierce the corporate veil of the legal entity, in order to impose personal liability on the corporate officer or director or partner that has committed the said abusive act.

However, the use of the institution of disregarding the corporate entity has been considerably expanded in Brazil, especially by the Labor Courts and by many Public Treasury judges, inasmuch as they see in the legal provisions that regulate the direct liability of partners or

officers and directors -- joint or secondary -, notably those contained in the Consolidation of Labor Laws and National Tax Code, the grounds to declare the disregarding.

With certain frequency, people that were – or are – directors or officers of companies have had their assets blocked for payment of labor debts (most of the cases), and tax and social security debts. Important agents of the capital market have been affected, such as Pension Funds, Private Equity Funds and Venture Capital (important suppliers of capital to Brazilian companies), the Brazilian State Development Bank (BNDES) and any other entity that indicates directors or officers of companies in whose capital they maintain a relevant equity interest.

The inconvenience of imputing to any officer or director, shareholder or partner even those that do not make abusive use of the corporate entity, the liability for the debts of a company is incontestable, for this discourages business activity in general and the participation of investors in the capital stock of Brazilian companies. This liability should be regulated, in an exclusive and specific manner, by the corporation legislation applicable to the type of company chosen, impeding the employment of judicial discretion.

Given the relevance of the problem, the Brazilian legal channels have been working towards altering the existing situation. Accordingly, a group of specialists formulated a bill in this respect, admitting that, in the case of the abuse of corporate entity, characterized by deviation of the ultimate objective or equity confusion, the judge may, at the request of the party, or of the District Attorney's Office, declare that the effects of certain and determinate obligation relations are extended to the private property of the officers and directors or partners of the legal entity.

However, the extension of the effects of the obligations of the legal entity to the private property of the officer or director or partner that have not committed an abusive corporate entity act, through the deviation of the ultimate objective or equity confusion, to the detriment of the creditors of the legal entity or to their own benefit should be prohibited. Before disregarding the corporate entity, the judge should permit the exercise of adversary proceedings and the right to counsel, granting the party indicated as the perpetrator of the act

a period for the presentation of his defense and permitting the parties to produce the evidence that they deem necessary, it being certain that the judge may only declare disregarding the corporate veil in the cases expressly set forth in law, its application by analogy or by means of extensive interpretation being prohibited.

17. Insurance. As stated above, insurance is not used in practice as a tool to protect officers and directors in relation to actions for damages arising during the period in which they manage companies in a financial crisis situation. On this subject, I think that the law that disciplines company judicial reorganization and bankruptcy should stipulate that the officer designated to manage the reorganization of an insolvent company is obligated to take out professional liability insurance to cover possible damages caused by flaws in the fulfillment of his duties.

18. Criminal Liability. In the field of criminal liability, I think that, in addition to the crimes mentioned in item 11, the behavior consisting of the officer or director failing to notify the auditor in respect of an error detected in a financial statement should also be criminalized. In the case of a company's insolvency, I think that the conduct of the officer or director of selling his assets or transferring them overseas in order to make them inaccessible to the creditors should also be criminalized.

17. Enforcement. The new Brazilian law on insolvency²⁷ grants incontestable preference for the procedures aimed at the reorganization and recovery of an enterprise in crisis, in comparison to those that conduct the liquidation of the assets of the debtor, as occurs in the bankruptcy. Unfortunately, however, Brazilian law does not yet dispose of rules that regulate cross-border insolvencies, with respect, among other aspects, to international jurisdiction, to the applicable law and international cooperation between national and foreign authorities in transnational insolvency proceedings, including through the use of means that permit the rapid communication of official acts, etc.

Thus, in the case of the insolvency of a transnational group, in order for the procedures aimed at the reorganization to be effective, it is of vital importance that these aspects are regulated, for which the Model Law prepared by UNCITRAL (The Uncitral Model Law on Cross-Border

²⁷ Lei 11.101, of February 9, 2005

Insolvency Cases), and Council Regulation 1346/2000 of the European Union Council, of May 29, 2000, relating to the insolvency process, and that came into effect on may 31, 2002 should serve as a basis.

18. Conclusion. From all the foregoing considerations, one can conclude that, in the Brazilian insolvency law, there is a reasonable balance in respect of the protection of the various stakeholders, on the one side, and the officers and directors of the company, on the other, wherefore it is not necessary, upon the emergence of a situation of insolvency or vicinity of insolvency of a company, for the crew to abandon the ship, for fear of being held to answer by virtue of the consequences resulting from the difficult business decisions that must be taken in these circumstances. If they are in good faith, and if the acts performed were regular management acts, with a view to the interests of the company, and if they are assisted by the advice of professionals, there will be no danger of their personal liability.