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Brazilian Retail Chain Bankruptcy May Affect Ch. 15 Litigation

By **Bruno Meyerhof Salama** (March 2, 2023, 4:16 PM EST)

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U.S. courts have for a long time been viewed by plaintiffs lawyers as a highly desirable venue to sue non-U.S. companies.

Opportunities for such lawsuits arise when the foreign company is deemed to have sufficient minimum contacts with the U.S., such as when it issues securities in New York, sells harmful products to U.S. residents or infringes intellectual property of U.S. inventors.

Less talked about is the fact when foreign companies fail U.S. courts may also serve as a venue for bringing lawsuits against their shareholders, and sometimes even against their non-U.S. shareholders.

This is precisely what may happen with the trio of Brazilian billionaires — Jorge Paulo Lemann, Carlos Alberto Sicupira and Marcel Hermann Telles — partners at 3G Capital and longtime backers and shareholders of Americanas SA, formerly Lojas Americanas, one of Brazil's largest retailers that has just spectacularly failed.

After disclosing large unreported liabilities and starting reorganization proceedings in Brazil, Americanas filed for Chapter 15 bankruptcy in New York, a move that protects its U.S. assets from creditors, but may place those of its shareholders in peril.

Chapter 15 is the part of the U.S. Bankruptcy Code that deals with cross-border insolvency. It was added to the Bankruptcy Code in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act, and it is based on the Model Law on Cross-Border Insolvency developed by the United Nations Commission on International Trade Law.

Chapter 15 allows foreign representatives of a bankrupt or insolvent company to seek recognition of the foreign insolvency proceeding in a U.S. court to create a stay and prevent creditor actions on its U.S. assets.

Once recognized, the foreign representative can use the U.S. court to obtain assistance in administering the foreign proceeding, including the ability to gather assets, file claims, and take other actions to protect and maximize the value of the debtor's assets.

The flip side is that under Chapter 15, U.S. courts have latitude to tailor relief measures and accept claims designed to protect the bankruptcy estate. That opens the door for avoidance actions and other proceedings seeking to recover transfers made by the failed company prior to the bankruptcy filing and to claw back dividends paid to shareholders.

Clawing back dividends is never simple. The ability of creditors to claw back dividends paid by a foreign bankrupt company depends on a number of factors that range from the interpretation given by a particular U.S. court to the safe harbor provision of Section 546(e) of the Bankruptcy Code, to specific wording contained in the agreements between the bankrupt company and its creditors.

In addition, cross-border insolvency cases are inevitably complex, and the recognition and enforcement of judgments and orders issued in one country in another country can be subject to various legal and practical challenges.

However, the recurring topic in these lawsuits is that payments to shareholders were made in violation of the absolute priority rule whereby creditors have to be paid before funds can be distributed to shareholders.

The risk of shareholder liability is heightened in the presence of fraud, and the ongoing investigations might confirm that this is indeed the case at hand.

In January, Sergio Rial took office as CEO in Americanas but then promptly resigned after allegedly discovering unreported accounting **inconsistencies** initially estimated in the amount of approximately $3.9 billion.

Apparently, the accounting flaw was relatively simple and worked like this: Suppliers sold to Americanas for payment in up to 90 days, and then discounted their receivables with banks to anticipate payments.

Americanas then erased the debt to suppliers from its balance sheet but did not replace it with new debt to the banks. These balance sheets have been audited over the years by PricewaterhouseCoopers LLP and other Big Four accounting firms, and the scandal is now being called the Brazilian Enron.

The shareholders of Americanas have themselves experienced losses, as stock prices have tumbled. But the banks are yet to be paid, and they are exploring different possibilities to recoup their loans that now face the prospects of sizable haircuts.

This is in part because the courts in Rio de Janeiro, where Americanas is headquartered, have invalidated early maturity clauses that would have allowed creditors to jump ahead in the race to collect.

In its filings for corporate reorganization, Americanas informed that the accounting inconsistencies may affect its financial statements, including those of previous years.

That would lead to changes in the company's financials and thus could trigger a breach of the financial covenants that have been included in most of its credit transactions. As much as approximately $7.8 billion in corporate debt could be accelerated.

The partners at 3G Capital have legal and nonlegal reasons to be concerned.

They hold large stakes in high-profile companies like Anheuser-Busch InBev SA and The Kraft Heinz Co., but the latter has been recently involved in an accounting scandal and was charged by the U.S. Securities and Exchange Commission with engaging in a long-running expense management scheme that resulted in the restatement of several years of financial reporting.

Having to restate the financial reportings of Americanas could harm its image not only before the business community, but also with the relatively large number of angry Brazilians that would inevitably lose their jobs if Americanas were to eventually fail.

Beyond reputation, the 3G Capital partners have legal concerns.

While clawing back dividends from shareholders is theoretically possible under Brazil's Bankruptcy Law and Civil Code, bringing lawsuits in Brazil risks triggering lengthy court proceedings. Thus, the interest of creditors is resorting to U.S. courts where recoveries may be possible when dividends have been paid by a technically insolvent company.

Shareholders facing such claims can make use of different defenses like good faith, as well as other considerations under Brazilian law. Debates would probably also touch upon questions like the alter ego theory and piercing the corporate veil.

Lastly, there is the question of whether U.S. courts would establish personal jurisdiction over non-U.S. shareholders of a non-U.S. company like Americanas.

That would depend on an analysis of sufficient contacts with the U.S. and whether the 3G Capital partners could reasonably expect being subject to the jurisdiction of a U.S. court.

Having business or contacts with the U.S. that are relevant to the lawsuit or owning property, having an office or employees in the U.S., and sometimes even regularly conducting business with U.S. entities or individuals can be relevant factors.

The expression "Americanas" figures prominently in the name of this distressed Brazilian company, and now U.S. courts may turn out decisive to solve one of Brazil's most intriguing corporate law cases of recent years with potentially relevant impacts for the development of Chapter 15 litigation in the U.S.

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