AVOIDING THE GLOBAL TRAP: OVERCOMING NATIONAL BOUNDARIES IN ORDER TO ACCESS DEBTORS' FOREIGN ASSETS

1. ADDRESSING THE ISSUE

Due to the current expansion of markets made possible by globalization, transnational companies have been setting up their businesses around the world in a quest for better opportunities and less costs. In such scenario, Brazil and other countries from Latin America have been experiencing a flood of foreign players interested in consolidate their exchanges with our companies as well as taking part in the bidding processes being currently held, especially in light of the need to improve our national infrastructures.

Considering that surety bond is one of the main tools used to assure and help financing the critical projects and contracts in those countries, insurance companies are facing the challenge of analyzing foreign companies' financial muscle in order to ascertain their maximum capacity when acting as principals and guarantors for bonds to be issued. Although there are international financial standards meant to enable such task, one concern is always surrounding the professionals who perform the analysis: even if a foreign company has enough equity and revenue to support the risks undertaken, will the insurer be able to access such resources in case of default when most of them are located abroad?

2. REMARKS ON SURETY BUSINESS AND ITS DEFAULTS

2.1. Surety market frame

As it has been well stressed by literature surety bonds' structure consists of three distinct legal relations involving principal, insurer and obligee. Insurer's rights and obligations towards principal are usually laid out in an indemnity agreement whilst those between insurer and obligee are set forth in the policy.

The policy's main obligation is for the insurer to indemnify the obligee if the principal fails to uphold its contractual duties. On the other hand indemnity agreement states that once the insurer pays a claim it may then turn to principal for reimbursement of the amount paid as well as any legal fees incurred, as asserted by Gladimir Adriani Poletto "*the contract named General Contract Conditions is characterized by two different goals: the first one is to rule principal's and insurer's rights and obligations [...], and the second one is to provide guarantees in order to preserve the insurer in case of default*"[1]. In Brazilian market, however, the indemnity agreement goes even beyond the goal of reimbursement and also includes provisions concerning the premium owned by principal and the right to collect it.

For such reasons, when underwriting surety bonds the insurance companies must take into account not only the actuarial statistics from loss ratios but also the triad Capacity, Competence and Character as defended by João Gilberto Possiede, the first relates to principal's finan-

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[1] POLETTO, Gladimir Adriani. *O Seguro Garantia: em busca de sua natureza jurídica*. Cadernos de Seguro – Teses (Rio de Janeiro: FUNENSEG, 2003), 58.

cial and economic capacity of payment, the second one comprises its technical power and know-how to perform the contract, and the last one concerns principal's reliability [2].

In order to fulfill these requirements and help armor insurers against default risks, most companies in Latin America demand additional guarantees when issuing surety bonds. Brazilian insurers often ask principals to provide guarantors to the indemnity agreements and companies from other countries of the region are fond of using promissory notes for that matter. Such personal security measures are demanded from shareholders, members of economic groups or consortiums, parent companies or even a third party endued of better financial status. Carlos Hoyos Elizalde states, "*a very common situation for demanding additional guarantees is when small and moderate companies have another company as their only or main shareholder, the latter being the owner of an important size and solvency. When the principal doesn't meet all solvency requirements, it is usual to demand additional guarantees from the parent company*" [3].

Our purpose of study is to analyze the enforcement of such personal security measures in case a default arises and the main guarantor of the obligations is foreign company, which has been a common situation since transnational corporations started to set up their branches and operate in the region.

2.2. Premium Default

The first obligation undertaken by the principal in surety relations is to pay the respective premium for the bond issued. Unlike the usual consequence of the default in other insurance classes, lack of fulfilling the premium payment duty doesn't release the insurer from its own obligations towards the obligee.

Thus, even though the insurance company may not be earning any profit out of the bond issuance its risk capacity and exposure will remain compromised until the termination of the policy. For that reason it is critical to quickly restore the financial forecasts for that bond by collecting the premium from the guarantors.

In Brazil, as mentioned before, the tool used to retrieve premium from principal or its guarantors is the indemnity agreement. As a rule, this contract does not possess the power to be directly enforced in court due to its lack of determined term and amount owned. Notwithstanding, there is an exception when it comes to charging the premium, by force of the article 27 from Decree-Law 73/1966 it is possible to claim the debt through execution procedure.

Unfortunately, when dealing with foreign principals and guarantors such procedure becomes of little use since most of their assets are located outside the country's jurisdiction. Therefore, the insurer shall again plead for a declaratory judgement and then proceed to recognition and

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[2] POSSIEDE, João Gilberto. *Seguro Garantia: Os três C.* In: *Cadernos de Seguro Coletânea* (Rio de Janeiro: FUNENSEG, 2001), 2: 32-33.

[3] ELIZALDE, Carlos Hoyos. *El Seguro de Caución* (Madrid: Fundación Mapfre, 2012), 169.

enforcement of the sentence in the main debtor's jurisdiction in order to turn it into a useful writ of execution.

2.3. Performance Default

Theoretically, surety bonds are not supposed to cause any loss for the insurer since its underwriting process is not based on casualty but on principal's financial and technical capacity of fulfilling the contract. Hence, by their own nature, surety bonds are secondary to the principal. "*It is this assumption that drastically separates suretyship from insurance. Where the nature of the surety relationship is based on a no loss frame of mind, insurance expects losses and therefore distributes losses over a group or classification of risks*" [4].

Nevertheless, performance default by the principal occurs and ignites the procedure for termination of the contract between obligee and principal, resulting in the claim notice that shortly follows. Yet, another surety bond's intrinsic characteristic is the it has no actuarial based expected loss, i.e., once an indemnity is paid insurers call upon indemnity agreements in order to achieve the reimbursement from the principal or its guarantors as well as execute any additional collaterals given by them.

For that kind of default, being able to enforce the indemnity agreement is a critical issue since the premium is not set on the basis of anticipated losses, thus the company depend on the reimbursement to cover for what it pays to the obligee. Furthermore, surety bond claims have substantial severity when compared to general insurance classes.

Unlike the premium default, Brazilian law does not grant the insurer the possibility to directly enforce for the indemnity agreement in court when it is used to postulate refund for the actual indemnity paid. Therefore, it is necessary to file a preliminary declaratory judgement lawsuit through which one obtains an enforceable writ of execution.

Over again, though, when it comes to debtors whose main resources are found abroad, executive measures shall to achieve reimbursement must take place in the debtor's jurisdiction, which makes it necessary for the insurer to file two different lawsuits in distinct forums.

Regardless of the default's class, we must also take into account that in order for the lawsuits to be valid, foreign debtors must take part into it and be granted the due process of law as well as the opportunity to fairly present their cases. Such requirements often imply a substantial extension to the lawsuit time as well as the costs involved in finding and communicating them about the matter abroad.

3. PRIVATE INTERNATIONAL LAW SCENARIO

Establishing which jurisdiction is the competent one for each lawsuit is possible by applying a few legal concepts meant solve issues in the conflict of laws field.

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[4] LANGLEY, Keith A. and HOUSTON, Marchelle M. *Liability of the performance bond surety for damages*. In: The law of performance bonds, 2nd ed. (Chicago: American Bar Association, 2009), 433.

3.1. Lex loci vs. Lex rei sitae

The main applicable private international legal concepts which are able to solve the jurisdiction matters comprising defaults arisen from surety bonds are *lex loci contractus, lex loci delicti commissi* and *lex rei sitae.*

The first one attributes the solution to the law of the place where the contract is made or the act took place, unless it states otherwise. Often surety policies and indemnity agreements are concluded in the insurer's domicile, for that reason most declaratory judgement lawsuits are filed in the insurer's country. "*The key contracting act in determining which state's law applies is the last act in the formation of the insurance policy. insurance companies have argued that the last act is the countersigning by the insurance company at the insurance companies' home office*"[5]. Furthermore, due to national protectionism of insurance and financial markets, domestic risks must be undertaken only by insurance companies authorized to operate in the domestic market, which forces all insurance companies to have at least a branch inside the country's boundaries. As for the claim (*delicti commissi*), since the risk undertaken is a domestic one, the place where the principal's obligations shall be fulfilled and by extension where the default act shall take place will also be inside national borders.

On the other hand enforcement measures abide to a different principle which is the law where the property is situated. Once the jurisdiction for declaratory judgement is set and the insurer achieves a favorable decision on merits it is then mandatory to take such decision to the principal's or guarantor's jurisdiction where the respective law shall apply concerning the enforcement measures to be taken.

Generally, under regular circumstances and as long as the first jurisdiction's decision does not offend the other countries law, the second court is supposed to recognize the judgment regardless of the merit of the case and the proceed to the executory measures according to national rules. Nevertheless, it is important to be pragmatic in such cases for as it will be seen hereunder some bilateral agreements and domestic laws carry exceptions to whether the judge is allowed to revise the former decision.

3.2. Forum selection clause

Another solution to the conflict of laws which have been replacing the classical ones is the prior settlement of a forum clause in surety related contracts. That solution privileges the principle of the parties free will to establish the most convenient forum for their resolution of conflicts. Indeed, most policies and indemnity agreements signed by the insurers possess forum selection clauses in order to void further discussion on the matter.

Although such measure is in fact very advisable, it is important to keep in mind that this clause will only apply to the matters where the national sovereignty does not claim for exclusive jurisdiction, in other words, seldom will it be respected when trying to restrain property rights based on a decision that was issued by a court other than the one where the assets are located.

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[5]ANDERSON, Eugene R.; STANZLER, Jordan S. and MASTERS, Lorelie S. *Insurance coverage litigation*. 2nd ed. (New York: Aspen Publishers, 2005), chapter 6, 35.

3.3. Relevant Regulation
Where the recognition and enforcement of foreign decisions is concerned the main principles adopted may be found in the Hague Conference on Private International Law (HCCH). The Convention of 1 February 1971 on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters and its Supplementary Protocol set forth the basis on which domestic laws were inspired but not necessarily abide to.

According to the convention, a decision shall be entitled for recognition and enforcement as long as it: (a) was given by a court considered to have jurisdiction within the meaning of this Convention; (b) is no longer subject to ordinary forms of review in the State of origin; and (c) is enforceable in the State of origin.[6]

Notwithstanding the convention also contains the exceptions to the recognition and enforcement of a decision by a member state: (a) if recognition or enforcement of the decision is manifestly incompatible with the public policy of the State addressed or if the decision resulted from proceedings incompatible with the requirements of due process of law or if, in the circumstances, either party had no adequate opportunity fairly to present his case; (b) if the decision was obtained by fraud in the procedural sense; and (c) if proceedings between the same parties, based on the same facts and having the same purpose are pending before a court of the State addressed and those proceedings were the first to be instituted, or have resulted in a decision by a court of the State addressed, or even have resulted in a decision by a court of another State which would be entitled to recognition and enforcement under the law of the State addressed[7].

Unfortunately, even though HCCH has a large number of members and aims to standardize private international law practices among them, the Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters did not achieved the success of the other conventions issued by the Conference, for that reason it wasn't signed by the majority of the Conference members, which limits its power of enforcement.

At the regional level, Mercosur members have signed Las Leñas Protocol which also comprises provisions on recognition and enforcement of judgements granting decision an extraterritorial effect as long as (a) they take the formalities deemed necessary in order for them to be authentic in the original State; (b) they are translated to the language of the requested State, (c) that said judgments and arbitral awards emanate from a competent judicial or arbitral authority in accordance with the law on international jurisdiction in the requested State; (d) the party against which the decision is destined had been validly summoned and granted its opportunity fairly defend itself; (e) the decision is enforceable in the State of origin; and (f)

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[6] Chapter II - Conditions of recognition and enforcement. Article 4.

[7] Chapter II - Conditions of recognition and enforcement. Article 5.

the judgments and arbitral awards do not manifestly conflict with the principles of public order of the State where recognition and / or execution is sought[8].

Domestically, Brazil issued the Decree-Law 4.657/1942 (LINDB - Introduction Law for the Rules Under Brazilian Law System) containing the same principles discussed above, especially the jurisdiction based on lex loci standards (Article 12) and the requirements for the enforcement of foreign decision, which follow the basic requirements mentioned hereto except for the need to primarily recognize the decision in Brazilian Superior Appeal Court - STJ (Article 15, changed by Article 105 of Brazilian Constitution).

4. ASSETS' ACCESS MEASURES

Finally resuming the scope of this text, pior to issuing bonds and start lawsuits meant for recovering from principal's default, insurance companies might follow some precautional steps in order manage and mitigate the main risks arising from dealing with foreign debtors, which are: rising costs, substantial delay, and the complete lack of access to the foreign debtor's assets.

4.1. Checking for Agreements on Cooperation in Civil Matters

It is very common for governments to establish commitments regarding civil and comercial cooperation in a bilateral or multilateral range. Other than the regional covenants such as the ones in Mercosur, OAS or EU, countries may institute preferential conditions for recognition and enforcement of judicial decisions on a reciprocal basis.

Brazil is notably fruitful in signing bilateral civil cooperation agreements in order to avoid the lack of legal certainty arising from the need to execute a judge decision in foreign jurisdiction. The Ministry of Justice has even yielded a Manual for Civil Cooperation in order to gather all information on the cooperation among 41 countries that maintain specific treaties with our country as well as to provide a status on how deep are the basis and tools available for cooperation[9].

The main scope when analyzing such covenants is to identify whether the other country will be able to questioned the original decision when performing their recognition and enforcement procedures. When the answer is affirmative, it might be more profitable to start the lawsuit against the debtor directly in its jurisdiction State than being subject to a complete review on the merits of the decision. Checking those international treaties is also critical for assuring that any eventual requirement for a further enforcement will be fulfilled at the original lawsuit avoiding the need for an ulterior remediation, thus, saving time and potential costs resulting from unnecessary or useless steps.

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[8] Article 20 from Las Leñas Protocol.

[9] The 2012 version of the manual is 486 pages long and can be accessed on http://portal.mj.gov.br/cooperacao/data/Pages/MJDFBD6D24PTBRNN.htm by clicking on the 'CJI em Matéria Civil' link.

4.2. Judicial Power of Attorney
Another preventive measure that can be very useful to save time during the lawsuit meant to obtain a declaratory judgement is to require the principal and the guarantors for a Judicial Power of Attorney granting representation powers to someone residing inside the insurer's jurisdiction.

Usually, foreign companies will indicate a local representative employee or attorney who is responsible for managing their branch abroad but was not automatically able to represent the parent company which is the main financial guarantor of the bond.

Experience has shown that the designation may be even granted by inserting a power of attorney clause in the indemnity agreements or collateral's contracts already required from principals and guarantors.

By primarily defining the person able to represent the foreign company and obtaining his/her personal data insurers will save the time and costs involved in issuing and waiting for a letter rogatory to be answered and returned. It's important to mention that such letters play a critical part for the validity and further enforcement of any foreign decision since most countries adopt the compliance with the due process of law, right to adversary system and full defense principles as a requirement for recognizing foreign judgements.

The Judicial Powers of Attorney will make it possible to comply with such principles by only summoning the representative appointed by the guarantor or principal to defend the company without having to wait for further manifestation form the foreign entity.

4.3. Arbitration Clause
Insurers may also establish mandatory arbitration clauses in order to settle the matters arising from surety bonds default and enforcing the resultant arbitral award. Currently, most countries are familiar with had issued procedures to enforce arbitral decisions. Similarly to the power of attorney, the arbitration clause can be easily inserted in the indemnity agreements required from the principal and the collateral contracts.

The downside of such choice is that arbitration tends to be substantially more expensive to the parties than judicial resolution of conflicts. Furthermore, arbitration clauses are comprises lots of obligations and provisions which may represent a burden when the principal or guarantor derides to discuss the provisions to achieve a final agreement on them.

Nevertheless, it is still a good solution to avoid legal systems that allow the judges to question the former decision presented for recognition.

4.4. International Standard Guarantees
The last resource to an insurance company when there's no option but to start all lawsuit discussions directly in the debtor's jurisdiction is to save the operation by using international standard contracts the may ease the foreign judges appreciation of the matter.

Sometimes indemnity agreements lack enforcement power in other jurisdictions or even contain provision that are not subject to the autonomy of the contractual parties. In that scenario the formalization of a comfort letter would be a better accepted way to maintain the personal guarantee represented by the indemnity agreement.

Finally, when the legal structure of a foreign country does not allow the insurer to access the assets of the debtors, a robust collateral such as the standby letter of credit may mitigate the risks involved by providing direct access to principal's or guarantor's monetary resources.

5. FINAL REMARKS

After analyzing the panorama discussed above it is possible to imply that the current globalization level of operations has been forcing insurance companies the find new ways of preserving themselves from default without missing the opportunities brought by foreign players into the market.

In that context Private International Law tools available get a critical importance when underwriting risks for foreign principals and guarantors. Insurance companies should check foreign legal systems in order to determine whether they will be granted access to the debtor's assets and thus plan the best strategy for mitigating the risks. The main tools to strengthen the insurer position are power of attorney clauses, arbitration clauses and asking for stronger collaterals prior to issuing their bonds.

Although there are plenty of tools available for mitigating default risks it is critical to establish the right combination of them in a case-by-case approach. Such preventive behavior shall be able to increase insurance market opening to foreign players without losing track of the critical safety that must surround the such operations.