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Overview of the Latest Amendments to the Brazilian Judicial Reorganisation and Bankruptcy Law

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Acknowledgment

Many countries throughout Latin America continue to pursue the modernisation of their insolvency and restructuring regimes. This is an important process, as modern insolvency and restructuring laws encourage a greater entrepreneurial culture, enhance efficiency and the productive use of resources, and assist businesses navigate debt distress with a view to restructuring and reorganisation. Ultimately, these outcomes contribute to economic growth and attract foreign investment – which are especially significant as we navigate the current global economic downturn.

In that context, INSOL International is pleased to present this new technical paper, "Overview of the Latest Amendments to the Brazilian Judicial Reorganisation and Bankruptcy Law", authored by Marcelo Lamego Carpenter and Luis Tomás Alves de Andrade of Sergio Bermudes Advogados, Brazil.

The paper sets out some of the more important amendments made to that Law under reforms that came into effect in January 2021, including more flexible reorganisation processes, a DIP financing regime and the use of mediation in reorganisation – each of which have the potential to increase the likelihood of a successful restructuring outcome. The paper also provides commentary on Brazil's implementation of the Model Law on Cross-Border Insolvency under the amendments, as well as the option for procedural and substantive consolidation, and new provisions on labour credits and prior verification of a debtor's financial condition.

These new laws will be tested with the increase in insolvency filings expected over the next few years, and this will be a chance to develop new case law that will advance Brazil's insolvency ecosystem and may also serve as a useful law reform model for other Latin America nations.

INSOL International thanks the authors for their time and expertise in writing this paper, and we hope that our members enjoy reading it.

March 2023

Overview of the Latest Amendments to the Brazilian Judicial Reorganisation and Bankruptcy Law*

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1. Introduction

On 23 January 2021, exactly 30 days after being sanctioned by the President, Law No. 14.112 (Amendment) came into force in Brazil, thus amending the Brazilian Judicial Reorganisation and Bankruptcy Law (Law No. 11.101/05 – BRBL) and other legislation applicable to debtors in distress.

Law 14.112 implements several major changes to the Brazilian insolvency framework, including important procedural and substantive innovations, bringing it into line with international best practice. Among the most relevant updates are:

(i) the adoption of the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) (article 167-A);

(ii) new rules regarding debtor-in-possession (DIP) financing (articles 69-A to 69-F);

(iii) the possibility of creditors filing judicial reorganisation plans (article 56);

(iv) the introduction of dispute resolution methods, including mediation before or during the judicial proceedings (article 20-A and article 22, II, e and g);

(v) greater emphasis on extrajudicial reorganisation proceedings, with changes to procedure and quorum (article 161);

(vi) the possibility of extending the stay period;

(vii) changes to the classification of bankruptcy credits (article 83) and changes to the list of post-filing credits in bankruptcy proceedings (article 84);

(viii) the establishment of rules for procedural and substantive consolidation in matters involving economic groups (article 69-G); and

(xii) the possibility of negotiating with tax authorities alternative payment methods for federal tax (article 10-A, V, Law 10.522) and the possibility of tax authorities filing for bankruptcy of companies that are undergoing judicial reorganisation (article 73, V and VI).

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* The views expressed in this technical paper are the views of the authors and not of INSOL International.

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Like a scientist looking through a microscope, the interpreter of statutory provisions often needs to wait a while before perceiving any movement. The Amendment to the BRBL is still yet to be properly tested before the judiciary to permit definitive conclusions as to its practical effects to be drawn.

Based on our experience in acting in multiple insolvency proceedings in Brazil involving foreign creditors and investors and decisions rendered by foreign judges, we set out in this paper our considerations as to some of the updates to the BRBL that may have a direct impact on the participation of international players in Brazilian insolvency proceedings, including foreign creditors, debtors, investors, third parties and even judges.

2. Cross-border insolvency

From an international insolvency standpoint, the most relevant change implemented by the Amendment is the adoption in Brazil of the Model Law.

The Amendment to the BRBL includes an entire section to regulate cross-border insolvency proceedings, meaning proceedings that are being heard in two or more jurisdictions. Prior to this addition, there were no Brazilian rules on transnational insolvency proceedings, and the section has been welcomed by practitioners as a major improvement to Brazilian legislation.

Clearly inspired by the Model Law, the new section provides for cooperation between judges presiding over proceedings in Brazil and the competent authorities of other countries involved in transnational insolvency situations. The concepts of "foreign main proceedings", "foreign non-main proceedings" and a debtor's "centre of main interests" (article 176-B) reflect the concepts of "main proceedings", "ancillary proceedings" and the "COMI principle" established in Chapter 15 in the United States.

In addition, article 167-D provides that competence to recognise the existence of foreign main or non-main proceedings and to cooperate with the foreign authority lies with the court of the location of the debtor's main establishment in Brazil.

We will not address here all the steps necessary for recognition in Brazil of the existence of foreign insolvency proceedings as "main proceedings" or "non-main (ancillary) proceedings". We merely note, for the purpose of our analysis, that "main proceedings" means any foreign insolvency proceedings (reorganisation or bankruptcy), whether judicial or administrative, that have been initiated in the debtor's "centre of main interests".[3]

"Ancillary proceedings", on the other hand, refers to such proceedings that have been commenced in a place that is not considered the debtor's "centre of main interests".[4] It is important to note some of the main rules on transnational insolvency proceedings that have been included in the Brazilian judicial system by the Amendment. The first is the principle enshrined in article 167-G, according to which "foreign creditors have the same rights attributed to domestic creditors in judicial and extrajudicial reorganisation and bankruptcy proceedings." This principle was already widely accepted by courts and

[3] BRBL, art 167-B, II.
[4] *Idem*, art 167-B, III.

commentators as an implicit rule, but an express statutory provision gives more legal certainty to foreign players in transnational insolvency proceedings involving Brazilian jurisdiction.

A second important innovation is the possibility of interaction and direct communication between Brazilian and foreign judges, as provided for in article 167-P, without the need for time-consuming rogatory letters (i.e. letters of request). Anyone that has participated in transnational insolvency proceedings will appreciate the importance of expedited and direct communication between the different actors involved, especially judges who need to be fully informed on a timely basis as to all the nuances of the case, in order to better decide the matters under their scrutiny.

Finally, the Amendment enables a Brazilian judge, following recognition of the existence of transnational insolvency proceedings, to direct a wide variety of cautionary and protective measures so as to safeguard creditors' or debtors' rights as well as the assets of the insolvent company, without the need for service of foreign rogatory letters. Prior to the publication of the Amendment, Brazilian judges were allowed, in general, to implement decisions rendered by foreign judges provided the respective request was made in a rogatory letter. The Amendment authorises parties directly involved in the foreign proceedings (such as creditors, debtors and judicial administrators) to themselves apply to Brazilian and foreign judges for measures necessary to protect their interests, thus expediting the granting of the necessary relief.

These provisions will undoubtedly bring greater effectiveness and legal certainty to transnational insolvency proceedings in Brazil. The changes come at a time of significant increase in the number of cross-border insolvency situations, such as the recent judicial reorganisations of the Americanas Group and the Oi Group, both of which involved the filing of proceedings both in Brazil and abroad.

3. DIP financing

Section IV-A of the Amendment to the BRBL established new rules for the execution of DIP financing agreements with the debtor during judicial reorganisation, with the approval of the judge. Prior to the Amendment, judicial approval for DIP financing agreements was not mandatory. In practice, the financing party almost always demanded some sort of court approval so as to obtain more legal certainty in the transaction. However, the lack of express legal requirement for court approval occasionally gave rise to unexpected situations, such as debtors requesting court approval for DIP financing and judges deciding that they lacked jurisdiction to make a determination. The inclusion of article 69-A came in good time to remedy that particular situation in insolvency proceedings in Brazil.

However, the most significant change in relation to DIP financing loans is the alteration of the order of payment in the event of bankruptcy of the debtor. In some countries, DIP financing loans are considered senior to all other debt, equity or security issued by a debtor that is under judicial reorganisation and they are given priority for payment, ahead of all the company's existing debts.[5] In Brazil, however, prior to the Amendment, the advantages and benefits to investors seeking through DIP financing loans to inject

[5] L Liu, *Subnational Insolvency: Cross-Country Experiences and Lessons* (2008) World Bank, 20.

resources into to a debtor undergoing judicial reorganisation were not sufficiently apparent and did not guarantee any significant priority in relation to other post-filing debts.

Now, in accordance with article 84 of the BRBL, in the event of the debtor's bankruptcy, the DIP financing creditor must be paid promptly, immediately after the payment of some administrative expenses for the safeguarding of assets and payment of certain labor credits. The new rule is a significant improvement on the previous model, in which the DIP financing creditor ranked *pari passu* with a number of other creditors, many of which were unknown to third parties that did not have access to detailed information on the company.

Another important innovation introduced by the Amendment is that DIP financing may now be provided by any third parties, including shareholders and parent companies.[6] Prior to the Amendment, there was considerable discussion and debate as to whether shareholders should be allowed to benefit from the priorities granted by the law to DIP financing, *vis à vis* other creditors, especially in light of the fact that in some cases the shareholders may have contributed to the company's circumstances of distress.

The Amendment, in our view, adopted the most logical and effective approach, permitting any person, including shareholders, to benefit from the privileges conferred on DIP financing, thus raising the supply of credit to the company undergoing reorganisation.

Other provisions of the Amendment create additional and effective incentives to DIP financing, including:

(i) after DIP financing has been authorised by the reorganisation court, the post-filing nature of the debt (i.e. that it does not form part of the *concourse* of creditors) may not be modified by appellate / higher courts, nor can the guarantees furnished by the debtor in favour of an investor acting in good faith be modified;[7]

(ii) in the event of the judicial reorganisation being converted into bankruptcy prior to the full release of the DIP financing amounts, the agreement will be considered automatically terminated;[8] and

(iii) the guarantees and the preferences will be maintained up to the limit of the amounts actually released to the debtor before the date of the ruling that converted the judicial reorganisation into bankruptcy.[9]

4. Organisation of the general creditors' meeting

General creditors' meetings in Brazil are not for the faint-hearted, especially in cross-border insolvency proceedings, as we describe below.

In the Brazilian system, a judicial reorganisation plan can be amended during the general creditors' meeting even a few hours prior to voting. In fact, it is extremely common for a

[6] BRBL, art 69-E.
[7] *Idem*, arts 66-A and 69B.
[8] *Idem*, art 69-D.
[9] *Ibid*.

reorganisation plan to be greatly modified during the general creditors' meeting. We might hazard a guess that most transnational judicial reorganisation cases in Brazil have involved judicial reorganisation plans that were amended or modified significantly during the general creditors' meeting.

Imagine then the situation of creditors in different jurisdictions, subject to different time zones, having to review remotely the amendment proposals tabled during the general creditors' meeting convened to decide on the approval or rejection of the judicial reorganisation plan, without being able to produce certified translations or complementary documents to assist with the decision-making. An additional difficulty is that most of those creditors will be credit institutions or multinationals with complex decision-making structures requiring multiple approvals from their internal boards, committees and other corporate governance structures.

That, in a nutshell, is the turbulent and highly-charged atmosphere in which many judicial reorganisation plans have been voted on in Brazil during the last few years. Even though the results have been, in the main, highly satisfactory, the risks and the uncertainty involved are undeniable.

The Amendment, in our opinion, has made a major contribution to reducing the uncertainties inherent in the voting process. Article 39, §4o, included by the Amendment, now allows voting through the filing of "adhesion forms" signed by creditors, or by an electronic voting system or indeed any other form of voting considered safe by the judge, under the supervision of the judicial administrator.

The inclusion of this rule will provide more legal certainty in relation to the voting process, reducing the risks of last-minute changes to a reorganisation plan.

5. Alternative reorganisation plan proposed by creditors

The Amendment also implements in Brazil the possibility for creditors to propose an alternative reorganisation plan during the proceedings. This mechanism is already available in other jurisdictions, including the United States. According to the new rules, creditors will be entitled to propose a plan of their own if the debtor fails to obtain creditor approval for its reorganisation plan within the 180-day stay period.[10]

This stay period may be extended if delay in presenting the plan and obtaining approval was not caused by the debtor.[11] In other words, if the debtor's plan is not voted on or if it is rejected by the creditors, then the creditors will have an opportunity to propose their own reorganisation plan, provided that some relevant requirements are met.

In the case of a formal rejection of the debtor's reorganisation plan, the judicial administrator shall ask the creditors, at the end of the voting process, whether they intend to present an alternative plan. If that possibility is approved by the majority of the creditors present at the meeting, the creditors will be granted 30 days to present their alternative plan. It is important to note that this possibility will not be granted to creditors in the event of a cram down.[12]

[10] *Idem*, art 6, §4-A.
[11] *Idem*, art 6, §4.
[12] *Idem*, art. 58, §1º.

The alternative plan to be proposed by creditors will require written support from creditors who represent more than 25% of the total credits that are subject to judicial reorganisation or more than 35% of the creditors present at the general creditors' meeting.[13] Creditors are barred from including in the alternative plan new obligations on the debtor's partners or shareholders other than duties required by law or those that were previously agreed upon[14] and from imposing on the debtor or its partners / shareholders a greater sacrifice than what would result from a liquidation scenario.[15]

The possibility of presenting an alternative plan by creditors is an important modification to the BRBL and one that provides greater equilibrium between the powers of creditors and debtors throughout the judicial reorganisation proceedings.

There are still many questions to be answered in relation to the consequences of the modification. For example, will the creditors be able to vote on the plan that they present? And how will creditors have access to the information necessary for the drafting of their plan?

In any case, the modification of the BRBL seems, in our view, to be a positive one, as it encourages greater active participation by creditors during judicial reorganisation proceedings.

6. Procedural and substantive consolidation

Before the enactment of the Amendment, the BRBL did not contain any provision dealing with procedural and substantive consolidation of companies from the same economic group in the context of judicial reorganisation. The absence of legislative provisions in this regard led to frequent and heated arguments before the Brazilian courts, with debtors usually asserting a right to procedural and substantive consolidation and creditors arguing that only procedural consolidation would be admissible, given the need to preserve existing rights and guarantees. The Amendment finally established criteria for determining when procedural and substantive consolidations are admissible and what rules apply in such cases.

With respect to procedural consolidation, article 69-G now provides that debtors who are part of an economic group that is under the same corporate control are entitled to file for judicial reorganisation, albeit through a single proceeding and provided that each debtor individually submits the documents required by article 51.

According to article 69-I, procedural consolidation means the coordination of procedural acts and maintaining the independence of debtors, their assets and liabilities. When there is merely procedural consolidation, debtors are required to propose independent and specific means of reorganisation. However, they may present these in a joint single recovery plan,[16] which the creditors of each debtor will deliberate at separate general creditors' meetings, with individualised quorums.[17]

[13] *Idem*, art 56, §6, III, a & b.
[14] *Idem*, art 56, IV.
[15] *Idem*, art 56, VI.
[16] *Idem*, art 69-I, §1.
[17] *Idem*, art 69-I, §2 and §3.

Article 69-J provides that substantive consolidation can only be admitted by courts in exceptional circumstances. Regardless of any deliberation in general creditors' meetings, the judge may, exceptionally, authorise the substantive consolidation of the assets and liabilities of debtors who are part of the same economic group and that have filed for procedural consolidation. However, this can only occur if the court finds that the assets and liabilities of the debtors are interconnected (merged), so that it is not possible to identify the individual owners of the assets without excessive expenditure of time or resources. At least two of the following situations also need to be present: the existence of cross-guarantees; a relation of control or dependence between the companies; a corporate structure that is totally or partially identical; and /or joint activities in the market.

In line with the new provisions of the Amendment, following substantive consolidation, the debtors' assets and liabilities will be treated as though they belonged to a single debtor.[18] Substantive consolidation will also lead to the immediate extinction of personal guarantees and credits held by one debtor against another.[19] Real estate guarantees / liens that were granted in favour or of creditors will, however, remain unaffected.[20]

7. Mediation in reorganisation proceedings

Inspired by other laws that preceded it, such as the Civil Procedure Code and the Brazilian Mediation Law (Law 13.140), both enacted in 2015, the Amendment contains an entire section regulating mediation between creditors and debtors. The Amendment includes mechanisms to enable negotiation between the parties in a safe and propitious environment.

Direct negotiation between creditors and debtors prior to a filing for judicial reorganisation is very challenging. One of the most common difficulties is that whenever the debtor expresses an intention to enter into collective negotiations with creditors, that leads to creditors rushing to take all the judicial and extrajudicial measures available to protect their credits. A domino effect is created – the first creditor to "pull the trigger" generates a chain reaction among others, making it almost inevitable that the debtor will have to file for judicial reorganisation.

The judicial reorganisation process can be costly and lengthy, thus making negotiations even more challenging. The Amendment has now introduced important mechanisms that may help the parties to reach an amicable and negotiated resolution, thus avoiding the difficulties of administrative or judicial proceedings.

Article 20-B, §1 allows the debtor to present a mediation request in advance of a potential judicial reorganisation proceeding. The parties will have 60 days to conclude mediation and, during that period, the debtor will have the same protections it has in the stay period, even though it is not yet subject to judicial reorganisation. If the parties do not reach an agreement, the debtor will then proceed with the request for judicial reorganisation and the timeframe for mediation will be discounted from the formal stay period.

[18] *Idem*, art 69-K.
[19] *Idem*, art 69-K, §1.
[20] *Idem*, art 69-K, §2.

This innovation is very positive, as it allows creditors and debtors to negotiate in a protected environment with a view to avoiding the costs inherent to judicial reorganisation proceedings.

8. Labour credits

Prior to the Amendment, the BRBL already contained important provisions for the protection of labour credits in the context of judicial reorganisation – including the stipulation that labour credits are to be paid within one year[21] and the legal authorisation for labour lawsuits to be processed before labour courts until the respective credits are established in a final and binding employment law ruling. Following a final ruling, the credits must be included in reorganisation proceedings, on the list of creditors.[22]

In relation to the one year term for payment of labour credits, the Amendment introduced a new exception. According to §2 of article 54, the one year term may now be extended up to two years, if the reorganisation plan meets the following requirements, cumulatively:

(i) presentation of guarantees deemed sufficient by the court;

(ii) approval of the extended term by a majority of labour creditors; and

(iii) the plan makes provision for payment of the full amounts of labour credits.

Another important aspect of the Amendment is that certain labour credits that were previously not subject to non-judicial reorganisation proceedings may now be restructured in those proceedings, provided that their inclusion is duly negotiated with the respective labor unions.[23]

Finally, in the context of bankruptcy proceedings, the Amendment maintained the priority of labour credits over secured credits provided they do not exceed 150 times the minimum wage per worker.[24] However, the provision establishing that labour credits that have been assigned to third parties will be considered unsecured credits has been entirely revoked.[25] Instead, §5 of article 83 now provides that credits assigned to third parties under any title will retain their nature and classification in bankruptcy proceedings.

9. Prior verification

Another important provision inserted into the BRBL is article 51-A §5, which authorises the court, whenever it considers it necessary, to conduct a preliminary phase, named "prior verification" (*constatação previa*). This phase consists of verification of the actual, current operational conditions of the debtor and the adequacy of the documentation presented to support the request for judicial reorganisation.

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[21] *Idem*, art 54.
[22] *Idem*, art 6, §2.
[23] *Idem*, art 161, §1.
[24] *Idem*, art 83, I.
[25] *Idem*, art 83, §4.

Prior to the Amendment, the BRBL already set out in article 51 a list of documents required in support of the request for judicial reorganisation. The list included the balance sheets and cash flow reports of the debtor. Considering the technical complexity of analysis of accounting evidence, some insolvency judges in Brazil[26] faced difficulties in differentiating situations of genuine distress from fraudulent ones. In that context, some courts directed the adoption of a preliminary expert examination phase to assess the economic viability of the debtor.

The prior verification phase introduced by the Amendment reflects the practical experience that Brazilian courts – due to difficulties in assessing the economic viability of the debtor – have opted in some cases to make use of an expert examination phase that precedes the processing of the judicial reorganisation.

10. Conclusion

The abovementioned innovations are some of the most important developments introduced by the Amendment. While it is still too early to evaluate the impact these innovations may have on the Brazilian insolvency system, we consider that these modifications have brought the Brazilian legislation into line with the best international standards and provide more clarity and certainty for practitioners and other related parties dealing with insolvency proceedings in Brazil.

[26] "Perícia prévia de constatação da atividade e diligência inicial do administrador judicial." *In:* SIQUEIRA, Julio Cesar Teixeira. Recuperação Judicial de Empresas Médias e Pequenas: Guia Prático para o Credor e o Devedor. São Paulo: Trevisan, 2016, 157.

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