Pratt's Journal of Bankruptcy Law

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Victoria Prussen Spears

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Paulo Fernando Campana Filho

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Editor's Note: Brazil, Mexico and the United States
Victoria Prussen Spears 195

Proposal, Negotiation, and Approval of a Reorganization Plan Under Brazilian Bankruptcy Law – Part I
Paulo Fernando Campana Filho 197

The Mexican Non-Bank Lending Sector Crisis: A Bankruptcy Perspective
Francisco Javier Garibay Guemez, Francisco Garcia-Naranjo and Juan Pablo Garibay 217

Commercial Mortgage REITs: Tax Considerations When Dealing with Distressed Mortgage Loans
Kendal A. Sibley, George C. Howell, III, and Joshua R. Venne 228

Home Alone: Considerations on Efforts to Limit Venue
Brian F. Moore 238

U.S. Supreme Court Holds That Section 363(m) of the Bankruptcy Code Is Not Jurisdictional
Andrew M. Parlen, Jacob A. Adlerstein, Alice Belisle Eaton and Robert A. Britton 245

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Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2023)

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2023–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

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POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 230 Park Ave. 7th Floor, New York NY 10169.

Proposal, Negotiation, and Approval of a Reorganization Plan Under Brazilian Bankruptcy Law – Part I

By Paulo Fernando Campana Filho*

In this multi-part article, the author provides a brief description of the process of proposing, negotiating, and approving a reorganization plan under Brazilian law, especially after the enactment of a law reform in 2020 that significantly changed the legislation to make it more efficient and less debtor friendly. In this first part, the author provides an overview of insolvency legislation in Brazil and discusses pre-filing negotiations and the initiation of a court-supervised reorganization.[1]

1 Introduction

Brazilian reorganization proceedings are different in substance from U.S. Chapter 11 cases, despite their superficial resemblance. It has stroked many foreign investors and attorneys how debtor-friendly a reorganization proceeding in Brazil can be, even compared to its U.S. counterpart.[2] This is partly because, in many Brazilian cases, with the help of protective legal provisions and favorable application by courts, debtors have been able to approve unfeasible reorganization plans and shareholders have been allowed to keep their equity intact while creditors suffered a steep haircut. A broad law reform enacted in 2020 intended to increase the efficiency of insolvency proceedings and alter the incentives for negotiation in restructuring cases.

The purpose of this article to provide an overview on the mechanics of the process of proposing, negotiating, and approving a reorganization plan in Brazil after the enactment of the 2020 law reform. This article may hopefully serve as an introduction to foreign investors and attorneys who are not familiar with Brazilian legislation, but also to those who seek to understand how the reform is expected to impact the reorganization practice in the country.

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[1] Footnote numbering will continue in the next part of this article.

[2] Richard J. Cooper, Francisco L. Cestero & Daniel J. Soltman, Insolvency Reform in Brazil: An Opportunity Too Important to Squander, 14 PRATT'S J. BANKR. L. 29, 30 (2018).

2 Overview of Insolvency Legislation in Brazil

In Brazil, Federal Law 11,101, enacted in 2005, as amended, governs insolvency proceedings of business entities and individuals, including bankruptcy liquidations and reorganizations.[3] The insolvency of consumers, financial institutions, insurance companies, and other entities, is governed by different laws.[4] There are three types of insolvency proceedings which businesses can resort to pursuant to Law 11,101.[5]

A judicial reorganization (recuperação judicial) is a structured bargaining proceeding akin to a Chapter 11 case.[6] In a judicial reorganization, a debtor is expected to negotiate with its creditors a plan containing the terms of the restructuring of the debt and the treatment of the claims.[7] During the negotiations, the assets of the debtor are protected by a stay of proceedings.[8] If the plan is approved by the majorities required by law in each class of claims, it will be confirmed by the court and become binding on all affected creditors.[9]

A pre-packaged reorganization (recuperação extrajudicial) is a proceeding filed in court by the debtor after a plan has already been negotiated and signed by creditors holding a required majority of the impaired classes.[10] The debtor is not protected from holdout creditors during the negotiations, but only after the court proceeding is filed. A plan in a pre-packaged reorganization has different thresholds for being considered approved than its sibling in a judicial reorganization. Plus, a pre-packaged plan typically involves only one specific

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[3] The Brazilian Federal Congress has exclusive jurisdiction to pass legislation over civil, commercial, and procedural matters, including those related to insolvency, pursuant to article 22, I, of the Federal Constitution.

[4] Articles 1 and 2 of Law 11,101. Unless specifically stated otherwise, all legal provisions mentioned in this article refer to Law 11,101, the full text of which can be consulted online at the official website of the Brazilian Presidency at https://www.planalto.gov.br/ccivil_03/_ato2004-2006/2005/lei/l11101.htm.

[5] Thomas Benes Felsberg & Paulo Fernando Campana Filho, As Modalidades de Recuperação de Empesas no Brasil, in REVISTA DE DERECHO COMPARADO NO 15: REFORMAS CONCURSALES (SEGUNDA PARTE) 109, 114 (Julio César Rivera ed., 2009).

[6] Thomas Benes Felsberg & Paulo Fernando Campana Filho, Corporate Bankruptcy and Reorganization in Brazil: National and Cross-border Perspectives, in NORTON ANNUAL REVIEW OF INTERNATIONAL INSOLVENCY 2009 EDITION 275, 279 (Bruce Leonard ed., 2009).

[7] Id. at 280–282.

[8] Article 6.

[9] Article 58.

[10] Felsberg and Campana Filho, supra note 6 at 284–285.

class of claims or group of creditors with similar economic interests, while a judicial reorganization plan tends to be more comprehensive in respect to impairment of the debt.[11]

A bankruptcy liquidation (falência) is a court proceeding aimed at the collection and sale of the assets of the debtor, either as a going concern or piecemeal, and at the payment of the creditors with the proceeds, pursuant to a priority rule set forth in law.[12] A court-appointed judicial administrator has the role to collect and administer the assets of the bankrupt estate, and to assume representation of all related lawsuits.[13] The creditors, by voting of a qualified majority, may approve an alternative form of realization of the assets,[14] but that rarely takes place in practice; the debtor belongings are usually sold in a judicial auction after the business has been closed and dismantled.

2.1 Shortcomings of the 2005 Legislation

The current law replaced an old statute – Decree 7,661, which dated back from 1945 –, and was received with much fanfare at the time of its enactment, as it embodied a major leap in corporate insolvencies.[15] It passed after over 12 years being discussed in the Brazilian congress and had been heavily influenced by initiatives from the World Bank and the IMF.[16] However, in the following decade, academics and practitioners realized that, as much as the reform had improved over previous legislation, it still fell short of the best practices around the world.[17]

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[11] Richard J. Cooper, Adam Brenneman & Jessica E. McBride, A New World for LaiAmn Creditors: Insolvency Reform in Ian America, 11 Pratt's J. Bankr. L. 190, 198 (2015).

[12] Felsberg and Campana Filho, supra note 6 at 286–287.

[13] Article 22, I.

[14] Article 46 and 145.

[15] Thomas Benes Felsberg, Steven Kargman & Andrea Acerbi, Brazil Overhauls Restructuring Regime, 25 Int'l Fin L. Rev. 40 (2006); Felsberg and Campana Filho, supra note 6 at 278–279.

[16] Felsberg, Kargman, and Acerbi, supra note 15 at 40; Felsberg and Campana Filho, supra note 6 at 275–276; Felsberg and Campana Filho, supra note 5 at 109–110.

[17] Richard J. Cooper et al., The Brazilian Insolvency Regime: Some Modest Suggestions-Part I, 12 Pratt's J. Bankr. L. 81, 82 (2016); Luiz Fernando Valente de Paiva, Necessárias Alterações no Sistema Falimentar Brasileiro, in Dez Anos da Lei n.o 11.101/2005: Estudos sobre a Lei de Recuperação e Falência (Edição Kindle) (Sheila C. Neder Cerezetti & Emanuelle Urbano Mafioletti eds., 2015).

One of the main purposes of Law 11,101 was the protection of viable businesses and jobs by means of the judicial reorganization.[18] Some courts ended up being too debtor-friendly when construing the law in pursuit of this goal and would protect the debtor in a manner that put them in an advantageous position to negotiate with its creditors.[19] There have been even court decisions disregarding votes cast by creditors on the basis that they acted abusively during the negotiations.[20] Plus, law did not provide the best tools to allow the recovery of the business, as there were no proper rules incentivizing the extension of new money to reorganizing debtors.[21]

On top of that, Law 11,101 provided that a reorganization plan required not only the approval of a qualified majority of the creditors, but also the consent of the debtor.[22] The debtor was the only legitimate party to propose a plan and any modification should have its blessing.[23] It was common for controlling shareholders of the debtor to use this provision to their advantage, either to negotiate keeping equity in the business or the release of personal guaranties granted in favor of creditors.[24] And the absence of an absolute priority rule that should necessarily be observed in reorganization proceedings allowed plans to disfavor senior creditors while giving preferential treatment to junior claimholders.[25]

The pre-packaged reorganization remained largely unused, as there might not have been enough incentives for its employment as compared to a judicial reorganization – after all, it did not provide for a stay to protect the debtor during the negotiations, required high thresholds for approval of a plan, and did not offer adequate legal certainty for allowing sales free and clear or extending new financing.[26]

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[18] Felsberg and Campana Filho, supra note 6 at 278–279.

[19] Cooper, Cestero, and Soltman, supra note 2 at 29–31.

[20] Richard J. Cooper, Francisco L. Cestero & Jesse W. Mosier, Oi S.A.: The Saga of Latin America's Largest Private Sector In-Court Restructuring, 14 PRATT'S J. BANKR. L. 209, 216 (2018).

[21] Felsberg and Campana Filho, supra note 6 at 291.

[22] Cf. Cooper, Cestero, and Soltman, supra note 2 at 30.

[23] Id.; Giuliano Colombo & Thiago Braga Junqueira, Ten Years of the Brazilian Bankruptcy Law: Some Lessons Learned and Some Wishes for Improvement, 1 EMERGING MKT. RESTRUCTURING J. 11, 12 (2016); Cooper, Cestero, and Mosier, supra note 20 at 215–216; Richard J. Cooper et al., The Brazilian Insolvency Regime: Some Modest Suggestions-Part II, 12 PRATT'S J. BANKR. L. 160, 162–163 (2016).

[24] Colombo and Junqueira, supra note 23 at 12.

[25] Cooper, Cestero, and Soltman, supra note 2 at 30.

[26] Richard J. Cooper, Joel Moss & Adam Brenneman, Expedited Restructurings in the U.S.

Creditors would generally consider bankruptcy liquidation a poor alternative to reorganization, as it typically took over a decade to be concluded, and, during this period, the assets of the debtor would deteriorate.[27] A bankruptcy liquidation would not favor the debtor either; discharge took place only after five years following conclusion of the proceeding, and there was a high risk of spill-over to shareholders and officers. In many cases, approval of a plan of reorganization, inefficient as it might be, seemed a better outcome for both creditors and debtor than a bankruptcy liquidation.[28]

2.2 2020 Law Reform

In 2020, Law 14,112 was approved by Brazilian Congress to significantly amend Law 11,101, bringing a comprehensive reform to the insolvency legislation. The amendment came nearly four years after a working group of specialized practitioners and academics was appointed by the Ministry of Finance to prepare a first draft which was thoroughly modified by government officials prior to being submitted to Congress.[29] Although the amendment kept the basic structure of Law 11,101, it aimed at overcoming its major shortcomings and making it more efficient.[30]

The new law brought a new balance of forces in judicial reorganizations, with creditors being allowed to submit an alternative plan, without the consent of the debtor, under certain circumstances.[31] It also brought new provisions to

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and Select Latin American and Caribbean Jurisdictions, 7 Pratt's J. Bankr. L. 675, 687–689 (2011); Cooper, Brenneman, and McBride, supra note 11 at 198–199; Cooper et al., supra note 17 at 83–85.

[27] Cooper, Cestero, and Soltman, supra note 2 at 30; Colombo and Junqueira, supra note 23 at 12–13.

[28] Colombo and Junqueira, supra note 23 at 13.

[29] Daniel Carnio Costa & Alexandre Correa Nasser de Melo, Comentários à Lei de Recuperação de Empresas e Falência: Lei 11.101, de 09 de Fevereiro de 2005, de Acordo com a Lei 14.112, de 24 de Dezembro de 2020 39–40 (3 ed. 2022); Francisco Satiro Souza Junior, Comentários aos Artigos 47 a 50-A, in Comentários à Lei de Recuperação de Empresas (Atualizada de Acordo com a Lei 14.112/2020, Inclusive com os Vetos Afastados e com as Alterações à Lei 10.522/2002) (Paulo Fernando Campos Salles de Toledo ed., 2021).

[30] Costa and Melo, supra note 29 at 40–41; Guilherme Fontes Bechara & Andressa Scorza, Legislative Changes to Brazilian Bankruptcy Law on Sale of Assets in Judicial Reorganisation Proceedings, 15 Insolvency & Restructuring Int'l 10, 10 (2021).

[31] Paulo Fernando Campana Filho, Julia Tamer Langen & Pedro Terribile Garbugio, Alternative Plans of Reorganisation Proposed by Creditors in Brazilian Insolvency Law, 19 Int'l Corp. Rescue 199 (2022).

facilitate the sale of assets[32] and extending financing to the debtor.[33] The reform also sought to incentivize the use of pre-packaged reorganizations, by lowering the threshold requirements for approval of plan[34] and allowing the impairment of labor claims.[35] Finally, bankruptcy liquidations became more efficient: new provisions allow a quick sale of assets, to be concluded within 180 days,[36] and the discharge of the debtor at the closing of the proceeding or after three years of its commencement, whichever occurs first.[37]

While there is still little evidence on the actual impact caused by the 2020 law reform in real-world practice, there were significant modifications on several aspects of the legislation,[38] and which may cause meaningful alterations in the incentives for both debtor and creditors in the restructuring talks.

3 Pre-Filing Negotiations

Prior to the initiation of a judicial reorganization, debtor and creditors may voluntarily enter negotiations to seek a solution for the financial and economic crisis. Under the 1945 legislation, the debtor that called a group of creditors to propose a renegotiation of its debt on a private basis could be considered to have practiced an act of bankruptcy, which was enough reason for having a liquidation proceeding initiated in relation to its assets.[39] A long way has come since then, and Law 11,101 allows creditors and debtors to freely engage in renegotiation of the debt by means of private agreements, without the risk of such attempt being used as a trigger to commence a bankruptcy liquidation.[40]

In some cases, the outcome of the negotiations may be an out-of-court restructuring, concluded privately, or a pre-packaged reorganization plan; in others, an agreement may not be achieved, and a judicial reorganization may be

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[32] Bechara and Scorza, supra note 30.

[33] Marcelo Barbosa Sacramone, Comentários á Lei de Recuperação de Empresas e Falência 386–391 (3 ed. 2022).

[34] Article 163.

[35] Article 161, §1.

[36] Article 22, III, "j".

[37] Article 158.

[38] Costa and Melo, supra note 29 at 39–41.

[39] Felsberg and Campana Filho, supra note 6 at 284; Luiz Fernando Valente de Paiva, Elements of Bankruptcy Law and Business Rescue in Brazil, 1 Int' J. Insolvency L. 21, 39 (2017).

[40] Felsberg and Campana Filho, supra note 6 at 284; Paiva, supra note 39 at 39.

required. The legal mechanism employed for restructuring of the debt will depend on factors such as the type of indebtedness, the willingness of the parties to negotiate, and the results pursued.

3.1 Defining a Strategy for Restructuring the Debt

In many cases – as it also happens in other jurisdictions – a debtor facing a financial and economic crisis will seek the assistance of financial and legal advisors prior to defining a strategy to resolving the situation.[41] Such legal and financial advisors may help the debtor in the implementation of the envisaged restructuring, including the proposal and negotiation of a reorganization plan, should this be the case.[42] The type and level of indebtedness, as well as the willingness of the debtor to keep or terminate its business activities, may be key to define the most appropriate legal instrument.[43]

If the debtor is willing to close the business, then it may consider an ordinary winding-up (preceded by a negotiation with its main creditors), in which case all debt must be settled, or even a bankruptcy liquidation proceeding, if the former is not feasible.[44] The business may also be sold to a third party willing to continue pursuing the activities or with an appetite for facing a liquidation. A judicial reorganization proceeding is generally not meant to be an appropriate solution for these cases, as, under Brazilian law, it assumes the recovery – not termination – of the debtor's activities.[45]

A judicial reorganization may be an appropriate measure when the debtor intends to maintain its business.[46] If creditors are already seeking measures to collect their claims, the debtor may benefit from a temporary relief, within a judicial reorganization, that will allow a negotiation of the debt. If an investor intends to acquire part of the business but is discouraged by the risks associated with a transaction involving a company facing severe financial distress, then the legal protection conceded to a sale under a judicial reorganization can offer it

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[41] Cf. Stephen Lubben, The Chapter 11 Financial Advisors, 28 Emory Bankr. Dev. J. 11, 15–16 (2011).

[42] Cf. Costa and Melo, supra note 29 at 244.

[43] This may not differ much from what happens in the U.S. Cf. Sris Chatterjee, Upinder S. Dhillon & Gabriel G. Ramírez, Resolution of Financial Distress: Debt Restructurings via Chapter 11, Prepackaged Bankruptcies, and Workouts, 25 Fin Mgmt. 5, 11–14 (1996).

[44] Paiva, supra note 39 at 29–30.

[45] Article 47.

[46] Cf. Paiva, supra note 39 at 33.

enough comfort.[47] In multiple situations, though, a judicial reorganization may not be an obvious solution, and the debtor and its advisors may investigate alternatives to restructuring the debt, prior to diving into this complex, expensive, stigmatizing, and time-consuming endeavor.

3.2 Private Out-of-Court Restructurings

It has become common for debtors to recur to private negotiations with its main creditors to voluntarily resolve their (mainly financial) debt.[48] Creditors and debtors may enter these negotiations as potentially a less harmful solution than an in-court reorganization proceeding for resolving the indebtedness of a company.[49] However, multiple factors may be responsible for private negotiations not always having the desired outcome.[50]

These negotiations may be held with each creditor separately or with an organized group. The outcome of these discussions, when successful, may be a set of different agreements or a collective document setting out the terms of the restructuring (which may include shared collateral regulated by an intercreditor agreement). Out-of-court negotiations are possible when creditors voluntarily agree – usually on an informal basis – with a standstill, which entails not enforcing their claims for a certain period while the talks are ongoing.[51] The debtor usually undertakes to not take any action to weaken the rights of creditors during the standstill (such as challenging agreements or filing for a judicial reorganization, for instance).[52]

The success of a voluntary restructuring also depends on the willingness of each individual creditor to accept its terms.[53] In some cases, financial institutions are not encouraged to adhere to a private settlement – they might, for instance, hold collateral that could allow for an expedite recovery of their claim; the negotiation might negatively impact their balance sheets; or accepting the restructuring might be interpreted as a waiver of rights against the

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[47] Cf. Bechara and Scorza, supra note 30.

[48] UNCITRAL, LEGISLATIVE GUIDE ON INSOLVENCY LAW 21–22 (2005).

[49] As in a U.S. Chapter 11, a Brazilian reorganization also involves a level of uncertainty and both direct and indirect costs. See Pascal François & Alon Raviv, Heterogeneous Beliefs and the Choice Between Private Restructuring and Formal Bankruptcy, 41 N. AM. J. ECON. FIN. 156, 159 (2017).

[50] Paiva, supra note 39 at 39–40.

[51] Id. at 40.

[52] Id.; UNCITRAL, supra note 48 at 24.

[53] UNCITRAL, supra note 48 at 238–239.

debtor, triggering responsibility of the decision-makers (an issue which is far more pronounced in banks controlled by the government).[54] Such instances may require an insolvency proceeding which enables dissenting creditors to be bound to a plan approved by required majorities. A judicial reorganization may also be a solution to provide additional comfort to the parties when the restructuring involves the sale of the assets or granting new collateral to existing debt, especially to avoid a further declaration of ineffectiveness in case of a bankruptcy liquidation of the debtor.[55]

3.3 Negotiation of a Pre-Packaged Plan

A pre-packaged reorganization may be a useful tool to renegotiate debt in some circumstances, whenever a private restructuring is not possible, especially after the 2020 reform addressed some of its shortcomings. If creditors holding more than 50%, in amount, of the total claims in a class or in a group with similar economic interests, agree to sign a pre-packaged plan, then the debtor can request court confirmation to bind the dissenting minorities.[56] A pre-packaged plan will only affect one or more selected classes or groups of claims, while the others are left unimpaired.[57] This selection may be useful because a pre-packaged reorganization, much like a voluntary restructuring, typically involves a limited number of creditors and does not affect all claims.[58]

If the required documentation is submitted, the court will order a stay of proceedings for a period of 180 days in respect to all affected claims to protect the debtor's assets until a decision on confirmation of the plan is issued.[59] Before the filing, no stay is applicable – which means that the debtor is expected to privately negotiate with the creditors and seek approval of the pre-packaged plan without court protection. However, following the reform, the debtor is allowed to file the pre-packaged plan accepted by holders of at least one third of the claims, in amount, in each impaired category.[60] The debtor then has 90

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[54] Paiva, supra note 39 at 40.

[55] Article 129.

[56] Article 163, chapeau and §1.

[57] Richard J. Cooper, Francisco L. Cestero & Jonathan Mendes de Oliveira, Odebrecht Oil & Gas and the Use of Brazilian Extrajudicial Reorganization in Cross-Border Restructurings, 14 Pratt's J. Bankr. L. 328, 334 (2018).

[58] UNCITRAL, supra note 48 at 239–240.

[59] Article 163, §8.

[60] Article 163, §7.

days to obtain approval from the remaining creditors to provide to the court evidence that the required majorities adhered to the restructuring.[61]

After the filing (or the obtention of the required majorities, should this be the case), creditors will be notified and will have 30 days to file objections to the plan, to which the debtor will have 5 days to respond.[62] The court will then decide on the objections and issue its decision on confirmation of the plan.[63] Although the confirmation decision can be challenged by means of appeals, the use of a pre-packaged plan is generally simpler, cheaper, and more expedite measure to restructure debt than a full-blown judicial reorganization.[64] It has been successfully employed to restructure international bonds in certain occasions, such as in the cases of Lupatech (2014), USJ Açúcar e Álcool (2016), and Odebrecht Oil & Gas (2017).[65]

3.4 Court Protection During the Negotiations

The reluctance of creditors to agree to a standstill – especially of holdouts willing to take some advantage[66]– have been major hindrances to negotiating private agreements or pre-packaged reorganization plans. The law reform addressed this obstacle by introducing the possibility of debtors filing a preliminary injunction to obtain a 60-day court protection from enforcement measures.[67] The purpose of this stay is to provide the debtor a short relief to enable the conclusion of private negotiations with its creditors, thereby avoiding the need of a judicial reorganization.

The debtor who requests such injunction must submit to a negotiation with its creditors before a mediation and conciliation center of the judiciary.[68] The reform seeks to incentivize alternative dispute resolution mechanisms at any time and before any court,[69] either to avoid the need of a judicial reorganization (which is the purpose of the 60-day stay) or during the negotiation of a plan, with the purpose of facilitating an agreement on the restructuring terms.

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[61] Article 163, §7.

[62] Article 164, §2 and §4. Cf. Cooper, Cestero, and Oliveira, supra note 57 at 333.

[63] Article 164, §5.

[64] See UNCITRAL, supra note 48 at 239.

[65] Cooper, Cestero, and Oliveira, supra note 57 at 335–336.

[66] UNCITRAL, supra note 48 at 239.

[67] Article 20-B, §1.

[68] Article 20-B, §1.

[69] Article 20-A.

If the negotiations are unfruitful, and the debtor either files for judicial reorganization or submits a pre-packaged plan, the 60-day suspension will be deducted from any forthcoming stay period ordered by the court.[70] This rule discourages debtors from using the injunction as a maneuver to extend the stay of proceedings triggered by a judicial reorganization or by the filing of a pre-packaged plan.

Should an agreement be obtained during the 60-day stay, it will be confirmed by the court.[71] Should the debtor file for a judicial reorganization or a pre-pack within 360 days, the agreement will be revoked, and all original terms, conditions, and guarantees, of the restructured claims will be restored, although all valid acts practiced under its auspices (such as disposition of assets)[72] will be preserved.[73]

3.5 Considering Reorganizations for Small Businesses

Law 11,101 provides for a special judicial reorganization proceeding aiming at the restructuring of small businesses. Only business with yearly revenue of up to BRL 4.8 million (roughly USD 900,000, depending on the exchange rate), and which qualify as "micro" or "small-sized" under Brazilian law can recur to this proceeding.[74] Such businesses may submit a plan providing for payment of the pre-filing debt in up to 36 monthly installments,[75] being the first one necessarily due within 180 days from the date of the filing.[76] The plan may also provide for a haircut of the debt.[77]

The court will confirm the plan, making it binding for all parties involved, unless a qualified majority of the creditors in any class of claims file objections.[78] In this case, a creditors' meeting will not take place and the court will immediately convert the judicial reorganization into a bankruptcy liquidation of the debtor.[79] This special proceeding is more rarely used than traditional judicial reorganizations.

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[70] Article 2-B, §3.

[71] Article 20-C, chapeau.

[72] Sacramone, supra note 33 at 164.

[73] Article 20-C, sole paragraph.

[74] Article 70, paragraph 1.

[75] Article 71, I and II.

[76] Article 71, III.

[77] Article 71, II.

[78] Article 72, chapeau and sole paragraph.

[79] Article 72, sole paragraph.

4 Initiation of a Court-Supervised Reorganization

If the debtor is threatened by an involuntary bankruptcy filing, is under the risk of having its assets seized by creditors, or believes it is more convenient to leverage negotiations or attract investors, it may file for a judicial reorganization. While a judicial reorganization may be stigmatizing and expensive, it also may bring several benefits to the debtor, such as court protection from enforcement measures and the possibility of binding dissenting creditors to a plan. The judicial reorganization also creates obligations and limitations for the debtor, such as (a) the prohibition of distributing dividends until the approval of the reorganization plan;[80] (b) the requirement an auditing committee is formed, if the debtor is a publicly traded company;[81] and (c) the prohibition of disposing of non-current assets without proper authorization.[82]

Since its introduction, in 2005, the judicial reorganization has become wildly popular as a means of restructuring debt in Brazil. As of August 2022, over 15,000 businesses had filed for judicial reorganization under Law 11,101.[83]

4.1 Who Can File for Reorganization

A judicial reorganization can only be filed by a debtor (either an individual or an entity) under financial distress who has been regularly pursuing business activities for at least two years, and which is not bankrupt and has not obtained confirmation of a plan within the previous 5 years.[84] No insolvency test is required. Consumer and non-business entities, as well as banks and companies owned or controlled by the state, are generally not allowed to file for reorganization under Law 11,101.[85]

Individuals may file for judicial reorganization if they pursue regular business activities.[86] The amended law authorizes individual farmers and rural producers to request judicial reorganization,[87] as long as they submit the proper

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[80] Article 6-A.

[81] Article 48-A.

[82] Article 66.

[83] The information was retrieved from the website of Serasa Experian, which tracks companies that file for judicial reorganization, at https://www.serasaexperian.com.br/conteudos/indicadores-economicos/.

[84] Article 48.

[85] Article 2.

[86] Articles 1 and 48.

[87] See Souza Junior, supra note 29, comments to article 48.

accounting documentation.[88] However, shareholders and officers if a business entity are not allowed to file (even if they are guarantors of the debt or are under the risk of being held responsible for labor claims), unless they regularly conduct business activities on their own name as individual entrepreneurs.[89]

4.2 Groups of Companies

It has become increasingly common, since the enactment of Law 11,101, for related entities to file jointly for judicial reorganization, on the grounds that they belong to the same economic or corporate group.[90] "Economic group" has been very loosely defined for these purposes – in some cases, courts have accepted joint filings of entities which did not have the same shareholders nor a parent/subsidiary relationship.[91]

The reformed law regulates joint reorganizations, providing that the entities shall be under common corporate control and that each of them shall individually fulfill all the requirements for the filing, including the submission of the required documentation.[92] It is generally understood that the debtor is free to choose which entities will file for reorganization[93] – and many courts adopt a broad approach when analyzing whether they are part of the same group.[94]

4.3 Competent Court

The judicial reorganization shall be filed before the state court of the venue where the principal place of business of the debtor (or of the group of debtors) is located.[95] If the debtor has operations in multiple venues, the principal place of business is usually considered to be the most significant one from an economic perspective and does not necessarily coincide with the headquarters.[96] This construction of the law intends to make it more difficult for debtors to

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[88] Article 48, §3.

[89] Souza Junior, supra note 29, comments to article 47.

[90] See Sheila C. Neder Cerezetti, Reorganization of Corporate Groups in Brazil: Substantive Consolidation and the Limited Liability Tale, 30 Int'l Insolvency Rev. 169, 172 (2021).

[91] Id.

[92] Article 69-G.

[93] Sacramone, supra note 33 at 393.

[94] Cerezetti, supra note 90 at 172.

[95] Article 3 and 69-G, §2.

[96] Sacramone, supra note 33 at 81.

manipulate the competent court, as a simple transference of headquarters will not modify the venue where the reorganization shall be filed.[97]

The judicial reorganization may be filed before a court perceived as more debtor-friendly;[98] creditors can challenge the choice and request the case to be transferred to the venue they deem more appropriate. This may lead to significant litigation – after all, the determination of the court which presides over the case may significantly affect the proceeding and the outcome of the negotiations. In large cities, specialized courts tend to be more familiarized with bankruptcy matters and may be more equipped to resolve issues expeditiously.[99] More recently, there has been incentives towards the creation of courts dedicated to business or insolvency matters. Despite these efforts, courts around the country apply different constructions of the law on several matters,[100] including on whether creditors in the same class may receive different treatment and which provisions of a plan may be considered illegal.

4.4 Affected Claims

All pre-petition claims, with certain exceptions, are affected by the reorganization and can be impaired by the plan.[101] Pre-petition claims include all those which exist on the date of filing, even if not yet due.[102] The claim is usually considered as affected by the reorganization even if, on the date of filing, it is being litigated over and depends on a court decision to be recognized or to become enforceable.[103]

There is a significant number of claims not subject to a reorganization in addition to those incurred post-filing. Claims secured by assets whose title is transferred to the creditor – such as chattel mortgages, fiduciary assignments, and certain leasing agreements – are not affected by the reorganization, but, during the stay period, the relevant creditors are prevented from removing property which the court finds necessary for the conduction of the debtor's

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[97] Id.

[98] Gustavo Fávero Vaughn, Henrique Ceolin Bortolo & Natália Salvador Veiga, Três Pontos para Reflexão sobre a Reforma da Lei de Recuperação Judicial e Falência Brasileira, 4 Revista Jurídica Luso-Brasileira 443, 453–455 (2018).

[99] Id. at 447–448.

[100] Id. at 453–454.

[101] Article 49, chapeau.

[102] Article 49, chapeau.

[103] See Sacramone, supra note 33 at 105.

activities.[104] It is generally understood that claim secured by a fiduciary lien is only exempt from the reorganization if such lien is duly registered with the competent registry (of titles and deeds or of real estate, as the case may be) – which makes the security interest opposable to third parties – and up to the value of the collateral.[105] Other claims – such as tax obligations[106] and those deriving from advances on foreign exchanges[107] and aircraft lease agreements[108] – are also not subject to the reorganization and to the stay of proceedings.

5 Commencement Decision

If the required documentation is properly submitted, and there is indication that the debtor may still have a viable business, the court will issue a commencement decision, effectively initiating the reorganization.[109] On such decision, the court will, among other measures, appoint a judicial administrator with a monitoring role; instruct the debtor to submit the reorganization plan within 60 days; and order a stay of enforcement actions against the debtor.[110] From the commencement decision onwards, the debtor can only withdraw the reorganization request upon approval of a majority of the creditors.[111]

Upon request of the debtor, and provided that the measure is deemed necessary and appropriate, the court may anticipate certain effects of the commencement decision – notably the stay of proceedings –, while the documentation is yet pending review, with the purpose of protecting the assets in the meantime.[112]

5.1 Feasibility Test

Prior to issuing the commencement decision, and if it deems necessary, the court may appoint a professional to verify, within 5 days, whether the documentation submitted is adequate and complete and to assess whether the

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[104] Article 49, §3.

[105] João Pedro Scalzilli, Luis Felipe Spinelli & Rodrigo Tellechea, Recuperação de Empresas e Falência: Teoria e Prática na Lei 11.101/2005 858–859 (3 ed. 2018).

[106] Article 6, §7-B.

[107] Article 49, §4.

[108] Article 200, §2.

[109] Article 52, chapeau.

[110] Article 52.

[111] Article 52, §4.

[112] Article 7-B, paragraph 12.

debtor still has an activity or at least minimal conditions to keep operating.[113] This assessment may also indicate whether the principal place of business of the debtor is actually located at the venue where the filing was made.[114]

As the purpose of the judicial reorganization is to allow the debtor to maintain its operations, this assessment intends to prevent businesses which have permanently shut down from seeking to restructure its debt instead of winding up or filing for bankruptcy liquidation. A debtor which has suspended its activities on a temporary basis, but which may resume its operations in the future (especially following a successful restructuring), shall not be precluded from pursuing a judicial reorganization.[115] As such, this verification should not analyze whether the debtor has a viable activity; it is up to the creditors to decide, by majority voting, if the proposed plan is feasible and if the payment terms provided therein are acceptable.[116]

5.2 The Role of the Judicial Administrator

The judicial administrator shall be a suitable professional (preferably an attorney, economist, business administrator, or accountant) or entity appointed by the court on the commencement decision.[117] In large cases, the court usually appoints a large professional services entity, such as an international consulting or auditing firm. The court will determine the remuneration of the judicial administrator, which shall be paid by the debtor, and which may not exceed 5% of the total affected debt.[118]

In a judicial reorganization, the judicial administrator has largely a monitoring role, with functions such as overseeing the activities of the debtor, submitting reports to the court, providing information to creditors, verifying claims, opining on legal matters before the court issues a decision, and presiding over creditors' meetings.[119] The 2020 law reform included new functions that the judicial administrator shall perform, the extent of which has been heavily criticized and debated among academic and practitioners.[120] These new

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[113] Article 51-A.

[114] Costa and Melo, supra note 29 at 240.

[115] Sacramone, supra note 33 at 317–318.

[116] Article 51-A, §5. Cf. Costa and Melo, supra note 29 at 240.

[117] Article 21, chapeau.

[118] Articles 24 and 25.

[119] Article 22, I and II.

[120] Cf. Maria Isabel Fontana, Giovanna Vieira Portugal Macedo & Jéssica Malucelli Barbosa, Seção III: Do Administrador Judicial e do Comitê de Credores. Arts. 21 a 34, in Comentários

functions involve, among others, a duty to supervise the information provided by the debtor[121] and the negotiations with the creditors.[122] Although not directly involved in the negotiations, the judicial administrator may act to facilitate an agreement between debtor and creditors and to allow the court proceedings to proceed swiftly.[123]

The judicial administrator has a significant role in ensuring the disclosure of relevant information to the creditors, by submitting to the court a monthly report on the activities of the debtor.[124] Such reports are publicly available for creditors to consult. The judicial administrator may also request any information from the debtor or from the creditors[125] and shall promptly provide any information requested by the creditors.[126]

5.3 Stay of Proceedings

The commencement decision triggers a stay of enforcement actions against the debtor for a period of 180 days.[127] The purpose of the stay is to provide a temporary relief to allow the debtor to negotiate with its pre-petition creditors and seek approval of a reorganization plan. Prior to the 2020 reform, law provided that the stay was non-extendable, and creditors could proceed with individual enforcement measures after its expiration; however, courts often overlooked this provision and lengthened the protection for as long as the negotiation of the plan required, provided that the debtor had not blatantly contributed to the delay.[128]

The amended law provides that the stay can be extended only once, for an equal period of 180 days, if the debtor did not cause the delay in having the

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á Lei de Recuperação de Empresas e Falência 168, 176–191 (Joana Gomes Baptista Bontempo, Maria Fabiana Seoane Dominguez Sant'Ana, & Mayara Roth Isfer Osna eds., 2022); José Anchieta da Silva, Comentários aos Artigos 21 a 25, in Comentários á Lei de Recuperação de Empresas (Atualizada de Acordo com a Lei 14.112/2020, Inclusive com os Vetos Afastados e com as Alterações á Lei 10.522/2002), 176–178 (Paulo Fernando Campos Salles de Toledo ed., 2021).

[121] Article 22, II, "c".

[122] Article 22, II, "e", "f", and "g".

[123] Costa and Melo, supra note 29 at 159–162.

[124] Article 22, II, "c".

[125] Article 22, II, "d".

[126] Article 22, II, "b".

[127] Article 6, §4.

[128] Cooper, Cestero, and Soltman, supra note 2 at 32–33.

plan approved.[129] The total length of the stay in favor of the debtor should therefore not exceed 360 days – after that period is over, law allows creditors the opportunity to propose an alternative plan of reorganization.[130] Should creditors decide to submit such a plan – which shall be done within 30 days counting from the date on which the debtor's stay expired –, they will benefit from an additional stay of 180 days.[131]

During the stay, creditors holding fiduciary liens – whose claims are not affected by the reorganization – are prevented from removing property which the court finds essential to the business activities of the debtor.[132] The same rule applies to holders of claims deriving from lease purchase agreements and purchase and sales agreement providing a reservation of title to the seller.[133] The reorganization court has jurisdiction to determine which assets are to be deemed as essential[134] (and the list usually includes industrial plants, equipment, and the real estate where the assets are located). Such creditors are encouraged to negotiate with the debtor and reach an agreement over the restructuring of the debt during this period in which they cannot enforce their collateral.

The stay does not affect tax claims, which, as mentioned, cannot be impaired by the reorganization plan.[135] However, the reorganization court has jurisdiction to order that assets seized in tax enforcement actions are replaced by others if such property is deemed as essential to the debtor's activities.[136] The court may apply this provision to protect assets which may be used for the implementation of the restructuring.

5.4 Substantive Consolidation

Prior to the 2020 reform, substantive consolidation was widely accepted in cases where debtors filed jointly as an economic group.[137] In many cases, substantive consolidation was implied even without being determined by a

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[129] Article 6, §4.

[130] Article 6, §4-A.

[131] Article 6, §4-A, II.

[132] Article 6, §7-A, and 49, §3. Cf. item 4.4.

[133] Article 49, §3. Cf. item 4.4.

[134] Article 6, §7-A.

[135] Cf. item 4.4.

[136] Article 6, §7-B.

[137] Cerezetti, supra note 90 at 176–177; Joel Luiz Thomaz Bastos, Litisconsórcio Ativo e Consolidação Substancial na Recuperação Judicial, in 10 ANOS DA LEI DE RECUPERAÇÃO DE

court decision,[138] and creditors would cast their votes on the plan proposed by the group of debtor companies, without regard for the individual entities. As the matter became increasingly more litigated, some courts deferred to the creditors' meeting the decision on whether to consolidate the debtor companies or not.[139] The lack of standards for allowing substantive consolidation in reorganizations led to such a degree of uncertainty that the introduction of specific rules on the matter was considered.[140]

The law reform specifically addressed substantive consolidation.[141] According to the amended legislation, the court may, under exceptional circumstances, authorize substantive consolidation of the debtor companies, whenever certain requirements are met.[142] The first of these requirements is that the assets or liabilities of the debtors are so commingled that identifying ownership would take an excessive amount of time or resources.[143] In addition, at least two of the four following additional requirements should be necessarily and cumulatively met: (a) there shall be cross-guarantees; (b) the debtors shall be under common corporate control or dependency; (c) the debtors shall have common shareholders; or (d) the businesses of the debtors shall be conducted jointly.[144] Some commentators already expressed a concern that these legal requirements would be excessively vague and could lead to substantive consolidation been authorized without appropriate thought and consideration.[145]

The court may rule on substantive consolidation at any time during the reorganization proceeding, including when issuing the commencement decision. In addition, although not explicitly provided for by the law even after the reform, it is still possible for creditors to deliberate, by majority voting, on whether the debtors should be substantively consolidated.[146]

Empresas e Falências: Reflexões Sobre a Reestruturação Empresarial no Brasil 211 (Luis Vasco Elias ed., 2015).

[138] Cerezetti, supra note 90 at 176.

[139] Cf. Sacramone, supra note 33 at 399.

[140] Cooper et al., supra note 23 at 161–162.

[141] Articles 69-J to 69-L.

[142] Article 69-J, chapeau.

[143] Article 69-J, chapeau.

[144] Article 69-J, I-IV.

[145] Maria Isabel Fontana, O Passo em Falso do Legislador com Relação à Consolidação Processual e Substancial, in Lei de Recuperação de Empresas e Falência: Pontos Relevantes e Controversos da Reforma pela Lei 14.112/20 138, 153–154 (Paulo Furtado de Oliveira Filho ed., 2021).

[146] Sheila C. Neder Cerezetti, A Consolidação Substancial Voluntária Após a Reforma

If substantive consolidation is determined, all cross-guarantees and obligations will be considered extinct but secured claims will not be affected.[147] The substantive consolidation under Law 11,101 is equivalent to the so-called "deemed" consolidation in the U.S.[148] – the legal entities are preserved, the only effect being that, for the purposes of the reorganization (i.e., for voting the plan), assets and liabilities of all debtors will be considered as pertaining to the group (and not to each individual entity).[149]

Concursal de 2020, in Direito da Empresa em Crise: Temas Atuais Sobre Recuperação Empresarial e Falência no Brasil 31 (Matheus Martins Costa Mombach & Paulo Fernando Campana Filho eds., 2022).

[147] Article 69-K, paragraphs 1 and 2.

[148] This was also the case of substantive consolidation in Brazil prior to the 2020 reform. See Cerezetti, supra note 90 at 176. On "deemed" consolidation, see William H. Widen, Corporate Form and Substantive Consolidation, 75 Geo. Wash. L. Rev. 237, 243–244 (2007); William H. Widen, Prevalence of Substantive Consolidation in Large Bankruptcies from 2000 to 2004: Preliminary Results, 14 Am. Bankr. Inst. L. Rev. 47, 50–51 (2006).

[149] Article 69-K, chapeau.