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ARTICLE

Alternative Plans of Reorganisation Proposed by Creditors in Brazilian Insolvency Law

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Synopsis

The possibility of creditors approving a reorganisation plan without the consent of the debtor is one of the key changes introduced in December 2020 when a general reform was enacted to overhaul Law 11,101 of 2005, the piece of legislation regulating corporate insolvencies in Brazil. This shift addresses one of the inadequacies of the previous legislation – the legal requirement that any plan of reorganisation could only be proposed by the debtor and that any amendment should have its consent.

In this article, we provide an overview of the mechanics of the alternative plan – including the procedure and requirements for filing and obtaining approval and court confirmation – and how it aims to improve over previous legislation.

1. A shortcoming of previous legislation

Since Law 11,101 came into force, in 2005, reorganisation was increasingly perceived as a debtor-friendly proceeding as case law developed. One of the reasons appointed for this – along with factors such as the lack of court specialisation and the ineffectiveness of liquidations as an alternative – was the legal requirement that any reorganisation plan could only be filed the debtor and any modification should necessarily have its consent.[1]

Under Brazilian law, a reorganisation could only be filed by the debtor – creditors would only be allowed to submit a petition for bankruptcy liquidation.[2] After the filing, the court would analyse the documentation submitted by the debtor and order the commencement of the reorganisation, which would trigger a stay of proceedings and a 60-day deadline for the debtor to present a plan providing for the means of restructuring of the activities and payment of the pre-filing creditors.[3] Should the debtor fail to file the plan within this deadline, the court would convert the reorganisation into a bankruptcy liquidation.[4] This led many debtors to submit placeholder plans just to comply with the deadline, so they could further negotiate the terms of the restructuring with its creditors while they were protected by the relief provided by the stay of proceedings.[5]

The plan was expected to be deliberated upon at a creditors' meeting held before the end of the stay of proceedings, which, according to law, should not exceed 180 days. However, courts would usually extend the stay, for as long as it was necessary for the plan to be approved, provided that the debtor had not contributed to the expiration of the deadline.[6] This exception ended up swallowing the rule: a study concluded that the stay was extended by the court in 38.4% of the cases and its average length until the plan was submitted to voting was found to be 506 days.[7]

The plan could be amended at any time prior to being submitted to voting, provided that the debtor agreed to any such amendment.[8] The fact that no plan could be

Notes

1 Richard J. Cooper, Francisco L. Cestero, and Daniel J. Soltman, 'Insolvency Reform in Brazil: An Opportunity Too Important to Squander', *Pratt's J. Bankr. L.* 14 (2018): 29–30.

2 Article 48 of Law 11,101. All legal provisions mentioned in this article refer to Law 11,101, unless noted otherwise. See also, Thomas Benes Felsberg and Paulo Fernando Campana Filho, 'Corporate Bankruptcy and Reorganization in Brazil: National and Cross-border Perspectives', in *Norton Annual Review of International Insolvency 2009 edition*, org. Bruce Leonard (Eagan: Thomson Reuters/West, 2009), 279.

3 Article 53. See also, Felsberg and Campana Filho, 280.

4 Felsberg and Campana Filho, 280.

5 Cooper, Cestero, and Soltman, 'Insolvency Reform in Brazil: An Opportunity Too Important to Squander', 33.

6 Cooper, Cestero, and Soltman, 33.

7 Marcelo Guedes Nunes et al., 'Observatório da Insolvência: Segunda Fase', 2021, https://abjur.github.io/obsFase2/relatorio/obs_recuperacoes_abj.pdf.

8 Giuliano Colombo and Thiago Braga Junqueira, 'Ten Years of the Brazilian Bankruptcy Law: Some Lessons Learned and Some Wishes for Improvement', *Emerging Markets Restructuring J* 1 (2016): 12.

voted without the debtor's consent[9] – equivalent to a veto power – resulted in a disproportionate bargaining power and an imbalanced reorganisation proceeding.[10] Approval of the plan by the required majorities in each class of claims (or fulfilling of cramdown requirements) would result in court confirmation; and its rejection would cause the conversion of the reorganisation into a bankruptcy liquidation – with no possibility of creditors proposing an alternative.

2. When and how creditors can file a plan

The provisions enacted by the reform substantially modify the previous legislation to provide more negotiating power to creditors in a reorganisation. The debtor is still the only party allowed to file for reorganisation,[11] and shall file the plan within a 60-day deadline after commencement of the proceeding.[12] However, the proceeding has been significantly altered and there are now two situations – the expiration of the stay period and the rejection of the debtor's plan –, analysed below in more detail, which would allow creditors to approve an alternative plan without the debtor having to consent to it.

2.1 Expiration of the stay of proceedings

Upon the filing of a reorganisation, and provided the documentation is in order, the court will order a stay of proceedings for a period of 180 days, which can be extended only once, for an equal period, as long as the debtor is nor responsible for the delay.[13] During this stay period, any amendments to the plan should be approved by the debtor before being submitted to voting at a creditor's meeting.[14]

This stay of proceedings granted by the court, of up to 360 days, is expected to provide enough relief time for the debtor to successfully negotiate its plan with the required majorities of creditors. If the 360-day stay expires without the debtor being able to obtain approval of the reorganisation plan at a creditors' meeting, then the creditors will be entitled to submit an alternative.[15] Due to this reason, the stay conceded in favour of the debtor corresponds now to an exclusivity period which should not be extended by the court to not disserve creditors' ability to propose their terms.

The alternative plan can be filed within 30 days counting from the termination of the stay of proceedings, considering any extension thereof. Upon submission of the creditors' plan, the court will order the stay of proceedings to remain effective for an additional 180 days, counting from the date in which the original stay ended.[16] During this period, creditors will be able to seek approval of the alternative plan without having to be concerned about obtaining debtor's consent, which will no longer be necessary.

2.2 Rejection of the debtor's plan at a creditors' meeting

If the debtor submits the plan to the creditors' meeting and fails to obtain approval by the requisite majorities, law no longer provides that the reorganisation will be converted into a bankruptcy liquidation. If the plan is rejected, then the creditors will be given the opportunity to negotiate and approve an alternative without the debtor having to agree to its terms.

Upon rejection of the debtor's plan, law provides that the court-appointed judicial administrator will submit to the creditors' meeting, on the same occasion, a deliberation on whether creditors would be willing to concede a deadline of 30 days for an alternative plan to be filed. Such deliberation will be considered approved with the favourable vote of holders of more than 50% of the claims, in amount, among those attending the creditors' meeting, regardless of the class of creditors they belong to. If this deliberation is not approved, then the court will convert the reorganisation into a bankruptcy liquidation.

Should the alternative plan be submitted within the aforementioned 30 days, the court will order the stay of proceedings to remain in force and effect for a further period of 180 days counting from the date in which the creditors' meeting which rejected the plan took place.[17] Then, creditors will be free to negotiate the terms of the restructuring and to deliberate the alternative plan at a further creditors' meeting, without the debtor having any veto power over its provisions.

Notes

9 Felsberg and Campana Filho, 'Corporate Bankruptcy and Reorganization in Brazil: National and Cross-border Perspectives', 281.
10 Colombo and Junqueira, 'Ten Years of the Brazilian Bankruptcy Law: Some Lessons Learned and Some Wishes for Improvement', 12–13.
11 Article 48.
12 Article 53.
13 Article 6, paragraph 4.
14 Article 55, paragraph 3.
15 Article 6, paragraph 4-A.
16 Article 6, paragraph 4-A, II.
17 Article 6, paragraph 4-A, II.

2.3 Expedited approval of an alternative plan

Creditors might be concerned that they would have to wait the lapse of the original stay period, or for the debtor to submit a non-agreed plan to voting (and be rejected) at a creditors' meeting, to obtain statutory authorisation to pursue approval of an alternative. Although these are the two situations in which an alternative plan can be presented, the pace of the proceeding is not necessarily controlled by the debtor.

If consensus around the plan seems unlikely, creditors can use certain mechanisms or tactics to expedite the process and to submit an alternative without having to wait for the full length of the stay period to elapse. Creditors may also use such tools to persuade the debtor to propose a more reasonable solution to avoid having its plan rejected and thereby being excluded from any further negotiations.

Creditors could, for instance, negotiate a draft reorganisation plan before the stay period is over. This would allow creditors to buy time by refining an alternative plan before it can be put to vote. It can also serve as a warning to the debtor that creditors are considering an alternative and thus it might be worth significantly improving its proposals. It should be noted that Brazilian law has no statutory provision denying the right of creditors to circulate or even file an alternative plan before the debtor's exclusivity period is over. However, as there are no court precedents yet on the matter, creditors might prefer to be cautious and not to disclose an alternative plan publicly before the appropriate time, to not interfere with the debtor's ability to successfully negotiate the terms of its restructuring.

Should creditors decide to pursue a more assertive strategy, it would be possible for holders of at least 25% of the total claims, in amount, in a class of claims, to request to the court that a creditors' meeting be convened.[18] In this case, all the expenses related to calling and implementation of the creditors' meeting will be borne by the creditors who requested it.[19] In this creditors' meeting, creditors will be able to deliberate on the debtor's plan, rejecting it right away, thereby triggering the 30-day deadline to submit a replacement or even allowing them to put the alternative to voting if there is already a consensus around it. Creditors holding more than 50% of the total claims, among those attending the creditors' meeting, can also decide on the conversion of the reorganisation into a bankruptcy liquidation[20] – a possibility which is seldom used, and which would deprive them from the chance of negotiating an alternative plan.

As an alternative to a creditors' meeting, creditors holding more than 50% of the total claims, in amount, could just sign a term expressing their willingness to reject the debtor's plan (or to have the reorganisation converted into a bankruptcy liquidation).[21] In this case, however, the threshold for the deliberation could be significantly higher, as the majority will be calculated based on the total amount of claims allowed in the reorganisation (and not only among those present at the creditors' meeting).

3. Content and requirements of a creditor's plan

The alternative reorganisation plan may provide for any means of restructuring and satisfaction of the creditors, provided that certain requirements – including those related to the rights of shareholders – are met.

The plan can provide for a debt-for-equity swap, for instance, which may result in a change of control of the debtor company.[22] This may be the preferred option for noteholders, who may be willing to retain a controlling interest in the debtor, especially in the case of publicly held companies – as shown in some past high-profile cases such as OGX, Lupatech, or Oi.[23] If the conversion of debt into equity results in a change of control, law provides that the shareholders will be allowed to exercise their right to withdraw from the company.[24]

The plan may also provide for the sale of assets or production units, free and clear of any liabilities of the debtor,[25] with the proceeds being reverted for the payment of the creditors. It should be noted that, if claims not affected by the reorganisation – including those held by tax authorities – are left unpaid after the proceeds are distributed, the creditors may be required to return any amount received.[26] In this case, the court will convert the reorganisation into a liquidation and the amounts arising from the sale will be frozen and

Notes

18 Article 36, paragraph 2.
19 Article 36, paragraph 3.
20 Article 73, I.
21 Article 45-A.
22 Article 56, paragraph 7.
23 Sheila Christina Neder Cerezetti, 'Comentários aos Artigos 55 a 59', 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)*, org. Paulo Fernando Campos Salles de Toledo (São Paulo: Thomson Reuters Brasil/Revista dos Tribunais, 2021), comments to article 56.
24 Article 56, paragraph 7.
25 Article 60.
26 Article 73, paragraph 2.

distributed to the creditors according to the priority rule set forth by law.[27]

The alternative plan may also provide that the shareholders will keep their equity in the debtor company and that they will continue to appoint the managers, or to manage the activities themselves, to fulfil the payment obligations to the creditors, in instalments and with any applicable haircuts. Although this is a common configuration of plans submitted by debtors in Brazilian reorganisations, it is unlikely to be adopted in alternative plans – creditors are keen to replace management of the restructuring company, and shareholders will hardly abide to complying with provisions they did not consent to. In addition, even if the equity would be left with the shareholders, any alternative plan providing for fixed payments would unlikely, as creditors, in addition to be willing to sweep any surplus, will not have the full picture of the cash generation without stepping in the business, which could prevent them from developing a credible estimate for deferred payments.

Even though the content of the alternative plan may vary – and any permissible means of restructuring can be employed –, there are certain requirements, provided by article 56, paragraph 6, of Law 11,101, that must be met for it to be submitted to voting, and which are described below.

3.1 Economic viability and submission of appraisal report

The alternative plan shall meet the same formal requirements as the plan filed by the debtor.[28] It must include a detailed description of the restructuring mechanisms to be employed[29] and evidence of the economic viability of the company.[30] In addition, the plan should also be accompanied by an economic and financial report and an appraisal of the assets of the debtor, subscribed by a licensed professional or by a specialised entity.[31] These formal requirements are meant to serve as parameters for creditors to analyse the feasibility of the plan.

Law does not provide whether the creditors are required to order a new economic and financial report and the appraisal of assets or whether they can use the ones filed with the debtor's plan. It is likely that creditors will prefer the latter, not only to save time and resources, but also because the debtor may not be willing to provide access to its facilities to allow such report and the appraisal to be concluded.[32]

3.2 Support in writing by creditors

Although the alternative plan is meant to be negotiated and approved without the debtor's consent, Brazilian law does not contain any explicit specific requirement that it should be proposed by a creditor. Therefore, the proponent of the alternative plan could, in principle, be either a creditor or a third party.

However, law requires that the creditors' plan can be submitted to voting only if supported, in writing, by creditors holding more than 25% of the total claims, in amount, affected by the reorganisation.[33] If the possibility of submission of the alternative plan derives from the rejection of the debtor's plan at a creditors' meeting, then, as an option, the alternative plan can be supported, in writing, by holders of more than 35% of the claims among those attending such meeting.[34] As it relate only to those present at the meeting, the 35% threshold may be particularly useful in cases in which there are significant creditors scattered around the world (such as in the case of noteholders) or indifferent to participate in the negotiations.

The rationale for this requirement is to only allow the submission of an alternative plan if supported by a substantial part of the creditors. In addition, this requirement also makes it more unlikely – but does not eliminate – the possibility of groups of creditors submitting concurrent alternative plans.[35]

3.3 No new obligations to the debtor's shareholders

The alternative plan cannot impose to the shareholders of the debtor any new obligation which were not previously established by agreement or by force of law.[36] As such, the alternative plan cannot provide, for instance, that the shareholders must contribute new capital to the debtor company or that they shall remain in management. The purpose of this requirement is to assure that the alternative plan will not worsen the legal and economic situation of the shareholders of the debtor.

Notes

27 Article 73, VI, and paragraph 2.
28 Article 56, paragraph 6, II.
29 Article 53, I.
30 Article 53, II.
31 Article 53, III.
32 Marcelo Barbosa Sacramone, *Comentários à Lei de Recuperação de Empresas e Falência*, 2nd edition (São Paulo: Saraiva, 2021), 508.
33 Article 56, paragraph 6, III, 'a'.
34 Article 56, paragraph 6, III, 'b'.
35 Sacramone, 508.
36 Article 56, paragraph 6, IV.

3.4 Release of individual guarantors

The alternative plan shall necessarily release all personal guarantees (such as an aval or a surety) granted by individuals to impaired claims held by creditors who either supported the plan or who voted in favour of it.[37] As such, guarantees granted by entities – such as related companies – are not legally required to be released by the alternative plan.

The purpose of this requirement is to release shareholders and officers, who usually grant personal guarantees to creditors, especially local financial institutions. Since the enactment of Law 11,101, in 2005, there is an ongoing dispute in courts on whether a plan of reorganisation can create release in favour of such third parties, namely in respect to those creditors who vote against the plan or make a reservation in respect to such provision. Creditors willing to support or approve an alternative plan must release such individual guarantors, without reserving their right to dispute the matter in court. Creditors who vote against the alternative plan (or who abstain from voting) are not legally required to release the individuals who granted a personal guarantee to their claims and may bring to court any dispute in respect to provisions releasing such guarantors.

3.5 Prohibition to impose to the debtor or its shareholders a sacrifice higher than in a bankruptcy liquidation

The alternative plan cannot impose to the debtor or to its shareholders a sacrifice higher than what a bankruptcy liquidation would entail.[38] This should generally be interpreted as the creditors not being able to keep any equity value left in the debtor company after full satisfaction of their claims unless there is express consent of the shareholders.

It is unlikely, although possible, that there is equity value left in the debtor company. The debtor is not required to show proof of insolvency for the purposes of filing for reorganisation. In addition, Brazil adopts a cash-flow approach, and not a balance sheet test, towards bankruptcy. The court will commence a bankruptcy liquidation proceeding of a debtor who does not pay its obligations on the due date or who performs bankrupt acts (such as abandoning or selling its establishment). As having a negative net worth is not a requirement for filing either reorganisation or liquidation, it is possible that the value of the assets of a debtor company exceeds the amount of debt, thereby leading to the possibility, at least theoretical, of shareholders being left with equity value.

4. Negotiation and voting of the alternative plan

Law imposes no restrictions for creditors to negotiate an alternative plan. However, it may only be submitted to voting if the legal requirements mentioned above are met, and only after the expiration of the original stay of proceedings ordered by the court or the rejection of the debtor's plan. The procedure for deliberation and court confirmation of the alternative plan – and which mimics the step taken for approval of the debtor's plan – are explained below.

4.1 Drafting the plan and calling a creditors' meeting

The alternative plan which meets the requirements set forth by law may be submitted to voting at a creditors' meeting. If the alternative plan had been previously negotiated and agreed upon, it can, in principle, be approved shortly after the debtor's plan is rejected, and even at the same creditors' meeting. Otherwise, creditors holding at least 25% of the claims, in amount, in a class of claims, may request to the court that a creditors' meeting is convened with the purpose of deliberating on the alternative plan. Such creditors will bear the costs related to calling and installing the creditors' meeting.

The creditors' meeting will be convened on its first call if holders of more than 50% of the claims, in amount, in each class of claims, are present.[39] If not, the meeting will be convened on the second call (which should take place at least 5 days after the first call),[40] with any number of creditors.

4.2 Deliberation of the alternative plan

The plan will be confirmed by the court if approved in each of the following four classes of claims: (i) holders of labour-related claims; (ii) holders of secured claims; (iii) holders of unsecured claims; and (iv) creditors who qualify as small businesses under Brazilian law. The plan must be approved by more than 50% of the creditors, in number, in the first and fourth classes, and by creditors holding more than 50% of the claims, in both number and amount, in the second and third classes. All majorities are calculated based on the total claims

Notes

37 Article 56, paragraph 6, V.
38 Article 56, paragraph 6, VI.
39 Article 37, paragraph 2.
40 Article 36, I.

held by creditors attending the creditors' meeting and who cast a vote either in favour or against the plan (i.e., who do not abstain from voting).

If the required majorities in each class of claims are not obtained, the plan can still be confirmed by court under the cramdown provisions of Law 11,101, provided that the following cumulative requirements are met:[41] (i) creditors holding more than 50% of the total claims attending the creditors' meeting vote in favour of the plan; (ii) the plan is rejected in no more than one class of claims (being approved in all the others); (iii) creditors holding more than 1/3 of the claims (in number or in both number and amount) in the dissenting class vote in favour of the plan; and (iv) the plan does not entail different treatment among creditors in the dissenting class.

The thresholds for approval of the alternative plan are the same required for the debtor's plan – with the only difference that a debtor's plan requires the consent of the debtor on top of the favourable votes of the majority of the creditors.

4.3 Term of acceptance of the plan

As an option, the creditors' meeting may be replaced by a term of acceptance of any deliberation of the creditors, including on the alternative plan.[42] Submitting a term of acceptance may save time and costs associated with calling and convening a creditors' meeting.

The quorum requirements for any deliberation are the same regardless of whether it takes place at a creditors' meeting or is reflected on a term of acceptance.[43] However, in the case of a term of acceptance, all majorities will be calculated based on all the claims allowed in the reorganisation, as it is not possible to disregard creditors absent from a creditors' meeting which does not take place.

4.4 Deliberation of a plan under a bankruptcy liquidation

If the alternative plan is rejected (or if the creditors show no interest in submitting it after the rejection of the debtor's plan), and cramdown confirmation is not possible, the court will convert the reorganisation into a bankruptcy liquidation. In this case, the court-appointed judicial administrator will collect and sell the assets in a public auction or by another mean approved by the court – a procedure which, following the reform, is supposed to not take longer than 180 days[44] – and distribute the proceeds among the creditors.

As an alternative to such sale, it is possible for creditors to approve a liquidation plan – a possibility which has been present in Brazilian legislation for many years, but which has seldom been used, and may get some traction after the reform. Such plan could settle the debt by any means allowed by law, which may involve an acquisition of assets through a special purpose vehicle or a debt-for equity swap.[45] Any such transfer of assets is performed free and clear of all liabilities of the debtor.[46] Law contains no provision in the sense that the requirements for an alternative reorganisation plan are present in a liquidation plan.

The liquidation plan is considered approved with the vote of creditors holding at least 2/3 of the claims attending the creditors' meeting. It is also possible to replace the creditors' meeting for a term of acceptance, in which case the threshold will be calculated based on the total amount of claims allowed in the bankruptcy proceeding.

5. Conclusion

The reform addressed, among other measures, the concern that Brazilian insolvency law was excessively pro-debtor since it did not allow creditors to submit an alternative plan. In practice, poor reorganisation plans were frequently preferred by creditors over a bankruptcy liquidation, an even more gruesome alternative. The possibility of submitting a plan to voting without the consent of the debtor, as included in the new legislation, provided more bargaining power to creditors. By giving the creditors the chance to propose a plan, as an alternative to the liquidation scenario, the insolvency law ultimately incentivises the debtor to formulate better plans. Nevertheless, some creditors may be reluctant to use this tool, as it requires the release of individual guarantors. In addition, proposing the alternative plan may require relevant financial information that the debtor could be unwilling to provide and there may be some scepticism in respect to its efficiency as there is no significant body of precedents applying this mechanism. All in all, the new provision was received with cautious optimism, and under the right circumstances, it could still prove to be a powerful tool for creditors and investors.

Notes

41 Article 58, paragraph 1.
42 Article 39, paragraph 4, I.
43 Article 45-A, chapeau and paragraphs 1 and 2.
44 Article 22, III, 'j'.
45 Article 145.
46 Article 145, paragraph 1.

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