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Brazil

Restructuring & Insolvency

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This country-specific Q&A provides an overview of restructuring & insolvency laws and regulations applicable in Brazil.

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Brazil: Restructuring & Insolvency

1. What forms of security can be granted over immovable and movable property? What formalities are required and what is the impact if such formalities are not complied with?

As per Brazilian law, there are four different types of in rem security interests: pledge (penhor), antichresis (anticrese), mortgages (Hipoteca) and fiduciary liens (propriedade fiduciária). Mortgages and antichresis are, with few exceptions, established over real estate property, while a pledge can be established over movable assets. Fiduciary liens may be established over all kinds of assets, movable or immovable.

Perfection of security interests requires its registration within the competent registry (Real Estate Registry, Registry of Deeds and Documents or Board of Trade or specific registries depending on the underlying asset, such as trademarks, ships or airlines).

Debtor under judicial reorganization must obtain court authorization for encumbering its non-current assets if such encumbrance is not provided for in the judicial reorganization plan.

2. What practical issues do secured creditors face in enforcing their security package (e.g. timing issues, requirement for court involvement) in out-of-court and/or insolvency proceedings?

Legally available measures for foreclosing on security interests – as well as the related challenges – depend on the kind of security interest involved.

There is a general limitation for creditors to establish upfront in the security agreement that they may retain ownership of the collateral for the payment of a debt in an event of default, thus making the sale of the asset to third-parties mandatory.

Sale of collaterals extrajudicially tend to be faster and less expensive, but some types of security interests only allow foreclosure to be made in-court (e.g., most mortgages).

The stay provided during in-court restructuring cases prevents the enforcement of mortgages and pledges and may also limit the right to enforce fiduciary liens if the collateral is deemed essential for the debtor's restructuring (being the essentiality concept interpreted broadly by Brazilian courts).

Additionally, adequate protection is not granted to secured creditors, which means their recovery under liquidation may be lower than the value of their collateral. In the other hand, the sale of assets requires authorization from the holder of the security interest and release of liens over the collateral only occurs after payment of the secured claim, in accordance with the terms provided for in the plan of reorganization.

3. What restructuring and rescue procedures are available in the jurisdiction, what are the entry requirements and how is a restructuring plan approved and implemented? Does management continue to operate the business and / or is the debtor subject to supervision? What roles do the court and other stakeholders play?

Brazilian insolvency legislation encompasses judicial reorganization (*recuperação judicial*), a judicial proceeding for debt restructuring similar to Chapter 11 of the US Bankruptcy Code, and extrajudicial reorganization (*recuperação extrajudicial*), a mix between an out-of-court workout with a prepacked Chapter 11 of the US Bankruptcy Code.

Both the judicial and the out-of-court reorganizations are voluntary proceedings and have the same general filing requirements: (a) not being involved in a liquidation proceeding, and if it has been, the resulting liabilities must have been declared extinguished by a final decision; (b) not have been granted judicial restructuring within the last 5 years; and (c) not have been convicted nor have, as an officer or controlling stakeholder, a person who has been convicted, of any of the crimes provided for in Brazilian bankruptcy law.

In the extrajudicial reorganization, the debtor may establish the class or groups of claims to be restructured, as long as all creditors of the same established classes or group are subject to the proceeding in respect of legal limits. The debtor files for court ratification of a plan of reorganization that binds all creditors encompassed therein if it is approved by creditors representing more than half of all the claims of each class or group of

claims.

In the judicial reorganization, creditors are organized in four different classes establish by law: labor claims, secured claims (mortgage or pledge), unsecured claims and claims held by small businesses. All classes of creditors may vote a plan of reorganization that shall be submitted by the debtor to the court within 60 days as from the decision allowing the restructuring process to continue. Labor and small businesses classes approve the plan by simple head count majority of creditor present at the meeting, while secured and unsecured claims classes require majority of head count and of claim amount also present at the meeting. If approved, the plan of reorganization is subject to court confirmation, which happens without a hearing. Cramdown rules are also applicable in special circumstances. If the plan is rejected or not put to vote until the end of the stay period, creditors that meet specific requirements are entitled to submit an alternative plan. If the alternative plan is rejected or not presented, the judicial restructuring is converted into liquidation proceeding.

As a rule, the debtor under judicial reorganization or out-of-court reorganization remains in possession of all its assets, as does shareholders and management, which continues to operate its business. Management may be replaced by a court appointed management only in case of fraud.

A bankruptcy trustee is obligatorily appointed in a judicial reorganization to act as an assistant to the court for the main purpose of helping the court with financial and economic issues, being also responsible for reporting the fulfillment of all obligations provided for in the plan of reorganization, as well as for coordinating the acts of the proceeding, such as presiding the general meeting of creditors. The trustee does not take any part in the debtor's management. In an out-of-court reorganization, although not mandatory, a trustee may also be appointed for the same purpose as in the judicial reorganization, respected the particularities of each proceeding.

4. Can a debtor in restructuring proceedings obtain new financing and are any special priorities afforded to such financing (if available)?

A debtor in restructuring proceedings may obtain any new financing possible, such as DIP-finance funding transactions, which may or not require approval of the court or plan of reorganization, depending on the need to encumber non-current assets. The court can also authorize second rank security interests over the assets of the debtor (except those under fiduciary lien) regardless of the consent from the first ranked creditor.

If the restructuring proceeding is converted into liquidation, the financing will be paid with priority, which shall be respected even if the court order that authorized the financing is reversed after the funds have already been disbursed.

5. Can a restructuring proceeding release claims against non-debtor parties (e.g. guarantees granted by parent entities, claims against directors of the debtor), and, if so, in what circumstances?

The Brazilian bankruptcy law does not provide for release of non-debtor parties – to the contrary, it specifically provides that third-parties guarantee shall remain in place. The plan of reorganization, however, under the assumption that creditors may waive the guarantee, may provide for release of third parties guarantees, although such issue has sparked considerable controversy.

Such provision is usually considered enforceable only for those creditors who voted in favor of the plan of reorganization without any reserve to the release. Recent case law from the Superior Court of Justice, however, has in some cases considered such provision applicable to all creditors subject to the plan of reorganization, regardless of whether they voted for or against the plan of reorganization or reserved the release of guarantees.

6. How do creditors organize themselves in these proceedings? Are advisory fees covered by the debtor and to what extent?

During the restructuring processes, creditors may file proofs of claim to discuss the amount and/or the classification of their claims, which are administrative or judicial procedure, depending on the stage of the case.

The bankruptcy law provides for a general meeting of creditors, which is responsible for approving the plan of reorganization and all deliberations that may affect the creditors or the bankruptcy case. Decisions other than approving the plan of reorganization are taken by simple majority of claims amount held by creditors present ate the general meeting of creditors.

During the general meeting of creditors, they may deliberate to form a creditors' committee. Creditor's committee aims to facilitate negotiations among the creditors and the debtor, monitoring the progress of the

proceeding, and seeking solutions that serve collective interests. They are rarely formed in Brazilian cases, as the members of the committee are personally liable for its actions and the debtor is not responsible for paying costs expenses the creditors may incur in participating in such committee.

7. What is the test for insolvency? Is there any obligation on directors or officers of the debtor to open insolvency proceedings upon the debtor becoming distressed or insolvent? Are there any consequences for failure to do so?

Insolvency, for the Brazilian legislation purposes, is not a financial or business concept, but a legal one, and is characterized either by: (i) defaulting on a payment, without a relevant legal reason, provided that it greater than the equivalent of 40 minimum wages; (ii) failing to deposit or provide security for an attachment within the legal term provided for; or (iii) performing any of the acts deemed a "act of liquidation", unless they are part of a plan of reorganization. Even if the company's liabilities exceed its assets, which may result in a financial insolvency, the debtor would only be insolvent, in the legal sense, if it incurred in one of the items mentioned above.

There are no mandatory circumstances in which the directors or officers must necessarily cause the debtor to file for in-court reorganization or liquidation in Brazil, which are a shareholders' decision. Fiduciary duties require that management recommend to shareholders alternatives to address the financial crisis of the company and act diligently in view of a possible insolvency scenario.

8. What insolvency proceedings are available in the jurisdiction? Does management continue to operate the business and / or is the debtor subject to supervision? What roles do the court and other stakeholders play? How long does the process usually take to complete?

In a broad sense, insolvency procedures in Brazil encompass liquidation (falência), judicial restructuring (recuperação judicial) and out-of-court restructuring (recuperação extrajudicial).

For legally insolvent debtors, the Brazilian insolvency legislation provides for a single procedure: liquidation (falência), the equivalent in Brazil to a Chapter 7 of the US Bankruptcy Code, which may be either voluntary or involuntary. The debtor under liquidation is dissolved, management is removed, and all assets and liabilities are transferred to the bankruptcy estate. The debtor may not engage in any corporate activities until all its liabilities are deemed extinct or lifted by the bankruptcy court.

The estate remains under management of a court appointed bankruptcy trustee until it is collected and sold for the payment of creditors pursuant to the legally determined claim priority. The bankruptcy trustee is responsible for managing and representing the bankruptcy estate.

Law n. 14.112/2020, which substantially amended the Brazilian bankruptcy law in 2020, aimed to expedite the liquidation proceedings, stablishing deadlines for sale of assets, limiting the timeframe for filing new proofs of claim, and reducing the timeframe in which the debtor would remain liable for its liabilities. After a more than one year after its enactment, actual results of this legislative initiative are yet to be seen.

Brazilian Civil Code (Law 10,406/2002) and Brazilian Corporate Law (Law 6,404/1976) also establish the proceedings for out-of-court wind downs, which solely demands shareholder's approval. Other federal laws provide for different types of liquidation procedures for special entities such as banks and insurers.

9. What form of stay or moratorium applies in insolvency proceedings against the continuation of legal proceedings or the enforcement of creditors' claims? Does that stay or moratorium have extraterritorial effect? In what circumstances may creditors benefit from any exceptions to such stay or moratorium?

When the liquidation decree is issued, the debtor is dissolved, management is removed, and all assets and liabilities are transferred to the bankrupt estate. The debtor may not engage in any corporate activities until its liabilities are deemed extinct or lifted by the bankruptcy court pursuant to the law.

The decree of liquidation subjects all creditors and claims to the procedure (even those with special priorities may file claims within the bankruptcy court) and their payments are made after the sale of assets by the estate. Some type of claims and securities are allowed to request restitution of assets from the estate, which have priority in payment, but actual payment may happen only after court authorization. All assets of the debtor are part of the estate, regardless of their location or possession.

10. How do the creditors, and more generally any affected parties, proceed in such proceedings? What are the requirements and forms governing the adoption of any reorganisation plan (if any)?

The liquidation decree subjects all creditors (which may only exercise their rights over the assets of the insolvent entity in accordance with the bankruptcy law) and suspends the right of retention over the assets subject to collection. The acts of attachment and payment of claims are centralized, and individual executions are not allowed.

Creditors may establish a creditors' committee, whose main responsibilities are to oversee the activities of the bankruptcy trustee, ensure compliance with the law, and provide opinions on any matters of interest in the liquidation proceedings.

It is the duty of bankruptcy trustee to present, within 60 days from its appointment, a plan for collection and sale of assets of the estate, with an estimated time of no more than 180 days for the sale of each asset after its collection. A general meeting of creditors may deliberate on the adoption of any other method for the sale of assets or any other matter that may affect their interests, including the possibility for creditors to be awarded the assets sold in liquidation or to acquire them through the establishment of a company or investment vehicle, or by converting debt into equity.

11. How do creditors and other stakeholders rank on an insolvency of a debtor? Do any stakeholders enjoy particular priority (e.g. employees, pension liabilities, DIP financing)? Could the claims of any class of creditor be subordinated (e.g. recognition of subordination agreement)?

In a liquidation procedure, the payment priority order is established by law.

As amended in the 2020 reform, the Brazilian Bankruptcy law establishes the priority claims in this order: (i) amounts deemed indispensable for the estate's management, (ii) labor wages due during the 3 months prior to the liquidation (limited to 5 minimum salaries per employee), (iii) financings granted during judicial reorganization (DIP financing), (iv) restitution in cash, (v) fees payable to the bankruptcy trustee in charge of the estate, (vi) court costs, (vii) sums provided to the estate by the creditors and (viii) expenses of the estate with recovery of assets, asset realization and distribution of the proceeds.

Such claims have priority over secured creditor claims, as they are considered vital for the continuation of the liquidation procedure.

Creditors who have fiduciary liens over the assets of the debtor or who entered into special types of foreign exchange agreements (ACC) with the debtor may seek their collateral or money restitution, as applicable, at any time during the liquidation procedure. Payments are made in a waterfall manner, insofar as one class is only paid if the previous one has already been paid in full.

After payment of priority claims, payments are made to labor claims up to 150 minimum wages (exceeding amounts are considered unsecured claim), secured claims, tax claim, unsecured creditors, fines, subordinated claims, and interests accrued during liquidation, in this order.

Although subordination of claims is possible, it is uncommon, being used usually for shareholders claims (loans, dividends etc.).

12. Can a debtor's pre-insolvency transactions be challenged? If so, by whom, when and on what grounds? What is the effect of a successful challenge and how are the rights of third parties impacted?

There are basically two grounds to challenge pre-insolvency transactions: (i) look back period and (ii) fraudulent transactions.

Firstly, the liquidation proceeding entails a look-back period of at least 90 days prior to the liquidation petition, the in-court restructuring that preceded the liquidation, or the first official protest for lack of payment. Transactions entered during this period may be voided to the benefit of the bankruptcy estate – examples of such transactions are payments of undue debt, acts performed free of charge, and granting collateral for securing previously existing debt. These transactions may be voided after being challenged by creditors or interested parties, or even without prior challenge.

Additionally, transactions involving simulated or fraudulent acts which may violate creditors' rights may be nullified through a special lawsuit to be filed by interested creditors, the public prosecutor, or the bankruptcy trustee.

13. How existing contracts are treated in

restructuring and insolvency processes? Are the parties obliged to continue to perform their obligations? Will termination, retention of title and set-off provisions in these contracts remain enforceable? Is there any ability for either party to disclaim the contract?

As a rule, bilateral contracts remain valid and enforceable, and the parties are obliged to comply with them.

In Brazil, the reorganization procedures are a means to deal with debt restructuring, mainly through refinancing, discounts and grace periods, the sale of assets or a combination of all the aforementioned. Debtors are not entitled to assume or reject executory contracts, nor renegotiate the terms of its commercial agreements.

Ipso facto clauses are considered valid and enforceable by law, although courts tend to not enforce them as per request of the debtor, especially in agreements essential for a successful restructure of the business. All other cases of termination remain enforceable.

14. What conditions apply to the sale of assets / the entire business in a restructuring or insolvency process? Does the purchaser acquire the assets "free and clear" of claims and liabilities? Can security be released without creditor consent? Is credit bidding permitted? Are pre-packaged sales possible?

The Brazilian Bankruptcy Law does not restrict the sale of assets but imposes the need for prior judicial authorization or authorization under the plan of reorganization if the assets being sold or encumbered are non-current assets.

In the event the court authorizes the sale, creditors representing more than 15% of the total claim amount subject to the restructuring proceeding may, upon presenting a bond or collateral, request the summing of a general meeting of creditors to deliberate on the sale.

The debtor may set forth in the plan of reorganization the sale (i) of the entire business, (ii) of assets individually, or (iii) of assets organized in an isolated productive unit, which consists of a block of tangible and intangible assets that, acquired by a third party, allows it to maintain the development of the business.

The investor which acquires a productive unit or the entire business shall not succeed any of the debtor's liabilities if, as applicable: (i) all the legal requirements for the sale are met (which includes the need that the investor is not related to the debtor); and (ii) claims not subjected to the proceeding are ensured, in the sale of the entire business, at least same payment conditions they would have in the event of debtor's liquidation.

Credit bidding is permitted and secured in rem interests may not be released without express approval of the creditor holding the respective right over the collateral.

15. What duties and liabilities should directors and officers be mindful of when managing a distressed debtor? What are the consequences of breach of duty? Is there any scope for other parties (e.g. director, partner, shareholder, lender) to incur liability for the debts of an insolvent debtor and if so can they be covered by insurances?

Pursuant to Brazilian law, there are no modifications to the director's and officer's duties depending on the financial situation of the debtor, nor are they obliged to file for a restructuring proceeding, which ultimately is a shareholder's decision. Directors and officers must recommend alternatives to address the company's distress to shareholders and act diligently in view of a possible insolvency scenario.

As a rule, directors and officers are only liable if they breach their fiduciary duties or in case of willful misconduct, fraud or acts in violation of Brazilian law or of the articles of association of the debtor. In this case, creditors may file a specific procedure regarding the piercing of the corporate veil to assess the liability of shareholders, directors and officers, all with due regard for the ordinary procedure established in the Brazilian Civil Procedure Code.

Shareholder's, director's and officer's liabilities may be covered by specific insurances, which generally restricts the possibility of coverage to cases in which there was no bad faith, fraud or acts in violation of Brazilian law or of the articles of association of the debtor on the part of the insured person.

Also, if directors and officers are convicted of any of the crimes established under Brazilian Bankruptcy Law, they will temporarily lose their ability to remain directors or officers or practice any corporate duties of any businesses.

16. Do restructuring or insolvency proceedings have the effect of releasing directors and other stakeholders from liability for previous actions and decisions? In which context could the liability of the directors be sought?

Restructuring or insolvency proceedings do not have the effect of releasing directors and other stakeholders from liability for previous actions and decisions, but it shall be analyzed as per applicable law, as the Brazilian bankruptcy law does not impose any changes in director's and officer's duties.

As a rule, directors and officers are only liable if they breach their fiduciary duties or in case of willful misconduct, fraud or acts in violation of Brazilian law or of the articles of association of the debtor. In this case, creditors may file a specific procedure for piercing of the corporate veil to assess liability of shareholders, directors, and officers, all with due regard for the ordinary procedure established in the Brazilian Civil Procedure Code.

17. Will a local court recognise foreign restructuring or insolvency proceedings over a local debtor? What is the process and test for achieving such recognition? Does recognition depend on the COMI of the debtor and/or the governing law of the debt to be compromised? Has the UNCITRAL Model Law on Cross Border Insolvency or the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments been adopted or is it under consideration in your country?

Brazilian bankruptcy law has adopted the UNCITRAL Model Law on Cross Border Insolvency, by means of the enactment of Law 14.112/2020 on December 24, 2020, although it is still be seen how case law adapts.

Local court may recognize concurrent foreign bankruptcy proceedings upon request of the competent foreign representative, although the mere existence of creditors or assets in Brazil does not impose such recognition.

The court of the center of main interest of the debtor in Brazil has jurisdiction over the case and recognition request shall include a list of all foreign processes related to the debtor that are known to the foreign representative, as well as the applicable documents. The center of main interest is also the relevant test for deciding whether recognition may be granted.

18. For EU countries only: Have there been any challenges to the recognition of English proceedings in your jurisdiction following the Brexit implementation date? If yes, please provide details.

N/A

19. Can debtors incorporated elsewhere enter into restructuring or insolvency proceedings in the jurisdiction? What are the eligibility requirements? Are there any restrictions? Which country does your jurisdiction have the most cross-border problems with?

There is no legal prohibition for debtors incorporated in other jurisdictions to enter into restructuring or insolvency proceedings in Brazil and such possibility is supported by case law. The relevant test for recognition of the Brazilian jurisdiction over the case is the location of the center of the main interest of the company.

Most cross-border cases in Brazil involve U.S. jurisdiction over the case, mainly because the debtor issued bonds under New York law and the implementation of the plan of reorganization for such creditors requires U.S. recognition of the plan of reorganization and its confirmation.

20. How are groups of companies treated on the restructuring or insolvency of one or more members of that group? Is there scope for cooperation between office holders? For EU countries only: Have there been any changes in the consideration granted to groups of companies following the transposition of Directive 2019/1023?

Brazilian bankruptcy law does not provide for any special treatment for companies of the same economic group of a debtor. The effects of any bankruptcy are applicable only to the debtor. In practice, affiliates of the debtor are more susceptible to lawsuits aiming to pierce the corporate veil as to hold the third party responsible for the liabilities of the debtor.

Also, debtors may file a restructuring procedure for one or more entities in a procedural consolidation and may also attempt a substantial consolidation of all the entities' assets and liabilities. A substantial consolidation may occur for debtors that are part of a group under common

corporate control, subject to a vote by the General Creditors' Meeting. Exceptionally the court may allow a substantive consolidation, without the need of the creditors' vote, upon finding that the assets or liabilities of the debtors are commingled, in addition to verifying, cumulatively, at least 2 of the following: I –cross-guarantees; II – control or dependency relationship; III – identical, in part or totally, shareholders; and IV – undertaking of its businesses in conjunction as a group.

21. Is your country considering adoption of the UNCITRAL Model Law on Enterprise Group Insolvency?

Currently there is no legislative bill proposal aiming to adopt the UNCITRAL Model Law on Enterprise Group Insolvency.

22. Are there any proposed or upcoming changes to the restructuring / insolvency regime in your country?

The Brazilian bankruptcy law was recently and significantly modified by Law 14.112/2020, enacted on December 24, 2020 and in effect since January 23, 2020, so there is no foreseeable change to the law at this time.

23. Is your jurisdiction debtor or creditor friendly and was it always the case?

Brazil may be considered a debtor friendly jurisdiction.

The Brazilian Bankruptcy Law was enacted in 2005, changing a previous bankruptcy system focused on the liquidation of the debtor.

With the enactment of Law 14,112/2020 during the current crisis, the bankruptcy law was substantially changed, among which is the inclusion of several creditor friendly mechanisms, such as the possibility of creditors presenting an alternative reorganization plan, the limitation of the stay period for 360 days and the possibility for the general creditors' meetings to decide on the sale of debtor's non-current assets in certain circumstances. Up to this moment, case law has considered to interpret the bankruptcy law more permissively to the debtor, under the assumption that such interpretation would improve the chances of a successful restructuring.

24. Do sociopolitical factors give additional influence to certain stakeholders in restructurings or insolvencies in the jurisdiction (e.g. pressure around employees or pensions)? What role does the State play in relation to a distressed business (e.g. availability of state support)?

Socio-political factors may play an important role in bankruptcy cases, especially for companies which are considered relevant employers and taxpayers, either on a local or on a national basis. Although they are usually not indicated as a basis for court decisions, these situations may influence the case, usually in direction of preserving the company and the going concern value of the business.

25. What are the greatest barriers to efficient and effective restructurings and insolvencies in the jurisdiction? Are there any proposals for reform to counter any such barriers?

One of the main barriers to effective restructuring of companies in financial distress is the exclusion of certain claims from the effects of the restructuring procedure, such as fiduciary liens and credits arising from advancing foreign exchange contracts, and tax claims, which, together, represent a relevant part of the indebtedness.

Such exclusions do not allow a complete restructuring of the company, and, at the same time, do not represent a great privilege to relevant creditors, as they are not entitled to foreclose the assets of the debtor for their payment during the bankruptcy case.

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