INSOL International

Module 4B

Guidance Text

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INSOL INTERNATIONAL
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CERTIFICATE
in INTERNATIONAL INSOLVENCY LAW

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CONTENTS

1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN BRAZIL

Welcome to **Module 4B**, dealing with international insolvency law in **Brazil**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of insolvency law in Brazil;
- a relatively detailed overview of Brazil's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of Brazil.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST on 31 July 2021**. Please consult the Foundation Certificate in International Insolvency Law website for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2021 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in Brazil:

- the background and historical development of insolvency law in Brazil;
- the various pieces of primary and secondary legislation governing Brazilian insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;
- the rules of international insolvency law as they apply in Brazil;
- the rules relating to the recognition of foreign judgments in Brazil.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Brazilian insolvency law; and
- be able to answer questions based on a set of facts relating to Brazilian insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO BRAZIL

Following more than three centuries under Portuguese rule, the Federative Republic of Brazil (Brazil) gained its independence in 1822, maintaining a monarchical system of government until 1889, when the country adopted the republican system. To this day Brazil is organised under a presidential republic. The country is located in South America, with around 210 million people spread within 8,516,000 Km². With a GDP of USD 1.84 trillion in 2019,[1] Brazil is the ninth-largest economy in the world.

The powers of the Union are the Executive, the Legislative and the Judiciary, which are independent and harmonious among themselves. The President is the head of the Executive and is directly elected by the citizens; he is the Chief of State and Head of Government. The Legislative is divided into two houses: the House of Representatives and the Senate, both elected by the citizens. The Judiciary has a main division: state-level (which includes the federal district) and federal-level justice, both comprised of first instance courts and courts of appeal. The Judiciary is comprised of judges who are not elected, but recruited by public exams. Exceptions apply with regards to the courts of appeal, where one-fifth of its members are chosen among prosecutors – who have to meet the criterion of at least 10 years of experience working as prosecutors – and among lawyers – who must meet the criteria of outstanding legal knowledge, unblemished conduct and at least 10 years of practice. The third and final instance of the Judiciary is composed of two superior courts: the Federal Supreme Court (*Supremo Tribunal Federal* – STF), which decides on constitutional matters, and the Superior Court of Justice (*Superior Tribunal de Justiça* – STJ), which decides on non-constitutional matters. Both courts are comprised of justices appointed by the President, chosen among individuals aged between 35 and 65. One-third of the justices of the Superior Court of Justice are chosen among the judges of the federal courts of appeals, one-third among the judges of the state courts of appeals, one-third, alternatively, between federal or state prosecutors and lawyers. There are also specialised courts to deal with labour, electoral and military disputes.

Brazil follows a federative system, dividing its organisation into three (3) different levels of federative units: the Union, the States and the Municipalities. Brazil is divided into 26 states and a Federal District. Each has its own governor and a house of representatives. Each state is further divided into municipalities and each one has its own mayor and a city council. Except for Senators, who remain in office for eight years, the remaining political positions are served for a four-year term.

[1] See https://data.worldbank.org/country/BR?locale=pt.

The Federal Constitution, enacted in 1988, is the supreme law of the country. The Constitution limits the powers of the federal, state and local governments and establishes the matters to be governed by federal, state or local legislation, as well as the field of competences of the Judiciary. Concerning legislation hierarchy, the Constitution is followed by complementary laws (which complement Constitutional provisions) and ordinary laws (which may be enacted by the Union, the States or Municipalities).

Brazilian law is based on statutes and derives mainly from the civil law systems of European countries (especially Portuguese law), being related to the Roman-Germanic legal tradition. More recently, an influence from the decision-making rule has been felt: a constitutional reform from 2004 has introduced a mechanism similar to the *stare decisis* (*súmula vinculante*) and there are other new rules regarding the subject in specific statutes, such as the Civil Procedure Code.

Despite being a federation, most of the relevant pieces of legislation are federal ordinary laws. The main reason behind this is the fact that the Union has the exclusive power to legislate on civil, commercial, criminal and procedural law, among other specific matters.[2] However, state-level justice has the jurisdiction to judge commercial disputes – including those regarding insolvency law.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal System

The history of Brazilian insolvency law shows a legislative fragmentation. The raison d'être of such fragmentation derives, directly or indirectly, from the frustrated attempt of the legislator to resolve economic crises without seeking coherent system solutions that are adequate to the country's reality.

In addition to Portuguese laws, applied as a result of the colonial period, Brazil has had at least seven major insolvency laws since its Independence, which can be divided into four phases:

Colonial Period (Portuguese statutes)		
Legal frame	**Enactment**	**Period of validity**
Portuguese Afonsine Ordinances	1446	1500-1514
Portuguese Manueline Ordinances	1514	1514-1603
Portuguese Philippine Ordinances	1603	1603-1916
Imperial Period		
Commercial Code of 1850	1850	Until 1890
Republican Period		
Federal Decree 917/1890	1890	Until 1902
Federal Law 859/1902	1902	Until 1908
Federal Law 2.024/1908	1908	Until 1929
Federal Decree 5.746/1929	1929	Until 1945
Federal Decree-Law 7.661/1945	1945	Until 2005
Current Period		
Federal Law 11.101/2005	2005	In force

[2] For a full list on the matters on which the Union has the exclusive power to legislate, see Article 22 of the Constitution at http://english.tse.jus.br/arquivos/federal-constitution.

The current Brazilian Restructuring and Bankruptcy Law, Federal Law 11.101, was enacted on 9th February 2005 (the "Bankruptcy Law"). This law replaced Decree-Law 7.661/1945, which had been in force for 60 years.

Inspired by the US Bankruptcy Code and the World Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, the Bankruptcy Law regulates bankruptcy, judicial recovery and extrajudicial recovery proceedings. The statute also has provisions on bankruptcy crimes.

The Bankruptcy Law broke the persistent – and culturally rooted – "creditor-debtor" pendulum paradigm, in an endeavour to preserve the enterprise, not exclusively in favour of the debtor but – in theory – in favour of all the creditors and other stakeholders. It was a huge change in Brazilian bankruptcy law.

The Bankruptcy Law offers debtors more effective means to overcome financial and economic crises (judicial and extrajudicial recovery) if compared to the old *concordata*, a proceeding that existed under the previous statute and which only allowed for the debtor to postpone payment to unsecured creditors or to pay unsecured creditors with haircuts. The judicial and extrajudicial recovery's aim is to allow for the debtor's economic and financial crises to be overcome in order to preserve the productive source, the workers' jobs and the creditors' best interests, while ensuring the enterprise's survival, thus promoting its social purpose and encouraging economic activities. The bankruptcy proceeding also seeks to be more effective than it was in the old Federal Decree-Law 7.661/1945: the liquidation perspective is to quickly remove unsuitable enterprises from the business fields while also aiming to maintain the continuity of the business activity (to the greatest possible extent).

Since its enactment in 2005, the Brazilian Bankruptcy Law has been amended a few times by other pieces of legislation: Complementary Law 147/2014, Federal Law 11.196/2005, Federal Law 11.127/2005 and Federal Law 12.873/2013, which introduced rules aiming to improve the position of micro and small enterprises as creditors;[3] to limit the remuneration of insolvency trustees in cases where the debtor qualifies as a micro or small enterprise;[4] to clarify requirements for the filing by legal entities in the agribusiness; to facilitate the lease of assets during liquidation whenever necessary to preserve their value;[5] to enhance the position of holders of lease of aircrafts and their parts.[6]

Specific legislation might be applicable to certain kinds of businesses, as we will see in paragraph 6.1 below.

4.2 Institutional Framework

Brazil has a range of different courts composing its Judiciary. There are Federal Courts – divided in courts of first instance and five Regional Federal Courts of Appeals (also, the creation of the sixth Regional Federal Court has been recently approved by Congress) –, Labour Courts – courts of first instance, 24 Regional Labour Courts of Appeals and the Superior Labour Court – and State Courts –

3 Bankruptcy Law, Arts 26 IV, 41 IV, 45(2), 83 IV d).
4 *Idem*, Art 24(5). Despite other requirements imposed by law, a micro enterprise is an individual entrepreneur or business legal entity whose gross revenues do not exceed BRL 360,000, whereas a small enterprise is an individual entrepreneur or business legal entity with gross revenues between BRL 360,000 and BRL 4,800,000.
5 *Idem*, Art 192, para 5.
6 *Idem*, Art 199, main section and paras.

divided in courts of first instance and State Courts of Appeals in each of the twenty-six States and the Federal District. Additionally, the Judiciary also comprises specialised courts to deal with electoral and military disputes. Finally, Brazil has two apex courts: the Superior Court of Justice and the Supreme Federal Tribunal.

The Superior Court of Justice, among other matters, has the jurisdiction to decide special appeals filed on cases decided, in a sole or last instance, by the Federal Regional Courts or by the Courts of Appeals of each of the states or of the Federal District, when the decision appealed (a) is contrary to a treaty or a federal law, or denies its effectiveness; (b) considers valid an act of a local government contested in the light of a federal law; or (c) gives a certain federal law a different interpretation than the one given by another court.[7] In other words, the Superior Court of Justice has jurisdiction over non-constitutional matters, with the primary goal of granting uniformity to the decisions of second instance courts about federal law.

The Federal Supreme Court, on the other hand, has the purpose of safeguarding the Constitution. It is competent to decide (a) direct actions of unconstitutionality of a federal or state law or normative act, and declaratory actions of constitutionality of a federal law or normative act, as well as (b) extraordinary appeal in cases decided in a sole or last instance, when the decision appealed (i) is contrary to a Constitutional provision, (ii) declares a treaty or a federal law unconstitutional, (iii) considers valid a law or act of a local government contested in the light of the Constitution, or (iv) considers valid local law contested in the light of federal law.[8]

Insolvency proceedings are run at the state-level Judiciary: first instance courts, State Courts of Appeal and apex courts (if applicable). Several judicial districts have civil, criminal and other specialised courts of first instance, but it is rarer to find courts that are specialised in insolvency proceedings. In less populated judicial districts, the same single court might have jurisdiction over civil, commercial and criminal matters. In other words, in some places the same state judge may be responsible for deciding criminal and civil matters and also be in charge of the judicial recovery and bankruptcy proceedings. In some larger and more developed judicial districts, however, there are courts that are specialised in business matters or even in insolvency proceedings exclusively.

In all the procedures regulated by the Bankruptcy Law, the criterion for determining which court has jurisdiction depends on the location of the main establishment of the debtor.[9] The wording “main establishment” gave rise to an early discussion on whether the main establishment should be the place where the administrative decisions take place or the one with the most significant economic activities; it is certain, however, that the main establishment is not necessarily the company’s registered office.

The Second Joint Panel of the Superior Court of Justice, in ruling on Conflict of Jurisdiction No. 32,988, decided, in the wake of the understanding existing under the old bankruptcy law, Decree-Law 7.661/1945, that the forum with jurisdiction to process the judicial and the extrajudicial recoveries as well as the bankruptcy proceeding would not necessarily be that of the registered office, but rather that of the place where the business activity remains centralised, forming the vital centre of

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7 For the full list of cases which can be decided by the Superior Court of Justice, see Art 105 of the Brazilian Federal Constitution at http://english.tse.jus.br/arquivos/federal-constitution.

8 For the full list of cases which can be decided by the Federal Supreme Court, see Art 102 of the Federal Constitution at http://english.tse.jus.br/arquivos/federal-constitution.

9 Bankruptcy Law, Art 3.

the main activities of the debtor[10] – and probably where its main assets are.[11] In a more recent decision, the Second Joint Panel of the Superior Court of Justice reaffirmed the same understanding, but added that the main establishment should be the place where the debtor has the higher turnover; in other words, the most important place from a business perspective.[12] However, the Court of Appeals of the State of São Paulo, by its Second Chamber Reserved for Business Matters, in a 2017 decision, ruled that the main establishment in the case was the place where the administrative, financial, commercial and operational decisions were taken and not the place where the industrial plant was located.[13] There are also decisions that used both criteria ("centre of activities" and "decision-making centre") as a basis for establishing the competence, mainly because usually there is a coincidence between them.[14]

In conclusion, the definition of what the main establishment is always demands the examination of facts and evidence.

When the case is filed in a civil court, not specialised in business matters and / or insolvency, it is more likely that it will take longer for a case to be processed. The same fact will probably increase the likelihood of unexpected decisions and the number of appeals as a result of that, as well as a decrease on the rate of the credit recovery and an increase of the costs of the proceeding. The World Bank Doing Business ranks Brazil 77th among 190 countries in resolving insolvency.[15] According to research conducted during 2013, which referred to several cases in the districts of São Paulo / SP, Belo Horizonte / MG and Contagem / MG, on the one hand a bankruptcy proceeding lasts on average nine years in Brazil, the total recovery rate of creditors is 12%, the costs incurred in liquidation are equal to 35% of the final value of the assets of the bankrupt estate and the bankrupt estate's assets lose 47% of its value; on the other hand, judicial recovery proceedings last four years, the direct costs are equal to 26% of the initial assets of the firm and the credit recovery rate is 25%, on average.[16]

Inside insolvency, a creditor often adopts a more passive role with regards to recovering his credit. In broad terms, a creditor who is subject to an insolvency proceeding has to ensure his claim is duly listed in the case's most recent public notice containing the full list of creditors, especially with regards to the value and the class in which the claim was inserted. In case the actual claim and the listed claim

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10 STJ, CC 32.988, Reporting Justice Sálvio de Figueiredo Teixeira, decided on November 14th, 2001.

11 TJSP, AI 990.09.372608-4, Chamber Reserved for Bankruptcy and Judicial Recovery, Reporting Appellate Judge Elliot Akel, decided on June 1st, 2010; TJSP, AI 642.782-4/0-00, Chamber Reserved for Bankruptcy and Judicial Recovery, Reporting Appellate Judge Elliot Akel, decided on June 30th, 2009.

12 STJ, AgInt on CC 147.714, Reporting Justice Luis Felipe Salomão, decided on February 22nd, 2017. See also, among others: TJRS, AI 70060247848, Fifth Civil Chamber, Reporting Appellate Judge Jorge Lopes do Canto, decided on June 26th, 2014 (It should be noted that the main establishment is measured by the concentration of the company's largest turnover, which may or may not coincide with the head offices).

13 TJSP, AI 2230327-51.2016.8.26.0000, Second Chamber Reserved for Business Matters, Reporting Appellate Judge Alexandre Marcondes, decided on April 11th, 2017. See also: TJSP, ED 2062296-73.2013.8.26.0000, Second Chamber Reserved for Business Matters, Reporting Appellate Judge Lígia Araújo Bisogni, decided on October 8th, 2014; TJSP, AI 0080995-49.2013.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appellate Judge Alexandre Marcondes, decided on May 21st, 2013.

14 STJ, Second Joint Panel, CC 37.736, Reporting Justice Nancy Andrighi, decided on June 11th, 2003; TJMG, AI 1.0525.13.017952-2/001, Eighth Civil Chamber, Reporting Appellate Judge Edgard Penna Amorim, decided on December 11th, 2014; TJSP, AI 0124191-69.2013.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appellate Judge Alexandre Marcondes, decided on December 5th, 2013.

15 See https://www.doingbusiness.org/en/data/exploreeconomies/brazil.

16 See http://www.scielo.br/pdf/rdgv/v13n1/1808-2432-rdgv-13-01-0020.pdf. According to the World Bank Doing Business (https://www.doingbusiness.org/en/data/exploreeconomies/brazil), in São Paulo the credit recovery rate is 18.2 cents on the dollar, the average time of an insolvency proceeding is four years, the cost of the procedure (% of estate) is 12% and the strength of insolvency framework index (0-16) is 13.0.

diverge – or in case the claim is not listed at all – the creditor has to present a proof or divergence to the judicial administrator, introducing evidence to support the claim.[17] In case the judicial administrator does not agree with such request, a creditor can also seek the listing of his claim by judicial means, filing a challenge[18] to the claim listing, initiating a new and independent lawsuit. Once the claim is duly listed, the creditor may negotiate the recovery plan and supervise the proceeding; the creditor must await its payment according to the recovery plan or to the extent that the liquidation of the estate allows.

Even upon an insolvency proceeding of the debtor, some creditors might hold specific securities or contracts which grant their claim immunity to any sort of restructuring. That is the case, for instance, for creditors secured by a fiduciary title on a given asset. Despite not being subject to the insolvency proceedings, these creditors may not retake possession of the collateral during the stay period (which lasts for 180 days, although several court decisions have extended this term under certain circumstances).

Outside of insolvency, on the other hand, most creditors will have to turn to the Judiciary in order to seek payment of the amounts owing to them. In that sense, Article 784, items I-XII, of Federal Law 13.105/2015 (the Brazilian Civil Procedure Code) lists the documents that are characterised as extrajudicial enforceable titles under Brazilian law, meaning that such documents can be used to start enforcement procedures without the need for prior judicial debate on the facts that gave rise to the title or its enforceability. The documents that allow for the direct initiation of an enforcement procedure are the following:

a) bills of exchange, promissory notes, invoices, bonds and cheques;

b) public deeds or other public documents executed by the debtor;

c) a private document executed by the debtor and by two witnesses;

d) a transaction instrument ratified by the Public Prosecutor's Office, by the Public Defender's Office, by the Public Attorneys' Office, by the lawyers of the parties to the transaction or by a conciliator or mediator accredited by the court;

e) a contract guaranteed by a mortgage, pledge, *antichresis* or other security interest and one guaranteed by a bond;

f) a life insurance contract in case of death;

g) a claim arising from annual rent and emphyteusis;

h) a claim, supported by documentary evidence, arising from the rental of real property, as well as additional charges, such as condominium fees and expenses;

i) a certificate of overdue tax liability issued by the Federal, State, Federal District and Municipal Tax Authorities, relative to claims registered pursuant to the law;

[17] Bankruptcy Law, Art 7, Para 1.
[18] Bankruptcy Law, Art 8.

j) claims relative to the ordinary and extraordinary fees of a residential condominium, provided for in the respective agreement or approved at a general meeting, provided there is documentary evidence;

k) a certificate issued by a notary public or registry office relative to fees and other expenses due for the acts performed by them, as determined in the legally established price lists;

l) all the other instruments which, as expressly provided by law, are enforceable.

Thus, someone who has a claim (i) based on any of these documents or on a judicial title and (ii) and that is certain in terms of existence and value,[19] is allowed to initiate a foreclosure action (an execution proceeding). In case a creditor does not hold any of the above documents, he may still file a suit against the debtor. In such a case, the judicial proceeding initiates by a cognisance phase, which transitions into an enforcement phase in case there is a judgment in favour of the creditor. The cognisance phase allows for an ample discussion on facts and allows the debtor to present an extensive defence. In conclusion, the lack of an extrajudicial executive title makes the recovery of the claim less certain and less rapid.

Certain securities, however, allow for the immediate repossession of the collateral without the need to involve the Judiciary. That is the case of creditors guaranteed by a fiduciary title on a certain asset. This kind of security is in most of the cases exclusively held by financial institutions.

It is hard to estimate how long judicial lawsuits take in Brazil. The place where the lawsuit is filed; whether the court is specialised in enforcement proceedings; the kind of security; court and register bureaucracy; and the economic-financial situation of the debtor are among the factors that might affect the timeframe. On average, execution proceedings last six years and six months at federal level and four years and two months at state level.[20] The World Bank Doing Business ranks Brazil in 58th among 190 countries in terms of enforcing contracts.[21]

Brazil does not have an insolvency regulator. The most recent proposed statutes aiming to reform the national insolvency system also make no reference to the creation of such an agency.

Self-Assessment Exercise 1

Question 1

Is it fair to say that in Brazil anyone holding a written document is allowed to file a foreclosure lawsuit, with no need for a previous cognisance phase to determine the validity and liquidity of the claim?

Question 2

Is a debtor authorised to file for judicial recovery in any of the courts where it has a branch?

[19] Brazilian law uses the term *dívida líquida e certa*.
[20] See https://www.cnj.jus.br/wp-content/uploads/2020/08/WEB-V3-Justi%C3%A7a-em-N%C3%BAmeros-2020-atualizado-em-25-08-2020.pdf.
[21] See https://www.doingbusiness.org/en/data/exploreeconomies/brazil.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

Several forms of security are available under Brazilian law in order to grant priority to creditors over certain assets in case the debtor goes into bankruptcy, judicial recovery or extrajudicial recovery. The available securities are divided into two main groups: (i) *in rem* guarantees, which are backed by a certain asset or group of assets, and (ii) personal guarantees.

The following *in rem* guarantees are available under the Brazilian legal system:

a) pledge;

b) mortgage;

c) *antichresis*; and

d) fiduciary title.

Personal guarantees, in contrast, do not grant priority over assets of the debtor but make third parties liable for the payment of the debtor's debts. Personal guarantees are divided into a) *fiança* and b) *aval*.

Starting with the *in rem* guarantees group, a pledge is an *in rem* lien on movable assets. In general, a pledge depends on the actual tradition (transference) of the collateral to the creditor; in other words, the creditor takes possession of the asset offered by the debtor to guarantee the transaction. With a pledge of receivables, sometimes there is a transfer of the physical document that represents the claim (such as a promissory note or a bill of exchange), but in other cases this transfer does not happen. In any case, in order for the pledge of a receivable to be enforceable against third parties, it is necessary to notify the third-party debtor that the claim was pledged to a certain creditor and that, present certain circumstances, payment must be made directly to the pledgee.

In order to be valid and enforceable against third parties, a pledge needs to be registered with the Registry of Titles and Documents of the places where the parties are domiciled.[22] Unlike standard registration at the Registry of Titles and Documents, certain assets lead to special registration provisions:

a) a pledge of shares must be registered in the company's book of nominative shares. If the company has book entry shares, the pledge needs to be registered with the financial institution which is responsible for the book entries;[23]

b) a pledge of a vehicle needs to be registered with the state department of registry of vehicles of the state where the vehicle is registered.

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22 Federal Law 10.406/2002 (the Civil Code), Art 1.462; Federal Law 6.015/1973, Arts 127, II and IV, and 129, item 7.

23 Federal Law 6.404/1976, Art 39, main section and first para.

There is no specific rule regarding additional registration of the pledge of quotas of a limited liability company, but it is recommendable to register the pledge agreement with the Board of Trade and to make reference to the existence of the pledge in the articles of association of the company.

On the other hand, a pledge of machinery and equipment must be registered with the Real Property Registry of the place of the real property in which the machinery and equipment are.[24] The so-called rural pledge – which offers livestock, growing or unharvested crops, processed or stored produce, cut firewood and vegetable charcoal as collateral – must be registered with the Registry of Real Properties of the place where these assets are located.[25]

In the financial market, it is common to see receivables pledge agreements where the debtor is required to collect the receivables through specified bank accounts. This kind of structure allows banks to immediately seize the deposited proceeds in case of default.

A second kind of *in rem* guarantee, the mortgage, is an *in rem* lien on real property and certain other assets for security for the payment of a debt. The following assets and rights might be hypothecated:

(a) immovable properties and their accessories;[26]

(b) ownership rights on immovable properties;

(c) railroads;

(d) vessels;

(e) aircrafts, their engines, parts and accessories.[27]

In order to be valid and enforceable against third parties, a mortgage of real properties with value higher than thirty minimum wages must be created by a public deed[28] and it must also be annotated in the records of the real property with the Real Estate Registry. A public deed is not necessary when the mortgage is created in connection with finance agreements entered into with financial institutions within the National Housing System.[29] Mortgages guaranteeing certain securities also do not require public deeds in order to be duly created.[30]

A mortgage of an aircraft and its parts must be registered with the National Registry of Aircrafts[31] and a mortgage of vessels must be registered with the Maritime Court.[32]

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24 Federal Law 10.406/2002, Art 1.448 and Federal Law 6.015/1973, Art 167, item 4.
25 Federal Law 10.406/2002, Art 1.438 and Federal Law 6.015/1973, Art 167, item 15.
26 Accessories are assets incorporated to the land, which cannot exist without it. For instance, additional constructions or trees. Note, however, that a standing forest, if located in the property and duly annotated in the records of the real property, might be sold separately and, in this case, is considered as a movable asset.
27 Federal Law 7.565/1986, Art 138 main section and first para.
28 In Brazil, agreements to transfer ownership on real property or to create *in rem* liens on real property must be prepared by and signed before a public notary. Certain exceptions to this rule exist for transactions within the financial market. See Civil Code, Art 108.
29 Federal Law 4.380/1964, Art 61, para 5.
30 Federal Decree-law 167/1967, Federal Decree-law 413/1969, Federal Law 8.929/1994, Federal Law 10.931/2004.
31 Federal Law 7.565/1986, Art 141.
32 Federal Law 7.652/1988, Art 12.

The State of São Paulo Appellate Court decided an interesting case involving a maritime mortgage on a Liberian vessel. In the case, BTG Pactual Cayman Branch filed a foreclosure lawsuit against the debtor OSX 3 Leasing (a BV company) and attached the vessel, which was registered in Liberia. Nordic Trustee ASA opposed the attachment, on behalf of bondholders (bonds were issued in the Norwegian capital market). The court ruled that the mortgage was not valid because: (i) Liberia was not a signing party to any international treaty adopted by Brazil recognising the validity of a mortgage on a vessel registered in a country other than Brazil, (ii) according to Brazilian law, the law of the domicile of the owner shall apply to movables taken to other places by the owner as well as to define whether an asset should be considered movable. However, the court said this rule is only applicable to assets that can be easily moved from one place to the other, which was not the case because the vessel was not built to navigate but, instead, was built in Singapore and sent straight to Brazil where it would stay for 20 years at the Brazilian coast, to be used as a platform for oil exploration. Consequently, it was decided that the Dutch law should not be applied, despite the fact that the owner of the Vessel was domiciled in the Netherlands.[33] The Superior Court of Justice, however, reversed the Appellate Court's judgment in light of international treaties Brazil is a part of and considered the maritime mortgage as a valid guarantee.[34]

Another type of *in rem* lien is the *antichresis*, an agreement by which the debtor assigns to the creditor the income from immovable properties. However, this is not a commonly used form of security.

It is important to point out that in judicial or extrajudicial recovery and in bankruptcy, the security with *in rem* guarantees is a secured claim only up to the limit of the value of the asset serving as a guarantee. The amount owing that is not covered by the value of the asset is considered unsecured.

Presenting more relevant distinctions, a fiduciary title is also an *in rem* lien on assets securing the payment of a debt. The two main differences between the fiduciary title and the mortgage (and other *in rem* guarantees) is that the title to the property of the asset is transferred to the creditor, who can sell the property in case of default without the need to go to court. Also, in judicial or extrajudicial recovery, or bankruptcy of the debtor, the creditor keeps the right, under certain circumstances, to take possession of the asset and sell it outside the bankruptcy proceedings. This is the reason why fiduciary title is increasingly used when compared to other types of *in rem* guarantees (especially pledge and mortgage).

There is no need for a public deed, but the agreement must be duly annotated with the Real Estate Registry, with the National Registry of Aircrafts or with the Maritime Court if the assets are, respectively, real property, an aircraft or a vessel. A fiduciary title on a vehicle must be registered with the state department of registry of vehicles of the state where the vehicle is registered. Fiduciary title on other movable assets (not vehicles) must be registered with the Registry of Titles and Documents of the place where the debtor is domiciled.

However, the Superior Court of Justice, in a case decided on 17 December 2015, made a distinction between a fiduciary title on tangible movable assets on the one hand and a fiduciary title on fungible assets and fiduciary assignment of receivables,

[33] TJSP, AI 2153991-40.2015.8.26.0000, Thirteenth Chamber of Private Law, decided on February 13th, 2016.
[34] STJ, REsp 1.705.222, Fourth Panel, Reporting Justice Luis Felipe Salomão, decided on November 16th, 2017.

on the other.[35] The Fourth Panel of the Superior Court, in a 3 to 2 majority decision, decided that, according to Federal Law 10.931/2004, Article 66-B, the registration of the fiduciary title is not a requirement for the perfection of the fiduciary ownership of fungible assets and for the fiduciary assignment of receivables. In such cases, registration is only necessary to enforce the security against third parties. As a consequence, a claim guaranteed by a fiduciary assignment of receivables must be enforceable in a recovery proceeding even if the registration is made after the filing of the recovery proceeding. The minority, however, argued that the other creditors of the Debtor under recovery are affected by the existence of this kind of security because a claim secured by a fiduciary title will not be subject to the same haircuts and the other terms and conditions imposed by the recovery plan to other creditors. The dissenting minority also argued that creditors cannot be surprised by the existence of securities that were not made public, creating an open avenue for fraud.

Along with some other guarantees, certain types of contracts are not subject to judicial or extrajudicial recovery and bankruptcy. This is the case with two popular business agreements: lease with option to purchase contracts[36] and advances on foreign-exchange contracts.[37] A lease-purchase agreement grants the debtor the option to acquire the object of the lease at the term of the contract; since the creditor retains title to the asset until the option is made and executed, the property rights prevail and any claim arising out of such contract is not subject to a restructuring procedure. On the other hand, advances on foreign-exchange contracts are popular agreements among companies that export goods – the advances allow for the exporter to finance its activity. Once again, the property rights will prevail: not only are such claims not subject to a judicial recovery or bankruptcy procedure, but financial institutions may even file for the restitution of advances that have already been made.

Secured assets in cases of pledge, mortgage and *antichresis* fall in the insolvent estate upon bankruptcy and are subject to judicial and extrajudicial recovery,[38] but the holders of fiduciary titles (as well as creditors of lease with option to purchase contracts and of some other types of contracts) can enforce their security outside the insolvency process. However, during the 180-day stay period provided for in the case of judicial recoveries, the creditor is not allowed to sell or remove from the debtor's establishment any capital goods which are considered to be essential to the debtor's business.

Even though fiduciary titles should provide for a quicker recovery of the collateral, it is still a very common situation under judicial recovery cases for a creditor who has a perfected security interest on a certain asset to not be allowed to take possession of the asset. This seems to be perfectly valid during the 180-day stay period, since Article 49, Paragraph 3, of the Bankruptcy Law states that essential capital goods may not be removed from the debtor's establishment during that period. The problem, however, is that even after this term creditors might face difficulties in taking possession of the asset if the court considers the asset as being fundamental for the turnaround.

For one, the 180-day stay period has been extended in several cases when the debtor was not responsible for not approving a plan within this period (the ideal time

35 STJ, REsp 1.412.529, Fourth Panel, Reporting Justice Marco Aurélio Bellizze, decided on December 17th, 2015.
36 See Bankruptcy Law, Art 49, third para.
37 *Idem*, Art 49, para 4 and Art 86, item II.
38 Bankruptcy Law, Art 49.

frames provided by the Bankruptcy Law are not always met in reality).[39] On top of that, the Superior Court of Justice has already decided that creditors cannot automatically resume foreclosure measures as soon as the 180-day term is over.[40] No expropriation can occur without the consent of the Bankruptcy Court. This scenario sometimes makes it very difficult for the holder of a fiduciary title to enforce his rights, especially as the Courts tend to judge in favour of the debtor. In addition to that, furthering the challenges faced by creditors, even the fiduciary assignment of receivables are often not enforceable due to a Court order. In other words, even though accounts receivable (such as credit card revenues) do not fall into the "capital goods" category, the fiduciary assignment of these claim rights as collateral is not always easily enforceable.[41]

Third parties might also guarantee the obligations of the debtor, either through an *in rem* lien (described above) or through a personal guarantee, meaning a promise made by an individual or a legal entity (the guarantor) to accept responsibility for some other party's debt (the debtor) if the debtor fails to pay it.

There are two kinds of personal guarantees:

a) *fiança*, which can be implemented through a guarantee agreement, a letter of guarantee or the inclusion of specific clauses in a finance, lease or other agreements; and

b) *aval*, which is a personal guarantee of debts represented by certain instruments of credit (*título de crédito*), for instance, promissory notes, checks, bills of exchange. A single signature of the person as grantor in the instrument of credit is enough to create the guarantee.

Besides the fact that the *aval* is always a guarantee to a debt represented by an instrument of credit, the guarantor in an *aval* guarantee is jointly liable with the debtor for the payment of the debt. If, however, there is more than one guarantor to the same payment obligation, it is possible to agree upon whom the obligation to pay shall first fall. In a *fiança* guarantee, on the other hand, the rule is that, absent agreement to the contrary, the creditor needs to demand payment from the debtor first. Another difference between the two kinds of personal guarantees is that the obligation of the guarantor in an *aval* guarantee is considered to be autonomous from the obligation of the debtor, so that whoever issues his signature in a title as guarantor is directly linked to the creditor. Thus, if, for instance, the creditor assigns the claim to a third party in good faith and the original transaction between the debtor and the creditor is later on considered to be void, the guarantors continue to be liable for the payment to the assignee. In a *fiança*, however, the guarantee is not autonomous from the debtor's obligations and, in this sense, the guarantor may not pay the creditor if the original obligation is void.

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39 STJ, AgRg on CC 111614, Second Joint Panel, Reporting Justice Nancy Andrighi, decided on November 10th, 2010; TJSP, AI 2000601-16.2016.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appeal Judge Francisco Loureiro, decided on March 10th, 2016; TJSP, AI 2215674-15.2014.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appeal Judge Francisco Loureiro, April 8th, 2015.

40 STJ, AgRg on CC 127.629, Second Joint Panel, Reporting Justice João Otávio de Noronha, decided on April 23th, 2014; STJ, AgRg on CC 125.893/, Second Joint Panel, Reporting Justice Nancy Andrighi, decided on March 13th, 2013.

41 TJRJ, AI 0039244-09.2015.8.19.0000, Twenty Second Civil Chamber, Reporting Appeal Judge Carlos Santos de Oliveira, decided on September 8th, 2015; TJRJ, AI 0074750-46.2015.8.19.0000, Eighth Civil Chamber, Reporting Appeal Judge Cezar Augusto Rodrigues Costa, decided on April 19th, 2016; TJRJ, AI 0074750-46.2015.8.19.0000, Seventh Civil Chamber, Reporting Appeal Judge Cezar Augusto Rodrigues Costa, decided on April 19th, 2016.

As far as the wording of the Bankruptcy Law goes, third party guarantees are not affected by the bankruptcy or judicial or extrajudicial recovery of the debtor. The creditor maintains the right to enforce the obligation against the guarantors.[42] However, a recent trend shows that certain debtors are including provisions in their judicial recovery plans releasing third parties from their obligations, thus extinguishing the personal guarantees that were in place. The Superior Court of Justice does not seem to have yet reached a final understanding on the matter, but there are judgments in favour of the legality of the third-party release.[43]

The Bankruptcy Law authorises the debtor to use any lawful means to structure the turnaround.[44] As for *in rem* guarantees, the law further states that "[U]pon the disposal of an asset under *in rem* guarantee, suppression or replacement of the guarantee must only be permitted with the express approval of the creditor holding the respective guarantee." Courts have decided that no guarantee could be replaced or suppressed without the consent of the creditor who benefits from the security.[45]

However, the Third Panel of the Superior Court of Justice held, on 13 September 2016, that the security granted by the debtor (but not by third parties) could be eliminated if the recovery plan is approved by the creditors in a general meeting of creditors.[46] The recovery plan in this case contained a clause that led to the following result: "Premise 4: Once approved the present plan, there will be the suppression of all personal guarantees and collateral currently existing on behalf of creditors so that the Debtor can be restructured and perform its activities under a clean name, both the company and its partners, as a result of the NOVATION which results from the approval of the plan". The plan was approved by 100% of the secured creditors who attended the meeting, representing 82.83% of the total value of the secured claims. In a majority decision, the court held that the interest of the majority of the creditors should prevail. That is to say, the court held the understanding that the dissenting creditor is bound to the decision of its class of creditors (so that the creditor's individual consent would not be necessary). The decision, however, made no reference to the quality of the security held by the majority of the creditors. This is a surprising decision, which goes against the whole idea and purpose of having collateral to secure a debt.

Despite the controversy, the Superior Court of Justice further confirmed the same understanding in a more recent case, allowing for the suppression of guarantees by non-consenting creditors, as long as the provision is contained in an approved judicial recovery plan.

According to the internal rules of the Superior Court, insolvency matters are decided by the Third and Fourth Panels. When there is a conflict between decisions from different Panels, the party can file an appeal to be decided by a Joint Panel. A final decision on whether judicial recovery plans are capable of suppressing guarantees of non-consenting creditors is yet to be issued; however, the current trend shows it is a possibility.

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42 Bankruptcy Law, Art 49, first para.

43 The most recent case being STJ, REsp 1.700.487, Third Panel, Reporting Justice Ricardo Villas Bôas Cueva, Reporting Justice for the written opinion Marco Aurélio Bellizze, decided on April 2nd, 2019.

44 Bankruptcy Law, Art 50.

45 TJSP, AI 0110681-86.2013.8.26.0000, Second Chamber Reserved for Business Matters, Reporting Appeal Judge José Reynaldo, decided on February 3rd, 2014; TJSP, AI 0288896-55.2011.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appeal Judge Pereira Calças, decided on July 31st, 2012.

46 STJ, Resp 1.532.943, Third Panel, Reporting Justice Marco Aurelio Belizze, decided on October 10th, 2016.

Self-Assessment Exercise 2

Is it correct to say that in a bankruptcy a claim secured by a mortgage on real property has priority over an unsecured claim no matter the value of the collateral?

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

IMPORTANT NOTE

Throughout the text you will find the terms “credits” and “debts” being used interchangeably. In Brazil the term “credit” is normally used due to the fact that the law refers to “the credits against the debtor” instead of “the debts of the creditors”. For the same reason the word “credit” instead of “claim” is used, because one might have a “claim” but not necessarily a “credit”. The law refers to the “list of creditors” and not the “list of debts” or to the “list of claims”. In an attempt to avoid any confusion on the part of candidates undertaking this course, the term “credits” has largely been replaced by the term “debts”.

The Bankruptcy Law regulates the judicial recovery,[47] the extrajudicial recovery[48] and the bankruptcy (liquidation)[49] of entrepreneurs, individuals or legal entities who perform business activities. Non-business associations (such as co-operatives, foundations and associations and other non-business legal entities) and professionals are excluded from its application.

The distinction between business and non-business entities refers back to the Civil Code, Article 966. Business entities are those engaged, on a professional basis, in organised economic activity for the production or trade of goods or services. A person who exercises an intellectual profession of scientific, literary or artistic nature – such as a lawyer, an artist, a physician – is regarded as exercising a non-business activity. The Brazilian insolvency system does not provide these persons and entities with modern statutory provisions, leaving them to a state in which the restructuring of debt is often unachievable; the civil insolvency regime, regulated in the Former Civil Procedure Code, is applicable, and Federal Law 5.764/1971, which defines the National Policy of Co-operativism, regulates the extrajudicial liquidation of co-operatives.

This seemingly unequitable scenario has given rise to a recent trend where the Judiciary has allowed the filing of judicial recovery cases by certain non-business

47 A court-supervised proceeding.
48 The extrajudicial recovery is a hybrid proceeding, which starts as an out-of-court restructuring followed by a court procedure to approve the arrangement.
49 The term bankruptcy is used in Brazil to refer to what is referred in some jurisdictions as liquidation.

individuals and entities, such as associations[50] and rural producers[51]. The use of a bankruptcy (liquidation) procedure by these agents, on the other hand, does not yet seem to be a tendency. Nonetheless, there is still no definite standing on the issue: first instance courts and courts of appeals are still likely to dissent on the possibility of non-business agents making use of provisions set forth by the Bankruptcy Law.

In any case, the Bankruptcy Law does not apply to *empresa pública*[52] and *sociedade de economia mista*.[53] Currently there is no statute regulating the bankruptcy proceedings of such entities.

Government controlled or private financial institutions, credit unions, consortia, supplementary pension companies, health care plan companies, insurance companies, capitalisation companies and other organisations legally equivalent to those listed above, cannot apply for extrajudicial or judicial recovery but are subject to extrajudicial intervention and extrajudicial liquidation. The crisis of those legal entities, if submitted to an ordinary market solution, can cause serious socio-economic repercussions, especially systemic risk and social unrest. In light of that, for example, Federal Law 6.024/1974 regulates the intervention and extrajudicial liquidation of financial institutions, both imposed by the Central Bank of Brazil; the Central Bank is also allowed, if certain circumstances are present, to impose a special temporary administration on a financial institution.[54] In the same way, Federal Decree-law 73/1966, which regulates the National System of Private Insurance, authorises the Superintendence of Private Insurance (SUSEP) to intervene or liquidate insurance companies.

The Bankruptcy Law is divided into eight chapters:

(1) Preliminary Provisions;

(2) Provisions Common to Judicial Recovery and Bankruptcy;

(3) Judicial Recovery;

(4) Conversion of Judicial Recovery into Bankruptcy;

(5) Bankruptcy;

(6) Extrajudicial Recovery;

(7) Criminal Provisions; and

(8) Final and Temporary Provisions.

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50 TJRJ, AI 0031515-53.2020.8.19.0000, Sixth Civil Chamber, Reporting Appeal Judge Nagib Slaibi, decided on September 2nd, 2019.

51 TJSP, AI 2251128-51.2017.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appeal Judge Alexandre Lazzarini, decided on May 9th, 2018.

52 *Empresa pública* is a legal entity created by a specific statute, which belongs to the Federal, State or local government.

53 *Sociedade de Economia Mista* is a corporation created by a specific statute, with the majority of the voting rights held by the Federal, State or local government.

54 Federal Decree-Law 2.321/1987, dated February 25th, 1987.

Other statutes play an incidental role in the Brazilian insolvency system. Some examples are:

(a) The Civil Procedure Code,[55] since pleadings, written motions and other papers presented during insolvency procedures must be in conformity with its procedural rules;

(b) The Civil Code,[56] which contains a section entitled "The Law of Enterprises", regulating the existing types of business and non-business associations which may be adopted for an entity (with the exception of Corporations which are regulated with more detail by a specific statute). The Civil Code also contains provisions on commercial and civil obligations, debt instruments and securities;

(c) The Corporations Act,[57] the main piece of legislation for corporations, containing provisions on the creation and extinction of corporations, the duties of officers, the structure of management, among others;

(d) The Constitution, dated as October 5th, 1988, which contains succinct provisions on property and economic activity.

The debate on whether a given legal system is debtor or creditor-oriented is often subject to controversy. This being said, one could argue that the Brazilian insolvency system is slightly bent towards a debtor-friendly approach. The legislation itself does not deviate significantly from neutrality, but court decisions – which have a central role in the insolvency procedures – have shown that the Judiciary is particularly concerned with the preservation of productive activity. Besides, the recovery plan in a judicial recovery can only be presented by the debtor. Thus, although there is room for negotiation, creditors do not have a more effective means to recover their credit, such as imposing a plan on the debtor.

As previously explained, one of the main changes caused by the Bankruptcy Law was the introduction of a proper means for the restructuring of enterprises under financial and economic crisis. In that sense, Article 47 of the Bankruptcy Law is an important guide to the bankruptcy courts, stating the legislator's concern with stakeholders:

> "Article 47. The object of judicial recovery is to make it possible for the debtor to overcome his economic and financial crisis in order to be able to maintain the production source, employment of workers and interests of the creditors, thus contributing to preserve the company and its social aim and to foster economic activity."

Since principles guide the application of rules, one of the consequences of Article 47 is that many court decisions will end up adopting a more favourable position towards the debtor, as long as that means preserving productive activity, thus maintaining jobs, the offering of services and goods to consumers, etc.

A recurrent example of the adoption of such positioning is the fact that even though Article 6, Paragraph 4, of the Bankruptcy Law reads that the stay period will not, under any circumstances, be extended over the period of 180 days, courts frequently extend the 180-day term under the argument that the recovery of the business would

[55] Federal Law 13.105, dated March 16th, 2015.
[56] Federal Law 10.406, dated January 10th, 2002.
[57] Federal Law 6.404, dated December 15th, 1976.

be compromised if the stay is not to be maintained for the time needed to negotiate and approve (or reject) a plan. Although some court decisions have ruled that the extension of the stay period can occur solely in cases where the debtor did not give cause to the non-approval of the plan within the initial term, courts in general have a low level of scrutiny to allow the extension of the stay period.

The Bankruptcy Law adopts the concept of debtor-in-possession for judicial recovery, which means that the debtor continues to manage the business during a judicial recovery under the supervision of the creditor's committee (in cases where the Committee is set up) and the judicial administrator (who is appointed by the judge), as well as the creditors and the public prosecutor. Thus, throughout the judicial recovery procedure, the debtor or its administrators must carry on their businesses, unless dismissal of the debtor from management is provided for in the recovery plan or in case the debtor (or its managers) have acted in a faulty manner as provided for by Article 64, which reads that the mangers shall be removed if the debtor or its managers:

(a) have been sentenced finally and conclusively for a crime committed under previous judicial recovery or bankruptcy or for a crime against property, public welfare or economic order provided for by applicable law;

(b) show strong signs of having committed a crime provided for herein;

(c) have acted with malice, simulation or fraud against the interests of its creditors;

(d) have engaged in any of the following acts:

  (i) incurring personal expenditures that are manifestly excessive in relation to his equity condition;

  (ii) incurring expenses, the nature and extent of which cannot be justified in view of the capital or type of business, movement of transactions and other similar circumstances;

  (iii) unjustifiably decapitalising the company or carrying out transactions that impair its regular functioning;

  (iv) simulating or omitting claims on submitting the list referred to in Article 51, main section, III, of the Bankruptcy Law (the complete list of creditors) without any relevant reason under the law or being supported by a court decision;

(e) have refused to provide information requested by the judicial administrator or the other Committee members; or

(f) have its dismissal provided for in the judicial recovery plan.

In such cases, the bankruptcy judge will call a general meeting of creditors to decide on who is to assume the management of the debtor's business. Until the meeting is called, the judicial administrator takes control of the business.

In an extrajudicial recovery, the debtor or its administrators must carry on the business and there is no rule regarding dismissal from management. There is no judicial administrator, creditor's committee nor general meeting of creditors in an extrajudicial recovery.

In a bankruptcy, the debtor loses the power to manage the business. From the declaration of bankruptcy, the debtor loses the right to manage his property or dispose of it. The bankrupt debtor is also disqualified to engage in any business activities from the declaration of bankruptcy until the judgment extinguishing his obligations. In a bankruptcy proceeding, the judicial administrator will be responsible for the sale of the assets and payment of the creditors. The bankruptcy proceeding is supervised by the creditor's committee (if formed) as well as the creditors, the debtor and the public prosecutor.

Brazil does not have a bankruptcy regulator. The judicial administrator can be an individual or a legal entity, appointed by the court to oversee the judicial recovery or conduct the liquidation of the company in a bankruptcy and must be a reputable professional, preferably a lawyer, economist, business manager or accountant, or a specialised legal entity. When a legal entity is appointed, it must provide the name of the individual who is going to be in charge of the insolvency proceeding.

The judicial administrator's tasks include the overall oversight of the insolvency procedures, the notification of debtors of the commencement of an insolvency procedure, the analysis of the proof of claims presented by creditors in order to review the list of creditors presented by the debtor and to consolidate it, to preside over the general meeting of creditors, to keep the court informed about the implementation of the recovery plan by the debtor as well as about the debtor's financial situation, etc. In liquidation bankruptcies, the judicial administrator takes over the management of the estate and will be responsible for the sale of the assets and payment of the debts of the estate. Under certain circumstances, the judicial administrator might seek court authorisation to continue the business activities in order to preserve the value of the assets. In this case the judicial administrator may hire professionals to assist him. In both kinds of proceedings, the judicial administration must also analyse requests presented by different stakeholders during the insolvency proceedings and present an opinion to support the judge's decision.58

One important aspect that needs to be highlighted is that the judicial administrator is not responsible for assisting management in a diagnostic of the causes of the economic and financial crisis of the debtors and to propose measures to be adopted by the debtor for the turnaround. In Brazil the judicial administrator is an extension of the bankruptcy judge, who helps the court with the analysis of the claims presented by creditors and keeps the court and the other stakeholders aware of the manner in which the debtor is performing. Turnaround professionals exist, but they are specialised individuals or companies hired by the debtor to prepare appraisals, estimate cash flows, suggest changes and actions to be taken and, sometimes, even assuming an active role in the management of the debtor's business. In a bankruptcy proceeding, however, the judicial administrator must provide a report about the causes and circumstances that led to bankruptcy.

Creditors also play an active role in insolvency procedures. Other than presenting their proof of claim in judicial recoveries and bankruptcies, creditors may object to any claim listed in the public notices of each procedure, thus exercising a task of supervision. Creditors may also object to the recovery plan, which automatically leads to the need of a general meeting of creditors being called to vote on the plan. In an extrajudicial recovery, the creditors may also object to the recovery plan. The recovery plan, however, is exclusively presented by the debtor in both a judicial or an extrajudicial recovery proceeding, although such plan may be negotiated with the creditors. There is not a single scenario in which creditors are authorised to present

58 The main duties of the judicial administrator are provided for in Art 22 of the Bankruptcy Law.

an alternative recovery plan. In addition to that, it is the creditors who often initiate the bankruptcy proceedings, seeking the involuntary bankruptcy of a company that has defaulted on a given debt.

A committee of creditors must be formed by resolution of any of the classes of creditors at the general meeting of creditors and is composed of one representative and two alternates of each one of the classes of creditors, that is, the classes of (i) labour creditors, (ii) creditors with *in rem* guarantees or special privileges, (iii) unsecured creditors and creditors with general privileges, and (iv) creditors defined as small or micro enterprises. Although authorised by law upon request of a single class of creditors, the cases where a committee is formed are very rare.[59] One of the reasons for this might be the fact that the fees of the members of the committee are paid by the creditors, who might not be willing to expend funds in the restructuring of the debtor, especially when they do not have the means to do so at the same time as they need to manage their own business. Besides, there are concerns regarding the risk of liability for members of the committee.

When the committee of creditors is formed, it has several duties, for example, supervising the activities of the debtor and examining the accounts of the judicial administrator, monitoring the course of the proceedings and informing any violation of the rights or injury to the interests of the creditors. In a judicial recovery, the committee of creditors will also supervise the debtor's activities, submit monthly reports to the court and supervise the fulfilment of the debtor's obligations under the recovery plan.[60]

The creditors also have an important role to play when the general meeting of creditors is called. The general meeting is divided into four classes of creditors: (i) labour creditors, (ii) creditors with *in rem* guarantees, (iii) unsecured creditors and creditors with special or general privileges, as well as subordinate creditors, and (iv) creditors defined as small or micro enterprises. The general meeting is usually called to make a decision regarding the judicial recovery plan, but it has other important functions, such as to decide any matter in the creditors' interest and to approve alternative types of asset settlement in bankruptcy.[61] The general meeting of creditors must be convened by the judge at least 15 days beforehand, by notice published in the official press and in widely circulated newspapers in the localities of the headquarters and the branches of the debtor; the public notice must contain the date, place and time for the meeting in its first and second calls, the agenda and the place where the creditors may obtain, if applicable, a copy of the judicial recovery plan to be submitted for resolution by the general meeting. The general meeting of creditors is chaired by the judicial administrator, who appoints one secretary among the present creditors. In order to be convened on the first call, a specific quorum must attend the general meeting of creditors: creditors holding over half of the claims of each class. On the second call, which must take place at least five days after the first call, the general meeting of creditors is convened with any given quorum of creditors. Finally, there are different *quora* for resolutions, depending on the subject.[62]

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59 If the creditors' committee is not formed, the judicial administrator or, if the judicial administrator is not able to do so, the court, may perform the activities of the committee.

60 See the Bankrruptcy Law, Art 27, for a more detailed list of duties of the committee of creditors.

61 *Idem*, Art 35.

62 For the resolutions' *quora*, see Art 42 (general rule, applying to any matter); Art 44 (1st special rule, applying to members of the creditors' committee); Art 45 (2nd special rule, applying to the plan); and Art 46 (3rd special rule, applying to alternative means of asset liquidation).

The law also grants access to the public prosecutor to information about the debtor and his business in order to provide the prosecutor with the necessary means to file criminal charges, whenever necessary. In addition, the prosecutor can file an appeal against a decision that homologates a judicial recovery plan, question any debt included in the list of creditors, oppose the terms and conditions for the sale of assets and file revocation suits to make certain transactions of the debtor before the filing, void or ineffective.[63]

6.2 Personal / consumer bankruptcy

The Bankruptcy Law only applies to businessmen and business legal entities. Despite the recent trend where the Judiciary is also accepting the filing of judicial recoveries by some non-business agents, this tendency seems to be linked to the magnitude of these agents, such as associations and rural producers that have large incomes and employ a significant number of individuals. In this regard, the decisions making an exception to the prohibitive provisions of the Bankruptcy Law do not point towards an unrestricted use of Federal Law 11.101 by any sort of non-business agent, such as consumers.

In this respect, if an individual or a legal entity carries on a business activity, filing for judicial recovery or bankruptcy is permitted. If, on the other hand, the individual or the legal entity perform an activity deemed as a non-business occupation, then Federal Law No. 5.869/1973 (the "Former Civil Procedure Code")[64] applies. The insolvency procedure set forth by the Former Civil Procedure Code,[65] referred to as "civil insolvency" (*insolvência civil*), is designed to liquidate the assets and liabilities of the debtor. The statute does not provide for a means of restructuring the debt through a recovery plan.

To understand who qualifies for the civil insolvency regime, it is necessary to understand the definition of an entrepreneur, an individual who carries on a business activity. Article 966 of the Civil Code defines an entrepreneur as "anyone who engages, on a professional basis, in organised economic activity for the production or trade of goods or services". The sole paragraph of the same article goes further to clarify that a person who exercises an intellectual profession of a scientific, literary or artistic nature, even in conjunction with assistants or collaborators, is not an entrepreneur unless the exercise of that profession constitutes an element of entrepreneurship.

Thus, anyone that does not fit into this definition is subject to the civil insolvency regime. A law firm, for instance, no matter how big it is, cannot apply for judicial or extrajudicial recovery and, as a consequence, does not have any similar means to reorganise the business, and is not subject to bankruptcy. That is due to the fact that lawyers are considered to perform an "intellectual" profession, rather than a business activity. The same understanding applies to accounting firms. To a great extent, the distinction between business and non-business professions is merely the result of a

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63 The Superior Court of Justice decided that the Public Prosecutor's Office shall only act in insolvency proceedings when determined by the Bankruptcy Law (STJ, AgRg no Ag 1.328.934, Fourth Panel, Reporting Justice Marco Buzzi, decided on 04/11/2014; STJ, REsp 1.230.431, Third Panel, Reporting Justice Nancy Andrighi, decided on October 18th, 2011); see Bankruptcy Law, Arts 8, 19, 22 para 4, 30 para 2, 52 I, 59 para 2, 99 XII, 104, VI, 132, 142, para 7, 143, 154 para 3, and 187, para 2. However, since the Public Prosecutor's Office must act as *custus legis* (guardian of the law) whenever there is a public and social interest involved (Constitution, Art 127, and Civil Procedure Code, Art 178), it is common that the public prosecutor will act throughout all the insolvency proceedings.

64 Articles 748 to 786-A.

65 See the Civil Procedure Code, Art 1.052.

historic division – which tends to explain why massive law and accounting firms are considered as non-business activities, regardless of clearly seeking profits.

There is no formal obligation for the debtor to file for insolvency and, as a matter of fact, there are many individuals that do not ever file for insolvency, and keep on litigating against their creditors who, after years trying to find and seize assets, will ultimately give up. The problem, however, is that the individual will remain for years with credit restrictions and limitations to do business. On the other hand, there is no threshold for filing a civil insolvency petition with regards to a specific amount of debt.

The civil insolvency may be initiated by the debtor or by any creditor, before the court where the individual is domiciled. If the request is presented by a creditor, the debtor may avoid the declaration of insolvency if he or she makes a deposit of the amount claimed and/or opposes the request, arguing that (i) he or she owns assets that value more than the amount of the claim of the creditor who filed the request for insolvency, (ii) the court is not competent to process the request, (iii) the creditor is asking payment for a larger amount than he or she would be entitled to, or (iv) certain facts exist that would make the title void or unenforceable.[66]

The law presumes the debtor to be insolvent (i) when the debtor is sued in an enforcement lawsuit and has no free assets to guarantee the debt and (ii) when a court determines the precautionary seizure of debtor's assets based on the following facts: (a) a debtor, who does not have a fixed domicile, attempts to absent himself, to dispose of his assets or does not pay due obligations, (b) a debtor with domicile (1) is absent or tries to sneak away from attachment of his or her assets, (2) sells or encumbers real property remaining with no free and clear assets to guarantee the other debts, and (3) transfers or tries to dispose of assets or to commit any fraud to thwart an enforcement lawsuit or to injure creditors.

Once the debtor is declared insolvent, the debtor's debts are accelerated, the assets that might be seized to pay creditors are taken into custody by the administrator of the estate, the creditors will be called to present their claims before the court and the foreclosure lawsuits that have already been filed will be sent to the court where the civil insolvency is being processed.[67]

Individuals and legal entities that are not entrepreneurs are significantly restricted when it comes to their legal options for restructuring their debts. The lack of a restructuring regime makes it common for consumers to attempt to refinance their debts directly with the creditors. Creditors such as financial institutions often enter into out-of-court arrangements with consumers for the payment of debt, offering clients discounts or other benefits. One of the main tools for creditors when seeking to satisfy their claim is inserting the debtor's name in lists held by institutions of credit protection.

There are no statutory provisions on post-bankruptcy compositions.

The appointment of an administrator is made by the judge in charge of the insolvency procedure. There is a single administrator throughout the entire procedure, with no provision for interim administrators. The administrator is chosen among the holders of the largest claims. When creditors are not willing to act as administrator, the court

66 A list of matters that can be brought to court by the debtor to oppose the declaration of insolvency can be found in Arts 741, 742 and 745 of the Former Civil Procedure Code.

67 "The sale of assets of the debtor implemented in an execution by a creditor, after the declaration of insolvency of the debtor, in a forum other than the universal insolvency court, is null and void." (STJ, REsp 1074724, Fourth Panel, Reporting Justice Raul Araújo, decided on April 27th, 2017.

may appoint a non-creditor. As a matter of fact, before 2005 the Brazilian insolvency law used to have a similar provision but many courts did not follow the rule because creditors usually did not want to be the administrator of the estate. As a consequence, the courts used to appoint a non-creditor and to review the decision if one of the holders of the largest claims filed a complaint and declared to be interested in working as administrator of the estate.

The administrator must sign a term of commitment within twenty four (24) hours of his nomination by the judge, in which it will be stated that the duties to the job will be fulfilled with loyalty. As such term is signed, the trustee will also present his debt note.

The administrator is in charge of all the property of the insolvent debtor. It is the job of the administrator to (i) take custody of all the property of the insolvent debtor, (ii) judicially represent the estate, hiring lawyers, whose fees will be subject to court approval, (iii) practice every act in order to preserve rights of the estate, as well as actively seek payment of claim rights and (iv) sell, by auction, the assets of the estate. In sum, the administrator is in charge of collecting all the non-exempt assets and realising them in order to satisfy as much debt as possible.

In the sentence which declares the insolvency, the judge shall order the publication of a public notice calling creditors to present, within twenty (20) days, the declaration of their claims along with the documentation proving it. After the 20 days period, within five (5) days the judicial registrar shall order every declaration. Following such measure, all creditors will be notified by public notice to claim preferences, nullities, simulations, frauds or falsehood in debts and contracts, within twenty (20) days. Of course, these terms are not automatic, and require the court to take the necessary measures to publish notices to the parties and the Civil Procedure Code, which was enacted in 2015, determines the procedural terms must be counted only on business days.

The Former Civil Procedure Code does not have specific provisions regarding the treatment of contracts. According to Article 792 of the Civil Procedure Code, the transfer or encumbrance of assets are considered to be done in fraud (a) when a claim based on real right or with re-petitioning claim is pending on the asset, provided that the pending process has been registered in the respective public registry, if any; (b) when the existence of a foreclosure lawsuit has been recorded in the property registry; (c) when it has been registered, in the registry of the property, a judicial mortgage or other judicial act attaching the asset issued in the same lawsuit where the the existence of fraud has been argued; (d) when, at the time of the transfer or encumbrance, the debtor has been sued and the result of the lawsuit could put him into insolvency; (e) in all other cases referred to by the law.

To deal with this and other matters the court needs to apply general rules of law and, in many circumstances, courts apply the principles of the Bankruptcy Law as well. A disposition or payment of debt, for instance, may be declared void at any time if the creditor proves that such act led the debtor to insolvency or it was practiced when the debtor was already insolvent, according to Article 158 of the Civil Code.

One important aspect to be considered when dealing with civil insolvency is that some assets of the debtor are exempt. Federal Law 8.009/90, for instance, provides for a homestead exemption; however, this exemption will not apply to claims for (i) salaries and social security due to workers of the residence, (ii) financing of the construction or acquisition of the property, (iii) child or spouse support, (iv) taxes due

on the property, (v) an obligation secured by the property; (vi) rental personally guaranteed by the debtor.

Other exemptions include: (i) assets declared by law or by voluntary act[68] as inalienable assets; (ii) personal property, belongings and household appliances that furnish the residence of the debtor, except for those of a high value or those that exceed common needs corresponding to an average standard of living; (iii) clothing and personal belongings of the debtor, except for those of high value; (iv) earnings, salary, retirement benefits, survivors' pensions, pension funds, as well as amounts given by a third party and destined to the support of the debtor and his or her family, the earnings of self-employed workers and professional fees;[69] (v) books, machines, tools, utensils, instruments or other personal property necessary or useful for the exercise of the profession of the debtor; (vi) life insurance; (vii) materials necessary for works in progress, unless the works in progress have been seized; (viii) small rural properties, as defined by law, used by a family; (ix) public funds received by private institutions for compulsory investment in education, health and social work; (x) amounts deposited in *caderneta de poupança* (a kind of savings account), up to a limit of forty (40) minimum salaries;[70] (xi) funds received by a political from public sources, as imposed by law; (xii) proceeds from the sale of real estate units, under the real estate development regime to be used on the construction. The exemptions under items (iv) and (ix) are not applicable to the case of the levy of execution for the payment of support obligations (child, family and spousal support), regardless of its origin, nor to sums exceeding fifty (50) minimum monthly salaries.

Article 961 of the Civil Code states that an *in rem* claim has priority over any kind of personal claim; a privileged personal claim over a simple claim; and a special privilege over a general privilege.

Federal Law 5.172/1966 (the "Brazilian Tax Code"), Article 186, states that tax claims have priority over any other claim, except for labour claims and claims resulting from on-the-job accidents. The sole paragraph of Article 186 states that in bankruptcy, (a) tax claims do not prefer extra-bankruptcy claims or amounts subject to restitution under the terms of the bankruptcy law, nor to claims with an in rem guarantee, in the later case, up to the value of the asset; (b) the law may establish limits and conditions for the priority of claims deriving from labour law; and (c) tax fines have priority only over subordinated claims.

Thus, theoretically, apart from the claims that do not fall subject to the civil insolvency procedure, such as the expenses of the estate and the courts costs, which precede all others in preference, the claims should rank as follows: (i) Labor claims; (ii) Tax claims; (iii) Expenses of the estate; (iv) Debts of the estate; (v) *In rem* secured claims; (vi) Special privilege claims; (vii) General privilege claims; (viii) Unsecured claims.

However, several scholars argue that the rules of the Bankruptcy Law should be applied by analogy and the ranking of claims in a civil insolvency should be the same

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68 For instance, under certain circumstances, a person might donate a house to be used as a residence, together with securities intended to produce income to be applied to the maintenance of the property and the support of the family (see Art 1.711 of the Civil Code).

69 In a case where a similar rule from the Former Civil Procedure Code was discussed, the Second Joint Panel of the Superior Court of Justice decided that the rule was applicable only to the last received remuneration (STJ, REsp 1.203.060, Reporting Justice Isabel Galotti, decided on August 13th, 2014).

70 In September 2020, when this material was updated, the national minimum salary was BRL 1,045 per month – the equivalent of approximately USD 200. The national minimum salary is reviewed annually. States might fix a larger amount as minimum regional salary.

as in a bankruptcy:[71] (i) labour claims, limited to one hundred and fifty (150) minimum wages and claims arising out of on-the-job accidents [72]; (ii) claims with *in rem* guarantees; (iii) tax claims (except fines); (iv) special privilege claims[73]; (v) general privileged claims[74]; (vi) unsecured claims; (vii) contractual penalties and fines for breach of criminal or administrative law, including tax-related fines; (viii) subordinate claims.

After the assets of the debtor have been sold and the proceeds used to pay the creditors, the procedure can be finished and the debtor will remain liable for any amount still due to creditors for the next five (5) years. After this term the debtor may request the court to declare that his or her liabilities are extinguished.

There is no provision for small estates, but there are judicial precedents determining that assetless estates cannot enter civil insolvency proceedings since there is no utility.

Overall, there is a broad perception in Brazil that the country lacks adequate tools to deal with consumer bankruptcy. The Brazilian legal system is yet to come up with legislation offering both a quick liquidation procedure for non-business entities and any sort of means for restructuring of debt.

Self-Assessment Exercise 3

Civil insolvency is the legal regime to deal with the insolvency of:

a) an insolvent debtor;
b) anyone who does not pay a debt on the due date;
c) anyone who, being insolvent, is an individual entrepreneur or a business legal entity;
d) a debtor that, being insolvent, is not qualified as an individual entrepreneur or a business legal entity.

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

[71] MARINONI, Luiz Guilherme, *Código de processo civil comentado artigo por artigo* / Luiz Guilherme Marinoni, Daniel Mitidiero 2 ed – São Paulo: *Editora Revista dos Tribunais*, 2010, pp 733-734; RIBEIRO, Darci Guimarães, *Aspectos Procesales del Concurso en el Brasil. Revista de Processo*, vol 225/2013, pp 105-121, nov 2013; ASSIS, Araken de, *Manual da Execução*, 20 ed – São Paulo: Thomson Reuters Brasil, 2018, p 1322.

[72] Any amount exceeding the 150 minimum wages threshold will be ranked as an unsecured claim.

[73] Claims that have priority to be paid from the proceeds from certain assets. A list of cases can be found in the section related to corporate liquidation.

[74] Claims that have priority to be paid from the proceeds from all the assets of the debtor. A list of cases can be found in the section related to corporate liquidation.

6.3 Corporate liquidation

6.3.1 General overview

A solvent individual or legal entity can liquidate his / its business out of court. An insolvent individual or legal entity, however, must go to court to liquidate his / its business. Insolvent non-business legal entities or individuals will be liquidated through a civil insolvency procedure while individual entrepreneurs and business legal entities will go into bankruptcy. Below we will discuss the bankruptcy of individual entrepreneurs and business legal entities only.[75]

Although the purpose of the bankruptcy procedure is to liquidate the assets and use the proceeds to pay the creditors, one of the goals of the Bankruptcy Law is to preserve the productive use of the company's goods, assets and productive resources. In order to do this, the law determines that the assets should be sold altogether, as a business unit – or, alternatively, as individual branches – whenever this sale is possible and expected to generate proceeds of a larger amount than the proceeds expected to be generated if the assets are sold separately. The Bankruptcy Law states that the liquidation procedures must be carried out in the fastest and most cost-effective way.

There are two ways of entering liquidation: it may be voluntary (when the request for bankruptcy is filed by the debtor) or involuntary (when the request is filed by a creditor). While the claim for voluntary bankruptcy does not depend on any additional qualification by the debtor (other than being an entrepreneur), or any decision of its creditors, being expressly regulated by Article 105 *et seq* of the Bankruptcy Law, involuntary bankruptcy proceedings depend on the applicant creditor meeting certain legal criteria as set out below.

6.3.2 Commencement of bankruptcy

Pursuant to Article 94 of the Bankruptcy Law, there are three situations that allow the commencement of an involuntary bankruptcy procedure in Brazil, which may be requested by a) any creditor,[76] b) the surviving spouse, any heir of the debtor, or the estate's administrator, or c) a shareholder of the debtor under the law or the articles of incorporation of the company. The scenarios that allow for the commencement of the proceeding are the following:

(1) the debtor, without a relevant reason under the law, does not pay on the due date a debt that is certain on its value (*dívida líquida*) and it is expressed in one or more extra-judicially or judicially enforceable titles[77] duly protested,[78] the sum

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75 For additional information about the distinction between the civil insolvency procedure and the bankruptcy procedure, see para 6.1; see para 6.2 for additional information about the civil insolvency procedure.

76 If the creditor is an individual entrepreneur or a business legal entity, he / it must prove the regularity of the business by showing a certificate from the Board of Trade. If the creditor is not domiciled in Brazil, he / it must post a bond of sufficient value for the payment of costs and fees of the proceeding as well as for the payment of indemnification, if the bankruptcy is maliciously sought by the creditor.

77 See para 4.2.

78 Under Brazilian law, certain indebtedness titles may (and sometimes must) be sent to the protest officer for protest, meaning that an official notice is sent to the debtor to pay or recognise the existence of the debt, or informing the debtor of the creditor's intention to file for debtor's bankruptcy.

of which exceeds the equivalent of 40 minimum wages[79] on the date of the petition for bankruptcy;[80]

(2) the debtor faces an execution proceeding related to any *dívida líquida* and does not timely pay the debt, deposits the amount due and / or appoints sufficient assets for attachment within the proper time frame of execution proceedings;

(3) the debtor has performed any of the following acts (unless they are part of a judicial recovery plan):

- liquidated his assets precipitately or resorted to ruinous or fraudulent means to make payments;
- carried out, or by unequivocal acts attempted to carry out, with the objective of delaying payments or defrauding creditors, a simulated transaction or the disposal of part or all of his assets to a third party, whether or not a creditor;
- transferred an establishment to a third party, whether or not a creditor, without the consent of all the creditors and without keeping sufficient assets to settle his liabilities;
- simulated the transfer of his principal establishment with the object of circumventing the law or inspection, or to harm a creditor;
- gave or increased a guarantee to a creditor for a debt contracted previously without keeping sufficient assets free and clear to settle his liabilities;
- absented himself without leaving a qualified representative with sufficient funds to pay creditors, abandoning an establishment or attempting to hide from his place of domicile, the locality of his headquarters or of his principal establishment;
- failed to perform, within the established term, an obligation assumed under the judicial recovery plan.

The three involuntary gateways hold in common the fact that they do not require proof of the insolvency of the debtor. The law lists a series of relevant acts which suggest that the debtor either has no means to fulfil his obligations as he should, or that the debtor, without any relevant reason, simply does not want to pay his debts on the due date.

After service of process, the debtor has a 10-day period to present his defence against an involuntary bankruptcy petition. Article 96 of the Bankruptcy Law contains a list of facts that can prevent a bankruptcy decree:

(a) falsity of the title presented by the creditor;

(b) statute of limitations applies to the case;

(c) nullity of the obligation or its title;

[79] The minimum wage refers to a worker's salary over the period of one month. In the most part of 2020, the minimum wage was BRL 1,045. The amount of 40 minimum wages adds up to an amount close to USD 8,000.

[80] There are no special provisions that apply to small or assetless estates.

(d) the debt has already been paid;

(e) any other fact that extinguishes or suspends the obligation, or does not legitimise the collection of the claim presented by the creditor;

(f) defect in the protest or in its instrument;

(g) filing of a petition for judicial recovery during the 10-day term that the debtor has to oppose the request for bankruptcy;

(h) cessation of corporate activities for more than two years prior to the petition in bankruptcy, evidenced by a proper document of the Board of Trade, which must not prevail against evidence that the debtor has, in fact, developed his business activities anytime during the referred period.[81]

One important aspect to be noticed is that in cases where the request for bankruptcy is made based on the non-payment of a debt or the unsuccessful execution of a debt, the debtor may deposit the amounts due (with adjustment for inflation, interest and attorney fees) and present other arguments to avoid his bankruptcy. If the arguments presented by the debtor to avoid bankruptcy do not prevail, the creditor will withdraw (take) the deposit, but the debtor will not go into bankruptcy.

If the debtor is not able to sustain one of the defences above, nor able to deposit the sum due to the creditor, the judge will decree his / its bankruptcy. On the other hand, if the arguments for no payment are accepted by the court, the judge will reject the request for bankruptcy. If the bankruptcy has been maliciously required by the creditor, the creditor may be ordered to indemnify the debtor.

Both parties have a 15-day term to file an appeal against the decision that accepts or rejects the request for bankruptcy. However, if the court declares the bankruptcy of the debtor, the appeal does not suspend the effects of the bankruptcy order, unless the reporting judge of the competent court of appeals issues a preliminary order to suspend the bankruptcy, which is very rare in practice.

A bankruptcy may also be voluntarily filed by the debtor. However, there is no statutory obligation to file for liquidation under any circumstances. Holding a shareholder, officer or director[82] liable for not filing for bankruptcy is not a common scenario.

The court decision that decrees the debtor's bankruptcy must also, among other measures, appoint the judicial administrator, fix the starting date for the suspect period (see item 6.3.8) and prohibit any act of disposal or encumbrance of the debtor's assets.[83]

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81 The Bankruptcy Law also states that the bankruptcy of a corporation or of an estate (of a deceased person) must not be declared (i) if the corporation has been liquidated and the assets shared among stakeholders, or (ii) after one year of the death of the deceased person.

82 Note, however, that directors and officers must comply with the duty of loyalty and the duty of care, laid out by the Corporations Act. Trading without proper diligence could subject a director or an officer to liability for breaching the duty of care. Fraudulent trading could render a director or an officer liable for the breach of the duty of loyalty, since officers must always act in the best interests of the company, not themselves.

83 Bankruptcy Law, Art 99.

6.3.3 Appointment of the judicial administrator

The judicial administrator is appointed by the court and must be a reputable professional, preferably a lawyer, economist, business manager or accountant, or a specialised legal entity. Within 48 hours of his appointment, the judicial administrator has to present himself to the court and sign an instrument of commitment before assuming all responsibilities inherent thereto.

The judicial administrator plays an important role in the bankruptcy proceeding. He is in charge of winding-down the business towards its liquidation and taking on the management of the bankrupt estate. In addition to that, the judicial administrator also oversees the procedure as a whole, granting validity to the acts performed under the bankruptcy procedure.

The judicial administrator's duties include:

(a) notifying the creditors listed in the first public notice containing the list of creditors, stating the date of the bankruptcy decree and the kind, amount and rating established for the claim;

(b) providing all information requested by creditors;

(c) providing extracts of the debtor's books;

(d) requiring any information whatsoever from creditors or from the debtor;

(e) preparing a reviewed list of creditors based on the information presented by the creditors and information gathered from the debtor;

(f) representation of the estate;

(g) requesting the judge to call a general meeting of creditors;

(h) hiring professionals or specialised companies, whenever necessary, duly authorised by the court, to assist him in the performance of his duties (for instance, in the appraisal of assets);

(i) making statements whenever required by the Bankruptcy Law;

(j) informing creditors when and where they will have daily access to the bankrupt's books and documents;

(k) examining the debtor's accounting books;

(l) listing any legal proceedings against the debtor and assuming the judicial representation of the bankrupt estate;

(m) receiving and opening mail addressed to the debtor, delivering any matter to him that is not of interest to the estate;

(n) submitting, within 40 days from the signing of the instrument of commitment and extendable for a like period, a report on the causes and circumstances that led to the state of bankruptcy, in which he must indicate any civil or criminal liability of the parties involved;

(o) taking into custody the debtor's assets and documents;

(p) performing the necessary acts to preserve and sell the debtor's assets and to use the proceeds to pay the creditors;

(q) requesting the judge for the advance sale of assets that are perishable, that might deteriorate or considerably devalue, or that require a hazardous or costly conservation;

(r) performing all acts to preserve rights and actions, to collect debts and attest the discharge of obligations upon its full payment;

(s) redeeming attached, pledged or legally withheld assets on behalf of the estate and with court authorisation;

(t) representing the bankrupt estate in court and, if necessary, hiring an attorney, whose fees must first be established and approved by the Committee of Creditors;

(u) to submit to the judge for attachment to the case record, until the tenth (10th) day of the month following the due month, a statement of account of the trust, clearly specifying income and expenditure;

(v) presenting monthly reports to the court;

(w) rendering accounts at the end of the proceeding, when replaced, dismissed or resigning from the position.

The judicial administrator's fees are established by the judge in charge of the bankruptcy procedure. In any event, the total amount paid to the judicial administrator may not exceed 5% of the amount payable to the creditors (but the judicial administrator's remuneration decreases to a 2% limit in case of a micro or small enterprise bankruptcy).

6.3.4 Proof of claims

There are three lists of creditors in any liquidation procedure. The lists identify the creditor and the nature and amount of the debt. Each list is published in the official press. The lists are also frequently made available by the judicial administrators in their websites.

The order that decrees the bankruptcy of the debtor will determine the publication of the first list of creditors. After the publication of the list, creditors have a period of 15 days during which they are able to request the judicial administrator to include any missing claim or the correction of any claim that has been incorrectly listed. The requests are usually done by e-mail or by correspondence. Article 9 of the Bankruptcy Law lists the requirements that must be met by creditors, for example the name of the creditor, address, amount of the debt, documents that prove the existence of the debt, etc. No legal fees need to be paid by creditors in order to present their requests during this first stage, referred to as the administrative phase of the proof of claims ("administrative" referencing the fact that it does not happen before a judge).

Based on the request and evidence provided by the creditors and the debtor, the judicial administrator must present the second list of creditors. After the second list,

creditors, the debtor (or its shareholders) and the prosecutor are able to present oppositions to the court regarding the new list of creditors within a period of 10 days from the publication of the creditor's list elaborated by the judicial administrator. Since oppositions / objections comprise the judicial phase of the proof of claims, where the creditor is unsuccessful he has to bear the legal fees and judicial costs relating to this process. Oppositions / objections are processed as independent lawsuits, under a separate case record. As an independent lawsuit, creditors and debtors may take the matter on appeal and, in rare cases, even to the higher courts.

The third and final list is the general list of creditors, which reflects the decisions on the oppositions / objections by the judge.

The proof of claims proceeding runs in parallel to the bankruptcy proceeding and is basically the same as that of the judicial recovery proceeding, although some differences apply, especially regarding late claims.

6.3.5 The committee of creditors

The committee of creditors is an auxiliary organ in the bankruptcy proceeding. Its duties are basically those of supervising the validity of the procedure. In practice, the committee of creditors is rarely formed. The reason there is creditor apathy in setting up the committee of creditors can be attributed to the fact that creditors have to pay the fees of the members of the committee and there is also concern regarding the liability of the members of the committee if they act negligently.

If a committee of creditors is formed, it will be comprised of:

a) one representative appointed by the labour creditors;

b) one representative appointed by creditors with claims based on *in rem* guarantees and special privilege claims;

c) one representative appointed by creditors with unsecured claims and general privilege claims; and

d) one representative appointed by creditors classed as micro enterprises and small companies.

In cases where creditors do not set up a committee of creditors, the judicial administrator, or the judge in the case of conflict of interest, carries out its duties.

6.3.6 Effects of bankruptcy

Once a decree of bankruptcy has been issued, the debtor loses the ability to manage his assets or to dispose of them. Likewise, the debtor becomes disqualified to engage in any business activities until the decision, by the bankruptcy court, that extinguishes its liabilities. The decision finally extinguishing the obligations of the debtor takes place (i) if all the creditors are paid; (ii) if more than 50% of the unsecured creditors are paid after the debtor's assets are sold; (iii) if five years have passed since the decision that ended the bankruptcy proceeding; or (iv) if 10 years have passed since the decision that ended the bankruptcy proceeding in case the debtor was convicted of a bankruptcy-related crime as provided for in the Bankruptcy Law.

Once the judicial administrator has signed the instrument of commitment, he must take the assets and documents of the debtor into his custody. Immediately after taking custody of the assets, the judicial administrator must take the necessary steps to sell the assets. The judicial administrator must try to sell the business as a whole or, if that is not possible, sell each commercial establishment as a whole (for those businesses which possess, as an example, different stores, storage units, etc.). The sale of blocks of assets, for example a set of assets arranged in a specific manner for economic reasons, are preferred over individual asset sales unless, of course, the value of the proceeds expected to be received if the assets are sold separately is larger than the amount expected to be received in a case where the assets are sold together.

There are three different manners in which the assets can be sold:

(a) by oral bidding at an auction;

(b) by way of sealed bids; or

(c) by public proclamation.

In the case of sealed bids, sealed envelopes containing the closed bids must be delivered to the court office against the issuance of a receipt, to be opened by the judge on the day and at the time and place stated in the public notice. The public proclamation is a combined form of the other two modes of sale, consisting of two stages: the receipt of sealed bids followed by an auction by oral bidding. Only the offerors who submitted proposals of not less than 90% of the highest bid offered, will be allowed to participate in the oral bidding phase.

Other manners of selling the assets may be authorised if requested by the judicial administrator or the Committee of Creditors and the court accepts the reasons advanced for doing so. Furthermore, the judge must approve any other mode of asset sale if approved by the general meeting of creditors.

Assets are sold free and clear of any liabilities or encumbrances. In addition, the bankruptcy court has jurisdiction over all lawsuits involving the bankrupt estate's assets, with a few exceptions.[84] For example, lawsuits where the parties argue as to whether an obligation to pay exists will proceed until a final decision is reached and thereafter the claimant will have to present his claim before the bankruptcy court and ask for his claim to be included in the list of creditors. Labour claims will proceed before the labour courts until a final decision is taken and thereafter the employee must request the inclusion of his claim in the list of creditors of the bankrupt estate. Lawsuits dealing with tax claims will proceed before the competent court dealing with tax issues. If the existence of a tax debt is recognised by the tax court, the bankruptcy court will be advised of the amount of the claim for inclusion in the list of creditors.

A bankruptcy decree also determines the acceleration of debts not yet due on the date of the decree[85] and suspends the statute of limitations and any executory

[84] See Bankruptcy Law, Art 76.

[85] According to the Bankruptcy Law, Art 122, debts of the debtor falling due by the date of the decree of bankruptcy are subject to set-off, with preference over all other creditors, whether or not arising from the bankruptcy decision, with due regard for the requirements of civil law.

lawsuits against the debtor.[86] The stay is essential for the judicial administrator in collecting the estate's assets, selling them and paying the creditors.

The estate is represented by the judicial administrator in every lawsuit.

6.3.7 Effects on contracts of the debtor

Brazilian law distinguishes between unilateral and bilateral contracts. Unilateral contracts are those in which only one of the parties has obligations; bilateral contracts are those in which both parties are mutually obliged to perform.

The judicial administrator, having being duly authorised by the committee of creditors (which is rarely created), may opt to preserve unilateral contracts and perform the debtor's obligations as long as the result is the decrease of the debtor's liabilities (or prevents the debtor's liabilities from increasing), or if the contract is essential for the maintenance of the debtor's assets.

Bilateral contracts are not terminated by bankruptcy and may be performed by the judicial administrator if the performance reduces or prevents an increase in the liabilities of the bankrupt estate, or where it is necessary to maintain and preserve its assets. Within 90 days following the signing of the instrument of commitment by the judicial administrator, a creditor may request the judicial administrator to declare, within 10 days, whether he will perform the debtor's obligations under the contract. If the judicial administrator does not respond to such a request, or he decides not to perform under the terms of the contract, the creditor may seek damages due to non-performance of the contract, which will be listed as an unsecured credit (debt).

Article 119 sets out distinct rules for a variety of contracts, such as purchase and sale agreements and lease agreements. In the same vein, Articles 120 and 121 establish special provisions for power of attorney and current account contracts.

Set-off applies to debts of the debtor falling due by the date of the bankruptcy decree, with priority over all other credits (debts), whether or not the debt becomes due in reason of the bankruptcy decree. The Bankruptcy Law does not allow the set-off of credits (debts) in two cases: i) when the credit was transferred after the decree of bankruptcy, or ii) when the claims were transferred prior to the bankruptcy decree with the intent to commit fraud. A credit transferred after the decree of bankruptcy, however, is still subject to set-off in case of succession by merger, spin-off, consolidation or death.

There are no statutory rules for the treatment of essential contracts (such as those relating to the provision of water, electricity and communication services, for example).

6.3.8 "Suspect period" and its effects on bankruptcy

The bankruptcy decree (order) will set out the "suspect period" relating to the bankruptcy of the debtor, which may not be retrospective for a period of more than 90 days from the filing of the petition requesting the bankruptcy, or from the time of the first protest by a creditor due to default (a protest is the act by which a creditor registers a credit note before an official registry, making it known to the general public that a debtor has defaulted on a given obligation). This period is referred to as

[86] It is important to stress that tax-related executions are not suspended by the granting of a judicial recovery decree in respect of a debtor.

the "suspect period", during which a variety of acts may be rendered ineffective towards the bankrupt estate, for example:[87]

(a) payment by the debtor, within the suspect period, of debts that have not yet fallen due, by any means whereby the claim is extinguished, including advances on a given note payable;

(b) payment of debts, within the suspect period, that have become due and enforceable, in a way not provided for under the terms of the contract;

(c) the granting of an *in rem* guarantee, including a lien, within the suspect period, in relation to a debt previously entered into but not secured. If the assets given in mortgage are the object of other subsequent mortgages, the bankruptcy estate will receive the part of the proceeds that should have applied to the creditor of the revoked mortgage;

(d) acts performed free of charge (for example, a donation or services performed free of charge) during the two years preceding the decree of bankruptcy;

(e) the waiver of an inheritance or legacy during the two years preceding the decree of bankruptcy;

(f) the sale or transfer of an establishment without the express consent of or payment to all creditors existing at the time, sufficient assets not having remained in the debtor's estate to settle the liabilities, unless, within 30 days, there is no opposition by creditors after being duly notified, either judicially or by a deeds and documents registry officer;[88]

(g) registration of *in rem* rights and of a property transfer *inter vivos*, for a consideration or free of charge, or an annotation of real property made after the decree of bankruptcy, unless there is a previous annotation.

Apart from the suspect period, acts performed with the intent to cause damage to creditors may be revoked. However, to revoke an act based on Article 129 of the Bankruptcy Law, the plaintiff does not need to argue and prove that the debtor and the third party acted with the intent to defraud other creditors. On the other hand, a lawsuit seeking the revocation of an act that is not listed in Article 129 requires evidence that the act was implemented with the purpose of harming other creditors. Besides, a disposition or remission of debt may be declared void at any time if it is proven that such act led the debtor to insolvency or was entered into by an already insolvent debtor.[89]

87 See Bankruptcy Law, Art 129.

88 The Deeds and Documents Registry is a registry where documents are filed in order for them to be made public and be enforceable against third parties. Sometimes the law imposes these types of registrations (for instance, contracts executed in other jurisdictions). The Deeds and Documents Registry might also be used to formally send notices to someone, as a way of producing stronger evidence that the notice was delivered and received by a certain person. In this sense, one of the ways one may stop the avoidance of a sale of an establishment is by providing evidence that there was consent from all the creditors at the time of the sale. The proof that consent was given is assumed in cases where the creditors are notified and do not oppose it. Such notification may be done in two ways, i) either judicially or ii) by means of a Deeds and Documents Registry officer (an employee of the Registry).

89 Civil Code, Art 158.

6.3.9 Claim for restitution

It is important to point out that the Bankruptcy Law grants certain parties the right to seek restitution of assets or funds in possession of the estate. In general terms, a third party has the right to a restitution of assets that belong to him, but are in the possession of the bankrupt estate. Such a claim seeks to reclaim the property from the estate in order to be returned to the creditor.

In addition, the Bankruptcy Law further authorises the return to the seller of an asset sold on credit and delivered to the debtor during the 15 days prior to the petition for bankruptcy, but only if the asset has not yet been disposed of.

The Bankruptcy Law further states that restitution in cash must be made i) if the asset that was delivered to the third party no longer exists at the time of the claim for restitution, in which case the plaintiff is entitled to receive the appraised value of the asset or, if it has been sold, the price it was sold for, in both cases with monetary compensation; ii) of the amount delivered to the debtor, in domestic currency, resulting from an advance on an export exchange contract, pursuant to Article 75, paragraphs 3 and 4, of Federal Law 4.728/1965, provided the full term of the transaction, including any extensions, does not exceed the term established in the specific rules of the competent authority; and (iii) of the amounts delivered to the debtor by the *bona fide* contracting party in the event the contract is revoked or declared ineffective.

The amounts due as a result of a restitution lawsuit must be paid in priority to all other claims, including super priority claims.

The restitution suit will run under a separate case record. The debtor, the committee of creditors, the creditors and the judicial administrator will be notified about the existence of the request in order to oppose it or not.

6.3.10 Payment of creditors and list of priorities

Article 83 of the Bankruptcy Law sets out the ranking of claims in the bankruptcy procedure. These are as follows:

(a) labour claims, limited to 150 minimum wages[90] and claims resulting from work-related accidents;

(b) claims secured by *in rem* guarantees;[91]

(c) tax claims, excluding fines;[92]

(d) special privilege claims;

(e) general privilege claims;

(f) unsecured claims;

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[90] Labour claims assigned to third parties are considered unsecured claims, losing their privilege through the assignation. See: STJ, AgInt on AREsp 818.764/SP, Third Panel, Reporting Justice Ricardo Villas Bôas Cueva, decided on June 7th, 2016.

[91] The priority conferred on secured claims is limited to the value of the collateral. If the proceeds from the sale of the collateral are insufficient to pay the debt in full, the balance is treated as an unsecured claim.

[92] Federal taxes are paid first, followed by state and local taxes.

(g) contractual penalties and fines for breach of criminal or administrative law provisions, including tax-related fines;

(h) subordinated claims.

If there is any balance after payment of these creditors, the balance must be delivered to the debtor. Apart from the ranking laid out in Article 83, there are claims that have super priority in the liquidation procedure, the so-called *créditos extraconcursais*:[93]

(a) fees payable to the judicial administrator and his assistants and labour-related claims (or work-related accident claims) for services rendered after the decree of bankruptcy;

(b) sums provided to the bankrupt estate by the creditors;[94]

(c) expenses in connection with the collection of assets that belong to the estate, management, asset realisation and distribution of the proceeds, as well as the court costs relating to the bankruptcy proceedings;

(d) court costs in respect of actions and executions in which the bankrupt estate was unsuccessful;

(e) obligations resulting from valid acts performed during judicial recovery (or after the decree of bankruptcy) and taxes due after the bankruptcy process had already commenced.

However, the order of payment in a bankruptcy proceeding is a little bit more complex because there are, for example, necessary payments to be paid in relation to the administration of the bankrupt estate. In this regard the order of payment is as follows:

(a) Indispensable expenses relating to the administration of the bankruptcy, including the possibility of provisional continuation of the business activities, must be paid by the judicial administrator as cashflow allows;[95]

(b) Labour claims for salary due in the three months preceding the bankruptcy decree, up to an amount equalling five minimum wages per employee, must be paid as soon as there are available funds;[96]

(c) Cash restitution claims;[97]

(d) Super priority claims (the so-called *créditos extraconcursais*);[98]

(e) Claims subject to the bankruptcy proceeding (in accordance with the ranking laid out by Article 83);[99]

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93 Bankruptcy Law, Art 84.

94 This refers to cases in which a specific creditor is particularly interested in speeding up a certain act, eg where a lessor pays for the transportation of the bankruptcy estate's goods from the property to somewhere else, so as to have his property back in order as quickly as possible.

95 *Idem*, Art 150.

96 *Idem*, Art 151.

97 *Idem*, Art 86.

98 *Idem*, Art 84.

99 *Idem*, Art 83.

(f) Interest on claims due after the decree of bankruptcy[100] (except for interest due on debentures) and for interest due on claims guaranteed by *in rem guarantees*, in the latter case up to the value of the collateral, which are paid together with the other claims subject to the bankruptcy proceeding (para e) above);

(g) The balance, if any, which must be delivered to the bankrupt after all creditors have been paid.[101]

6.3.11 Termination of the insolvency proceeding

Once the assets have been sold and the proceeds distributed amongst creditors, the judicial administrator will submit his accounts to the bankruptcy judge within 30 days. After a decision is rendered on the judicial administrator's accounts, he must submit his final report on the bankruptcy to the Bankruptcy Court within 10 days. The final report must include the amount of the proceeds from the sale of the assets, the amount of the liabilities and the amount of the payments made to creditors, as well as debtor's liabilities that will survive beyond the bankruptcy.

Brazil does not grant a fresh start for the debtor as a result of the termination of the bankruptcy procedure. The debtor's remaining liabilities will only be extinguished if all the claims are paid with the exception of subordinated claims and less than 50% of the value of the unsecured claims. If these thresholds are not met, the debtor will have to wait for five years (if the debtor or its managers have not been convicted of any bankruptcy offences) or 10 years (if the debtor or its managers have been convicted of any bankruptcy offences) in order to enter into business activities again.

Self-Assessment Exercise 4

Question 1

Under Brazilian law, creditors are paid observing the following priority order:

1. Tax claims, secured claims, labour claims.
2. Tax claims, labour claims, secured claims and unsecured claims.
3. Labour claims (limited to 150 minimum wages), secured claims, tax claims (except fines), unsecured claims.
4. Labour claims, secured claims, tax claims, unsecured claims

Question 2

It is correct to say that:

1. A third party whose assets have been taken into custody by the judicial administrator of a bankrupt estate may file a restitution lawsuit.
2. After termination of the bankruptcy procedure the debtor is allowed to immediately resume business activities.
3. An insolvent law firm can file for bankruptcy under the Bankruptcy Law.
4. The holder of a claim that was not paid in the due date can file for the bankruptcy of the debtor, no matter the amount of the claim.

[100] *Idem*, Art 124.
[101] *Idem*, Art 153.

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.4 Receivership

There is no system of receivership in Brazil in regular insolvency proceedings.

There are some similar regimes to the receivership system in special statutes regarding financial institutions, credit unions, consortia, supplementary pension companies, health care plan companies, insurance companies, capitalisation companies and other organisations legally equivalent to those listed above. In this sense, Federal Law 6.024/1974 regulates the intervention and extrajudicial liquidation of financial institutions (and credit unions), both imposed by the Central Bank of Brazil; according to the Decree-Law 2.321/1987, the Central Bank is also allowed to impose a special temporary administration on a financial institution (and credit unions). Federal Decree-law 73/1966 authorises the Superintendence of Private Insurance (SUSEP) to intervene or liquidate insurance companies. In the same way, health care plan companies are subject to the management and extrajudicial liquidation of the National Supplementary Health Agency (ANS) (Law 9.656/1998).

6.5 Corporate Rescue

6.5.1 General

When business legal entities and individual entrepreneurs face a crisis, it is usual that debtors negotiate with creditors. In practice, it is becoming relatively common for debtors to engage in informal creditor workouts, including sometimes the use of the so-called standstill contract (which, in Brazil, is not statutorily regulated). Currently, extrajudicial renegotiation with creditors is expressly permitted[102] – an important fact when compared to the former Decree-Law 7.661/1945, which provided that the mere notice by a debtor to its creditors proposing an amicable moratorium, the remission of claims or the assignment of assets with the goal of overcoming a business crisis situation, was an act of bankruptcy.

Where an informal creditor workout or market solutions are not sufficient to overcome the debtor's financial crisis, it is possible to file for judicial recovery or extrajudicial recovery.

The goal of a judicial or extrajudicial recovery is to make it possible for the debtor to overcome its economic and financial crisis. By doing so, the debtor is able to maintain the production of goods and the offering of services, retain jobs and preserve the interests of the creditors. In this sense, the recovery procedure cannot be used to liquidate the business; the sale of the entire business of an insolvent debtor should occur in a bankruptcy proceeding. However, although questionable, there have been cases where the sale of the whole business was contemplated as part of the recovery plan.

Only business legal entities and individual entrepreneurs qualify as suitable debtors to undergo a proceeding under the terms of the Bankruptcy Law; as long as they are

[102] *Idem*, Art 167.

not *empresas públicas* or *sociedades de economia mista*[103] and the economic activity they engage in is not subject to special protective provisions (such as finance, credit, supplementary pension, health care and capitalisation activities).

Moreover, the debtor must comply with four additional conditions to make use of the corporate rescue provisions:

(a) not being bankrupt or, if he has ever been declared bankrupt, the resulting liabilities have been declared extinguished;

(b) not having obtained a concession for judicial recovery within the last five years;

(c) not having obtained a concession for judicial recovery for micro or small enterprises within the last five years; and

(d) the debtor, officers and controlling shareholder not having been convicted of any offences relating to insolvency procedures.

Groups of companies are eligible for the filing of a restructuring procedure as a group. There is no rule about the subject, but there are a series of judicial decisions that allow for the joint filing of a corporate restructuring. Procedural consolidation in such cases is well accepted; however, the consolidation of assets and liabilities (substantive consolidation) must be put to a vote at the general meeting of creditors, or subject to a decision by the Court on a case-by-case basis.[104]
Furthermore, there is a single gateway for entering corporate rescue: the voluntary filing for corporate restructuring and, if the debtor is a business legal entity, such as a corporation, it is necessary to have the previous authorisation of the shareholders in general meeting.[105] A creditor cannot file for the judicial recovery of a debtor, but creditors must approve the recovery plan and, in this sense, will negotiate and may present alternative rescue methods.

There is no obligation to file for corporate rescue under any circumstances. No officer, director or shareholder will be held liable on that account. It is also not likely for courts to hold the view that an officer, director or shareholder is directly responsible for the poor performance of the company. Regardless of the lack of specific bankruptcy-related provisions, officers, directors and shareholders may be

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[103] For the definitions of *empresas públicas* and *sociedades de economia mista*, see fn 52 and 53.

[104] According to a study from the University of São Paulo, however, reality shows that courts have not been adopting a clear distinction between procedural and substantive consolidation. The study concludes that (i) procedural consolidation requests are not always analysed by courts upon deciding on the granting of the process of judicial recovery; as the arguments presented by the debtors to file together are usually based on facts that could lead to the piercing of the corporate veil, or to the extension of the effects of the bankruptcy of one debtor to another, procedural consolidation exposes the creditors to the risk of a substantive consolidation; (ii) for the same reasons, the substantive consolidation might be viewed as a necessary result of the procedural consolidation; and (iii) the transaction costs of treating debtors as single entities gives rise to a concrete possibility of having the substantive consolidation as a natural result of the procedural consolidation, without further thought. The study is available at https://www.researchgate.net/publication/311677436_A_silenciosa_consolidacao_da_consolidacao_substancial_Resultados_de_pesquisa_empirica_sobre_recuperacao_judicial_de_grupos_empresariais.

[105] The resolution's *quora* depends on the type of the business association. For corporations, the Corporations Act provides that, except as otherwise provided for by law, the resolutions of a General Meeting (including for filing for judicial or extrajudicial recovery) shall be passed by a simple majority of votes, abstentions not being taken into account; but in case of urgency, as happened in the OI Case, the request for recovery may be made by the officers, as agreed with the majority shareholder, if any, immediately calling a General Meeting in order to vote on the matter. On the other hand, for limited liability companies, the resolution for filing for corporate rescue shall be taken by votes representing more than half of the stock capital; however, if there is urgency and with the authorisation of the holders of more than half of the stock capital, officers may require judicial or extrajudicial recovery prior to a formal meeting.

held responsible for a breach of fiduciary duties, such as the duty of care and the duty of loyalty, both provided for by the Corporations Act. In this sense, there is currently case-law and legal writing stating that if the delay in filing for corporate rescue amounts to a breach of the directors' and officers' (as well as the controlling shareholder's) fiduciary duties, they might be held responsible for the damages caused to the debtor. However, the understanding that upon insolvency officers hold fiduciary duties towards creditors is not yet a popular thesis.

The judicial recovery and extrajudicial recovery procedures will be discussed separately below.

6.5.2 Judicial recovery

A petition for judicial recovery must present, in addition to the requirements set forth in the Code of Civil Procedure:[106]

(a) a statement setting out the causes of the economic and financial crisis of the debtor;

(b) accounting statements for the last three financial years and for the current year (balance sheet, accrued income statement, income statement of the current year and management report on cash flow and projection);

(c) full nominal list of creditors, stating their address, kind, rating and updated amount of the claim;

(d) full list of employees with their respective functions and salaries;

(e) certificate of regular standing of the debtor with the Board of Trade, updated articles of incorporation and minutes of appointment of current officers;

(f) list of private assets of the debtor's controlling partners and officers;

(g) updated statements of debtor's bank accounts and financial applications;

(h) certificates of the protest offices[107] in the judicial district of the debtor's domicile or headquarters and branches;

(i) list of all legal actions to which the debtor is a party, with an estimate of the respective amounts involved.

If the above-mentioned documents are in order, the judge must grant an order for judicial recovery. After such a decision has been granted by the court, the debtor is only allowed to withdraw from the restructuring procedure if the creditors agree to it.

On the other hand, conversion from judicial recovery to liquidation must be ordered in the following circumstances:

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[106] See Civil Procedure Code, Art 319.

[107] A "Protests Registry" is a public institution, serving a public function, which is managed by an individual who was approved by public selection (consisting of an evaluation of a specific exam score and academic titles held by such individual, such as a master's degree or a PhD). When a debtor defaults on an obligation, the "instrument" that documents the obligation, such as a credit note or a contract, may be taken to a Protests Registry so that the creditor can publicise to the general public that the debtor has defaulted on the obligation. A "certificate" from the protest offices would refer to a document listing whether there are protests against a specific company in the jurisdiction of the Registry.

(a) where there is a resolution to this effect by the general meeting of creditors;

(b) due to a failure by the debtor to submit a recovery plan within the legal time frame;

(c) when the recovery plan has been rejected by creditors; and

(d) due to non-performance of any obligation assumed under the recovery plan during the two years following the filing for judicial recovery.

The debtor or its officers and directors continue to conduct the corporate activities of the debtor, under supervision of the creditor's committee, if any,[108] the judicial administrator, creditors and the public prosecutor.[109] However, once the judicial recovery petition has been filed, the debtor is no longer allowed to dispose of or encumber any items or rights relating to his permanent assets, unless they are of evident utility, which has to be recognised by the bankruptcy judge after hearing the creditor's committee. Additionally, the suffix "under judicial recovery" must be added to the debtor's name in all documents and notices.

In the same order granting judicial recovery, the judge also *inter alia* orders the commencement of the stay period (moratorium) and appoints the judicial administrator.[110]

The stay takes effect as soon as the judge in charge of the restructuring process accepts the processing of the procedure. The stay does not arise automatically from the mere filing of the procedure by the debtor. Article 6 of the Bankruptcy Law states that the stay period lasts for 180 days and must not, under any circumstance, be extended; judges and Courts of Appeal are, however, likely to extend the stay if the restructuring plan has not been put to a vote by the creditors during that period and as long as the delay cannot be attributed to the debtor. As soon as the stay period is in place, creditors subject to its effects are no longer able to seize any assets from the debtor (including cash).

Lawsuits claiming a non-fixed amount (unliquidated claims) will proceed at the same court until the amount is finally established, labour claims will proceed before labour courts until the amounts are fixed and tax-related executions are not suspended by the granting of a judicial recovery order.

The judicial administrator is often selected from a list of candidates held by the court. The judicial administrator must be a reputable professional, preferably a lawyer, economist, business manager or accountant, or a specialised legal entity. Within 48 hours of his appointment, the judicial administrator has to present himself to the court to sign an instrument of commitment to confirm his appointment and to assume all responsibilities inherent to the judicial recovery procedure. The judicial administrator's fees are established by the judge in charge of the insolvency

[108] The committee of creditors' duties are basically those of supervising the validity of the procedure. However, as already stated, the committee of creditors is not frequently formed, since there is no remuneration for the creditors that take part in it. Where there is no committee of creditors, the judicial administrator, or the judge in the case of incompatibility, carries out its duties.

[109] In exceptional cases, where the debtor or his officers have made themselves guilty of illegal acts, such as committing a crime against property, public welfare or the economic order, or unjustifiably decapitalising the company or simulating or omitting claims on submitting the debtor's claim list, the debtor will be removed from the control of the company. In such cases, the judge will call a general meeting of creditors to decide on who is to assume the management of the debtor's business and the judicial administrator takes control of the debtor until the meeting is called.

[110] Bankruptcy Law, Art 52.

procedure and are paid by the debtor; the total amount paid to the judicial administrator may not exceed 5% of the amount payable to the creditors and the judicial administrator's remuneration decreases to a 2% limit in the case of a micro or small enterprise judicial recovery.

As an auxiliary of the Judiciary (officer of the court), the judicial administrator can be removed or dismissed by the court. In the context of judicial recovery, the judicial administrator's main role is to oversee the procedure and ensure its correct implementation. Besides his main role, the judicial administrator has a vast variety of duties in regard to a judicial recovery. These duties are to:

(a) send a letter to the creditors listed in the first public notice containing the list of creditors, stating the date of the petition for judicial recovery (or decree of bankruptcy) and the kind, amount and rating established for the claim;

(b) promptly provide all information requested by interested creditors;

(c) provide extracts of the debtor's books when requested;

(d) require any information whatsoever from creditors or the debtor or his officers;

(e) draw up the second list of creditors;

(f) consolidate the general list of creditors (the third public notice);

(g) request the judge to call a general meeting of creditors in the circumstances provided for in the Bankruptcy Law;

(h) hire professionals or specialised companies, subject to court authorisation, to assist him whenever necessary in the performance of his duties;

(i) make a instatement in the events provided for in the Bankruptcy Law;

(j) monitor the debtor's activities and performance under the judicial recovery plan;

(k) file for bankruptcy in the event of the non-performance of any obligation provided for under the recovery plan;

(l) submit a monthly report on the debtor's actives to the judge, for inclusion in the record;

(m) submit a report on the implementation of the recovery plan.

As far as creditors are concerned, all claims existing on the date of the petition for judicial recovery are subject to judicial recovery, even if they are not yet due (Art 49). In this sense, no obligation arising after the commencement of the judicial recovery procedure is subject to the recovery procedure plan.

This provision gave rise to a heated debate concerning the situation of individuals and legal entities that carry on rural activities and their ability to file for judicial recovery. Rural producers are subject to a particular set of rules under the Civil Code: whether their activity is considered a "business" activity for legal purposes is dependent on the producer registering with the Board of Trade. Said registration, however, is not mandatory; the only consequence of not registering is that the rural producer is considered as carrying on a "non-business" activity from a legal

perspective. This peculiar legal regime eventually brought about an important issue before the Judiciary: should a rural producer file for judicial recovery, are all of his / its liabilities subject to the proceeding or are only the liabilities incurred after registration before the Board of Trade subject to being adjusted under a judicial recovery? The Superior Court of Justice took a debtor-friendly view on the issue, thus allowing all of the liabilities of the rural producer to be restructured, irrespective of whether they were incurred at a time the producer was considered as carrying on a "non-business" activity (prior to registration).[111]

Additionally, a number of creditors are entirely excluded from the restructuring procedure, thus making them theoretically immune to the procedure, such as holders of fiduciary title securities, leases with an option to purchase contracts and advance on foreign-exchange contracts.[112] In these cases, the property rights prevail (the respective claims do not form part of the restructuring proceeding). However, during the stay period the property securing such claims cannot be taken from the debtor if the property is essential for the business activities of the debtor. Tax claims are also not subject to the judicial recovery process.[113]

There is a procedure for the proof of claims (which is basically the same as the procedure in a bankruptcy proceeding), that runs in parallel to the judicial recovery proceeding:

(a) From the moment of the publication of the first public notice (which is drafted by the debtor himself) in the official press, creditors that are subject to the judicial recovery process have 15 days to submit their proof of claim to the judicial administrator; proof of claims are frequently sent electronically by email.[114] During these 15 days, which comprises the administrative phase of the proof of claims, the creditor does not incur any cost, even if the judicial administrator does not decide in favour of the creditor. There are no specific rules on the admission or rejection of claims by the judicial administrator. There are also no specific rules relating to the judicial administrator having to motivate his decisions, although they often do;

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111 STJ, REsp 1.800.032, Fourth Chamber, Reporting Justice Marco Buzzi, Reporting Justice for the written opinion Raul Araújo, judged on November 5th, 2019.

112 Despite the claims being immune to the judicial recovery process, the actual execution of the claim might still face obstacles. None of the debtor's assets may be repossessed or affected without authorisation from the bankruptcy court. Since first instance judges have a tendency to protect the enterprise, preserving its commercial activity, it is not rare for the court to block the repossession of collateral that, in theory, should have been considered completely immune to the restructuring proceeding. STJ, Second Joint Panel, AgRg on CC 133.509/DF, Reporting Justice Moura Ribeiro, decided on March 25th, 2015; STJ, Second Joint Panel, AgRg on CC 140.146/SP, Reporting Justice Marco Buzzi, decided on February 24th, 2016.

113 One of the ways by which the tax authorities sought to obtain the payment of tax liabilities was the legal condition for the debtor's recovery plan to only be approved upon the presentation, by the debtor, of a certificate of good standing on tax debts (Bankruptcy Law, Art 57). Despite the legal provision and the existence of a statute regulating the payment in instalments of tax claims (Law 10.522/2002, Art 10-A), a number of judicial precedents have determined that the presentation of the referred certificate is not mandatory and that the payments of taxes in instalments is unconstitutional. In addition, regardless of tax claims being immune to the restructuring proceeding, bankruptcy courts often do not allow for the assets of the debtor to be affected during the procedure – the strong tendency of judgment in favour of the preservation of the business activity ends up weakening the immunity that should have been applied to tax claims. More recently, however, courts have started to decide that the debtor needs to settle the tax liabilities either by paying them or by adhering to a payment instalment plan (STJ, REsp 1.716.048, Second Chamber, Reporting Justice Herman Benjamin, judged on May 8th, 2018).

114 The request for claim listing shall contain (i) the creditor's name and address and the address where he shall be informed of any act of the proceeding; (ii) the amount of the claim, updated to the date of the petition for the judicial recovery, its origin and rating; (iii) the documents evidencing the claims and mention of all other evidence to be produced; (iv) indication of the guarantee provided by the debtor, if any, and the respective instrument; (v) specification of the object of the guarantee in the creditor's possession.

(b) After the judicial administrator has decided on the proof of claims, he must proceed to publish the second public notice containing the list of creditors. The judicial administrator drafts the second claim list based on the debtor's list, as well as on the debtor's accounting books, commercial and tax documents and the proof of claims submitted by creditors;

(c) After publication of the second public notice in the official press, creditors, the debtor (or its shareholders) and the prosecutor have a 10-day period to object the list of creditors – this is the so-called judicial phase of the proof of claims. Any claim may be challenged and the creditor may also argue a claim is missing and must be listed. Challenges to claims run under a separate case record and are given their own case number. Since challenges to claims take place in court, the creditor bears the risk of the challenge being unsuccessful and may be ordered to pay the associated legal fees and judicial costs. The debtor is heard by the court and presents its challenge to whatever decision has been taken in relation to its claim. The judicial administrator will also issue an opinion on the issue. Challenges are finally decided by the judge in charge of the recovery procedure and an appeal may be filed against the court's decision;

(d) Where a creditor whose claim was not listed misses the 15-day period for the presentation of the proof claim during the administrative phase, the consequence is that the claim will be regarded as a "late claim" and, as a result, the creditor will not have the right to vote at the general meeting of creditors until his claim is recognised by the judge and the proof of claim will be processed as an opposition, that is, the admissibility of the claim will be decided by the judge appointed to the case. In other words, a late request for the listing of a claim not only strips the creditor of his voting right, but also makes the creditor vulnerable to bearing legal fees and judicial costs should the claim be successfully opposed by the debtor;

(e) Finally, in terms of Article 19 of the Bankruptcy Law, the judicial administrator, the committee of creditors, any creditor or the Public Attorney's Office representative may, by use of the ordinary procedure provided for in the Code of Civil Procedure, request the inclusion of a claim in the final list or the exclusion, a different rating or the rectification of any claim in the event of the discovery of documents not considered by the decision, falsity, malice, simulation, fraud or essential error in relation to the claim. The third and final list is the general list of creditors, reflecting the decisions on any challenges in regard to the claims.

Once the decision granting the beginning of the judicial recovery process is published, the debtor must submit a judicial recovery plan to the court within 60 days, under penalty of conversion of the judicial recovery into liquidation if this time limit is not met.

The plan must contain:

(a) a detailed description of how the debtor will be rescued;

(b) a statement regarding the economic feasibility of the plan; and

(c) an economic-financial and appraisal report regarding the debtor's assets.

The economic feasibility of the plan must be ascertained by the creditors; the court does not make a decision in this regard.

A judicial recovery plan can provide for any means of recovery for the debtor,[115] dispositions of the debtor's assets under its terms may be made free of any encumbrance and the winning bidder does not inherit the debtor's obligations. However, there are legal limitations on the recovery plan in regard to labour claims. The labour class of creditors must be paid in full within one year and within the first 30 days, the plan must provide for the payment of labour-related claims that have fallen due during the three months prior to the judicial recovery petition, to a maximum of five minimum wages. As a practical matter, in most of the recovery plans the above-mentioned term of 30 days and one year are counted from the moment the court confirms the recovery plan which has been approved by the creditors.

Additionally, the extinction or the substitution of guarantees, as well as the suppression of the exchange variation of claims in foreign currency, is not permitted unless the creditor holding the claim specifically agrees otherwise in the judicial recovery plan. Finally, despite the fact that the Bankruptcy Law determines the four classes of creditors in which creditors are divided so as to deliberate on the recovery plan (labour claims, secured claims, unsecured claims and claims by micro and small enterprises), there is some room for discretion within each class: subclasses are allowed as long as they are created with basis on objective parameters.[116] As an example, courts have allowed more favourable payment conditions for creditors that will continue to do business with the restructured enterprise,[117] as long as no disrespect is shown to the rights of the other creditors.

The presentation of the recovery plan is published in a public notice in the official press, which will also contain the period for stating any objections against it, which is 30 days. However, if the list of creditors prepared by the judicial administrator has not yet been published, the 30-day term for objections will only start when the referred list of creditors is published. If no creditor objects to the plan, it is automatically approved. Where an objection to the plan is made, a general meeting of creditors must be called and will be put to a vote by the creditors.[118]

The general meeting of creditors is considered a single meeting from a legal perspective, even if it is adjourned several times and divided into a number of

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[115] The Bankruptcy Law, Art 50, provides for an exemplative list on the means of recovery that the plan may adopt: I – granting of special terms and conditions for the payment of obligations fallen or falling due; II – spin-off, merger, consolidation or transformation of a company, opening of a wholly-owned subsidiary, or quota or share assignment, with due regard for the partners' rights, pursuant to applicable law; III – change in corporate control; IV – full or partial replacement of the debtor's officers or change in his management bodies; V – granting creditors the right to separate election of officers and to veto powers on matters specified in the plan; VI – capital increase; VII – succession or lease of an establishment, including to a company formed by the employees themselves; VIII – reduction in salaries, offsetting of working hours and workday reduction, by collective agreement or convention; IX – payment in kind or renewal of outstanding debts, with or without constitution of own or a third party guarantee; X – formation of a company of creditors; XI – partial sale of the assets; XII – equalization of financial charges relating to debts of any kind, the initial term being the date of distribution of the petition for judicial recovery, applying also to rural credit contracts, without prejudice to the provisions of specific law; XIII – right of enjoyment of the company; XIV – shared management; XV – securities issuance; XVI – formation of a specific purpose company to adjudicate, in payment of the claims, the debtor's assets.

[116] STJ, REsp 1.634.844, Third Chamber, Reporting Justice Ricardo Villas Bôas Cueva, judged on May 12th, 2019.

[117] For example, a common subdivision of Class III (unsecured creditors) is the distinction between negotiating creditors and non-negotiating creditors.

[118] The general meeting of creditors is usually only called to approve, reject or modify the judicial recovery plan, but it also has a duty under judicial recovery to pass resolutions on: (i) the formation the committee of creditors, (ii) withdrawal by the debtor from the recovery procedure; (iii) the appointment of a judicial officer where the debtor is excluded from managing the business and (iv) any other matter affecting the creditors' interests.

encounters. For example, the creditors may decide to adjourn the general meeting for a few days in order to negotiate a different recovery plan with the debtor. The only creditors who may attend and exercise their right to vote on the recovery plan are those who were present at the time the general meeting of creditors was convened for the first time. Only creditors whose claims are affected by the re-negotiated plan have the right to vote on the plan. If no changes to the original conditions of payment are made in respect of a specific creditor, the creditor will not be included for the purposes of passing a resolution on the recovery plan. The *quora* required for the passing of the resolution at the general meeting of creditors will vary, depending on the class of creditors involved. The majority needed by each class of creditor for approval of the judicial recovery plan, is as follows:

Class	Criteria for Approval
Labour Claims	Majority by head count of attending creditors
Secured Claims	Majority by head count and by value of the claims of the attending creditors
Unsecured Claims	Majority by head count and by value of the claims of the attending creditors
Claims by micro and small enterprises	Majority by head count of attending creditors

It is not possible for a single class to approve and adopt the recovery plan separately. All four classes must approve the plan.[119] Once the plan has been approved by the general meeting of creditors, it will be enforced against minority dissenting creditors.

Where there are no objections by creditors to the recovery plan – or it has been approved by the general meeting of creditors – and as long as the other additional requirements of the Bankruptcy Law (such as the submission of clearance certificates for tax debts)[120] are met, the judge will grant the judicial recovery. Despite not assessing the economic provisions of the plan and its feasibility, the Bankruptcy Court is in charge of ensuring its legality: the Court may reject some clauses that are against the law and, sometimes, depending on the number of illegalities, may even deny the confirmation of the plan and call another meeting of creditors to review the recovery plan.

Even if the judicial recovery plan is not approved by the general meeting of creditors, Article 58 of the Bankruptcy Law contains provisions on the cramdown of the judicial recovery plan. Under the Brazilian system, the cramdown is merely the adoption of lower thresholds with regard to the approval quorum on the judicial recovery plan:

> "Article 58. The requirements of this Law having been met, the judge shall grant the judicial recovery of the debtor whose plan has not been objected to by any creditor pursuant to article 55 hereof or has been approved by the general meeting of creditors pursuant to article 45 hereof.

[119] Bankruptcy Law, Art 45.
[120] See note 115.

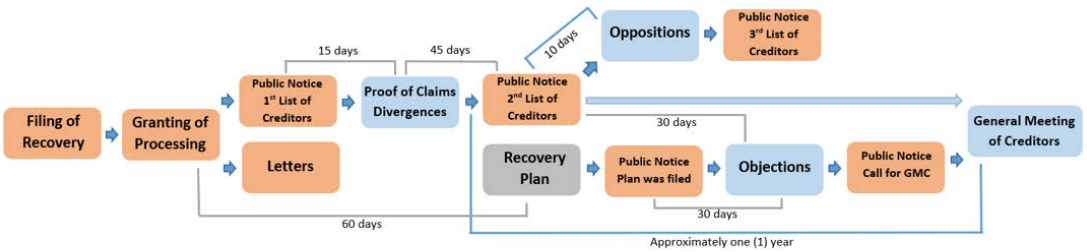
> Paragraph 1. The judge may grant judicial recovery based on a plan that has not been approved pursuant to article 45 hereof, provided it has obtained, cumulatively, at the same general meeting:
> I – the favorable vote of creditors representing over half the amount of all credits represented at the general meeting, independently of classes;
> II – the approval of two (2) of the classes of creditors pursuant to article 45 hereof, or if there are only two (2) classes with voting creditors, the approval of at least one (1) of them;
> III – in the class that rejected it, the favorable vote of over one-third (1/3) of the creditors, computed pursuant to article 45, paragraphs 1 and 2, hereof.
> Paragraph 2. Judicial recovery may only be granted pursuant to Paragraph 1 of this article if the plan does not entail different treatment among the creditors of the class that rejected it."

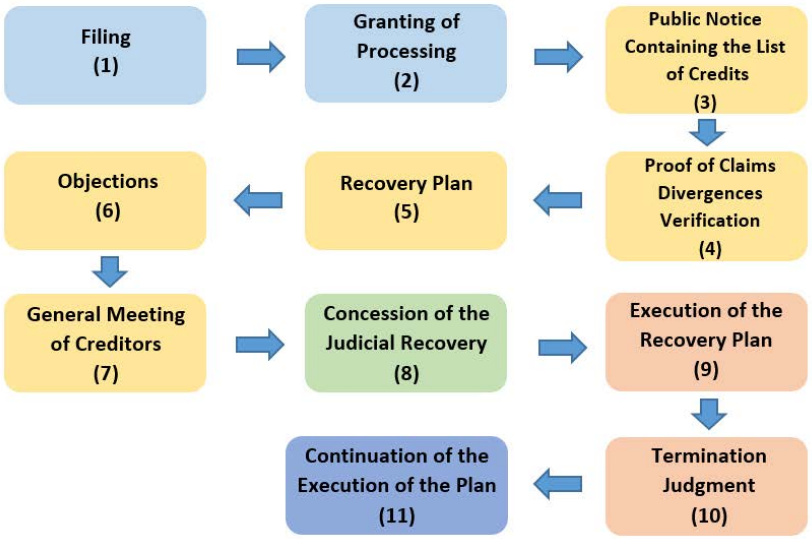
Any creditor, or the Public Prosecutor's Office, can appeal against a decision that grants the judicial recovery.

Once the judicial recovery is granted, the debtor remains under the judicial recovery procedure for two years.[121] During this period, the non-performance of a recovery plan provision leads to the conversion of the recovery procedure into bankruptcy. After the two year period, the non-performance of a plan provision does not lead to the bankruptcy of the debtor, but the impaired creditor may seek execution of the plan or the debtor's bankruptcy through the traditional bankruptcy gateways.

Below are two brief charts relating to the judicial recovery proceeding.

[121] More recent decisions have accepted early termination of the judicial recovery procedure if the debtor can demonstrate that all obligations contemplated in the recovery plan have been fulfilled before the end of the two-year term.





The judicial recovery procedure has some deficiencies that make it less effective than it could be. Post-commencement financing (also referred to as DIP financing) is encouraged, but the creditor is not well protected.[122] Existing equity is highly protected, the judicial recovery plan will not necessarily affect it and there are no legal provisions dealing with voidable dispositions (unless it is clearly fraud), nor a suspect period prior to the filing of the judicial recovery procedure. The creditors are not allowed to present an alternative recovery plan, putting them in the position of deciding whether to accept a bad plan or putting the debtor into bankruptcy. There is no neutral or favourable tax treatment in the case of restructurings (for example, debtors will have to pay capital gains tax if the recovery plan proposes a "haircut" in the value of the claims).

6.5.3 Judicial recovery for micro and small enterprises

The Brazilian Constitution contains a provision for micro and small enterprises to receive incentives from the Legislator.[123] Complementary Law 123/2006 provides that micro enterprises are those whose gross revenues do not exceed BRL 360,000 per year and small enterprises are those with gross revenues in excess of BRL 360,000 but not exceeding BRL 4,800,000 per year.[124]

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[122] Pursuant to Art 67 of the Bankruptcy Law, "Credits [claims] accrued from obligations contracted during the judicial recovery, including claims related to expenses with goods / services suppliers and loan agreements, shall be deemed extra-bankruptcy" if the debtor's judicial recovery is converted into bankruptcy; however, it is not an efficient privilege since there are other creditors who will receive earlier payment in a bankruptcy. In addition, Art 67's sole paragraph states that "All unsecured claims subject to the judicial recovery belonging to goods / services suppliers that do not halt such supply after the judicial recovery filing shall be given a general priority to claim in the event of bankruptcy abridgment, limited to the amount of goods / services supplied during the recovery period."

[123] Constitution, Art 179.

[124] See note 4.

The special regime for micro and small enterprises is more focused on tax benefits, but there are some benefits in other areas, such as insolvency law.

Bankruptcy Law provides for a special procedure for micro and small enterprises, but the procedure is not mandatory: the debtor can choose between the regular regime of judicial recovery or the special procedure for micro and small enterprises. Furthermore, the requirements for filing for the judicial recovery are the same and the special judicial recovery plan must also be presented within 60 days of the filing for judicial recovery.

However, the plan encompasses all existing claims at the time of the filing, even if they are not yet due (apart from those relating to the borrowing of official funds, tax claims and other legal exceptions, as is the case in a regular judicial recovery). The plan may only provide for a maximum of 36 months' instalment payments of equal and successive amounts, which will be monetarily restated to include interest equivalent to the *Taxa Selic*,[125] as well as haircuts on claims. The first instalment must be paid within 180 days from the filing of the judicial recovery petition before a court. The plan must also provide for authorisation by the judge for the debtor to increase expenses or hire employees. Consequently, the recovery procedure for micro and small enterprises provided for in the Bankruptcy Law is very restricted and is quite often ineffective in allowing for the restructuring of a micro or small enterprise experiencing a financial crisis.

One of the main advantages for the debtor is the fact that there is no judicial administrator, which makes the proceeding much less expensive when compared to a regular restructuring.

Another difference is that a general meeting of creditors is not called. If creditors holding over half the claims of each class object to the plan, the judicial recovery will be dismissed and it will be converted into bankruptcy. If this is not the case, the judicial recovery will be granted.

6.5.4 Extrajudicial recovery

A debtor who qualifies for the filing of a judicial recovery procedure may opt to apply for an extrajudicial recovery instead. A debtor may not file for extrajudicial recovery if a petition for judicial recovery is pending, or if he has obtained judicial recovery or legal ratification of another extrajudicial recovery plan within the previous two years.

The extrajudicial recovery procedure is a special regime that is only considered by the court in the final phase of the process, when the extrajudicial recovery plan is approved by the bankruptcy court. The recovery plan is negotiated out of court between the debtor and his creditors and once the negotiation has been completed, the debtor files for extrajudicial recovery, seeking approval of the plan by the court.

The recovery plan may be imposed (crammed down) on the dissenting creditors as long as 60% of the creditors in each class vote in favour of the plan. The plan may not provide for advance payments of debt, nor the unfavourable treatment of creditors who are not subject to the plan; additionally, the suppression or the substitution of guarantees, as well as the suppression of the exchange variation of

[125] *Taxa Selic* is the interest rate equivalent to the reference rate of the Special Settlement and Custody System (Selic) for federal securities. See http://idg.receita.fazenda.gov.br/orientacao/tributaria/pagamentos-e-parcelamentos/taxa-de-juros-selic.

claims in foreign currency is not permitted unless the holder of the respective claims specifically consents to it in the recovery plan.

Besides complying with the requirements of the Civil Procedure Code, the petition for an extrajudicial recovery procedure must explain the reasons for the request and the recovery plan and, where there are dissenting creditors, must also present (i) a report of the debtor's assets and financial situation, (ii) accounting statements for the last financial year and those specially prepared for the recovery and (iii) a complete list of creditors.

After receiving the petition for an extrajudicial recovery, the bankruptcy judge will determine the publication of a public notice calling all creditors to file their objections to the plan, which must be filed within 30 days – and during such period the debtor must prove that a letter has been sent to all creditors domiciled or headquartered in Brazil and who are subject to the plan, stating the delivery of the petition, the conditions of the plan and the period during which objections may be lodged. Opposition / objections to the plan can be motivated solely on the following grounds: (i) failure to meet the minimum approval rate for a compulsory extrajudicial recovery (three-fifths of the total amount of credit (debt) in each class of creditors), (ii) the performance of any of the acts that led to bankruptcy (Art 94) or that are fraudulent (Art 130), or non-compliance with any other requirement of the Bankruptcy Law, and (iii) non-compliance with any other legal requirement.

Where objections are presented, the debtor has a five-day period to provide an answer to the objection. After that (and despite not being provided by the Bankruptcy Law) the Public Prosecutor's Office is usually subpoenaed for acknowledgement of the plan's contents and the objections presented by creditors. Finally, the court will decide whether or not to ratify the recovery plan. The extrajudicial recovery plan can only be rejected by the court if the plan does not comply with the law and, if the plan is not ratified, the debtor may, in the future, file a new petition for the ratification of an out-of-court recovery plan.

It is possible to appeal against the decision that ratifies (or does not ratify) the extrajudicial recovery plan.

The plan becomes effective after its court ratification, but the recovery plan can provide for prior effects in regard to the change in the value of claims, or for payment to adherent creditors.[126]

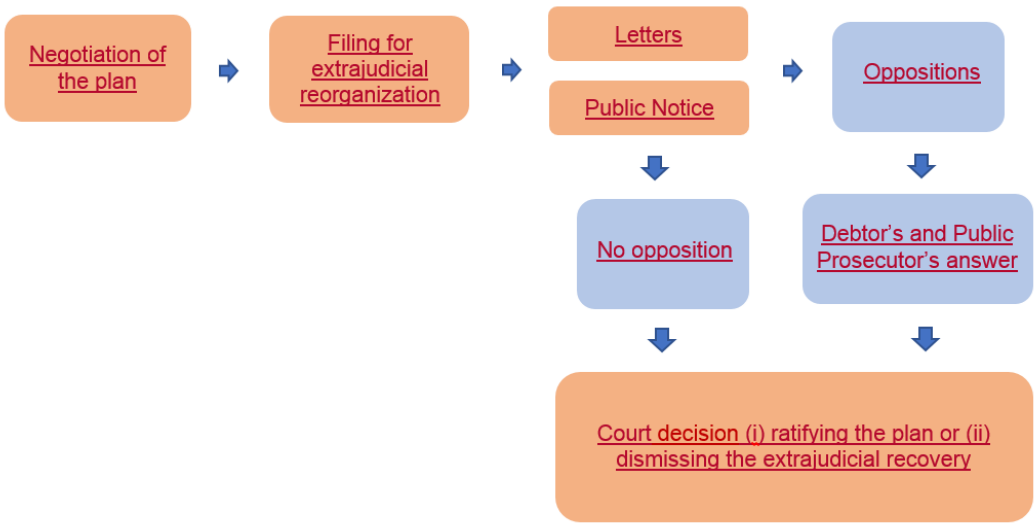
When compared to the judicial recovery procedure, the extrajudicial recovery procedure is (i) more flexible, (ii) simpler, (iii) faster, (iv) less expensive and (v) less risky. That is because there is no general meeting of creditors, creditor's committee or judicial administrator and it is easier to approve the plan. In addition, there is no risk of conversion to bankruptcy nor the two-year period in which the proceeding remains running after approval of the plan.

On the other hand, there are some disadvantages to the extrajudicial recovery procedure, for example: (i) labour-related claims are excluded, (ii) there is no stay

[126] Bankruptcy Law, Art 165: "The out-of-court recovery plan is not to be enforced before its judicial ratification. Paragraph 1. However, the plan may call for purposes production prior to approval, provided exclusively in relation to the change in the value or the payment of the signatory creditors. Paragraph 2. In the case of Paragraph 1 of this Article, if the plan is later rejected by the court, the signatory creditors are again entitled to demand their credits as per original condition, minus the amounts actually paid."

(moratorium),[127] (iii) assets are not disposed of free of encumbrances, thus binding the buyer to the liabilities incurred by the debtor, (iv) there is a risk of acts performed in terms of the plan being considered ineffective or being revoked should the debtor be declared bankrupt and (v) there is no provision relating to post-commencement (DIP) financing.

Below is a brief chart setting out the extrajudicial judicial recovery proceeding:



Self-Assessment Exercise 5

Question 1

Why is the extrajudicial recovery procedure not as attractive a means of restructuring as the judicial recovery procedure?

a) Not that different from a contract;
b) More costly and risky;
c) Does not include labour claims and does not allow the sale of assets free and clear of liabilities;
d) The agreement has to be approved by a court.

[127] Despite the fact that the Bankruptcy Law has no provisions on a stay period taking place under an extrajudicial recovery procedure, some authors argue that creditors who have not voluntarily joined the extrajudicial recovery plan, but who will be subject to it if the plan is approved by the necessary *quorum* and approved by the court, will have their foreclosure lawsuits suspended while the extrajudicial recovery is being processed. In fact, the Court of Appeals of the State of São Paulo has already rejected a bankruptcy request filed by a creditor who had objected an extrajudicial recovery plan where approval was pending, deciding that the mere filing of the extrajudicial recovery hinders the filing of an involuntary bankruptcy suit when the creditor filing for it might be subject to the plan, at least until the time of the official approval judgment (TJSP, AI 990.10.104784-5, Chamber Reserved for Bankruptcy and Judicial Recovery, Reporting Appeal Judge Romeu Ricupero, decided on June 1st, 2010). In the same vein, the Court of Appeals of the State of São Paulo has already determined that a stay period should be applied to creditors who will be subject to the extrajudicial recovery plan in case the plan is approved by the necessary creditors and approved by the court (TJSP, AI 2201705-59.2016.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appeal Judge Cesar Ciampolini, decided on February 22nd, 2017; TJSP, AI 2204224-07.2016.8.26.0000, First Chamber Reserved for Business Matters, Reporting Appeal Judge Cesar Ciampolini, decided on February 22, 2017; see also TJSP, AI 2187066-36.2016.8.26.0000, First Chamber Reserved for Business Matters, Reporting Judge Cesar Ciampolini, decided on February 22nd, 2017).

Question 2

Why is the sale of a productive unit especially attractive as a means of recovery within the judicial recovery?

a) Because it is implemented thought a judicial auction;
b) It can be made free and clear of liabilities and result in a better sale price for the assets; and the sale will not be presumed to be void if the debtor ultimately goes into bankruptcy;
c) Purchaser will inherit the existing liabilities, which benefits the creditors of the estate;
d) The sale can be implemented by any legal means.

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

The Brazilian legal system has not adopted the UNCITRAL Model Law on Cross-Border Insolvency and there are no specific bilateral or multilateral treaties or conventions that apply to cross-border insolvency matters. Specific legislation on the matter is still to be enacted. The country adopts a territorial approach when dealing with insolvency: the Bankruptcy Law states that the court of the place where the debtor has its main establishment, or where the branch of a foreign company is located, is the competent court to grant judicial recovery or to declare the debtor bankrupt. Consequently, if a debtor with operations in Brazil through a branch, for instance, is declared bankrupt in another jurisdiction, it will be necessary to initiate a bankruptcy procedure in Brazil in order to deal with the assets located in Brazil.

However, one practical and important aspect that needs to be considered whenever dealing with this matter in cases of insolvency proceedings, is that any company that wants to set up an agency or a branch to operate in Brazil needs to seek government approval beforehand.[128] Thus, in the vast majority of cases, companies willing to operate in Brazil use an independent corporate form as there is no need to obtain approval to own shares of a corporation or of a limited liability company, for example. As a result of this, if the parent company is liquidated in a foreign jurisdiction and the administrator of the foreign estate wants to liquidate the subsidiary in Brazil, the Brazilian company, as an independent legal entity, will have to be liquidated in Brazil. Assuming, for the purpose of the example, that the Brazilian company is insolvent, an independent bankruptcy proceeding will have to be initiated in Brazil.

Despite this, there have been several cases where foreign companies have filed for recovery in Brazil together with other companies of the same economic group.

[128] Federal Decree-law 4.657/1942, Art 11, para 1. See also the Civil Code, Art 1.134.

Among these cases are the OAS[129] and OGX cases.[130] These cases all have in common the fact that the foreign companies were mere financial vehicles for the Brazilian companies. The courts' arguments in accepting the filing by foreign companies in these cases, include:

(a) the foreign companies only served as financial vehicles for the Brazilian companies to issue debt securities and raise money abroad in order to explore certain operational activities in Brazil;

(b) the foreign and national entities form a single economic group that develops a single business activity;

(c) the funds to pay the debts of the foreign companies come from the business activities that the Brazilian companies develop in Brazil; and

(d) business decisions were made in Brazil and the relationship between the Brazilian and the foreign companies was clearly one of subordination rather than of co-ordination.

On the other hand, reaffirming the many obstacles that arise when dealing with cross-border insolvency, it is argued that:

(a) if the debtors do not comply with the terms of the recovery plan, the court cannot place the foreign companies into bankruptcy – creating an unacceptable legal advantage to foreign entities;

(b) judicial recovery in Brazil creates uncertainty because it would subject foreign creditors to payments in a different country and subject them to jurisdictional laws that are different from those the parties agreed upon in their agreements;

(c) in order to accept a Brazilian court's jurisdiction to process a foreign company's request for judicial recovery, it is necessary to substantively consolidate the assets of said companies and a Brazilian company cannot consolidate assets of a foreign company, especially if they are not in Brazil; and

(d) Brazilian law cannot be applied and its remedies cannot be used to protect foreign companies without violating the sovereignty of each country.

The Appellate Courts of the States of São Paulo[131] and Rio de Janeiro[132] have held that foreign companies can file together with the other companies of the same enterprise group. In both cases however, appeals are pending before the Superior Court of Justice.

In a more recent case, the OI case,[133] this issue was again brought to court. In the OI case, the judicial recovery was filed by a group of companies, including two Dutch

[129] Case No. 1030812-77.2015.8.26.0100, First Bankruptcy and Judicial Recovery Court of São Paulo (SP), filed on March 31st, 2015.
[130] Case No. 0377620-56.2013.8.19.0001, Fourth Business Court of Rio de Janeiro (RJ), filed on October 30th, 2013.
[131] TJSP, AI 2084295-14.2015.8.26.0000/50000, Second Chamber Reserved for Business Matters, Reporting Judge Carlos Alberto Garbi, decided on August 31st, 2015.
[132] TJRJ, ED 0064658-77.2013.8.19.0000, Fourth Civil Chamber, Reporting Judge Gilberto Campista Guarino, decided on February 19th, 2014.
[133] Case No. 0203711-65.2016.8.19.0001, Seventh Business Court of Rio de Janeiro (RJ), filed on June 20th, 2016.

companies, both controlled by the OI Corporation. The Dutch companies initially filed a suspension of payment proceeding in the Netherlands. The proceedings were later converted into liquidation. The trustees of the Dutch companies opposed the presentation of a judicial recovery plan by the companies without them being heard. The Bankruptcy Court of the 7th Business Court of Rio de Janeiro decided that the decisions of the Dutch Court liquidating the Dutch companies first had to be approved by the Superior Court of Justice. Without this, the trustees would still be allowed to present arguments, but the managers of the Dutch companies previously appointed by the OI Corporation would continue to represent the Dutch companies.

This matter was taken to the Southern District Court of New York, where the parties litigated about whether Brazil or The Netherlands should have been considered the centre of main interest of the Dutch companies. The American court ultimately considered Brazil as the centre of main interest.

Self-Assessment Exercise 6

Is it fair to say that Brazilian courts have been considering Brazil as the centre of main interests and that Brazilian bankruptcy courts are competent to process a judicial recovery of an economic group, including a foreign legal entity used by the group of companies to obtain financing for the operational activities developed in Brazil?

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

Brazil has internal legislation governing the recognition of foreign judgments: both Federal Decree-Law 4.657/1942 (Law of Introduction to the Norms of Brazilian Law) and Law 13.105/2015 (Civil Procedure Code) are particularly relevant. Aside from these, there are a wide range of international treaties and other pieces of legislation governing international judicial co-operation.

The Law of Introduction to the Norms of Brazilian Law states that Brazilian courts shall comply with the *exequatur* granted and, in the manner established by Brazilian law, execute the measures ordered by the competent foreign authority, observing the law of the foreign country regarding the object of the measures to be taken.[134] A foreign judgment granting interlocutory relief may be executed.[135]

The Law of Introduction to the Norms of Brazilian Law further states that a decision from a foreign jurisdiction must be executed in Brazil if the following requirements are met:

(a) the decision has been taken by a competent court;

(b) the parties have been summoned or the legal requirements for a default judgment have been verified;

[134] Article 12, para 2. See also the Civil Procedure Code, Arts 960 and 961.
[135] Civil Procedure Code, Art 962.

(c) the decision has become final and have the necessary formalities for enforcement at the place where it was taken;

(d) the decision has to be translated into Portuguese[136] by an authorised interpreter;[137]

(e) the decision has been approved by the Federal Supreme Court.

However, the requirement under (e) above was repealed by the Federal Constitution enacted in 1988 and the Superior Court of Justice is now the competent court to approve court decisions from foreign jurisdictions and to grant an *exequatur* to rogatory letters. What this means is that all the conditions regarding the enforceability of a foreign decision must be analysed by the Superior Court of Justice. In addition, the Civil Procedure Code, which applies to commercial issues, further states that a foreign decision may also not violate a Brazilian *res judicata*[138] decision or Brazilian public policy.[139] The foreign decision will not be ratified when the Brazilian courts have exclusive jurisdiction; the provision is also applicable to the grant of an *exequatur* to a rogatory letter.[140]

It is also necessary to take note of what Article 24 of the Civil Procedure Code states:

> "Article 24. The action brought before a foreign court does not induce *lis pendens* and does not prevent the Brazilian judicial authority from knowing the same cause and those related to it, except as otherwise provided for in international treaties and bilateral agreements in force in Brazil.
> Sole paragraph. The pending case before the Brazilian jurisdiction does not prevent the homologation [approval] of a foreign judicial sentence when required to produce effects in Brazil."[141]

In summary, whenever seeking the enforcement of a final decision or even a preliminary decision from a foreign court in Brazil, the foreign decision will have to be approved by the Superior Court of Justice in order to be enforced, or any measure to be taken, in Brazil. The granting of an *exequatur* in regard to a preliminary decision, however, follows a more expedite proceeding when compared to the proceeding applicable to a final decision. The Superior Court of Justice may also grant an

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136 *Idem*, Art 224 ("Documents written in a foreign language will be translated into Portuguese to have legal effects in the country").

137 An official or sworn translator, according to Art 216-C of the Superior Court of Justice Internal Regulation. See also Civil Procedure Code, Art 192: "In all acts and terms of the process the use of the Portuguese language is mandatory. Sole paragraph. The document written in a foreign language can only be added to the case file if it is accompanied by a Portuguese version processed through the diplomatic channel or the central authority, or signed by a sworn translator."

138 *Res Judicata* means a certain decision is final and not susceptible of change: either there is no form of appeal left against it or the option to appeal it has precluded. In light of the *Res Judicata Doctrine*, a court will not judge again on a matter that has already been settled by the Judiciary.

139 The Civil Procedure Code, Art 963, *caput*, provides that "The following are indispensable requirements for the ratification of the decision: I – that it be rendered by an authority with jurisdiction; II – that it be preceded by suitable service of process, even if there is default; III – that it be effective in the country where it was rendered; IV – that it does not violate a Brazilian res judicata decision; V – that it is accompanied by an official translation, unless its waiver is provided for in a treaty; VI – that it does not contain an express violation of public policy."

140 *Idem*, Art 964. For more information on the procedures for approval, see the Civil Procedure Code, Arts 960 to 965 and the Superior Court Internal Regulation, Arts 216-A to 216-N.

141 "The existence of a lawsuit filed in Brazil with the same parties, the same pleading and the same cause of action does not preclude the foreign judgment. Hypothesis of concurrent competence (Articles 88 to 90 of the Code of Civil Procedure), there being no offense to national sovereignty." (STJ, SEC 14.518, Special Court, Reporting Justice Og Fernandes, decided on March 29th, 2017).

exequatur without first summoning the other party to the proceeding in cases where the summoning could result in the inefficacy of the order.

Regarding the actual execution of the foreign decision after its approval, the court with jurisdiction to do so is a federal first instance court and the enforcement is sought at the request of the party seeking execution of the foreign decision.[142]

Concerning international co-operation, the competent authority from a foreign country, such as a judicial court, may seek direct assistance from the Brazilian authorities in order to perform certain acts or to obtain specific information. A request for direct assistance constitutes a request that, due to its administrative nature, does not require the judgment of the Superior Court of Justice. In this case, the request is sent directly to the Ministry of Justice. Direct assistance may be requested, for instance, when the foreign authority needs to know the address of someone in Brazil, wants to get copies of certain documents, or information about the existence of lawsuits.[143]

Apart from what has been set out above, it is important to check whether Brazil and the country where the request for international co-operation emanates from, are perhaps signatories to bilateral or multilateral international treaties on the matter. Brazil is a party to several treaties and conventions,[144] and those agreements may contain distinct provisions relating to the standard procedure.

As regards the grounds for not recognising foreign decisions, anything which is offensive to Brazil's sovereignty, the dignity of any natural person and / or the maintenance of public order, are recurrent arguments for denial.

In an interesting case where the formal requirements for recognition were met, the Superior Court of Justice refused to approve a foreign court's decision because it would undermine the ongoing judicial recovery of a Brazilian subsidiary company (in the Grupo Manacá case) and affect the country's sovereignty. The holding company in this case held 99,5% of the shares of the Brazilian company, which was under judicial recovery at the time. The liquidator of the parent company, which was under liquidation in the British Virgin Islands, notified the Brazilian company about his intention to take possession of the assets of the Brazilian company to pay debts of the BVI's company. At a later stage, the liquidator sought official approval in Brazil of the decision handed down in the court of the British Virgin Islands. The Superior Court of Justice found that official approval would jeopardise the purpose of the judicial recovery procedure taking place in Brazil, which was to create the means for the restructuring of the company.[145]

Finally, Brazil is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and to the Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards (the Panama Convention). These treaties have been incorporated into Brazilian law through Federal Decree No. 4.311/2002 and Federal Decree No 1.902/1996, respectively. The provisions of the Civil Procedure Code also apply, subordinately, to the enforcement of arbitral awards.[146]

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142 Civil Procedure Code, Art 965.
143 *Idem*, Arts 28 to 34.
144 A list of the international treaties on civil matters subscribed by Brazil can be found at http://www.justica.gov.br/sua-protecao/cooperacao-internacional/cooperacao-juridica-internacional-em-materia-civil/acordos-internacionais.
145 STJ, SEC 11.277, Special Court, Reporting Justice Francisco Falcão, decided on June 15th, 2016.
146 Civil Procedure Code, Art 960, Third Para.

Self-Assessment Exercise 7

It is correct to say that:

a) Brazil has adopted the UNCITRAL Model Law?;
b) A decision from a foreign court can be enforced in Brazil if it is a court where the debtor has his centre of main interest?;
c) The Superior Court of Justice must officially approve a foreign court decision from a competent foreign court?;
d) The Superior Court of Justice will not grant an *exequatur* to a foreign court if the decision violates Brazilian public policy?

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

9. INSOLVENCY LAW REFORM

The current Bankruptcy Law – Federal Law 11.101/2005 – was enacted on 9 February 2005. Nonetheless, the statute was initially proposed in 1993, which emphasises the fact that the Bankruptcy Law in place was the result of a lengthy legislative process. Recent years have given rise to significant debate as to whether there is a need to update the current statute, especially after Brazil faced a drastic economic crisis in 2015-16, a scenario that had barely been left behind when the coronavirus pandemic took place in early 2020.[147] The Covid-19 pandemic, of course, has also brought new vigour to the discussion.

Among the many proposed statutes under review of the Legislative (especially in light of the Covid-19 crisis), the Proposed Statute 6.229/2005 has gained the most importance[148]. The stated goal of the new project is to modernise the Brazilian restructuring and liquidation system, given that the system is perceived as slow and inefficient, generating a low rate of credit recovery.

The Proposed Statute has the following guiding principles:

(a) the preservation of business activity;

(b) the development of the credit market;

(c) the incentive of the productive application of economic resources, entrepreneurship and a swift re-commencement of business activity (fresh start);

[147] According to World Bank data, Brazil reached its highest Gross Domestic Product (GDP) in 2011, reaching the value of USD 2.616 trillion. In contrast, in 2016 the total GDP for Brazil was USD 1.794 trillion, a severe decrease. Further data on financial and social statistics may be found at: https://data.worldbank.org/country/brazil. The peak of the economic crisis also made 2016 the year with the most filings for judicial recovery since the effective date of the Bankruptcy Law, totaling 1,863 requests. Further statistics on bankruptcy and judicial recovery procedures can be found at https://www.serasaexperian.com.br/amplie-seus-conhecimentos/indicadores-economicos.

[148] As of September 2020, Proposed Statute 6.229/2005 had already been approved by the House of Representatives. It is currently under the scrutiny of the Senate.

(d) the institution of legal mechanisms that prevent undesirable strategic behaviour from parties to a judicial or extrajudicial recovery or bankruptcy; and

(e) the improvement of the underlying system, including the intensive use of electronic means of communications, doing away with unnecessary procedures, the professionalisation of the judicial administrator and the specialisation of first instance judges in charge of the procedures.

The Proposed Statute provides for a number of modifications to the current Bankruptcy Law, still keeping Federal Law 11.101 as its basis. The most relevant modifications are highlighted below:

(a) the utilisation of currently available technologies to publicise acts related to the procedures, as well as allowing electronic or written voting at the general meeting of creditors;

(b) the termination of the judicial recovery procedure with the official approval of the recovery plan, making it unnecessary for the procedure to be monitored for a period of two years;

(c) provisions relating to the financing of companies under judicial recovery, regarding such claims as not being subject to the existing procedure, as well as such claims having priority in the case of bankruptcy;

(d) provisions relating to the judicial recovery of groups of companies and substantive consolidation;

(e) provisions relating to more favourable instalment payments in regard to tax liabilities for debtors under judicial recovery and other tax improvements;

(f) the adding of two new grounds for the conversion of a judicial recovery into liquidation, namely (i) where it is identified that the debtor is disposing of its assets in order to have a restructuring work in the same way as a liquidation and (ii) where there is default in instalment payments made to the tax authorities;

(g) as regards extrajudicial recovery, there are proposals to incentivise its use, such as the introduction of a stay period;

(h) provisions relating to the termination of the bankruptcy procedure where there are no assets, or where the debtor's assets are insufficient to pay the costs of the procedure;

(i) providing for the prompt realisation of assets in bankruptcy procedures, in up to 180 days from the decree of bankruptcy;

(j) the shortening of terms for the discharge of the debtor's obligations when bankruptcy is terminated;

(k) a prohibition on the distribution of profits or dividends to shareholders during the judicial recovery until the approval of the recovery plan;

(l) the sale of the company as a whole as a means of restructuring under a judicial recovery plan;

(m) the possibility of holding a mediation procedure prior to or throughout a judicial recovery; and

(n) adoption of the UNCITRAL Model Law on Cross-Border Insolvency.

In addition to these proposed reforms, there is another relevant project currently being processed by Congress, namely the new Commercial Code.[149] This proposed Bill proposes changes to the generally applicable principles applying to the insolvency system, without replacing the Bankruptcy Law but adding a few modifications to it – for example, provisions on procedures related to transnational insolvency and the extension of the Bankruptcy Law provisions also to those who do not carry on business activities.

Another relevant Bill is the Senate's Proposed Statute 283/2012, which partially reforms the Consumer Protection Code. Among its provisions are a number of measures to protect consumers from becoming over-indebted, as well as presenting a more modern alternative to formal civil insolvency – the possibility of consumers presenting a payment plan of up to five years in order to be granted a discharge.

Finally, there are dozens of other Bills aiming to modify specific aspects of the Bankruptcy Law, all under consideration by either the Senate or the House of Representatives. Some of the more noteworthy proposals are as follows:

- Senate Proposed Statute 245/2015, which prohibits real property under lease to be repossessed by the lessor during the judicial recovery procedure;
- Senate Proposed Statute 140/2011, providing new procedural rules for the general meeting of creditors;
- Proposed Statute 8.924/2017, aiming to subject certain guarantors to the same protection as the debtor under judicial recovery procedures;
- Proposed Statute 4.593/2016, extending the possibility of filing for judicial recovery to non-business parties, including co-operatives; and
- Proposed Statute 4.586/2009, making claims guaranteed by a fiduciary assignment of receivables to be subject to the judicial recovery procedure.

10. USEFUL INFORMATION

- For the Bankruptcy Law in English, which was used in this material, see: http://lickslegal.com/pdf/Licks%20Attorneys%20-%20Brazil%20-%20Statute%2011101%20(digital).pdf.
- For the Civil Code in English, see: https://www.global-regulation.com/translation/brazil/2904141/law-no.-10406-of-january-10%252c-2002.html.
- For the Civil Procedure Code, which was used in this material, see: (i) https://www.academia.edu/34625082/Brazilian_Code_of_Civil_Procedure_English_Version_?auto=download; and (ii) http://www.frediedidier.com.br/wp-content/uploads/2017/10/CPC-Brasileiro-traduzido-para-o-ingl%C3%AAs.pdf.

[149] Senate Proposed Statute 487/2013.

- For the Former Civil Procedure Code, see: https://wipolex.wipo.int/en/legislation/details/9756.

- For the Corporations Act, see: http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf.

- For the Constitution of the Federative Republic of Brazil, see: http://english.tse.jus.br/arquivos/federal-constitution.

- For statistics on judicial recovery and bankruptcy, see: (i) https://www.serasaexperian.com.br/amplie-seus-conhecimentos/indicadores-economicos; (ii) http://doingbusiness.org/en/data/exploreeconomies/brazil; and (iii) http://www.scielo.br/pdf/rdgv/v13n1/1808-2432-rdgv-13-01-0020.pdf.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

Is it fair to say that in Brazil anyone holding a written document is allowed to file a foreclosure lawsuit, with no need for a previous cognisance phase to determine the validity and liquidity of the claim?

Question 2

Is a debtor authorised to file for judicial recovery in any of the courts where it has a branch?

Commentary and Feedback on Self-Assessment Exercise 1

Question 1

No. Not all written documents authorise the creditor to initiate a foreclosure lawsuit. If the document is not an extrajudicially or judicially enforceable title, a prior cognisance phase will be necessary.

The Civil Procedure Code lists the types of documents that fall into the categories of judicial (Art 515) and extrajudicial titles (Art 784). A common example of a judicial title is a court decision; common examples of extrajudicial titles include contracts and promissory notes.

Question 2

No. The debtor has to file before the court of the place where he has his main commercial establishment or branch (in case of a foreign company).

The wording of the Brazilian Bankruptcy Law refers to the “main” establishment of the debtor, which is a somewhat vague term. Although decisions from the Superior Court of Justice have interpreted the meaning of “main establishment” as the place where the highest turnover is (that is, the most important establishment from a business perspective), some Appellate Courts have interpreted the meaning of “main establishment” as the place where the main administrative decisions are held (the headquarters).

The definition of a debtor’s main establishment thus depends on a fact-intensive investigation.

Self-Assessment Exercise 2

Is it correct to say that in a bankruptcy a claim secured by a mortgage on real property has priority over an unsecured claim no matter the value of the collateral?

Commentary and Feedback on Self-Assessment 2

No. The priority of the secured claim is limited to the value of the collateral. As an example, a creditor who has a credit (debt) of BRL 100,000 secured by assets the market value of which is BRL 70,000, has a claim of BRL 70,000 with priority over unsecured creditors; the remaining BRL 30,000 is an unsecured claim with the same priority as every other unsecured claim.

If the value of the collateral keeps going down, the value of the allowed secured claim must also be lowered. If, on the other hand, there is an increase in the value of the collateral, then the value allowed as a secured claim must also go up.

Self-Assessment Exercise 3

Civil insolvency is the legal regime to deal with the insolvency of:

a) an insolvent debtor;
b) anyone who does not pay a debt on the due date;
c) anyone who, being insolvent, is an individual entrepreneur or a business legal entity;
d) a debtor that, being insolvent, is not qualified as an individual entrepreneur or a business legal entity.

Commentary and Feedback on Self-Assessment Exercise 3

The correct answer is:

d) a debtor that, being insolvent, is not qualified as an individual entrepreneur or a business legal entity.

Civil insolvency is the option for individuals and specific legal entities (such as foundations and associations, which do not have a lucrative goal, that is to make a profit) to liquidate their debts. These debtors may not use the provisions of the Brazilian Bankruptcy Law; instead, civil insolvency is regulated by the former Civil Procedure Code. Civil insolvency does not provide for a means to restructure debts, but only to liquidate them.

Self-Assessment Exercise 4

Question 1

Under Brazilian law, creditors are paid observing the following priority order:

1. Tax claims, secured claims, labour claims.
2. Tax claims, labour claims, secured claims and unsecured claims.
3. Labour claims (limited to 150 minimum wages), secured claims, tax claims (except fines), unsecured claims.
4. Labour claims, secured claims, tax claims, unsecured claims

Question 2

It is correct to say that:

1. A third party whose assets have been taken into custody by the judicial administrator of a bankrupt estate may file a restitution lawsuit.
2. After termination of the bankruptcy procedure the debtor is allowed to immediately resume business activities.
3. An insolvent law firm can file for bankruptcy under the Bankruptcy Law.
4. The holder of a claim that was not paid in the due date can file for the bankruptcy of the debtor, no matter the amount of the claim.

Commentary and Feedback on Self-Assessment Exercise 4

Question 1

The correct answer is:

3. Labour claims (limited to 150 minimum wages), secured claims, tax claims (except fines), unsecured claims.

Question 2

The correct answer is:

1. A third party whose assets have been taken into custody by the judicial administrator of a bankrupt estate may file a restitution lawsuit.

Self-Assessment Exercise 5

Question 1

Why is the extrajudicial recovery procedure not as attractive a means of restructuring as the judicial recovery procedure?

a) Not that different from a contract;
b) More costly and risky;
c) Does not include labour claims and does not allow the sale of assets free and clear of liabilities;
d) The agreement has to be approved by a court.

Question 2

Why is the sale of a productive unit especially attractive as a means of recovery within the judicial recovery?

a) Because it is implemented thought a judicial auction.
b) It can be made free and clear of liabilities and result in a better sale price for the assets; and the sale will not be presumed to be void if the debtor ultimately goes into bankruptcy.
c) Purchaser will inherit the existing liabilities, which benefits the creditors of the estate.
d) The sale can be implemented by any legal means.

Commentary and Feedback on Self-Assessment Exercise 5

Question 1

The correct answer is:

c) Does not include labour claims and does not allow the sale of assets free and clear of liabilities.

Question 2

The correct answer is:

b) It can be made free and clear of liabilities and result in a better sale price for the assets; and the sale will not be presumed to be void if the debtor ultimately goes into bankruptcy.

Self-Assessment Exercise 6

Is it fair to say that Brazilian courts have been considering Brazil as the centre of main interest and that Brazilian bankruptcy courts are competent to process a judicial recovery of an economic group, including a foreign legal entity used by the group of companies to obtain financing for the operational activities developed in Brazil?

Commentary and Feedback on Self-Assessment Exercise 6

Yes. Despite raising controversies, the matter had to be decided by the Brazilian Judiciary in some of the most important restructurings of Brazilian business groups, such as the OI, OAS and OGX cases.

Brazil has not yet included the UNCITRAL Model Law on Cross-Border Insolvency in its legal system and there are no specific bilateral or multilateral treaties or conventions that apply to cross-border insolvency matters. Despite the lack of a statutory source of Law, so far the Judiciary has decided that the foreign legal entities may also be restructured through a judicial recovery procedure taking place in Brazil.

Self-Assessment Exercise 7

It is correct to say that:

a) Brazil has adopted the UNCITRAL Model Law?;
b) A decision from a foreign court can be enforced in Brazil if it is a court where the debtor has his centre of main interest?;
c) The Superior Court of Justice must officially approve a foreign court decision from a competent foreign court?;
d) The Superior Court of Justice will not grant an *exequatur* to a foreign court if the decision violates Brazilian public policy?

Commentary and Feedback on Self-Assessment Exercise 7

The correct answer is:

d) The Superior Court of Justice will not grant an *exequatur* to a foreign court if the decision violates Brazilian public policy.

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