

Brazil: Amendment of Bankruptcy Code Approved by Federal Senate, Awaiting Presidential Approval

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Bill No. 4458/2020 (“Bill 4458” or the “Bill”), which amends the Brazilian Bankruptcy Code (Law 11,101/2005) (“Bankruptcy Code”), was approved by the Federal Senate on November 25, 2020, and has been sent to the president for approval.

The Bill changes certain provisions of the Bankruptcy Code, including the sections relating to: (i) the automatic stay period in which the lawsuits filed against the company under court-supervised reorganization must be stayed; (ii) the sale of assets, including an expansion of the protection to the buyers regarding the debtor’s liabilities; (iii) credit assignments, which will maintain their nature and classification after the assignments, including labor claims; and (iv) the requirements for approval of the plan by cramdown.

The Bill is innovative because it regulates issues that had not been foreseen in the Bankruptcy Code, such as: (i) the requirements for procedural and substantive consolidation; (ii) mediation and conciliation in judicial reorganization proceedings; (iii) the presentation of an alternative reorganization plan by creditors; (iv) financing obtained during the judicial reorganization proceeding (“DIP Financing”); and (v) the rules of transnational insolvency.

Some of the main changes that will apply if the Bill is enacted are the following:

- **DIP Financing:** Bill 4458 regulates financing for companies under court-supervised reorganization. The Bill changes the order of payment of credits provided in Sections 83 and 84 of the Bankruptcy Code for the event of a liquidation scenario and provides a priority for the payment of new financing before cash refunds and “proceeding fees.” In this regard, the Bill seems to favor financing, as this amendment, in theory, increases the chances of credit recovery in case of default. The Bill also provides for the “immutability” of the effects of the decision approving the financing since the priority (non-subject to the proceeding) of the amounts financed by the lender in good faith and the guarantees granted by the debtor will be maintained, even though the decision that approves the contracting of the financing is reformed. However, the Bill provides that “the guarantees provided and the preferences will be kept up to the limit of the amounts actually delivered to the debtor.” Therefore, the guarantees and preferences do not encompass interests and

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penalties. In addition, Bill 4458 states that any person may provide a DIP Financing, including partners and entities that are part of debtor's economic group.

- **Derivatives and Repurchase Agreements**

(“Repos”): Bill 4458 states that the judicial reorganization will not affect creditors' rights of accelerating and offsetting debts related to derivatives and repos.

- **Procedural and Substantive Consolidation:**

Procedural Consolidation occurs when companies of the same corporate group jointly file a request for court-supervised reorganization. Substantive Consolidation also implies the uniting of debts and assets of all companies, with the debt to be restructured through a single judicial reorganization plan. The Bill provides that Procedural Consolidation may occur when a request for court-supervised reorganization is filed by companies under a common corporate group. In this case, the debtors must individually submit the relevant documentation for the analysis of the request. However, the means of recovery must be proposed independently and specifically. Substantive Consolidation, on the other hand, may be granted exceptionally for debtors of the same economic group when there is interconnection and commingling of assets and liabilities, plus the occurrence of at least two of the following: (i) cross guarantees between debtors; (ii) control and dependency relationship; (iii) total or partial identity of the corporate structure; and (iv) joint performance in the market.

- **Alternative Plan:** In the current Bankruptcy Code, only the debtor can file a judicial reorganization plan, and any changes proposed by the creditors depend on the debtor's authorization. The Bill provides for the possibility of creditors presenting an alternative plan if the judicial reorganization plan proposed by the debtor is rejected or in the event that the reorganization plan is not submitted by the debtor within the automatic stay provided for in article 6 of the Bankruptcy Code. There are several requirements for the approval of an alternative plan by the creditors: (i) the alternative plan cannot be approved by cramdown; (ii) written support from

creditors representing more than 25 percent of total credits subject to judicial reorganization or more than 35 percent of credits held by creditors present at the meeting that decided to grant a deadline for the presentation of an alternative plan; (iii) release of personal guarantees from those who vote in favor of the alternative judicial reorganization plan “will plan”; and (iv) no imposition on the debtor or its partners is of greater sacrifice than that which would result from the liquidation in a bankruptcy.

- **Sale of Isolated Productive Units (“UPIs”):** The Bill provides that, in case of an UPI sale, and if the sale observes the legal formalities, the object of the sale will be free from not only the debtor's tax and labor liabilities (as in the previous provisions) but also those of an environmental, regulatory, administrative, criminal or anti-corruption nature. Article 60-A conceptualizes UPI, clarifying that it can encompass assets or rights of any nature, including equity interests. In addition, the Bill foresees that, even in the event of asset emptying, legal transactions will not be declared null and void, and only the products of the sale should be blocked or returned, if already distributed. In addition, it is worth mentioning the expansion of sales modalities, encompassing any type of auction (electronic, face-to-face or hybrid), through a competitive process organized by a specialized agent or any other type, provided that: (i) it is approved by the general meeting of creditors and (ii) it is fixed in the judicial reorganization plan or authorized by the judicial reorganization court, after the manifestation by the bankruptcy trustee and the creditors committee. These rules were included to discourage unreasonable objections to the sale of assets and require the presentation of a serious proposal for the acquisition as well as a deposit that is 10 percent of the sale amount.
- **The Direct Sale of Assets:** The Bill modifies art. 66 of the Bankruptcy Code, which regulates the sale of assets through court approval. The Bill provides for the need for court approval for the sale of “non-current assets.” The concept of non-current assets is broader than the concept of permanent assets in the previous wording, as it includes the assets that fall under the “long-term

assets” accounts. In this way, Bill 4458 expands the cases in which prior court approval is required for the sale. The Bill also regulates the right of creditors to call a meeting to deliberate on the sale preceded by court approval, provided that the request is: (i) submitted by creditors holding more than 15 percent of the total amount of credits subject to judicial reorganization and (ii) preceded by the provision of a security equivalent to the total value of the sale. The Bill also charges the creditors with the costs of summoning and holding the meeting. The broad protection against the debtor’s past liabilities is expressly provided for sales preceded by court approval if the legal formalities are observed.

- **Mediation and Conciliation in Judicial Reorganization Proceedings:** The Bill provides that mediation and conciliation should be encouraged in any degree of jurisdiction before or during

judicial reorganization. The Bill expressly prohibits the use of mediation or conciliation to discuss the legal nature and classification of credits. In addition, the Bill provides for the possibility of the debtor pleading, prior to the request for judicial reorganization, preliminary injunction to suspend the enforcements filed against the debtor, for a period of up to 60 days, as an attempt to settle with the creditors. If there is a judicial reorganization or extrajudicial reorganization after the preliminary injunction, the 60-day period will be deducted from the automatic stay period.

- **Transnational Insolvency:** The Bill provides for transnational insolvency articles inspired by the UNCITRAL Model Law. In summary, these rules aim to regulate cooperation between judges and other competent authorities in Brazil and other countries.

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