

The Brazilian corporate insolvency legislation reform: fostering distress investing

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Authors

Sergio Savi

Federal Law 14.112/2020, which came into force on January 23, 2021 introduced significant changes to judicial reorganization and other insolvency proceedings governed by the Brazilian Insolvency Law.

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One of the cornerstones of any corporate insolvency system is reliability. The proposition is even more valid when it comes to investments in a distressed environment, where the legal framework should

- reduce transaction closing time;
- provide for free and clear assets sales; and
- give priority to new money,

all combined with transparency and due process.

Federal Law 14.112/2020, which came into force on January 23, 2021 (New Legislation), introduced significant changes to judicial reorganization (JR) and other insolvency proceedings governed by the Brazilian Insolvency Law, Federal Law 11.101/2005 (LRF – Lei de Recuperação e Falências). Even though the reform, as a whole, is not free from criticisms, it aims at fostering investments by granting additional protection to purchasers of assets and debtor-in-possession lenders.

The New Legislation provides that, if authorized by the JR court, the debtor-in-possession may contract DIP loans, offering its own or third parties' assets as collateral. Anyone can be the DIP lender, including pre-petition creditors and the debtor's shareholders.

The New Legislation also makes it clear that DIP loans are excluded from the JR and will have priority for repayment over practically all other claims in the event of debtor's bankruptcy liquidation. Due to the amendment in the bankruptcy liquidation waterfall rules, shareholders will also rank senior if they provide the DIP financing, as long as the DIP lending transactions are arms' length.

Lastly, if the loan has been disbursed by the lender, any modification of the JR judge's decision authorizing the DIP loan will not modify the loan's priority status nor affect the collateral granted to lenders in good faith.

With respect to sales of assets, in addition to expressly providing that an isolated business unit (IBU) may be composed of assets of any kind (tangible

or not), including equity interests, and under any legal structure, the New Legislation amended the LRF to make it even clearer that IBU sales are free and clear of liabilities of any kind. The new rules also provide that the sale of IBUs to good-faith investors, as authorized by the JR court or as provided under an approved and confirmed JR plan, cannot be set aside or unwound after the transaction is closed with receipt of funds by the debtor.

Another significant improvement under the New Legislation is the greater flexibility in holding a competitive bidding process to sell assets, including IBUs. A new provision allows a “specialized agent” to run the asset sale process, as detailed under the JR plan, departing from the old-fashioned courtsupervised auction system.

Although it is still too early to know whether the highlights outlined above will streamline the investment process for debtors in JR, it seems clear that the New Legislation is aimed at improving LRF’s framework for investments, which at least theoretically should help foster transactions that bring liquidity to debtors in possession.

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