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Recent decisions on procedural consolidation in judicial reorganization proceedings

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In Brazil, court-supervised business reorganization proceedings, known as "judicial reorganization" or "judicial recovery" proceedings ("RJ" – recuperação judicial), are governed by Law 11.101/05 (the "LFR" – Lei de Falência e Recuperação Judicial, the Bankruptcy and Judicial Reorganization Law) and secondarily by the Code of Civil Procedure ("CPC" – Código de Processo Civil).

Until the amendments made by Law 14.112/20, which reformed the LFR, there was no specific treatment for RJs filed by more than one debtor company, and such proceedings were dealt with under article 113(II) and (III) CPC.

In the law governing distressed businesses, joinder of plaintiffs in RJ proceedings is known as procedural consolidation, as opposed to substantive consolidation, which deals with the possible material effects resulting from processing RJ[1] proceedings together.

As a rule, joined plaintiff companies should be treated as independent vehicles, respecting the separate legal personality and assets of each company.

This means that if substantive consolidation does not take place in addition to procedural consolidation, some of the companies could have their plan approved and their judicial reorganization granted by the court, while others will have their bankruptcy decreed.

Prior to the reform of the LFR, consolidation of RJ proceedings was often based on concepts not provide for in corporation law, and on sometimes very wide ties between the companies concerned, such as the fact that they have shareholders in common, or a common management, or even the same address[2].

With the reform, the LFR now provides expressly for procedural consolidation, which is applicable to companies that are members of a "group under common control" (article 69-G).

The provision seems to have been drafted so as to restrict procedural consolidation to cases in which the companies are part of a de facto corporate group, with concentrated control and influence between all the companies within the group[3].

Although it's still too early to tell whether the courts will interpret the new rules literally, recent decisions from the São Paulo State Appeals Court[4] suggest that they will.

To date, the recent Appeal Court's decisions on procedural consolidation have focused on the existence (or not) of corporate ties between the companies. According to Appeal Judge Maurício Pessia,

procedural consolidation of RJ proceedings requires “that there is clear common control of all the companies seeking procedural consolidation of their applications for judicial reorganization.”

Similarly, Appeal Judge Sergio Shimura highlights that the simple allegation that the applicant companies “form a de facto economic group ... is not sufficient to grant judicial reorganization.”

If this position prevails, the structure of corporate groups will become a key element in determining whether the companies in the group will be able to reorganize under a single RJ proceeding.

NOTES:

1. Initially developed by the courts in the United States, substantive consolidation consists of grouping together all or some of the assets and liabilities of the companies applying for RJ. If substantive consolidation is granted, all the companies will be liable for the debt and the reorganization of the group as a whole.

2. CEREZETTI, Sheila Christina Neder; SOUZA JÚNIOR, Francisco Satiro de. “A silenciosa ‘consolidação’ da consolidação substancial”. In: Revista do Advogado, São Paulo, v. 36, n. 131, p. 216-223, 2016.

3. PRADO, Viviane Muller. “Noção de grupo de empresas para o direito societário e para o direito concorrencial”. In: Revista de Direito Bancário e do Mercado de Capitais, v. 1, p. 140-156, 1998.

4. São Paulo State Appeals Court (TJSP – Tribunal de Justiça do Estado de São Paulo), Interlocutory Appeal AI no. 2062604-31.2021.8.26.0000, 2nd Business Law Chamber, Judge Maurício Pessoa, judged August 19, 2021; Interlocutory Appeal AI no. 2055901-84.2021.8.26.0000, 2nd Business Law Chamber, Judge Sergio Shimura, judged July 19, 2021. Our translation.

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