Judicial and extrajudicial recovery: understand the process

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The preservation of viable companies maintains value, stimulates investments and entrepreneurship, maximizes credit recovery, job creation and, ultimately, a country's economy. Judicial and extrajudicial recovery are legal mechanisms, provided for in Law N° 11.101/05, which aim to enable the restructuring of corporate debts, by majority decisions, under the supervision of the Judiciary.

In recent years, for several reasons, many companies have found it difficult to maintain their activities in a sustainable and profitable manner. This scenario illustrates the moment of instability in the Brazilian economy and the challenges that entrepreneurs have faced.

In August 2019 alone, the Serasa Experian Bankruptcy and Recoveries Indicator registered 142 requests for judicial reorganization of companies. This represents an increase of 7.6% over the same period last year. Regarding extrajudicial recoveries, between January and August 2019, 18 applications were filed in the country - an increase of 50% over the same period last year.

Although the recovery system needs improvement - including Bill 10.220/18, proposing some changes, it is at an advanced stage in the Chamber of Deputies - the experience of almost 15 years of the Law on the Recovery and Bankruptcy of Companies (LRF) has demonstrated the usefulness of judicial and extrajudicial recovery as instruments to prevent bankruptcy of viable companies.

In this article, we will discuss a little more about this legal mechanism and how it can help an organization to rebuild itself and avoid its end. Follow the reading!

How does corporate judicial recovery work?

The judicial reorganization process aims to facilitate an orderly negotiation between the debtor company(ies) and its creditors, with the purpose of reorganizing the company and enabling the continuity of its operations.

Therefore, the discipline of judicial reorganization includes a specific procedure that formally orders relevant stages of the negotiation, such as the form and timing of the presentation of a Judicial Reorganization Plan ("Plan") and the discipline of the General Creditors' Meeting ("AGC ") That will decide on the approval, modification or rejection of the Plan.

Filing an application for judicial reorganization requires compliance with certain prerequisites required by law. Some of them are:

- have at least two years of regular activity;
- not having failed before;
- in case of previous bankruptcy, it must have been declared extinct;
- it cannot have obtained a judicial reorganization grant in the last five years;
- he cannot have been convicted or have not, as administrator or controlling partner, a person convicted of bankruptcy crime.

The current legislation only applies to entrepreneurs and business companies. Other organizations, such as public companies, mixed-capital companies, credit unions, financial institutions, private pension entities, companies operating health care plans, capitalization companies, insurance companies and electricity concessionaires, may not require judicial reorganization (nor extrajudicial recovery) and are subject to their own systems for restructuring their liabilities.

What are the steps in judicial reorganization?

The process of judicial reorganization of companies occurs in several phases. It is essential that the debtor company seek specialized legal advice to assist it in conducting all stages of the procedure. Hiring financial advisors is also recommended.

Initial phase

After the filing of the judicial reorganization request and having the company fulfilled the requirements for filing the request, the judge responsible for the judicial reorganization will defer its processing, which will mark the beginning of the process.

When deferring the processing of the judicial reorganization, the judge determines the suspension of the course of all actions and executions that are pending against the debtor company for a period of 180 days.

Actions that demand a gross amount are not suspended, such as knowledge actions and labor claims, as well as credit actions that are not subject to judicial reorganization, however, the removal of essential assets from the establishment of companies under judicial reorganization during this period is prohibited.

The suspension of actions and executions for a period of 180 days aims to allow the practice of acts aimed at negotiating the Plan, namely: the presentation of the Plan, the elaboration of the list of creditors entitled to participate in the AGC, the realization of the AGC to deliberate on the Plan and, finally, its approval by the recovery court.

Bankruptcy Trustee

With the approval of the judicial reorganization process, a judicial administrator will be appointed, whose role is to assist the judicial reorganization judgment in the organization of the process (as in the verification of credits and in the conduct of AGC) and in the supervision of the debtor company. The company's management is maintained with the power to conduct business.

The judicial reorganization plan and the general meeting of creditors

The debtor company must present its Recovery Plan in court, containing the means of recovery and the forms of payment of creditors within 60 days, under penalty of convolution of the Bankruptcy Judicial Recovery.

The Plan may provide for various means of judicial reorganization, such as:

- debt restructuring, through rebates and extensions;
- the conversion of debt into equity interest;
- the sale of assets and equity interest.

After the presentation of the Plan and the list of creditors by the judicial administrator, any creditor may object to the Plan, so that the judge may convene a General Meeting of Creditors, which will decide on the judicial reorganization plan. There are four classes of creditors who will vote for AGC:

1. the class of labor creditors;
2. the class of creditors with collateral;
3. the class of subordinate, privileged and unsecured creditors;
4. the class of creditors qualified as micro and small businesses.

The approval of the Plan will depend on its approval in all four classes, subject to the quorums provided for by law. If the Plan does not obtain approval in all classes, the judge will: (a) convict bankruptcy, or, if certain legal requirements are met, (b) impose bankruptcy on creditors despite rejection of the Plan.

Supervision period

After the Plan is ratified, the debtor company will remain under the judge's supervision until the obligations provided for in the Plan are due and are due within 2 years. During this period, failure to comply with any obligation assumed in the Plan will result in the bankruptcy of judicial reorganization.

After the 2 years of inspection and unless peculiarities of the specific case that require more time from the company under judicial supervision, the judge will end the judicial recovery.

Credits subject and non-subject to recovery

There are credits that are subject to judicial and extrajudicial recovery and there are others that are not. Subject (or contest) credits are those that can be modified by the Plan; non-subjects, as a rule, preserve the original conditions. Examples of credits that cannot be changed by the Plan are those that come into existence after the filing of the recovery and those guaranteed by fiduciary alienation (the most common type of guarantee in the financial system).

Although the Plan only modifies subject credits, the company's viability (and the execution of the Plan) depends on the payment of non-subject credits as well. Thus, it is very common for there to be negotiations parallel to the Plan involving creditors holding such credits.

How does extrajudicial business recovery work?

Extrajudicial Recovery, in turn, works as an agreement negotiated between the debtor company and one or more groups of creditors that can be submitted for judicial approval and, in this case, its terms start to bind all creditors of the group of covered creditors, through the adhesion of 60% of creditors. The main difference for the judicial reorganization is that the effective negotiation of the Plan occurs before the filing of the request.

How to succeed in the recovery process?

The Recovery Plan (judicial or extrajudicial) is the main legal instrument for corporate reorganization. It embodies the measures for its uplift, predicting how creditors will be paid and under what conditions.

In order to prepare the Plan, it is important to carry out a detailed analysis of the debtor company's economic and financial situation, assessing the difficulty it is experiencing and aiming at building a viable solution.

The construction of the Plan is not always a linear process, it reflects interactions with different groups of creditors and whose final version is the product of the composition of all the interests involved.

The approval of the Plan by the creditors and its approval by the court is a relevant step in the company's restructuring process. However, the company must be able to comply with the Plan, so that the awareness of the parties involved of the company's real payment capacity is a fundamental aspect of the process.

Having made all the considerations regarding the judicial and extrajudicial recovery of companies, it is clear that these are relevant mechanisms to allow the rise of economically viable companies, but which are going through a time of crisis.

Judicial or extrajudicial recovery will not always be the appropriate or least costly way to resolve the company's crisis, so that prior analysis of options and their effects, with specialized guidance, is always necessary.

Having decided on the best alternative for the company in crisis, the procedure must be conducted with diligence and care, aware of its effects and strategic decisions that can be decisive in the success of the procedure, thus requiring specialized legal and financial advice.

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