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The main changes to the Reorganization and Bankruptcy Act

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Authors

Natalia Yazbek

Sergio Savi

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On 12/24/2020, in an extra edition of the Official Gazette, he published the Act no. 14,112/2020, which updates and amends the law relating to court-supervised reorganization ("RJ"), out-of-court reorganization ("RE") and bankruptcy, insolvency proceedings regulated by Act No. 11,101/2005 (" LRF"). In short, the new act reflects the text of the Bill No. 4,458/2020, which had been passed by the Federal Senate and the Brazilian House of Representatives, with some relevant vetoes exercised by the President of the Republic of Brazil.

Many are the changes introduced by the new act, among which, in relation to the restructuring of companies, it is worth highlighting the rules that are (1) providing greater legal certainty to financing for companies under RJ and disposal of assets; (2) regulating cross-border insolvency; (3) allowing creditors to propose a court-supervised reorganization plan ("PRJ"); (4) authorizing the restructuring of labor claims in RE proceedings; and (5) decreasing the support quorum required for approval of an out-of-court reorganization plan.

Among the vetoes of the President of the Republic of Brazil, it is important to highlight those which prevented the entry into force of new rules that would allow the reduction of tax costs associated with renegotiating debts and gaining capital resulting from the sale of assets and rights in the context of insolvency proceedings.

One of the highlights of the new act is the increased protection given to loans made to the debtor under RJ, popularly known as *DIP financing (Debtor in possession financing - "DIP")*, with detailed rules in a specific section of the LRF.

Under the new act, if it is authorized by the judge, the debtor under RJ may take out DIP loans by giving assets it owns or of third parties as security (including members and companies of the same group which are not under RJ). The new law also makes it clear that the DIP will be first priority and have priority of payment over almost all debts in the event of the debtor's bankruptcy, and it is only after the expenses necessary for the bankruptcy and overdue salary management in the three (3) months preceding the adjudication of bankruptcy up to the limit of five (5) Brazilian minimum wages per worker. The bill also clarifies that the change in degree of appeal against the decision authorizing the DIP loan cannot change its first-priority nature (that is, privileged in the event the RJ is converted into bankruptcy), nor the guarantees granted to the creditor in good faith, if the disbursement has already been carried out.

Another positive aspect of the new act is the increased protection provided to the disposal of debtor's assets in insolvency proceedings.

In addition to expressly providing that an isolated production unit ("UPI") may be formed by the assets of any kind (tangible or not) including equity interests, a concept that had already been applied in recent years based on jurisprudential construction, the new act clarifies that the sale of assets to a third party in good faith, authorized by a court or under a PRJ approved in the general meeting of creditors ("AGC") cannot be canceled or rendered ineffective after the legal transaction is carried out with the receipt of funds by the debtor.

The bill provided for the amendment to the sole paragraph of art. 60 of the LRF, to make it even clearer that the UPI purchaser from debtors under a RJ fail to succeed them in their obligations of any kind. The new wording, however, was vetoed by the President of the Republic of Brazil, with justification at least questionable about risks to the purchaser arising from environmental and anti-corruption nature obligations. This causes uncertainty for investment in companies in crisis.

Regarding the tax credits, the new act brings timid advances, such as the increase in the number of installments for the payment of tax debts in installments, from 84 to 120, and it is possible to carry out transactions with the Tax Authority, according to the regulation of Act No. 13,988/2020. The Tax Authority, however, remains excluded from effects of RJ and acquires legitimacy to make a statement on several acts under RJ, among them, the disposal of the debtor's assets.

The President of the Republic of Brazil unfortunately vetoed the most relevant part of the bill for the restructuring of companies in crisis, which provided the rules by reducing the tax cost associated with the renegotiation of debts and capital gain arising from the disposal of assets and rights in insolvency proceedings.

The new act also brings important advances as it uses cross-border insolvency rules of the UNCITRAL Model Act, published in 1997, with measures that allow the recognition of the foreign insolvency proceedings in Brazil, as well as it provides mechanisms for cooperation between local and foreign judges. This aims at affording greater protection and legal certainty to cross-border investments.

Another significant change brought by the new act is that the creditors can propose an alternative PRJ, provided that (1) the one submitted by the debtor is rejected in the AGC and (2) the creditors in the AGC approve, by majority of present credits, the presentation an alternative plan prepared by them ("PRJ Creditors") within 30 days.

The PRJ Creditors shall meet certain conditions in addition to those applicable to any PRJ. Among them (i) the support of creditors representing more than 35% of this debt in the AGC which approved the presentation of PRJ Creditors or 25% of the debt subject to RJ and (ii) the non-imposition of the debtor or its members, of greater sacrifice than that which would result from the bankruptcy.

Finally, there was greater flexibility in the rules applicable to RE. The new act started to authorize the restructuring of labor credits, provided that such credits are collectively negotiated with the union of the respective professional category.

And it has become easier to avail of the RE to restructure the obligations with a certain group of creditors, to the extent that the necessary support quorum, which was 60%, increased to more than half of the credits of each type covered, and it is still possible to start the RE plan approval request with proof of the consent of one third (1/3) of all credits of each type covered by it and with the commitment, within ninety (90) days, as of the request date, to reaching the legal quorum required for binding creditors.

As in any process of change, the changes introduced by the new act not immune to criticism. The new act will become effective in 30 days from its publication in the Official Gazette. This requires a detailed discussion with law professionals, as well as efforts by Brazilian courts in their application to allow the scope of the LRF objectives.

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Natalia Yazbek

Sergio Savi