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Brazilian senate approves long-awaited law

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Brazil's National Congress building at sunrise (Credit: Shutterstock.com/061Filmes)

Brazil's senate has approved a long-tabled bankruptcy law, which is set to introduce cross-border provisions based on the UNCITRAL Model Law to the country's regime.

Brazilian lawyers confirmed to GRR that the senate had approved the bill for Law No. 4,458/2020 on 25 November and it was now heading to Brazil's president for sign-off.

If enacted, the bill would amend Brazil's current 2005 Bankruptcy Law to add cross-border provisions based on the Model Law, as well as a 180-day stay period on claims against debtors, a new option for creditors to file an alternative restructuring plan if the debtor's plan fails, and debtor-in-possession (DIP) financing, among other things.

It would also reduce the time period after which debtors can make a fresh start, and permit debt-for-equity swaps as well as the sale of distressed businesses as a whole for the first time.

According to Thomas Felsberg, founding partner of Felsberg Advogados in São Paulo, Brazil's president now has 15 days to sanction the bill.

TozziniFreire partners Flávia Cristina Moreira de Campos Andrade and Liv Machado in São Paulo, who wrote a memo on the bill's passing, tell GRR that while the president legally has the power to veto bills if they violate the public interest, it is unlikely to happen to this bill as it has generally received the Brazilian government's support.

"Considering that the Finance Minister Paulo Guedes negotiated the approval of the bill with the senate and declared that the bill will help companies affected by the COVID-19 crisis, we believe it will probably be approved by the President Jair Bolsonaro in the next weeks," they tell GRR.

The bill will then come into force 30 days after it is published in Brazil's Official Gazette, which Andrade and Machado anticipate will be in early 2021.

A briefing on Demarest's website states that the bill received only a few modifications at the senate stage, and looks "substantially the same" as it did in front of the house of representatives.

If enacted, the bill will see Brazil adopt the UNCITRAL Model Law on Cross-Border Insolvency, introducing a recognition mechanism and provisions on international cooperation between judges and national authorities in the event of a cross-border bankruptcy. Demarest's briefing cautions, however, that the bill adopts the Model Law "with some modifications".

The bill will also allow creditors to present an alternative plan at the end of the 180-day stay period if deliberations have yet to take place on the debtor's own plan, or if creditors have voted against that plan. An alternative plan has to be presented by a minimum threshold of creditors within 30 days of a negative vote on the debtor's plan.

Creditors' alterative plans may provide for the conversion of debt to equity, according to the bill, but dissident shareholders will be guaranteed withdrawal rights.

A new DIP financing mechanism in the bill will permit debtors in judicial reorganisations to apply to the court to enter a post-petition financing agreement. DIP financing agreements may be guaranteed by a lien on rights or assets belonging to the debtor or third parties, and may be used to fund the debtor's restructuring expenses, general activities or to preserve the value of its assets.

Other provisions in the bill offer protections to potential buyers of distressed companies or parts of distressed companies by stipulating that sales will be free of liens; that the buyer will not take on any of the debtor's obligations as successor; and that assets sales and guarantees cannot be annulled after a transaction is completed.

The bill also clarifies that group companies can apply for procedural consolidation before the Brazilian courts and can also apply for substantive consolidation of their assets or liabilities with the court's permission. To permit substantial consolidation – meaning all the debtors become jointly and severally liable – the court has to be satisfied that there are particular circumstances at play where comingled assets or liabilities exist between the companies.

According to Demarest, the bill also brings about "significant modifications" to Brazil's extrajudicial reorganisation process, including a lower majority threshold for approval, and the potential inclusion of labour-related claims.

Elsewhere, the bill contains sections on derivatives – stipulating that a request for judicial reorganisation will not have any effect on the exercise of existing early maturity or offsetting rights – tax reliefs related to reorganisations and assets sales, and other procedural changes.

Among those procedural changes, the bill aims to encourage conciliation and mediation of debt disputes – though it prevents mediation on the classification of creditors' claims and over the voting criteria for creditors' meetings.

Andrade and Machado tell GRR that the bill's mechanisms "will be important to help Brazil to enhance its economy and recover from the effects of global pandemics".

However, they note some parts of the bill, particularly the section on mediation, could have gone further. In Colombia's recently-amended bankruptcy law, for example, a new emergency negotiation procedure similar to mediation comes with its own stay period to prevent creditors filing enforcement proceedings against the debtor.

"For this reason, despite the honorable intentions to incentivise mediations and avoid mass filings in the judiciary, the new provisions regarding mediation may not be very effective," Andrade and Machado note.

Back in May, partner Fabiana Solano and associate Thiago Dias Costa from Felsberg Advogados, similarly expressed caution over the bill's substantive consolidation provisions. In a column for GRR, they argued the provisions, while being "a clear improvement" on the 2005 law that did not stipulate when consolidation could take place, were "excessively open to different interpretations".

Demarest's briefing acknowledges "controversy" over certain topics, but says the Bill's approval represents "an important step in the modernisation of insolvency proceedings in Brazil, notably in view of the legitimate concern to provide incentives for investors to deploy capital in distressed companies".

The long-anticipated Law No. 4,458/2020 is separate to a covid-19 related bill that was presented to Brazil's Chamber of Deputies in April, suspending all debt-collection activities against debtors for 60 days in respect of defaulted obligations after 20 March.

That law cleared Brazil's house of representatives but was never discussed in the senate. Andrade and Machado note that it is now largely redundant as the temporary measures envisaged in it were only due to last until the end of December.