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Insolvency Reform in Brazil: An Opportunity Too Important to Squander

By Richard J. Cooper, Francisco L. Cestero, and Daniel J. Soltman*

Recently, the Brazilian government has announced plans to reform the Brazilian Bankruptcy Law, with an intention to focus on shortening the average period that a debtor remains in bankruptcy, enhancing options for debtor in-possession financing, and making the asset sale process easier. This article offers an overview of the Brazilian recuperação judicial *process and an explanation as to the features of the current regime that have caused it to be so debtor-friendly, provides an overview of the existing framework in the United States and the state of play in selected other Latin American jurisdictions with respect to plan exclusivity, and puts forward a proposal for reform in this area in Brazil.*

When Brazil enacted its new insolvency regime in 2005 (the "Brazilian Bankruptcy Law"),[1] it was heralded as the most modern in Latin America and a significant improvement for creditors.[2] However, Brazil continues to lag behind its neighboring countries in terms of successful reorganizations and remains a decidedly debtor-friendly jurisdiction.[3] There are a number of

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[1] Law No. 11.101/05.

[2] In many ways, it has been an improvement. For example, average creditor recoveries have improved from .2 percent, in the previous regime, *see* Jeffrey M. Anapolsky and Jessica F. Woods, *Pitfalls in Brazilian Bankruptcy Law for International Bond Investors*, 8 J. Bus. & Tech. L. 307 (2013), to over 15 percent, *see* World Bank Doing Business 2017, *Resolving Insolvency in Brazil (Rio de Janeiro), available at* http://www.doingbusiness.org/data/exploretopics/resolving-insolvency. Assumptions and methodology with respect to the World Bank Doing Business statistics are available at http://www.doingbusiness.org/methodology/resolving-insolvency.

[3] In addition to low average creditor recoveries as noted above, the average proceeding in Brazil can take several years to resolve. A recent study in Brazil found that the average time between the court's order accepting jurisdiction over the *recuperação judicial* proceeding and a creditor vote on a plan of reorganization was 507 days (nearly a year and a half). *See*

reasons for this, including the general absence of a dedicated judiciary with expertise in insolvency matters,[4] the fact that liquidation is not a viable alternative for creditors given the time, expense and destruction of value that it entails, the lack of an absolute priority rule to guide recoveries under judicial recovery plans, the failure of courts overseeing the *recuperação judicial* process to require that debtors affirmatively and timely move the restructuring process along within finite time periods and provide sufficient information to creditors during the pendency of the process for the purpose of evaluating potential recoveries as well as possible claims against third parties that could bring value to the estate (often such claims are against affiliates of the debtor), the potential liability for creditors that seek to play an active role in the *recuperação judicial* process or even to vote against a plan and the weak or ineffective institutional protections embedded in the law (formal creditor committees, the Judicial Administrator, etc.) to protect creditor interests.

However, perhaps the largest reason that Brazil remains such a debtor-friendly jurisdiction is that the debtor maintains the exclusive right to present plans of reorganization throughout the entire *recuperação judicial*[5] process (i.e., creditors do not have the ability to put forward a plan of reorganization for a creditor vote). By the time a debtor does put forward a real and complete plan of reorganization for a creditor vote, creditors are often left with a "take-it-or-leave-it" scenario, where voting against the plan would force the company into liquidation (a slow-moving, costly, non-transparent and value destructive process that leaves all parties worse off), but voting for the plan leaves creditors with an unsatisfactory outcome, often from both a creditor-recovery perspective and with respect to the operational prospects of the reorganized debtor.

Under the Brazilian Bankruptcy Law, the debtor's exclusive right to propose plans of reorganization was to be counterbalanced by a number of defined creditor protections, including, among others, the right to enforce fiduciary

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http://www.tjsp.jus.br/Noticias/Noticia?codigoNoticia=44867 (the "Insolvency Observatory Study"). Even where a speedy consensual resolution is reached, a debtor remains subject to the court's jurisdiction for two years after plan confirmation, during which time the failure to meet obligations as provided for under a plan can result in liquidation. *See* Brazilian Bankruptcy Law art. 61. Liquidation proceedings in Brazil take even longer than *recuperação judicial* proceedings. In a recent example, Banco Santos S.A.'s liquidation proceeding, commenced in 2005, remains unresolved and incomplete 12 years later.

[4] Although there are bankruptcy courts in São Paulo and commercial courts in Rio de Janeiro, there is no nationwide dedicated bankruptcy judiciary.

[5] The Brazilian Bankruptcy Law provides for three types of proceedings: *recuperação judicial* (in-court reorganization, analogous to a U.S. Chapter 11 proceeding); *recuperação extrajudicial* (out-of-court reorganization, a type of pre-packaged restructuring option) and *falência* (liquidation).

liens notwithstanding the stay imposed by the *recuperação judicial* process, definitive and non-extendable deadlines for the reorganization process, complete, timely and effective information sharing, working creditor committees, the right to challenge pre-petition transactions that may be fraudulent or preferential and the unequivocal right to reject a plan of reorganization without liability. However, the application of the law has gradually and increasingly deprived creditors of these protections while keeping intact the debtor's exclusive right to present plans of reorganization. The debtor's exclusive right to propose a plan, when combined with the unpalatable nature of the Brazilian liquidation procedure and the erosion of creditor protections during the pendency of the *recuperação judicial* proceeding, has clearly tilted the restructuring landscape even further in the favor of the debtor and its shareholders. While the stated purpose of the law was to promote the reorganization of companies, the consequence of the application of this exclusive right, together with the weakening of creditor protections, has been to strengthen the leverage of shareholders to the detriment of fast and effective reorganization proceedings, often leaving the few companies that do recover with the same set of issues (and management and governance) that led them to file for *recuperação judicial* in the first place.

Recently, at least partly in response to Brazil's recent recession[6] and the rising number of bankruptcies in Brazil in the wake of the *Lava Jato* scandal, the Brazilian government has announced plans to reform the Brazilian Bankruptcy Law, with an intention to focus on shortening the average period that a debtor remains in bankruptcy, enhancing options for debtor in-possession financing and making the asset sale process easier. Any reforms should squarely address the imbalance of power that currently exists in favor of debtors in *recuperação judicial* proceedings, as only this will create the adequate framework to promote and accelerate effective reorganizations. Accordingly, when evaluating potential modifications to the existing Brazilian Bankruptcy Law,[7] legislators would be wise to not only address some of the issues mentioned above but also to

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[6] Brazil's GDP growth of just over one percent in the *first* quarter of 2017 marked the first quarter of GDP growth since 2014. While some analysts see this as a sign that Brazil is emerging from its three-year recession, others have noted that the growth in Q1 2017 was primarily due to growth in the agriculture sector and are not confident that the upward trend will continue across Brazil's economy.

[7] The authors, as well as Brazilian practitioners, have recently published other articles regarding potential reforms to the Brazilian insolvency regime. *See, e.g.*, Richard J, Cooper, Francisco L. Cestero, Jesse W. Mosier & Daniel J. Soltman, *The Brazilian Insolvency Regime: Some Modest Suggestions—Part 1*, Pratt's Journal of Bankruptcy Law (February/March 2016); and Richard J, Cooper, Francisco L. Cestero, Jesse W. Mosier & Daniel J. Soltman, *The Brazilian*

reconsider the debtor's exclusive right to present plans of reorganization, as the ability of creditors to propose creditor-led plans has proven to be a very effective tool for many successful reorganization systems around the world.

The remainder of this article is divided into four parts. The first part offers an overview of the Brazilian *recuperação judicial* process and a deeper explanation as to the features of the current regime that have caused it to be so debtor-friendly; the second part provides a brief overview of the existing framework in the United States and the state of play in selected other Latin American jurisdictions with respect to plan exclusivity; the third part puts forward a proposal for reform in this area in Brazil; and the fourth part offers a brief conclusion.

THE IMBALANCE OF POWER IN *RECUPERAÇÃO JUDICIAL* PROCEEDINGS

Lack of Meaningful Deadlines

Creditors in *recuperação judicial* proceedings are disadvantaged from the outset because the deadlines imposed by the Brazilian Bankruptcy Law do very little in practice to influence the debtor's behavior, and their position only becomes more difficult as the proceeding progresses, given the limited other options for creditors to meaningfully influence plan development aside from voting against one *after* it has been finally submitted for a vote.

Upon the filing of a *recuperação judicial* petition, the Brazilian Bankruptcy Law imposes three key deadlines designed to move the proceedings forward at a reasonable pace: (i) a plan must be filed within 60 days after the court's order accepting jurisdiction over the proceedings;[8] (ii) a creditor vote on a plan must be held within 150 days of the court's order accepting jurisdiction over the proceedings (the meeting at which such vote takes place, the "General Meeting of Creditors", or "GMC");[9] and (iii) the automatic stay that applies with respect to creditor actions against a debtor's assets will terminate 180 days after the court's order accepting jurisdiction over the proceedings.[10] While these deadlines would seem to give some structure to the proceedings by imposing a series of interim deadlines and an outside date after which the balance of power might shift back to creditors, in practice, these deadlines are either unenforce-

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Insolvency Regime: Some Modest Suggestions—Part 2, Pratt's Journal of Bankruptcy Law (April/May 2016).

[8] *See* Brazilian Bankruptcy Law art. 53.

[9] *See id.* art. 56, ¶ 1.

[10] *See id.* art. 6, ¶ 4.

able or extended as a matter of course.[11]

For example, with respect to the initial 60-day plan filing deadline, due to the clear mandate in the Brazilian Bankruptcy Law that such deadline is "non-extendable" and the statutorily imposed penalty of liquidation if no plan is on file, debtors often file plans with minimal detail (or "shell" plans) that they do not intend to put to creditor vote, but instead are filing simply to meet the statutory requirement. Although such plans are often brazenly one-sided, filed without consultation with creditors and arguably non-compliant with the Brazilian Bankruptcy Law requirement that the plan include "a detailed description of the means of reorganization to be used," courts rarely, if ever, will impose consequences relating to the quality of the first plan filed.

Similar issues arise with respect to holding the GMC. *First*, the law does not provide, and thus courts will not impose, any consequence if a GMC is not held within the 150-day window. *Second*, and relatedly, in practice, regardless of when a GMC is first scheduled, a debtor will typically adjourn the vote as many times as necessary until it believes that it has sufficient votes for plan approval.[12] These barriers to meaningful enforcement make the 150-day deadline for holding a GMC aspirational at best.

The 180-day stay termination deadline is no more of a stick for the debtor than the 60-day plan filing deadline or the 150-day GMC deadline. Notwithstanding that the Brazilian Bankruptcy Law states that the term of the stay is "non-extendable" and there would be real consequences for the debtor if the stay was not extended (i.e., creditors would likely bring actions against it immediately), in practice, the stay is usually extended as a matter of course. While the judicial standard for granting an extension is generally that the delay not be attributable to the debtor's conduct, the standard is applied in very liberal and debtor-friendly terms.[13]

The lack of meaningful deadlines is an unfortunate trend, because it demonstrates an erosion of a number of principles in the Brazilian Bankruptcy Law clearly designed to protect creditors (e.g., a debtor should begin negotia-

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[11] Additionally, although the Brazilian Bankruptcy Law refers to calendar days rather than business days, recent changes in Brazilian non-bankruptcy law have spurred a trend among courts to begin counting applicable deadlines under the Brazilian Bankruptcy Law in business days, thus decreasing the impact of the deadlines even if they were enforced.

[12] This is because the consequence of creditors voting against a plan is liquidation for the debtor and liquidations in Brazil are mired with problems and delays. *See* Brazilian Bankruptcy Law art. 56, ¶ 4.

[13] In fact, the Insolvency Observatory Study found that the stay was extended in nearly 30 percent of *recuperação judicial* cases.

tions with its creditors and develop a plan early on, debtors cannot be shielded from their creditors forever, etc.). Indeed, the matter of course stay extensions are particularly troubling, because it would appear to be in direct contravention of the plain language of the Brazilian Bankruptcy Law.[14]

Consequently, until the GMC, when creditors are provided with an opportunity to vote on a plan of reorganization, absent holding a position that is sufficiently large so a plan cannot be confirmed without them (which in turn raises concerns of abusive power and potential disregard of voting rights), there is often very little that creditors can do to pressure the company into meaningful negotiations or move the restructuring along at a quicker, value-preserving pace.[15] To the contrary, absent unusual circumstances, debtors are mostly free to pursue the restructuring at their own pace and present a plan of reorganization on their own timeline.

Unfavorable Cramdown Rules

Compounding the balance of power issue, the applicable voting rules at the plan approval and confirmation stage only provide creditors with limited bargaining power. The Brazilian Bankruptcy Law provides for only four classes of creditors: labor, secured, unsecured and small companies. A plan is approved at the GMC if (all metrics are with respect to those actually present and voting at the GMC):[16]

- A majority in number of labor creditors vote in favor of the plan;
- A majority in number of small company creditors vote in favor of the plan;

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[14] Anecdotally, Oi S.A.'s *recuperação judicial* proceeding has followed this path. The company filed for bankruptcy in June 2016, filed a shell plan in September 2016, and as of December 5, 2017, had yet to submit a credible plan of reorganization for consideration at a GMC. This case illustrates the risks of affording debtors the exclusive right to present plans of reorganization. Given the damaging effects that certain actions by some of Oi S.A.'s shareholders and their board representatives have had on the reorganization process, both the bankruptcy court in Rio de Janeiro and the Brazilian public prosecutor have entertained the possibility of allowing creditor-led plans to be presented for a vote under certain circumstances, and the court has imposed a number of other measures to curtail the power of shareholders and their board representatives to unduly influence the reorganization process. (The authors' firm represents the steering committee of an ad hoc group of bondholders in connection with Oi S.A.'s restructuring.)

[15] Indeed, even where creditors are proactive throughout the process and in the Brazilian court, they face a number of risks, ranging from potential liability if they chose to sit on a creditors' committee to recent decisions holding that creditors' behavior was "abusive."

[16] *See* Brazilian Bankruptcy Law arts. 41, 45.

- A majority in number of secured creditors and a majority in amount of secured claims vote in favor of the plan; and
- A majority in number unsecured creditors and a majority in amount of unsecured claims vote in favor of the plan.

Even if every class does not approve of the plan, a plan may be crammed down on a class if (all metrics are with respect to those actually present and voting at the GMC):[17]

- Three out of the other four classes approve the plan as described above;[18]
- A majority in amount of all claims vote in favor of the plan;
- More than one-third (in number for labor and small company and in both number and amount for the secured and unsecured classes) in the dissenting class vote in favor of the plan; and
- There is equal treatment among creditors in the dissenting class.[19]

Although the thresholds for approval and protections against cramdown are in some ways substantively similar to those in the United States, one important protective aspect present in the United States that is missing in the Brazilian regime is the absolute priority rule (or some variant of it), which provides, in brief, that in order for a plan to be crammed down on an unsecured class, for any given class of unsecured creditors, either (A) the unsecured class must be paid in full or (B) no class of claims or interests (i.e., equity) junior to such unsecured class shall receive any distribution on account of their prepetition claims or interests. The absolute priority rule is designed to prevent the company's equity holders from retaining the reorganized company's value by cramming down a plan on the company's prepetition unsecured creditors.

In Brazil, not only can debtors typically control the content and timing of submission of their reorganization plans, they can also cram down on a large

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[17] *See id.* art. 58.

[18] Until recently (when the small companies class was added), the Brazilian Bankruptcy Law only provided for three classes of claims. Unfortunately, when the small companies class was added, the provisions relating to cramdown were not amended correspondingly. As a result, Brazilian Bankruptcy Law art. 58, ¶ 1(III) still refers to a requirement of "approval of two (2) of the classes of creditors present . . . or if there are only two (2) classes with voting creditors, the approval of at least one (1) of them". Reputable scholars have differing views as to whether a class may be crammed down when only two classes approve of the plan, or whether three out of four classes are required to cram down the fourth.

[19] In practice, a "menu" of options is also possible under certain circumstances, provided that the various options offer reasonably equivalent recoveries.

dissenting class with the support of only one-third of such class, and can do so without any obligation to propose a plan that adequately compensates creditors for their sacrifices in a reorganization with any potential future value created as a result of such sacrifices.[20] This problem is compounded by the difficulties and expenses faced by bondholders that wish to vote in reorganization proceedings, resulting typically in a low turnout at the GMC and increased risk of cramdowns.[21]

It is important to make clear that the absolute priority rule does not prohibit shareholder recoveries. In fact, the U.S. Bankruptcy Code allows for confirmation of a *consensual* plan that pays unsecured creditors less than the full value of their claims but provides some recovery to equity, and there are judicially fashioned exceptions to the absolute priority rule to address situations where the results of the rule would be found inequitable, such as when equity holders provide post-petition "new value" in furtherance of the restructuring. In practice, in the U.S. the absolute priority rule principally serves to set a starting point for debtor and creditor negotiations, where the legislated presumption is that equity holders' recoveries should be subordinated to creditor recoveries and shareholders are motivated to make the arguments as to why that should not be the case in any particular situation. Its absence in Brazil means that the starting point, and all too often the ending point, of any creditor negotiation is that the equity of the debtor is largely left intact.

FRAMEWORKS FROM OTHER JURISDICTIONS

United States

In contrast to Brazil, the United States has long imposed a balanced framework, which provides the debtor with an initial period of plan exclusivity, but gives creditors significant rights to intervene when appropriate progress is not being made.

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[20] A particularly alarming cramdown example recently occurred in Grupo Schahin's *recuperação judicial* proceeding. In short, a secured creditor with claims large enough to prevent cramdown had its vote disregarded at the GMC because the court found it was behaving "abusively" (an ill-defined and judicially created concept) based in part on the fact that the plan would have provided the creditor with a higher recovery than in liquidation (the statutorily mandated result of creditors not approving a vote at the GMC). This is a concerning precedent because it effectively amounts to the court superimposing its own commercial judgment on creditors and disenfranchising creditors when the court comes to a different commercial conclusion.

[21] *See* Francisco L. Cestero & Daniel J. Soltman, *The Fight for Bondholder Suffrage in Brazilian Restructurings*, Pratt's Journal of Bankruptcy Law (January 2016) (discussing, *inter alia*, the risk of bondholders not being able to vote at GMCs).

Upon filing for Chapter 11 in the United States, the U.S. Bankruptcy Code provides an initial period of 120 days (the "Initial Exclusivity Period") during which a debtor retains the exclusive right to file a plan of reorganization.[22] The debtor may, "for cause," make a motion to extend exclusivity beyond the Initial Exclusivity Period, and similarly, any party in interest may, "for cause," make a motion to terminate exclusivity at any time (in either case, such motions are upon notice and hearing, and may be opposed by parties in interest).[23]

As noted above, the debtor's exclusivity may be extended beyond the Initial Exclusivity Period (and, in practice, is often extended more than once), but can never be extended beyond 18 months after the bankruptcy filing date.[24] Once the debtor's exclusivity has terminated (either by statute or upon motion), any party in interest, including creditors, equity holders or otherwise, may file a plan of reorganization with the court. It is not uncommon for there to be competing plans of reorganization on file with a court in a Chapter 11 proceeding, though a court will typically not allow both to be simultaneously solicited for approval.

In practice, the ability of creditors to object to the debtor's motion(s) to extend exclusivity, file motions to terminate exclusivity and submit competing plans of reorganization have all been important leverage points in plan negotiations, which have frequently proven helpful in fostering the development of fair and equitable plans of reorganization, and perhaps more pertinent to the case at hand, fast and successful reorganizations.

Contrary to what some may expect, the right of creditors to propose plans of reorganization has not made debtor-proposed plans irrelevant. Debtor-proposed plans are still the norm in the United States, and the law protects debtors that indeed negotiate in good faith and fulfill their obligations. For example, if the debtor files a plan of reorganization during its exclusivity period (either the Initial Exclusivity Period or pursuant to an extension as discussed herein), the debtor is automatically provided with an additional two months to solicit votes on such plan, during which period no other party may file a

[22] *See* 11 U.S.C. § 1121(b) ("Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter.").

[23] *See* 11 U.S.C. § 1121(d); 11 U.S.C. § 1121(d)(1). "Cause" is not defined in the U.S. Bankruptcy Code, but courts have generally employed a totality of the circumstances analysis and analyzed factors such as the size and complexity of the case, whether the debtor has made progress negotiating with creditors, whether the debtor is proceeding in good faith, etc.

[24] *See* 11 U.S.C. § 1121(d)(2)(A) ("The 120-day period specified in paragraph (1) may not be extended beyond a date that is 18 months after the date of the order for relief under this chapter.").

competing plan. As with the absolute priority rule, the principal consequence of the right of creditors to propose plans of reorganization has been to incentivize good faith negotiation among the parties and confirmation of consensual plans of reorganization.

Argentina and Mexico

Other Latin American jurisdictions have also adopted limited exclusivity concepts, and in many cases, these frameworks have helped to help implement a balance of power between debtors and creditors. For example, under Argentina's *concurso preventivo* regime, a debtor has an initial 90 business day period (running from the date upon which the court approves the debtor's proposed classification of creditors) to formulate its plan of reorganization for unsecured creditors, which period is extendable for up to 30 business days at the court's discretion.[25] Following the exclusivity period, if no debtor-proposed plan has been confirmed, either by class approval or by way of cramdown,[26] rather than move immediately to liquidation, creditors or other third parties may file a petition in court indicating their interest in acquiring the shares of the debtor and presenting an alternative plan of reorganization. During this period, the debtor may also propose modifications to its prior plan, or any proposed by creditors or other third parties, and seek creditor approval. If an alternative plan obtains the required creditor approval, the law contemplates the mandatory transfer of the shares of the debtor to the alternative plan proponent at a judicially approved valuation. Similarly, in Mexico's *concurso mercantil* regime[27] during the first 185 days (extendable up to 90 days no more than twice) (the "Reorganization Phase"),[28] a court-appointed mediator (a *conciliador*)

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[25] *See Ley de Concursos y Quiebras*, Ley 24.522 art. 43.

[26] With respect to unsecured creditors, a plan is deemed approved by creditors if it is approved by a majority in number and 2/3 in amount of creditors in each class. *See id.* art. 45. With respect to secured creditors (to the extent applicable), 100 percent class consent is required (though secured creditors can opt to renounce 30 percent or more of their security interest and have their debt bifurcated into secured and unsecured claims). *See id.* art. 43. However, even without class approval, a plan may be confirmed if (i) the plan was approved by both (a) at least one impaired class of unsecured creditors and (b) unsecured creditors representing at least three-fourths of the aggregate outstanding unsecured claims voting on the plan, (ii) the plan provides at least liquidation value to creditors and (iii) the plan does not provide for discriminatory treatment among classes. *See id.* art. 67.

[27] *See Ley de Concursos Mercantiles y de Reforma al Artículo 88 de la ley Orgánica del Poder Judicial de la Federacion (última reforma publica* 1/10/2014) (the "Mexican Concurso Law").

[28] The first 90-day extension may be requested by the *conciliador* (if it believes the parties are close to reaching an agreement) or creditors representing 50 percent of the recognized claims in the proceeding. The second 90-day extension may be requested by the debtor together with 75

facilitates a discussion between the debtor and its court-recognized creditors[29] seeking an agreement on the restructuring with an aim of preserving the debtor as a going concern. If no plan is confirmed[30] by the end of the Reorganization Phase, a liquidation results.[31] The hard one-year deadline for approving a plan of reorganization effectively forces a negotiation among the parties and serves to incentivize debtors and creditors to work together to develop a consensual plan.[32]

PROPOSAL FOR REFORM

With this background, the authors would propose that, whatever other reforms that the Brazilian legislature may be considering to the Brazilian Bankruptcy Law, it adopt the following minimum reforms (the "Proposed Reforms"):

- Eliminate the 60-day plan-filing deadline;
- Instead, provide the debtor with an initial exclusivity period of 90 days[33] (measured from the date on which the court accepts jurisdiction over the case) in which it alone may file a plan of reorganization (the "Initial Brazilian Exclusivity Period");
- After the Initial Brazilian Exclusivity Period, allow for three additional exclusivity extensions,[34] each of up to 90 days (the "First Extension," the "Second Extension," and the "Third Extension," respectively, and the entire period through which the debtor retains exclusivity, the "Brazilian Exclusivity Period"):

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percent of the recognized claims in the proceeding. *See id.* art. 145.

[29] The *conciliador* is also responsible for making proposals with respect to which claims will be recognized in the proceeding.

[30] A plan may be confirmed if it is approved by a majority of all voting creditors (subject to certain limitations on the voting power of intercompany claims). *See* Mexican Concurso Law art. 157. However, a plan can be vetoed by a majority in amount of unsecured creditors voting (excluding intercompany claims). *See id.* art. 163.

[31] *See id.* art. 145.

[32] The reorganization laws of Colombia also grant creditors the power to present plans of reorganization.

[33] The framework for the Proposed Reforms assumes that the relevant deadlines will in fact be counted in calendar days, notwithstanding the recent trend in Brazil to count in business days. *See supra* note 11.

[34] The authors have not in this article proposed specific standards for the extensions or termination of exclusivity, but would suggest something similar to the U.S. system, where courts employ a totality of the circumstances analysis and will grant relief for "cause." *See supra* note 23.

  - The First Extension and the Second Extension must be for cause and on notice to the bankruptcy court and can be opposed by parties in interest.
  - The Third Extension must also be for cause and on notice to the bankruptcy court and can be opposed by parties in interest, but will also only be granted if the debtor can demonstrate the support of 25 percent of its total third-party creditors by amount.
  - At any point during the Brazilian Exclusivity Period, a party in interest may make a motion to terminate exclusivity for cause.
- At the end of the Brazilian Exclusivity period (whether at the end of day 360 or because it has otherwise been not extended or terminated before that), any party in interest may file a plan and seek to present it for a vote at the general meeting of creditors;[35]
- As in the United States, if a debtor proposes a complete and good-faith plan within the established deadline, the debtor could be granted limited additional time to complete the approval process by the court.

This proposal combines some of the most important elements from other jurisdictions that contemplate creditor-led plans, such as an initial exclusivity period, opportunities to gradually extend it or terminate it early, and conditioning at least one subsequent extension on a threshold level of creditor support. Although this proposal would not directly solve many of the issues identified (e.g., unenforced deadlines, consistent stay extensions, etc.), allowing creditor proposed plans in Brazil could substantially mitigate their impact and

[35] The authors recognize that corresponding changes may need to be made elsewhere in the Brazilian Bankruptcy Law in order to account for creditor proposed plans. For example, the Brazilian Bankruptcy Law would likely need to be changed to provide for a result other than liquidation if a creditor-proposed plan was not approved at a GMC in order to avoid creditors having unchecked power to force a vote that they know will not be approved and force the debtor into a liquidation. Moreover, as a trade-off for legislation that encourages shareholders of debtors in *recuperação judicial* to negotiate with creditors, Brazilian legislators may also be wise to consider amendments to art. 49 of the Brazilian Bankruptcy Law, which prohibits releases of non-debtors. Specifically, the legislature may want to consider creating a limited carve-out that would allow individual shareholders to be released from guarantees as part of a confirmed plan of reorganization. Absent such a change, such shareholders (particularly where they have a controlling interest and cooperation may be necessary for plan consummation at least from a corporate law perspective) may not be sufficiently incentivized to work collaboratively with creditors, as they could not be personally released as part of a plan. The authors do not purport to address every such corresponding change, but instead simply note that the impact of the Proposed Reforms must be carefully considered.

shift the balance of power back toward creditors in a way that will help make the entire regime more effective.

Needless to say, there are multiple alternatives to solve the central problem raised by this article, and many of the specifics of our proposal can be adjusted without materially altering its expected results. That said, creditor-led plans have proven to be a very useful and effective tool to promote fast and successful corporate reorganizations in many jurisdictions, and the idea deserves careful consideration in Brazil. The system, as is, does not work, and statistics show that. Some commentators have raised concerns that creditor-led plans may be unfair to shareholders who have continued exposure to the enterprise after its exit from reorganization proceedings. In our experience this concern is overstated—it is the rare case where creditor recoveries are so bloated that equity holders can rightfully claim that, even without creditor sacrifices, the company would have survived and prospered. Indeed, most often companies that thrive post reorganization do so because of the sacrifices that their creditors have made as part of the restructuring process (typically by deleveraging the company) and/or changes the debtor has made to its business plan and strategy and new money or management that it has brought in as a result of the reorganization. Furthermore, many of these concerns could be addressed, at least partially, in the plans themselves or as part of the legislative reform efforts in Brazil (such as the release of non debtors). Finally, to state the obvious, leaving control of a troubled enterprise in the unfettered hands of the same controlling shareholder(s) that led it to problems is generally not the answer.

CONCLUSION

Although admittedly a creditor-friendly proposal in that it advocates shifting the power dynamic back toward creditors away from debtors, the Proposed Reforms would, in fact, benefit both creditors and debtors. For instance, allowing creditor-proposed plans would incentivize boards of directors to consider their relationships with creditors and a path to confirmation *before* filing, and to work with their creditors to develop consensual plans in good faith. Consequently, fully consensual plans would be more likely. In addition to making consensual plans more likely, the Proposed Reforms could also serve to incentivize creditors to make debtor in possession ("DIP") loans in a way that they were not previously incentivized to do (particularly on a true emergency basis before a plan has been fully agreed to, DIP lenders can take comfort in the fact that creditors are likely to have strong voice in negotiating the plan that is ultimately confirmed). Moreover, the Proposed Reforms would fit within the stated goals of the Brazilian insolvency reforms—by allowing creditor-proposed plans, it would lessen the chances that a debtor would sit in insolvency

proceedings without taking action for an extended period, in turn ultimately bringing the proceedings to a speedier (and hopefully consensual) resolution.

Finally, following a three-year recession in Brazil, it is also important to consider the macro-level impact of shifting power toward creditors and, specifically, the Proposed Reforms. The wave of recent bankruptcies has made investors weary and made it more difficult for Brazilian companies to access international markets. Increased protection against downside risk by implementing greater protections for creditors in *recuperação judicial* proceedings may incrementally decrease the cost of borrowing internationally, and in a time where Brazil's economy needs bolstering, it would be in the public interest to enact reforms that may do just that.