

The effects of judicial reorganisations on the accelerated maturity of company debts in Brazil*

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Due to present political and economic circumstances in Brazil, the number of judicial reorganisation requests has considerably increased in the past few years. As a result, courts have been tested on a number of issues and new legal interpretations have been adopted. Specifically, recent court rulings have determined that provisions under financing agreements setting forth the acceleration of outstanding debt as a consequence of judicial reorganisation filings by debtors would contradict a legal purpose of protecting the debtor's going concern, and would thus be null and void. In this scenario, the article contains an analysis of the legal validity and effectiveness of debt acceleration contractual provisions in Brazil, particularly vis-à-vis the referred recent court rulings and their potential adverse impact on credit supply and risk management.

From January to May 2016, 755 requests for judicial reorganisation have been filed in Brazil, a 95 per cent increase from the ones registered during the same period in 2015, thus reaching a new historical record from 2006, when the current Judicial Reorganisation and Bankruptcy Law (Law 11.101/2005) came into effect.¹ From 2006 to 2011, the number of judicial reorganisation requests did not exceed 74 per month; between 2012 and 2015, the monthly number reached its peak in December 2015, with 150 requests, while in 2016, 377 requests for judicial reorganisation were registered in the month of September alone.

In this scenario, Brazilian courts have ruled on many issues related to judicial reorganisations, bringing forward new interpretations, which may bear an impact on the activities of companies and the corporate credit market.

For purposes of this article, we intend to analyse recent court decisions, notably from the judicial district of São Paulo,² which have considered abusive – and therefore null and void – provisions of financing agreements that determine the acceleration of debt if a judicial reorganisation procedure is filed by, or granted against, a certain debtor party.

As is well known, contractual provisions for the anticipation of the maturity of debts upon verification

of certain events are commonly adopted, nationwide and internationally, and economically justified to protect a contractual party from the deterioration of the credit risk of the other party in debt. Based thereon, market agents that provide or take on credit generally expect that when an event that increases risk arises – such as a judicial reorganisation – declaration of the acceleration of debt will be considered legally valid and enforceable.

The matter seems fairly straightforward, however, this is only at the level of contracts.

In the state of São Paulo – which is the most preeminent in Brazil from an economic standpoint – courts have certain chambers specialised in corporate law and reorganisations, whose decisions, as a result of their prestige and expertise, have a relevant influence on judicial rulings in the entire country. In different situations, specialised chambers have been responsible for inaugurating case law that is critical to judicial reorganisations and have caused a positive impact throughout. However, we have recently encountered a relevant number of decisions by those same chambers, which put at risk the rights of creditors to declare the accelerated maturity of debt, taking a direction that is conflicting with the logics of financing transactions.

There are decisions in this respect both to the detriment of pre-petition regular creditors ('regular creditors') – those whose credits are subject to the effects of the judicial reorganisation – and of pre-petition extra-composition creditors ('extra-composition creditors').³ Under Brazilian law, in the context of financing transactions, extra-composition credits normally comprise those with collateral in the form of fiduciary assignment or chattel mortgage of real estate or movable assets.⁴

Among the reasons for the court decisions, it has been determined that the acceleration of the maturity of payment obligations based on the filing or granting of a petition for judicial reorganisation would generate undue benefits for specific creditors, which would result in a privileged position if compared to other creditors.

According to Judge Marcelo Barbosa Sacramone – who is one of the main defenders of the position above – in regards regular credits, an early maturity clause would trigger an unequal condition between creditors in relation to their voting rights in the general meeting of creditors, when they meet to evaluate the judicial reorganisation plan. That is because debt acceleration would allow creditors protected by the clause to demand that their due amounts be paid immediately and, based thereon, any provision in the judicial reorganisation plan that may alter that immediate payment would give them the right to vote.⁵

With regards to extra-composition credits, the early maturity of debt would allow creditors, in the context of their payment collection efforts, to pursue and seize assets and goods that may often be essential to the company's operations. As a result, the company's going concern could be hurt – which would go against a principal legal objective of judicial reorganisations – ultimately generating social losses in the form of adverse effects to employment maintenance, tax payments and the circulation of goods.⁶

To support the view above, in the analysed court decisions it has been stated that Law 11.101/2005, differently from the previous Brazilian law on the matter (Decree 7.661/1945, which expressly and broadly provided for the accelerated maturity of debtor's obligations), determines the acceleration of the maturity of the debts only in case of bankruptcy events.⁷

Based on such perspective, the law's omission about the accelerated maturity of obligations as a result of judicial reorganisations would arguably be intentional, since a judicial reorganisation, unlike bankruptcy, would not be intended for the liquidation of assets to pay for liabilities, but instead to overcome a reversible economic or financial crisis.

Nevertheless, the legal argument adopted in the court decisions is substantially based on abstract

concepts, such as the social role and the preservation of the company, which would be applicable to almost all factual situations. Furthermore, the interpretation above of the legislator's omission as a rejection of the acceleration of debts in case of judicial reorganisation is conflicting with the general Brazilian civil legislation and with the principles that govern corporate law.

First, although Law 11.101/2005 is not explicit with regard to the validity of early maturity provisions in the case of judicial reorganisations, it also does not restrict the contractual adoption thereof. Considering that the Brazilian reorganisation law itself attributes to the parties involved a main role in solving the crisis affecting the company, the legislative omission above leads consistently to the conclusion that negotiating the accelerated maturity of the debt as an effect of the request for judicial reorganisation represents an unrestricted option to the contractual parties.

The argument described above of a supposedly privileged position of creditors that have adopted early maturity clauses in their contracts is also fragile. In fact, opposite to what the analysed decisions state, the acceleration of the maturity of the debt allows for the balancing of rights among creditors with intended equal standing.⁸

In the case of regular creditors, the early maturity clause serves to ensure that the total outstanding debt is immediately payable by third-party guarantors, as well as allowing the due amount be included in full within the credits that will be subject to the reorganisation plan. The latter effect avoids a creditor finding itself in a disadvantaged position in terms of timing of payment if compared to other creditors.

With regard to extra-composition creditors, the analysed judicial decisions are even more questionable. The accelerated maturity of debts is important so as not to cancel out the economic protection given by the specific collateral previously and legitimately negotiated between the parties. In other words, early maturity ensures that the cash flow that is obtained from the assets and rights granted as collateral is not utilised to pay other credits or, even worse, before foreclosure by the legitimate creditors, that such assets or rights are disposed of in the context of the implementation of the reorganisation plan.

Removing the validity of the accelerated maturity clause as a result of a request for judicial reorganisation would involve inserting extra-composition creditors – which should not even be affected by the reorganisation – into a comparatively disadvantageous position. Also, the reorganisation court should not have jurisdiction to, for the apparent sake of the preservation of the company, declare null and void a clause of a contract that is not subject to the judicial reorganisation.

Recently, based on such reasons, the Second Chamber of Corporate Law of the Appeals Court of São Paulo has changed one of Judge Marcelo Barbosa Sacramone's decisions mentioned above.⁹ The members of the chamber pointed out that the clause does not affect regular creditors, once they will all be subject to the effects of the reorganisation plan in any case, and that the judge is not allowed to appreciate the validity of a clause inserted in a contract that is not under the judicial reorganisation effects.¹⁰

As a matter of fact, it is the right of the creditor, guaranteed by the Brazilian Civil Code, to determine that a certain debt be payable before its maturity in the case of bankruptcy of the debtor or, in general terms, when there are collective claim proceedings:

'Article 333: The creditor shall have the right to collect the debt before the maturity date stipulated in the contract or established in this Code:

I – in the case of bankruptcy of the debtor or in *collective claims proceedings*' (emphasis added).¹¹

The analysed decisions mention, in summary, that judicial reorganisations would not be specifically included in the legal provision above. However, the Brazilian Civil Code came into force in 2002 and, therefore, precedes the introduction of judicial reorganisation proceedings in Brazil. If the lack of express reference to judicial reorganisations in the Brazilian Civil Code results from a chronological reason, excluding them from the scope of the early maturity legal provision does not seem convincing or reasonable.

Also, collective claims proceedings are verified in the undeniable interaction between regular creditors, in as much as judicial reorganisations create a stage for competitive debt collection efforts between both regular and extra-composition creditors. Therefore another reason for judicial reorganisations, as de facto collective claims proceedings, is to allow for the accelerated maturity of debts, and by such means fulfil the legal purpose to protect creditors that are threatened by the deterioration of the debtor's credit risk and the consequent collective efforts by other creditors to obtain payment.

In the context above, one cannot ignore that, if accelerated maturity clauses have been removed in the analysed court cases – as they would arguably put a creditor at a supposed advantage with regard to other creditors – that is because a judicial reorganisation comprises a collective claims proceeding among different creditors, however imperfect such proceeding may be.

Therefore, notwithstanding any contractual provision, a creditor has the right based on the Brazilian civil legislation to declare an outstanding debt as due and payable before the maturity date, not

only in the case of bankruptcy of the debtor, but also when there is a collective claims proceeding generated by a judicial reorganisation.

Additionally, the mentioned provision of the Brazilian Civil Code does not prevent contractual parties from electing other events as triggers for the accelerated maturity of payment obligations.¹² The Appeals Court of São Paulo has backed such a position on at least three different occasions, with the following line of reasoning:¹³

'The provision is not abusive since the risk of the transaction increases significantly in this case. Contrary to what was stated by the Judicial Trustee in his statement, the accelerated maturity of the transaction does not find any obstacle in Article 333 of the Civil Code. *First, the provision allows the creditor, in its Item I, to collect the debt before the due date stipulated in the contract in the case of bankruptcy of the debtor or collective claims proceedings (as occurs, for example, in the judicial reorganisation). In any manner, the cases of accelerated maturity of the debt provided for in the Civil Code are not exhaustive and nothing restricts the parties from agreeing to other terms. [...]* It is not up to the Judiciary to compel the financial institution to grant credit to anyone, nor substitute the bank in the analysis of the risks involved in the transaction.'¹⁴ (emphasis added)

The choice of other events, not specifically set forth in law, as causes for accelerated maturity of outstanding debt is a common practice in the financial market. That is because there are numerous events in which the financial situation of the debtor may deteriorate, increasing the risk of default.

Within such logic, in order to protect the creditor, financial covenants are customarily adopted to establish debt incurrence limitations for the debtor company, minimum revenue and debt expense ratios, restrictions to the use of proceeds, among others which, if violated, may give rise to accelerated maturity of debt. Such accelerated maturity situations may occur previously or even regardless of any judicial reorganisation of the debtor.

To prohibit the use of early maturity clauses in cases of judicial reorganisation, for reasons akin to the preservation of the company and of its social role, seems to be arbitrary. If this rationale is admitted, then the principle of freedom of contract will be hindered and legal uncertainty aggravated, with consequent disincentives to the development of the credit market.

As observed by Manoel Justino Bezerra Filho, although a reorganisation is a judicial procedure in Brazil, its economic substrate prevails over the legal one and, in that context, requires that the economic impact of legal decisions be assessed.¹⁵

It is therefore important to alert to the risk – recently created in Brazil – of creditors having to legally defend the validity and enforceability of accelerated maturity clauses, which have, for a long period of time in both the Brazilian and international markets, permitted legitimate contractual protection.

Notes

- 1 'Pedidos de recuperações judiciais aumentam 95% em maio e batem recorde histórico, revela Serasa Experian': <http://noticias.serasaexperian.com.br/pedidos-de-recuperacoes-judiciais-aumentam-95-em-maio-e-batem-recorde-historico-revela-serasa-experian>, accessed 23 February 2017.
- 2 The lower court decisions on the topic in proceedings No 1012521-92.2016.8.26.0100, No 1007989-75.2016.8.26.0100, No 1030812-77.2015.8.26.0100 (Judicial Reorganisation of the OAS Group) and No 1013569-56.2014.8.26.0068 are available at: www.tjsp.jus.br, accessed 23 February 2017.
- 3 The so called post-petition creditors are those whose credits arise after the judicial reorganisation request. See Art 49, Law 11.101/2005.
- 4 Article 49, s 3º, Law 11.101/2005.
- 5 M B Sacramone, 'Cláusula de vencimento antecipado na recuperação judicial' (Oct 2016) 131 *Revista do Advogado*, year XXXVI, 134. The argument is based on Art 45, s 3rd, Law 11.101/2005.
- 6 *Ibid*, at 136.
- 7 Article 77, of Law No 11.101/2005. 'The declaration of bankruptcy determines the accelerated maturity of debt of debtors and of unlimited jointly liable shareholders, with a *pro rata* reduction of interest, and converts all of the credits in foreign currency into local currency, based upon the exchange rate as of the date of the judicial decision, for all effects of this Law' (freely translated from the Portuguese version available at www.planalto.gov.br/ccivil_03/_ato2004-2006/2005/lei/111101.htm, accessed 23 February 2017).
- 8 J S Pacheco, *Processo de Recuperação Judicial, Extrajudicial e Falência* (3rd edn, Forense, Rio de Janeiro, 2009), 244.
- 9 Proceeding No 1012521-92.2016.8.26.0100; see: www.tjsp.jus.br, accessed 2 March 2017.
- 10 Bill of Review No 2075528-50.2016.8.26.0000, 2nd Chamber of Corporate Law, Judge Caio Marcelo Mendes de Oliveira [2017]; see: www.tjsp.jus.br, accessed 2 March 2017.
- 11 Freely translated from the Portuguese version available at: www.planalto.gov.br/ccivil_03/leis/2002/L10406compilada.htm, accessed 23 February 2017.
- 12 In these terms, C M S Pereira, *Instituições de Direito Civil: Teoria Geral das Obrigações* (Vol 4, 23rd edn, Forense, Rio de Janeiro, 2010) 193.
- 13 Bill of Review No 2019536-41.2015.8.26.0000, 1st Chamber of Corporate Law, Judge Pereira Calças [2015]. See also Bill of Review No 2091701-52.2016.8.26.0000, 2nd Chamber of Corporate Law, Judge Campos Mello [2016]: 'the circumstance of the filing for judicial reorganisation is not in itself enough to remove a clause with this content. On the contrary, in this Court it has already been decided that a judicial reorganisation can support the incidence of accelerated maturity without this provision being considered abusive'; Appeal No 0014495-65.2013.8.26.0011, 12th Chamber of Private Law, Judge Tasso Duarte de Melo [2015]: 'Thus, one cannot speak of illegality or abusiveness of a clause that permits the accelerated maturity of the bank credit note in the case of a request for judicial reorganisation of the main debtor (clause 08 pages 71, 88, 108, 124 and 141). Art 333 of the Civil Code discusses the legal hypotheses of the accelerated maturity of the debt, there being no impediment to the contractual stipulation of other cases that permit its incidence.' (Freely translated from the Portuguese versions available at: www.tjsp.jus.br, accessed 23 February 2017.)
- 14 Freely translated from the Portuguese version available at: www.tjsp.jus.br, accessed 23 February 2017.
- 15 M J Bezerra Filho, *Lei de Recuperação de Empresas e Falência* (7th edn, Revista dos Tribunais, São Paulo, 2011), 51.

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