THE INNEFFICIENCY OF THE CURRENT
JUDICIAL REORGANIZATION PROCESS OF
COMPANIES IN BRAZIL

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The perception that companies in financial difficulties need
to be preserved on behalf of social welfare (jobs and
stimulation to the economic activity), nearly generating a
state obligation to guarantee their survival at any cost, has given
rise to excesses.
The current legal device for judicial reorganization and
bankruptcy (Law 11.101/2005) in force in Brazil enables
maneuvers of companies which aim solely at having bankruptcy
and execution claims against them suspended, taking advantage of
the so-called stay period of 180 days. As an evidence of that, we
cite the statistic of only 30% of concession of recoveries in view
of the total of requests1. That is, for every ten filings of judicial
reorganizations, only three undergo the scrutiny of Article 58 of
the Judicial Reorganization Law. The vast majority fails to present
their reorganization plan or has the plan rejected by the creditors’
meeting.

On the other hand, it is seen that the corporate reorganization
mechanism often does not allow for an effective processing of
the reorganization plan, failing to encourage a healthy relationship
between those involved and leading viable enterprises to
bankruptcy. One cannot suppose that the creditors, just for being
responsible for the plan approval, must necessarily do so
consciously. Besides leaving little or no margin for the creditors
to present alternative plans, bankruptcy is put as the immediate
consequence of the non-approval at the meeting. In the first case,
the creditors fail to suggest broad changes to the plan or lack the
necessary information for an alternative. In the second situation,
in turn, the creditor’s options are greatly reduced. Either he votes
for the approval of any plan - even perceiving its evident
inconsistency - or he will face the certain loss for the debtor’s
bankruptcy (COELHO, 2018).
Thus, even if there is good intention by the debtor, the creditors
are susceptible to an innocuous meeting and to an often-
inconsistent plan. In this scenario, according to Oliveira (2015),
the operators of this important company recovery mechanism
find rates of only 5% of closure of the judicial lawsuit for

1 Serasa Experian Bankruptcy and Recovery Indicator: Total monthly survey of required
judicial reorganization, both deferred and granted. Division of total concessions 2,713
by the total requirements 8,884 in the period from Jan/09-Feb/18.
compliance with the plan. Besides cases in which the stir drags on for several years ahead of the stipulated by the legislation.

In order to digest the flaws of the current corporate recovery mechanism, suggestions for the adequacy of Law 11.101/05 are widely discussed in the legal, political, corporate and academic environment, in order to assert to society, the costly judicial recovery process. The expectation is that the recovery institute in Brazil may have its version updated. This may provide higher effectiveness, both from the point of view of the recovery of the debts inserted in the lawsuit, of the time and necessary costs³, as well as of the greater control and criterion for the deferral of requests at the time of the initial appeal.

To have an idea of the importance of discussing the efficiency of the recovery processes, member countries of the Organization for Economic Co-operation and Development (OECD) have the average cost of judicial reorganization operations at 9.1% of the total assets of the debtor³. That is, it is indeed a tremendous effort on the part of everyone involved, to have such an operation unanswered for years.

In Brazil, the legislation reform in 2005 mainly aimed at increasing the amount of debts paid by firms which entered the bankruptcy process. At the time of the legislative amendment, the creditors of firms undergoing judicial reorganization were facing a rate of only 0.2% recovery of their assets. In comparison, at the same time, creditors in the United States recovered their assets at a rate of 80.2%, in China at a rate of 31.7% and in India 24.6% ⁴ (PONTICELLI; ALENCAR, 2006).

Law 11.101/2005 brought an undeniable improvement to the asset recovery environment. Two of the major improvements presented by the current legislation were: (i) greater ease of sale of firms undergoing judicial reorganization through the exclusion of purchaser’s responsibility (Articles 60 and 141); (ii) alteration in the order of payments, with a limit for the labor claims, and the position of credits with real guarantee by the taxpayers (article 83).

Already in the first years of validity, the new legislation provided an increase in the asset recovery rate⁵ for something around 12%, such a leap in the effectiveness of the recovery system. Over the years, however, the performance of the Brazilian judicial reorganization system under the aegis of Law 11.101/2005 has been proven weak. It has been found, in the World Bank’s Doing

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² According a study by the World Bank, Doing Business - Resolving Insolvency, in Brazil, the necessary time for the creditors to recover their credit is four years, on average, and the cost of the procedure is 12% of the value of the debtor’s property. Both indicators are above the average of the world’s leading economies (1.7 and 9.1%, respectively).


⁵ The recovery rate is recorded as the portion recovered by secured creditors through judicial reorganization, settlement or debt execution proceedings.

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Business report that, despite an encouraging performance in the early years, the new system did not have the strength to take off, and fell far short of the other countries.

As a form of analysis, Figure 1 presents the historical performance of the asset recovery rate in Brazil, compared to countries with similar economic activity\(^6\) (Comparison Base), as well as of the more developed OECD countries. The result is a clear difference between the Brazilian system and the rest of the world. While the countries with activity similar to ours and the most developed ones nowadays recover, respectively, 37% and 72% of the assets involved in a judicial reorganization, Brazil is at a much lower level, close to 18% over the past few years.

Figure 1: Asset Recovery Rate

![Figure 1: Asset Recovery Rate](source: Author’s elaboration with data from the World Bank – Doing Business Report)

Clearly, the longer the period under judicial reorganization (horizontal axis), the lower the amount of recovered debt (vertical axis). Therefore, the hypothesis that judicial reorganizations take

\(^6\) We call this group Comparison Base, which is formed by countries which have a Gross Domestic Product at levels close to the Brazilian ones. Among others, Mexico, Russia, China, South Africa, Argentina, Peru and Turkey are considered here.
time for good use of the process to be made and debts to be paid is excluded. The delay is mere procrastination by opportunists or inefficiency of a system still without a practical result.

In Brazil, as occurred with the asset recovery rate, the average time of legal reorganizations was significantly improved with the institution of the new company reorganization law in 2005. However, once again the improvement was not sufficient. Still based on the excellent study annually elaborated by the World Bank, the Doing Business report, Brazil moved from an average duration of judicial reorganizations from 10 to 4 years after the new legislation. That is still distant from the average of countries such as the United States (1 year), China (1.7), Japan (0.6), Argentina (2.4), Russia (2) and Italy (1.8).

In addition to learning that the delay in the bankruptcy process greatly jeopardizes the effectiveness of asset recovery, it has also been determined that it drastically increases its cost to society, especially to the debtor. Figure 3 illustrates that processes with longer duration present higher costs necessary for the recovery of assets, indicating that inefficiency is contagious, as the longer the process, the more expensive and less effective it becomes.

Figure 3: Dispersion of the cost of the judicial reorganization process with respective duration in 74 economies

Source: Author’s elaboration with data from the World Bank – Doing Business Report

The suggestions for the reform of law 11.101/2005, the Law on Judicial and Extrajudicial Reorganization and Bankruptcy, come from diverse sectors. In order for the bill, altering the current legislation, to contemplate different opinions of society, the

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7 The time period measured by the World Bank’s Doing Business report spans from the company’s reorganization request until payment of part, or all the money owed to the bank. Potential delay tactics by the parties, such as delaying appeals or requests for extension, are taken into account.

8 The cost of the process is recorded as a percentage of the value of the debtor’s equity, and includes judicial costs and government fees; administrators’, auctioneers’, advisors’ and attorneys’ fees; and all other fees and costs. World Bank - Doing Business Studies, Resolving Insolvency (2017). Available at <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>.
Ministry of Finance created, at the end of 2016, a work group composed by 21 professionals.
The first point that deserves highlighting among the proposals for modernization of the Brazilian bankruptcy environment refers to the competent court to conduct the proceeding. Nowadays, incredibly complex proceedings and supported by an entanglement of economic-financial situations are under the responsibility of unprepared judges and without any experience in the subject.

Article 3 of the law in force establishes that the competent court is that of the location of the debtor’s main place of business. The draft amendment suggests, in § 1 of the same article, that in cases of judicial reorganization or bankruptcy with liabilities higher than three hundred thousand (300,000) minimum wages, on the date of filing, will be competent to the court of the state capital or the Federal District in which the main establishment is located. It further reinforces that this guideline must be followed until the Courts of Justice program specialized regional courts.

Another important theme under discussion is the so-called prior investigation. In sum, the aim is the opportunity for utilization of accounting information to avoid the deferral of the reorganization process to economically infeasible companies, and to identify settlement processes in which the collected assets are insufficient to reimburse the creditors (JUPETIPE, 2017).

The financing of the debtor during the judicial reorganization is also remembered in the modernization suggestions of the law.

Today, a company in bitter judicial reorganization, besides the delicate situation of having its survival challenged, an incredible difficulty to obtain new financing, an unforgivable gap of the current legislation. It is as if someone, even after being rescued from drowning, is deprived of vital oxygen.

Section IV-A of bill 10220/2018, which includes articles 69-A to 69-I, allows the debtor to enter into financing agreements, including those secured by encumbrance or alienation of assets and rights, theirs or third parties’, to finance their restructuring activities. In case of bankruptcy of the debtor, the amount of the funding effectively delivered to the debtor during the judicial reorganization will be considered exempt from bankruptcy and will confer preference to the lender (except in cases where the lender is a partner or relative up to the fourth degree). Thus, great progress in the success rates in judicial reorganizations is expected, recovering the confidence of the entrepreneurs and, consequently, heating up the economy.

Besides the aforementioned alterations, others are still being proposed and will require intense debate within the legislative branch, aiming at the due measurement of the aid each one of them will bring to the recovery environment. Bringing the spotlight to the discussion about the current process of judicial reorganization in Brazil is of fundamental importance, for the tragic consequence of continuing with an inefficient recovery mechanism. Several business opportunities are being lost, capital
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is deteriorating, and jobs are being lost, while huge amounts of resources are spent on lawsuits, mostly innocuous and time-consuming. The uncertainties which bring about an ineffective judicial reorganization process generate, besides distress to the affected parties (workers, creditors and debtors), irreversible losses to the productive chain.

The business reorganization tool is put into disrepute when its crooked utilization is allowed, both from the point of view of the debtor and of the creditor. Sometimes, there is an attempt to utilize the institute with the intention of merely procrastinating an inevitable bankruptcy and defrauding the creditors. Also, events in which the creditors’ hostile performance, acting deceitfully and truculently, directs the process towards an undue liquidation direction, are not uncommon. In both cases, society as a whole loses, due to the contamination of the important recovery environment.

REFERENCES


Serasa Experian Bankruptcy and Recovery Indicator: Monthly survey of total bankruptcies required and decreed, as well as total judicial reorganizations required, deferred and granted.


