MEDIATION AND JUDICIAL RESTRUCTURING PROCEEDINGS IN BRAZIL

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Brazilian mediation was formally regulated in 2016, when two important laws came into force, the "*Mediation Law*"[1] and the "Brazilian Civil Procedure Code"[2]. Both laws encourage the use of mediation. The Brazilian Civil Procedure Code establishes that mediation "shall be encouraged by judges, lawyers, public defenders and members of the Public Prosecution Service, even in the course of judicial proceedings"[3].

§ 1 – BRAZILIAN MEDIATION

The Mediation Law provides that mediation is:

> "the technical activity carried out by an impartial third party without decision-maker power, which if chosen or accepted by the parties, helps them and encourages them to identify or develop consensual solutions to the controversy"[4].

The Brazilian National Council of Mediation and Arbitration Institutions (CONIMA) also states that "mediation is a non-adversarial and voluntary method of dispute resolution, whereby two or more person seek a consensual solution that enables them to preserve their relationship. To this end, they use a third facilitator, impartial, competent, diligent, credible and committed to secrecy; that stimulates and enables the communication and helps in the search of the identification of the real interests involved."[5]

Finally, doctrine dictates that "mediation is one of the instruments of pacification of a self-composition and voluntary nature, by which a third impartial party acts as facilitator of the process of resumption of dialogue between the parties, before or after the conflict initiates."[6]

In sum, the main aspects of mediation are: (i) it is voluntary, (ii) the solution is consensual and not imposed to the parties and (iii) the mediator is impartial.

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[1] Federal Law number 13.140/2015.
[2] Federal Law number 13.105/2015.
[3] Section 3, sole paragraph, Brazilian Civil Procedure Code. Free translation
[4] Section 1, sole paragraph, Mediation Law. Free translation.
[5] Concept available at CONIMA´s website: http://www.conima.org.br/regula_modmed). Free translation.
[6] F. CAHALI, *Curso de Arbitragem*, 6th ed. Revista dos Tribunais, São Paulo, 2017, p. 87. Free Translation.

Many have discussed whether those aspects are compatible or not with judicial restructuring proceedings, due to the nature and characteristics of such proceedings, analysed in detail further in this study.

The bill that gave rise to the Mediation Law originally determined that conflicts related to judicial restructuring proceedings would not be subjected to mediation.[7] This provision was changed before the enactment of the law and, as a result the Mediation Law has no specific restriction on this matter.

In the other direction, the Brazilian Federal Courts Council ("CJF") has already stated that mediation is compatible with judicial reorganization[8]. This statement does not bind Bankruptcies Courts, but may be used as orientation to judges.

As illustrated, the subject is very controversial. This study aims to analyse the application of mediation in judicial restructuring proceedings and the best moment to perform it.

§ 2 – BRAZILIAN JUDICIAL RESTRUCTURING

Brazilian companies willing to overcome an economic crisis may benefit from a judicial restructuring proceeding, which is a mechanism that aims to allow a debtor company to renegotiate its debts with its creditors.

The Brazilian Bankruptcy and Restructuring Law[9] ("BRL") regulates the proceeding and establishes that:

> "(i) only the debtor may file a court application for restructuring;
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> (ii) there is a 180-day stay period for claims subject to the proceeding (those existing at the date of the filing, whether matured or not, with few exceptions provided by law), but it is not automatic upon filing, and applies only if and when the court authorizes the proceeding[10];
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> (iii) tax and a few other types of debts are not subject to the proceeding and creditors holding such debts may initiate or proceed with individual collection lawsuits against the debtor[11];
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> (iv) BRL does not provide for a specific status such as "debtor in possession" as in Chapter 11 of The US Bankruptcy Code, and as a general rule, the existing management of the debtor continues to operate the business on its own behalf.
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> (v) Regular business acts are allowed, but any sale of "permanent" assets is only allowed if authorized by the

[7] Bill of law 7169/2014. Section 3, Third paragraph. Free translation.

[8] Brazilian Federal Courts Council (CJF). *I Jornada de Prevenção e Solução Extrajudicial de Litígios*. Enunciado 45. Available at: http://www.cjf.jus.br/enunciados/enunsciado/900

[9] Federal Law number 11.101/2005.

[10] In practice, Courts tend to extend this 180-day term if they understand that this is essential for the company to overcome its crises.

[11] For more details regarding credits not subject to Brazilian reorganization proceedings, please see http://ojs.imodev.org/index.php/IJIL/article/view/157.

> Bankruptcy Court or provided for in the reorganization plan approved by the majority of creditors;
> (vi) while a judicial administrator nominated by the Court monitors the activities performed by the debtor, he/she mainly manages the judicial procedure acts, instead of replacing the management of the debtor company in operating the business;
> (vii) a judicial manager is only appointed when the debtor's existing management has been removed from their positions in exceptional legal cases[12]; and
> (viii) the general meeting of creditors is essential to the process."

The main premises of the judicial restructuring proceedings are: (i) creditors under the same situation must receive equal treatment (*par conditio creditorum*) and (ii) supremacy of the decisions taken at the general meeting of creditors. The judicial restructuring is also based on the principle of the preservation of the company, which provides that the goal of the proceeding is to allow the debtor company to overcome its crisis[13].

A) EQUAL TREATMENT

In insolvency proceedings, where a debtor company does not have enough assets to pay all its debts, creditors in the same situation must receive equal treatment, to ensure that the losses will be equally divided among all creditors.

In the past, much had been discussed on the application of the *par condicio creditorum* principle in judicial restructurings, on the basis that the equal treatment would be limited to forced liquidation proceedings.

This controversy is now over, after the Brazilian Federal Courts Council ("CJF") stated that the judicial restructuring is indeed subject to the *par condicio creditorum* principle[14].

However, in judicial restructuring proceedings it is possible to have differences of treatment between the creditors, as long as these creditors are not in the same situation and the variation of the treatment is reasonable and proportional to the distinctions between the creditors.

Doctrine dictates that:

> "it is precisely the diversity of interests to justify the separation of creditors into classes that brings as a reflection the possibility of assigning creditors differential treatment, according to the legal position they held"[15].

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12 Those exceptions are provided for in Section 64, BRL, and are related to the commitment of previous crimes and/or a fraudulent intent to lead the company to a bankruptcy in detriment of the creditors.

13 Section 47, BRL.

14 Brazilian Federal Courts Council (CJF). *II Jornada de Direito Comercial.* Enunciado 81. Available at http://www.cjf.jus.br/enunciados/enunciado/795.

15 Sh. CEREZZETI, "As Classes de Credores como Técnica de Organização de Interesses: em Defesa da Alteração da Disciplina das Classes na Recuperação Judicial"

Also, "such differentiated treatment is possible provided that there is a homogeneous interest between those creditors, whether on the basis of the nature of the credit or any other criterion of similarity justified in the plan, and that, of course, it does not harm other creditors and has been approved by the four classes".[16]

Following these lines of thought, the Brazilian Federal Courts Council ("CJF") concluded that:

> "the judicial reorganization plan shall provide for equal treatment for members of the same class of creditors who have homogeneous interests, whether these are based on the nature of the claim, the amount of the claim or other similarity criterion justified by the proposer of the plan and approved by the judge"[17].

Caselaw follows this same position and admits different treatments between creditors, provided the differences are justified[18] and approved by the General Meeting of Creditors.

Thus, even though some differential treatment is permitted, the debtor company is not allowed to propose certain payment terms only to a creditor (or group of creditors) at its own convenience. The payment terms must be proposed to all creditors under the same conditions, whether the debtor company is inclined to do so or not.

B) SUPREMACY OF THE GENERAL MEETING OF CREDITORS

The General Meeting of Creditors is a deliberation body essential to the judicial restructuring proceeding, with irrefutable authority over the matters it decides. The entity ultimately determines the outcome of the proceeding and the debtor company, once it has the function to approve or reject the restructuring plan[19].

Any reorganization plan must be approved by the following four categories of creditors in the General Meeting of Creditors: (i) labor creditors and creditors from workplace accidents, (ii) secured creditors, (iii) unsecured creditors and (iv) Small Business creditors[20].

In the first and fourth classes of creditors (labor and Small Business), approval is achieved with the favorable vote of the majority of creditors present at the meeting, regardless of the

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in P. TOLEDO, F. SATIRO, *Direito das Empresas em Crise*, ed. Quartier Latin, p. 369. Free Translation.

16 L. SALOMÃO, P. SANTOS, *Recuperação Judicial, Extrajudicial e Falência*. Editora Forense, 2nd ed., p. 319. Free Translation.

17 Brazilian Federal Courts Council (CJF). *I Jornada de Direito Comercial*. Enunciado 57. Available at: http://www.cjf.jus.br/enunciados/enunciado/795. Free translation.

18 São Paulo Court of Appeals. Interlocutories appeals 0187811-89.2012, 0372448-49.2010 and 2139325-68.2014.8.26.0000.

19 Section 35, I, a, BRL: The General Meeting of Creditors will have the function to approve, reject or modify the judicial reorganization plan. Free Translation.

20 Complementary Law 123/2006. Small Business are companies with an annual revenue up to a limit established by law and that have differentiated and favored treatment.

amount of their credits. In the other two classes (secured and unsecured), approval is achieved with the favorable vote of both (i) creditors representing more than half of the credit amounts represented at the meeting ("by amount") and (ii) the majority of creditors present at the meeting ("by head").

To avoid abuse of voting rights, the court may grant the judicial restructuring even when the plan is not approved pursuant to the quorum explained above, if certain vote combinations specified in the BRL are met. This court approval, known as cram down, is exceptional.

The decisions taken by the General Meeting of Creditors bind all creditors, even those who did not attend the meeting or vote against them.

The supremacy of the General Meeting of Creditors is such that it may deliberate the creation and termination of obligations and rights, provided the deliberations are not against the law. The Bankruptcy Courts have the power to control the legality of the deliberations of the General Meeting of Creditors and, if necessary, may annul them.

The doctrine exposes the essentiality of the General Meeting of Creditors: "the General Meeting of Creditors is the collective and deliberative body responsible for the manifestation of the predominant interest among those who hold credits against the debtor company [....]. For this reason, in respect to the interests of the creditors (without whose collaboration the reorganization is frustrated), the law reserves the most important decisions related to the overcoming of the economic activity in crisis."[21]

Also, "in this sense, the General Meeting of Creditors is a novelty in relation to the previous regime, because it brings the creditors to the center of the proceeding; they have been distanced from insolvency proceedings practically throughout the entire 20th century. Thus, just as the debtor can prepare the judicial recovery plan with great freedom, creditors have ample room to deliberate freely on the approval, modification or rejection of the recovery plan."[22]

The Brazilian Superior Court of Justice ("STJ") has ruled that "the judge must exercise control of the legality of the judicial recovery plan - which includes the repudiation of fraud and abuse of rights - but not the control of its economic feasibility"[23].

As a consequence of the supremacy of the General Meeting of Creditors, all business and economic measures to be adopted by the debtor company to solve its debts must be submitted to the General Meeting of Creditors. As an example of those measures, we could mention payments conditions and any difference of treatment between creditors.

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[21] F. COELHO, *Curso de direito comercial: direito de empresa: contratos, falência e recuperação de empresas,* 17th ed. Revista dos Tribunais, São Paulo, *2016. V.3. p. 366-367.* Free Translation.

[22] L. AYOUB, C. CAVALLI, *A Construção Jurisprudencial da Recuperação Judicial de Empresas*, Editora Forense GV-Rio, 2013, pp. 249-250. Free Translation.

[23] Brazilian Superior Court of Justice (STJ), 4th Group., Resp 1.359.311/SP.

C) PRINCIPLE OF THE PRESERVATION OF THE COMPANY

BRL establishes that "the judicial restructuring proceeding aims to provide the means to overcome the economic and financial crisis of the debtor, to allow the maintenance of the productive source, the employment of workers and the interests of creditors, thus promoting the preservation of the company, its social function and the stimulus to the economic activity"[24].

In other words, according to BRL, the main concerns of the judicial restructuring proceedings are: (i) overcome the crisis, (ii) maintenance of the productive source, (iii) employment, (iv) interests of creditors and (v) the preservation of the company.

Although the law mentions several concerns, doctrine and case law have agreed that the most important aspect of the judicial restructuring proceeding is the preservation of the company, having even elevated such aspect to the status of principle.

In this regard: "not by chance the Law establishes an order of priorities in the purpose it aims to pursue, placing as its first objective the 'maintenance of the productive source', which means, to maintain the business activity as fully as possible, making also possible the maintenance of the 'employment of workers'. Maintaining the business activity and the work of the employees, it will then be possible to satisfy the 'interests of the creditors'"[25]

And, "the analysis of the mentioned legal provision (section 47) reveals that judicial restructuring is a proceeding that aims at preserving the economically viable company and fulfilling its social function, stimulating the business activity."[26]

The principle of the preservation of the company has been the foundation of countless judicial decisions[27] and leads to the conclusion that the preservation of the company is the goal of a restructuring proceeding.

§ 3 – CHALLENGES OF PERFORMING MEDIATION WITHIN A JUDICIAL RESTRUCTURING PROCEEDING

After this brief explanation, we point out the main challenges of performing a mediation within a judicial proceeding. For that, it is important to bear in mind that the main aspects of a mediation

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[24] Section 47, BRL. Free translation.

[25] M. BEZERRA FILHO, *Lei de recuperação de empresas e falência: Lei 11.101/2005:comentada artigo por artigo.* 12. ed. Ver., atual. e amlpl. 7. *Ed.rev., atual. e ampl. São Paulo: Revista dos Tribunais, 2017. p.* 159. Free Translation.

[26] M. VALE, C. CHAVES, *A recuperação judicial à luz do novo Código de Processo Civil Brasileiro.* Revista de Direito Empresarial, Curitiba, v. 2, n. 2, p. 80-101.

[27] As example: Brazilian Superior Court of Justice (STJ), AgInt no CC 123834 SP 2012/0161201-1; AgInt no AREsp 1053565 RS 2017/0027691-3; REsp 1399853 SC 2013/0279456-5; REsp 1185567 RS 2010/0046214-9 and AgRg no REsp 1462017 PR 2014/0149202-6.

are: (i) it is voluntary, (ii) the solution is consensual and not imposed to the parties and (iii) the mediator is impartial.

Firstly, in case a mediation with certain creditor reaches a composition on the payments terms, the debtor company must propose those terms to all creditors under the same situation, due to the equal treatment rule. This weakens the voluntary and consensual aspects of a mediation.

Also, any agreement involving business and economic measures must be submitted to the General Meeting of Creditors, due to its supremacy. Thus, no settlement will be fully valid until the approval of the majority of creditors, including those not affected by the mediation[28].

Lastly, as the main goal of the judicial restructuring proceeding is the preservation of the company, the mediator may tend to favour the debtor company instead of being impartial.

Moreover, the restructuring proceeding is by nature a proceeding whereby several different players negotiate aiming to reach a consensual solution that may benefit (or reduce the losses) of the majority of the parties involved. Thus, performing mediation in a judicial reorganization proceeding may end up being an unnecessary overlapping of procedures with similar objectives and different premises.

§ 4 – MEDIATION IN THE RESTRUCTURING PROCEEDING OF OI GROUP

In 2017, a Brazilian debtor - Oi Group - has resorted to mediation within its judicial restructuring[29]. Oi Group is the largest judicial restructuring ever filed in Brazil, with more them 65,000 (sixty-five thousand) creditors and with a debt of over R$ 65 billion (sixty-five billion Reais) – approximately US$ 20 billion[30].

Oi Group had presented different mediations for players in different situations. This study will analyse the mediation proposed to private creditors, which gave rise to the discussions analysed herein.[31]

This mediation would have the purpose to simplify the proceedings at the General Meeting of Creditors by reducing the number of creditors, once the Creditors that settled would not attend to such meeting[32]. According to Oi Group the number

[28] All four classes of creditors (labor, secured, unsecured and Small Business) are called to the General Creditors Meetings that deliberates business and economic measures.

[29] 7th Business Court of Rio de Janeiro, lawsuit under number 0203711-65.2016.8.19.0001.

[30] The second largest judicial restructuring is Sete Brazil, with a debt around R$ 19 billion.

[31] Other very controversial mediation within Oi Group reorganization proceeding was proposed to the Brazilian Telecom Agency ("Anatel") and aims at converting the credit that Anatel holds against Oi Group (around R$ 11 billion) into measures for the improvement of the services provided by Oi Group. The Agency argues that its credit cannot be subject to a private mediation, besides not being subject to the proceeding.

[32] They would be all replaced by a single Trustee, as better explained below.

would reduce over 85%, about 55.000 (fifty-five thousand) creditors.
The mediation aims at creditors with credits lower than R$ 50,000.00 (fifty thousand Reais) – approximately US$ 15,000.00, which represents a large number of creditors[33].
Oi Group requested the Bankruptcy Court to approve the initiation of the mediation. Any creditor that agrees to take part of the mediation would have to accept the following requirements:
– Only creditors of up to R$ 50,000.00 (fifty thousand Reais) – approximately US$ 15,000.00 – would be able to take part in the mediation.
– Prearranged fixed payment terms: 90% of the credit paid on the date of the signing of the agreement and the remaining 10% paid after the approval of the reorganization plan.
– The respective creditor must renounce any challenge related to the amount of its credit.
– The respective creditor has to commit itself to vote in favor of the reorganization plan yet to be presented, by granting a power of attorney to a trustee appointed by the bankruptcy Court;
– The approval of the reorganization plan by the General Meeting of Creditors is a condition to the validity of the agreement.

The Lower Bankruptcy Court accepted the requirements imposed by Oi Group, with one exception. In view of the equal treatment rule, the court ruled that all creditors would be able to be part of the mediation regardless of the amount of its credit, provided that the agreement only regulates the payment of R$ 50,000.00 (fifty thousand Reais) and the remaining amount is paid in accordance to the reorganization plan.
This mediation has faced a considerable amount of challenges[34], due to the legal uncertainty of the requirements imposed by Oi Group and to a resistance to mediation within a judicial reorganization proceeding. We will now analyse the main arguments raised.
Some creditors argue that the so-called mediation proposed by Oi Group is not actually a mediation, but rather a unilateral proposal. The procedure does not have the characteristics of a mediation - voluntary, not imposed to the parties and with an impartial mediator – and is, in fact, a standard form that aims to protect only the interests of Oi Group[35].
In response, Oi Group defends that even if the procedure is not considered as a mediation, it must be used as a method of conflict resolution, that will simplify the restructuring proceeding with the reduction of the number of creditors on benefit of all players involved[36].

[33] Most of them are consumer, not used to complex negotiations.
[34] From several different categories of creditors (financial, suppliers and consumers).
[35] That would count on several creditors voting in favor of the plan (through a Trustee), regardless of the fact that these creditors would not be paid under such a plan.
[36] By simplifying the General Meeting of Creditors and its logistics.

Other arguments against the mediation, is that the creditors will be treated differently, which is only acceptable if (i) it is justified, (ii) it is approved at the General Meeting of Creditors and (iii) does not harm other creditors[37].

This is rebutted on the grounds that there is no difference in treatment, once all creditors have the option to accept the proposal.

Some claim that creditors who accept the proposal will receive around R$ 45,000.00 (forty-five Reais) – 90% of the credit up to the limit of R$ 50,000.00 – at the signing of the agreement (mediation). This is an advance payment, which is against the equal treatment rule.

The counter-argument is that the *par conditio creditorum* does not prevent the advance payment, as long as all creditor have the same conditions.

Also against the proposed mediation, some suggest that the creditors´ commitment to vote in favor of the plan will restrict Oi Group from making its plan attractive to other creditors, once the company will have already assured the favorable vote of the majority of the creditors[38].

As opposition, Oi Group explains that, according to BRL, the plan must be approved by both the majority of creditors and credits[39] and, therefore, the company must propose a plan that pleases higher creditors.

Some also claim that the proposed mediation is indeed a disguised way of buying votes, once the creditor receives an advance payment on the condition of voting in favor of the plan.

In response, Oi Group asserts that any creditor has the authority to vote at its own convenience, and if the advance payment meets its interest, there is no irregularity in that. In addition, Oi Group invokes the principle of the preservation of the company to demonstrate the importance of the mediation in overcoming its crises.

At last, those who are against the mediation explain that in view of the advance payment, the respective credit is extinguished and therefore, the corresponding creditor should not be allowed to vote in the General Meeting of Creditors[40].

In its defense, Oi Group inform that the approval of the reorganization plan by the General Meeting of Creditors is a condition to the validity of the agreement. Thus, the extinguishment of the credit will only occur after the General Meeting of Creditors.

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[37] These criteria could only be present if the mediation takes places after the General Meeting of Creditors, following the agreement of the majority of creditors.

[38] Due to the large number of creditors that would meet the requirements for the mediation (about 55.000 (fifty-five thousand) creditors).

[39] In the secured and unsecured classes.

[40] BRL provides that the creditor will not be entitled to vote if the plan does not change the amount or the payments conditions of its credits. (Section 45, paragraph 3).

For full comprehension, the table below summarizes the main arguments against and pro the mediation proposed by Oi Group:

Against[41]	**Pro**[42]
It is a unilateral proposal (and not a mediation).	There is no irregularity in pursuing an amicable settlement.
The differential treatment must be approved by the General Meeting of Creditors.	There is no difference in treatment, once all creditors have the option to accept the proposal.
The advance payment is against the equal treatment rule.	The *par conditio creditorum* does not prevent the advance payment, as long as all creditor in the sae conditions have the same opportunities.
The creditors' commitment to vote in favor of the plan will restrict Oi Group from making its plan attractive to other creditors[43].	The plan must be approved by both the majority of creditors and credits and, therefore, the company must propose a plan that pleases higher creditors.
Disguised way of buying votes.	Any creditor has the authority to vote at its own convenience. Principle of the Preservation of the Company.
Extinguishment of the credit: no voting rights.	The approval of the reorganization plan by the General Meeting of Creditors is a condition to the validity of the agreement.

After analyzing all challenges, the Bankruptcy Court of Appeals has ruled that the commitment to vote in favor of the plan and the obligation of granting a power of attorney to a trustee cannot be a requirement to the mediation. Other than that, the Court declared that the analysis of the arguments against the mediation will only be possible after the final conclusion of the General Meeting of Creditors.

In other words, the Bankruptcy Court of Appeals has not yet decided on the merits of these challenges, and the outcome is unpredictable.

CONCLUSIONS

Mediation is a method of conflict resolution that aims to get the parties together and amicably to a non-imposed solution. It is encouraged by Brazilian law and should be performed as frequently as possible.

Although the performance of mediation within judicial restructuring proceedings has some limitations, it should also be encouraged, as long as it respects the premises and principles of the BRL[44].

41 Some creditors presented the cons arguments.

42 Oi Group itself presented the pros arguments.

43 And would be against the freedom of voting, once the plan could change after the commitment is signed.

44 Equal treatment rule, supremacy of the General Meeting of Creditors, principle of the preservation of the company, among others.

Incidental matters – not directly related to the business and economic measures to be adopted by the debtor company to solve its debts - may be solved through mediation without much controversy. As examples of these incidental matters, we may mention (i) the amount and class of the credit of a certain creditor and (ii) the maintenance or termination of a business relationship between the debtor company and a supplier. The solution, however, must be ratified by the Bankruptcy Court, who will verify its legality.

Matters directly related to the business and economic measures to be adopted by the debtor company to solve its debts must be subjected to the General Meeting of Creditors. As a result, performing the mediation before the meeting may not be as helpful as desirable, especially because the General Meeting of Creditors is already the opportunity for different players negotiate aiming to reach a consensual solution.

Moreover, after the approval of a restructuring plan by the General Meeting of Creditors, the conflicts may be solved through mediation, as long as the plan approved provides so.

The reorganization proceeding of Oi Group is a leading case on the subject and the outcome is still unpredictable. This case, however, may not even be considered as a mediation and has several particularities. This could strengthen the natural resistance of insolvency practitioners to mediation.