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Judicial restructuring does not proscribe collection against guarantors or co-obligors

Brazil's Superior Court of Justice (STJ) Forth Panel recently upheld that the approval of a financial restructuring plan does not benefit guarantors or co-obligors. Creditors may collect in full from third parties that insured the obligation or from co-obligors.

Pursuant to the judicial restructuring procedure in Brazil, the company undergoing judicial restructuring can renegotiate its debt with creditors by way of a financial restructuring plan. Typically, such plans provide for extension of debt terms and/or partial debt forgiveness. As provided for under the Brazilian Bankruptcy and Reorganization Law (Law n. 11.101, 9 February 2005), once the plan is approved by a certain group of representative creditors it binds all creditors, including those not having agreed with the plan.

From this process, however, a question arises: if the company that is undergoing judicial restructuring is not the sole debtor should the other debtors benefit from the enforcement of the financial restructuring plan?

The query has its origins from interpretation of the language of the Law n. 11.101/05 itself under which approval of the financial restructuring plan results in a "novation."

As defined by the Brazilian Civil Code, novation has the effect of extinguishing the original obligation and thus guarantors and co-obligors are released. This conflicts with the very purpose of Law n. 11.101/05 (as was announced at the time of its enactment, it was drafted with the intention of more efficient credit recuperation towards lowering interest rates).

The STJ answered this doubt deciding that novation in the case of judicial restructuring is to be considered *sui generis* novation having effects separate and distinct from novation as stated under the Brazilian Civil Code.

Thus, the approval of a financial restructuring plan has the effect of novating the obligations to the restructuring company without impairing or releasing the obligations of guarantors or co-obligors, which continue to be liable for the original debt.

Mark Kreidel
mkreidel@levysalomao.com.br

João Pedro Biazi
jbiazi@levysalomao.com.br

São Paulo
Av. Brig. Faria Lima, 2601
12th floor - 01452-924
São Paulo, SP - Brazil
Phone. +55 11 3555 5000

Rio de Janeiro
Praia de Botafogo, 440
15th floor - 22250-908
Rio de Janeiro, RJ - Brazil
Phone. + 55 21 3503 2000

Brasília
SBN Q 1, Bl B, n. 14, Ed. CNC
2th floor - 70714-900
Brasília, DF - Brazil
Phone. + 55 61 2109 6070

contato@levysalomao.com.br