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TITLE: **THE ROLE OF JUDGES ON THE COMMENCEMENT OF REORGANISATION PROCEEDINGS**

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I hereby declare that I have read and understood the regulations governing the submission of Master of Law, LLM dissertations including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations

CHAPTER 1: INTRODUCTION

I. Aim

The aim of this dissertation is to elaborate on the role of judges on the commencement of judicial reorganisation proceedings in Mozambique. Judicial reorganisation proceedings are specialized court proceedings that occur under the presidency of a judge.

Although civil law actions, judicial reorganisation proceedings have its own idiosyncrasies. Therefore, it is regulated in a specialized law: the *Regime Jurídico da Insolvência e da Recuperação de Empresários Comerciais*, RJIREC.

II. Context

In 1990, at the end of the civil war, the Republic of Mozambique adopted a democratic system of government by approving a new Constitution of the Republic (CRM). The rationale for transitioning to democracy was to respond adequately to the challenges of a new business environment and to open the country up to private investment. For this reason, legal reform was undertaken. The *Regime Jurídico da Insolvência e da Recuperação de Empresários Comerciais* (RJIREC) was approved and, consequently, articles 1122 to 1325 of the Code of Civil Procedure[1] (CPC) — which had previously regulated bankruptcy — were revoked.[2]

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[1] Code of Civil Procedure is in Portuguese Código de Processo Civil, CPC.

[2] Due to the principle of separation of power, parliament has legislative authority as provided on article 169, 1 CRM. However, in terms of article 179,3 CRM, the legislature may, by means of law, grant authorization to the executive to legislate on a specific matter.

The *Regime Jurídico da Insolvência e da Recuperação de Empresários Comerciais* (Legal Regime of Insolvency and Business Reorganisation) provides for the scope of insolvency law; the declaration of insolvency and the procedures to be followed in such cases; judicial reorganisation proceedings; out-of-court reorganisation; conversion of reorganisation into bankruptcy; insolvency crimes and respective criminal procedure; and transitional and final provisions.

The new regime of insolvency and business reorganisation in Mozambique is innovative. For the first time in Mozambican law, insolvency regime not only contemplates judicial business reorganisation and (out-of-court business reorganisation)[3] but becomes the primary choice (as opposed to insolvency) for businesses facing financial distress.

The new insolvency regime is informed by the principles of preservation and recoverability of businesses in financial distress. Therefore, only business encountering severe financial distress to

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On the case of the RJIREC, parliament granted the executive authorization to legislate on insolvency and business reorganization. Such authorization was granted by Law nº 9/2013, of 1st March.

[3] Out-of-court business reorganisation, *recuperação extra-judicial*, is an out-of-court scheme regulated under Chapter VI of the new regime. Debtors in financial distress, who fall under the criteria of article 47 of the regime, may propose and negotiate a plan of recuperation directly with their creditors. Such proposal will be processed under the conciliation and mediation act and deposited in court. Hence, debtors eligible for out-of-court schemes of business reorganisation are those who fit the criteria for judicial business reorganisation.

the point where rescue is no longer possible may apply for liquidation,[4] and companies that may be rehabilitated should be granted permission to enter reorganisation proceedings. This is in line with the objective of the regime that is to promote the stimulus and the preservation of the company's economic activity and social functions.[5]

A company in financial distress shall, therefore, either approach its creditors for an out-of-court reorganisation or approach the court for judicial reorganisation proceedings as soon as it learns that the business is facing financial difficulties.[6]

The introduction of judicial and out-of-court reorganisation proceedings represents a paradigm shift from the previous insolvency regime, which was included in the CPC. The previous regime was creditor-orientated since its main objective was to

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[4] Article 102 RJIREC, approved by Decree-Law nº 1/ 2013 (RJIREC) reads: a company facing economic and financial distress and that believes not to meet the requirements to apply for judicial reorganization, shall apply for insolvency stating the reasons that prevent the continuation of its business activities and presenting documental evidence.

[5] Article 1 RJIREC.

[6] Article 1 RJIREC sets out the objectives of the regime and reads: 'the objective of the Legal Regime of Insolvency and Business Reorganization is to make viable the overcoming of the company's, and other entities referred on the next article, inability of fulfilling due obligations, in order to enable the maintenance of the source of production of employment and the interests of creditors, promoting therefore the stimulus and the preservation of its economic activity and social function' (self-translation).

maximise the collection of debts for the benefit of creditors. Nonetheless, the *concordata* (an agreement that the insolvent trader makes with most (or all) of his/her creditors to avoid bankruptcy)[7] and the agreement of creditors[8] were introduced as components of prevention of liquidation of the insolvent company. An approval and ratification of the *concordata* and of the agreement of creditors by the court would prevent the declaration of bankruptcy.

Though under the *concordata* the applicant and his/her creditors would endorse an agreement to rehabilitate the applicant's company, its main objective was to maximise debt collection — to the benefit of the applicant's creditors. Creditors would agree to the *concordata* only if it would be more advantageous for them than the liquidation of the company. The *concordata* however did not achieve its intended results, as the debtor was required to apply for it before he/she entered in default, or up to ten days from the cessation of payments (of his/her debts).[9]

Unlike common civil actions, under the RJIREC, with the admission of the application for judicial reorganisation proceedings (and with judicial declaration of insolvency), all lawsuits for debt collection against the applicant — as well as limitation periods — are suspended[10] and no new actions and executions are admitted. As a

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[7] Articles 1140 to 1152 CPC.

[8] Article 1167, 1 CPC provided that if neither the debtor nor his creditors proposed a *concordata,* or if the *concordata* - proposed either by the debtor or by his creditors - was not approved, creditors in a general assembly could decide to set up a limited company to continue the trading on behalf of the debtor.

[9] Article 140, 1 CPC.

[10] Article 6, 1 RJIREC.

result, creditors' rights (to collect debts or to enforce court decisions on debt collection inter alia) are affected.

Companies that are not insolvent or that are beyond rehabilitation — owing to the severity of their economic and financial difficulties — may apply for reorganisation proceedings to enjoy suspension of actions and executions, as well as suspension of limitation periods, hence abusing court proceedings.

It shall be argued that the role of judges on the commencement of judicial reorganisation proceedings is to guarantee that only those companies that are pre-insolvent and viable are allowed to enter reorganisation proceedings. In doing so, judges will be protecting creditor's rights; preventing abuse of process and preventing that state resources are wasted with lawsuits with no prospect of success.

It shall be also argued that to play their role, judges must dismiss applications for business reorganisation proceedings on the following grounds: lack of *locus standi*, absence of financial distress and impossibility of rehabilitation due to the severity of the financial distress.

It shall be also argued that because there is no specific provision for the preliminary dismissal of the debtor's application to enter reorganisation proceedings, the judges of the new regime must apply the provisions of the CPC that regulate preliminary dismissal because in terms of article 176 RJIREC the CPC is subsidiary law[11]

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[11] Subsidiary law is the law that is used to fill the *lacunae* on the specialized law. It is important to notice that it is the specialized law that regulates the use of subsidiary law on the situations not

to the regime. However, on interpreting and applying article 474 CPC, judges must consider the RJIREC's objectives and main principles which are the principles of preservation and the principle of recoverability, as well as general principles of law[12]. Judges must also take into consideration the idiosyncrasies of judicial reorganisation proceedings.

III. Outline

The arguments shall be developed in three phases.

First, the location of the new regime in the Mozambican legal system — and its relationship with general civil law, such as the Civil Code (CC) and CPC — shall be discussed.

Second, an interpretation of the relevant provisions of the new regime, as well as of the relevant provisions of applicable subsidiary law will be made. Such interpretation will consider general

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regulated thereon. On the absence of an indication of the subsidiary law, the judge must apply article 10 Civil Code (CC) that provides the criteria to be used for legal integration and gap filling.

[12] Article 9 Civil Code (CC) provides for the rules of interpretation of the law and reads as follows:

'1- The interpretation of the law must not be restricted to its letter. It must recreate, from the text of the law, the legislative reasoning considering the unity of the juridical system, the circumstances in which the law was made and the specific conditions of the time in which the law is applied.

2- The interpreter must not consider a legislative reasoning that has no minimal verbal correspondence with the letter of the law.

3- When the interpreter is establishing the mean and the scope of the law, he/she must presume that the legislator entrenched the best solutions and expressed its thinking and reasoning adequately.'

principles of interpretation of law and historical and systematic interpretation.

Third, the commencement of civil actions and its applicability to the commencement of judicial reorganisation proceedings as well as the institutes to which a judge can reach to archive the aims of the RJIREC.[13]

As per case law, owing to the similarities between the RJIREC and Brazilian insolvency law — and the fact that there are insufficient cases and final decisions in Mozambican courts — Brazilian case law will be used. The RJIREC is inspired by the Brazilian *Lei de Falências e Recuperação de Empresas* (Law of Bankruptcy and Business Rescue), Law nº 11.101 of 9 February 2005, and most of the provisions, particularly those related to judicial reorganisation, are identical. Portuguese jurisprudence, where there are similarities in the provisions and the objectives, will also be used, particularly because general law of Mozambique originates from Portuguese law and both jurisdictions share the same general principles and philosophy of law.

[13] The institutes referred to are preliminary dismissal, bad faith litigation and gathering of evidence ex officio.

CHAPTER 2: INSOLVENCY LAW UNDER THE 1961 CPC VS THE RJIREC

I. Introduction

This chapter aims to provide a greater understanding of the evolution of the insolvency law from the regime of the 1961 CPC to the RJIREC; to compare the previous regime and the new regime of insolvency and business reorganisation;[14] and to establish the location of the RJIREC in the Mozambican legal system.

While the previous regime of insolvency was part of the CPC, regulated in Chapter XV with the title *Da Liquidação de Patrimónios* (Liquidation of Assets), hence general law, the new regime of insolvency and business reorganisation (RJIREC) is a specialized law separated from the CPC.

The RJIREC is a specialized law insofar it intends to create an expeditious instrument to regulate a specific part of civil law: the insolvency of the debtor and the rights and obligations of the debtor himself and of his creditors and other interested parties. According to Catarina Serra, insolvency proceeding is a specialized process

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[14] The new regime of business reorganisation and insolvency, approved by the Decree-Law nº 1/2013, replaced Chapter XV of the Portuguese CPC, which was approved by the Decree-Law nº 44 129 of 28 December 1961. The CPC was enacted in the territory of the Colony of Mozambique — with minor adaptations — by the *Portaria* nº19 305 of 30 June 1962. *Portaria* was the regulatory legal instrument produced by one or more ministries. The ministries produced *portarias* by delegation of legislative power from the government. In the case of the colonies, such as Mozambique, the power to produce *portarias* was delegated to the ministry of colonies, *Ministro do Ultramar*.

because it is a process specifically created for the tutelage of the rights of debtors, creditors, and other subjects of the state of insolvency of the debtor. Serra is of the view that the singularity of insolvency proceedings results from the risk of non-realization of the rights of those subjects (debtors, creditors and others) or at least from the risk of limited realization of their rights.[15]

II. Insolvency regime under the CPC of 1961

The 1961 CPC provided a liquidation orientated regime for the benefit of creditors. On the number 28 of the preamble of the Decree-Law that approved the CPC, the legislator states that bankruptcy proceedings aim the liquidation of the debtor's assets for the common benefit of his/her creditors. The legislator also defines bankruptcy proceedings as collective execution that involves the suspension of singular executions.[16]

There were two different terms for insolvency. If insolvency was related to a trader, the term used was *falência,*[17] from the Latin *fallens* (from *fallo*), which means to deceive, to dissimulate, to trick.[18] According to Manuel Requincha Ferreira, the Latin expression *fallens (fallentis)* was used to express the breach of trust materialized by the debtor's non-payment of due debts. *Falência*, therefore, had

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[15] Serra, Catarina, *Lições de Direito da Insolvência*, (2018), Almedina, Coimbra, pg.47.

[16] Issá, Abdul Carimo Mohamed and others, *Código de Processo Civil*, (2010), Unidade Técnica da Reforma Legal, Maputo, pg. 29.

[17] Article 1136 CPC provided for the definition of state of bankruptcy. A trader who was unable to fulfill his obligations was deemed to be in state of bankruptcy.

[18] See Cordeiro, António de Menezes, *Introdução ao Estudo da Insolvência,* In O DIREITO (2005) Ano 137º, III, Almedina, Coimbra.

a negative connotation and was associated with maladministration, dishonesty and fault. If the insolvent was an individual, the term used was *isolvência* (insolvency),[19] which is derived from the Latin word *solver* which means to pay, to release, to untie. According to Manuel Requincha Ferreira, the predominant doctrine of insolvency considers that the original expression for insolvency is *solvendo non esse* (not solvent) which refers to the condition of those who do not pay their debts due to insufficiency of assets.[20]

According to Menezes Cordeiro, *insolvência* is the negation of *solvência* and has two advantages over the term *falência*: semantically *insolvência* is more neutral than *falência* and conceptually *insolvência* encompasses not only the liquidation of the universality of the debtor's assets but also includes the measures that may be adopted to recover his/her business.[21]

Under the regime provided by the CPC, the definition of a state of bankruptcy could be found under article 1135, which reads as follows: 'A trader unable to fulfil his obligations is deemed to be in a state of bankruptcy.'.[22]

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[19] In terms of article 1313, 1, CPC, a non-trader was deemed insolvent if his/her liabilities exceeded his/her assets.

[20] MR Ferreira, 'Estado de Insolvência' in R Pinto, *O Direito da Insolvência, Estudos*, (2011), Coimbra, pg. 113.

[21] See Cordeiro, António de Menezes, op.cit. pg. 466-467.

[22] The definition of obligation is that given on the article 397 CC, which clearly followed the classic theory of obligations, thus, the personalistic theory of Savingy. Obligation is defined as the juridical vinculum trough which one person is attached to the other to a certain performance.

The criterion for bankruptcy assessment was solely a debtor's inability to fulfil his/her due obligations. In terms of the CC, a debtor fulfilled his/her obligations when he/she performed those obligations. The performance and the exercise of the corresponding right had to be done in good faith.[23]

Under the CPC, a single creditor could apply for bankruptcy of his/her debtors.[24] In such a case, all creditors — even those owning credits that were not due — would be notified to claim their credits and be part of the proceedings.[25]

The new regime of insolvency follows the same principle: if one creditor applies for his/her debtor's insolvency, and the application is admitted, each creditor of that debtor will be called to be party of the proceedings.[26] Proceedings can also be initiated and entertained if the debtor has only one creditor because plurality of creditors is not a requirement of the new regime.

Bankruptcy proceedings, under the old regime, could be triggered by the debtor, by any of his/her creditors or by the National

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[23] Articles 762, 1 and 762, 2 CC.

[24] Article 1135 CPC.

[25] Article 1142, 1, b) CPC provides that on receipt of an application for declaration of bankruptcy and within the next forty-eight hours, the judge must designate date, time and venue for the meeting that intend to examine the credits owed by the debtor. Article 1142, 2 provides that the date, time, and venue of the meeting must be published on the local newspaper and by notices displayed on the door of the court and on the door of the debtor's headquarters.

[26] Article 93, 1, d RJIREC read in conjunction with articles 95 and 112, 2 both RJIREC.

Prosecuting Authority.[27] [28] If not triggered by the debtor, the case would not be publicised, as the debtor would still be awaiting citation (by the court of law) of the existence of a bankruptcy application.[29]

The exclusion of publicity was justified on the grounds that the debtor would still be able to suspend or stop the proceedings by paying the credits that initiated the insolvency proceedings, thus avoiding the stigma of maladministration.[30]

Under the new regime, the *MºPº* cannot trigger reorganisation proceedings but instead is summoned to intervene whenever there is a public interest and where the exercise of tutelage is warranted.[31]

To prevent the declaration of bankruptcy (under the old regime), the debtor could approach the court before the effective cessation of the performance of its obligations, or within the next ten days of the debts falling due, and request that the court convoked all the company's creditors.[32] On its petition the company would be obliged to reveal the causes of the bankruptcy; the date on which it ceased to perform its obligations; and to present evidence of all the alleged

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[27] Article 1136 CPC.

[28] The denomination of the National Prosecution Authority of Mozambique is *Ministério Público, MºPº.* In terms of article 236 CRM, the duty of the *MºPº* is to represent the State before the court of law; defend the interests established by law and control the legality and the terms of arrest; prosecute on behalf of the State and guarantee legal representation of minors, absents and incapables.

[29] Article 1138 CPC.

[30] Article 762, 1 CC.

[31] Article 4 RJIREC.

[32] Article 1140, 1 CPC.

facts.[33] Under the new regime, there is no deadline for the company to apply for insolvency or for reorganisation proceedings. However, the company ought to apply to enter proceedings as soon as it notices the presence of financial distress.

Under the RJIREC, when a company is cognisant that its debts are becoming due and cognisant that it will not be able to meet its obligations, it may anticipate its creditors and apply for judicial reorganisation proceedings. This is an extremely significant mechanism for debtors who may believe that the inability to pay their creditors is temporary, and that the business can be reorganised without the pressure of insolvency proceedings and individual executions. With this new mechanism, the company enjoys a moratorium since all lawsuits for debt collections against it will be suspended with the admission of the application by the judge.[34]

There are two substantial differences between the previous and new regime on the moratorium. Under the previous regime, although debtors enjoyed a moratorium, there was no time frame for it, and it would not affect lawsuits for collection of preferential debts that could be delt with by the bankruptcy process.[35] Under the new regime, actions and executions are suspended for 180 days from the date of admission of the reorganisation proceedings by the judge.[36] This deadline cannot be extended. At the end of the deadline, stayed

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[33] Article 1142, 3 CPC.

[34] In terms of article 1142, 3 *in fine*, lawsuits to collect secure credits with preference and that could be attended within the insolvency proceedings were not suspended.

[35] Article 1142, 3 CPC.

[36] Article 6, 1 RJIREC.

actions and executions are automatically reinstated[37] with no need for the judge's intervention or order.[38]

On the CPC regime it was imperative for the company's petition to be accompanied by the following: an inventory and balance sheet of its assets and liabilities; a record of all its creditors, with a clear indication of their addresses, a description of their credits, dates on which the credits became due, liens and collaterals enjoyed by each creditor; a list of all the debt collect lawsuits pending against the company; and the accounting books for the previous three years.[39]

On the CPC regime, the judge to whom the claim was assigned was obliged to issue his/her first decision within the next forty-four hours of receiving the application. On such decision, the judge had to appoint a bankruptcy administrator, as well as one or more creditors, and summon a creditors' meeting (designating the date

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[37] Article 6, 5 RJIREC.

[38] Article 6 RJIREC reads: '1. The declaration of insolvency or the admission of an application for reorganisation proceedings suspends the course of limitation periods and all actions and executions against the debtor…

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5. on reorganization proceedings, the suspension provided on the number one of this article cannot, in any case, exceed hundred and eighty days from the date of the decision that grants the right to enter reorganization proceedings and such deadline cannot be prorogued. At the end of the deadline the right of creditors to initiate or continue their actions and executions against the debtor is reinstated regardless of judicial decision.'.

[39] Article 1141, 2., a) to d) CPC.

and time) within the seventh and the 20th day — counted from the day of the decision — with the aim of verifying all the credits.[40]

Under the new regime, there is no deadline for the issuing of the first decision. Due to the principles of judicial reorganisation, judges must decide as soon as they are satisfied that all formal and material[41] requirements have been met. Judges must decide on a reasonable time frame, considering the complexities and the aims of the proceedings, as well as the undesirable consequences of a delay for good faith third parties.[42] Judges must always obey constitutional principles, such as the right to access a court of law, the right to a fair and adequate process and the right to receive a final decision within a reasonable amount of time.[43]

It is consequential that, under the previous regime, such a brief time frame (48 hours) rendered it impossible to conduct a thorough analysis of the debtor's financial situation. In fact, a thorough analysis was not even expected.

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[40] Article 1142, nº1, a); b) CPC.

[41] Material requirements are those requirements essential to the case. The absence of such requirements imped the continuation of the lawsuit. Formal requirements refer to the form in which the petition must be presented. If the petition present vices in form it can be amended.

[42] See Vaz Serra, Catarina, *O Processo Especial de Revitalização*, (2016), Almedina, Coimbra.

[43] Articles 62, 70 and 212, 1 CRM.

In both regimes the debtor remains in charge of the administration of his/her assets — and the management of his business — with the support and scrutiny of the administrator of insolvency.[44]

The old regime provided for an institute denominated *concordata* and an institute called *acordo de credores* (agreement of creditors).

In order to prevent bankruptcy proceedings (initiated by others), or suspend the effects of an ongoing proceeding, a debtor — not accused, convicted of or sentenced to any crime of fraudulent bankruptcy — could apply for a *concordata*, presenting what he/she considered the base for an agreement between him/her and those creditors who did not enjoy any lien or collaterals (to be part of the *concordata*, creditors were permitted to waive their liens and collaterals partially or totally).[45] Any of the debtor's creditors could suggest alterations to the debtor's proposed *concordata* or propose a *concordata* even if the debtor him/herself did not apply for it.[46]

The *concordata* was subject to the approval of the absolute majority of creditors entitled to vote, and the creditors had to represent at least 75 per cent of the debtor's credit (total amount in debt). The agreement had to be ratified by the judge.[47]

The *concordata* was a moratorium only for the unsecured credits (or for the secured credits whose creditors gave up their rights). The *concordata* used to be perceived as a favour granted to the debtor by his/her unsecured creditors rather than a reorganisation procedure

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[44] Article 1144 CPC and article 51, 1, c) RJIREC.

[45] Article 1147 CPC.

[46] Article 1152, 2 CPC.

[47] The *concordata* was regulated under articles 1140 to1166 CPC (Subsection II of the Chapter XV CPC).

because the objective of the creditors was to reorganise the debtor's business to maximise their own debt collection. Creditors would agree to enter, or would propose a *concordata*, only if it was more advantageous for them than liquidating the business. The creditors' aim was not solely to reorganise the debtor's business for any social reason; continuation of business operations or advantages to other interested parties would yield an unexpected benefit to creditors.

With the *concordata* an element of prevention of insolvency — instead of punishment — was introduced. Although the ultimate objective of creditors was to maximise debt collection, debtors had the benefit of preventing the negative approach of bankruptcy (*falência)* and would be able to save and reorganise their businesses. Communities in which businesses were established would also benefit from the *concordata*, since the agreement would result in the continuation of business operations.

A fascinating feature of the *concordata* was that creditors, even when the debtor had not applied for it, could propose one that could be voted on by all of them. As a result, a debtor could be forced into a *concordata* by the majority of his/her creditors. Moreover, if the concordata was not approved or was not presented, the company's creditors could decide to create a limited company to continue the business.[48] Under the RJIREC, debtors cannot be forced to enter reorganisation proceedings since only the debtor can apply for reorganisation.

[48] Articles 1167 to1173 CPC.

III. Dismissal of bankruptcy application under the CPC

(a) Introduction

The law of insolvency was part of the CPC and was regulated on Chapter XV of the book III (*Livro III*). The Book III of the CPC provides for the procedure to be fallowed on civil actions and executions.

Being part of the CPC, the law of insolvency was general. The first order on receipt of an application for bankruptcy occurred withing the context of the CPC.

In terms of article 474, 477 and 478 CPC, the first order on receipt of an application for a lawsuit may be one of three: citation of the defendant, preliminary dismissal of the application or an order to amendment the application and present absent documents.

(b) Preliminary dismissal of an application for bankruptcy

Any application for a civil lawsuit must be presented with evidence of the right alleged by the plaintiff.[49] Plaintiffs must present documents and a role of witnesses and may request production of other means of evidence.[50] Therefore, the onus to decide which documents to present, i.e., which documents are relevant as evidence of the right that is alleged and of the facts that are stated lies on the plaintiff.

On bankruptcy application, however, the legislator provided for documents that had to be presented with the application. If the plaintiff failed to present the documents provided on article 1141 CPC, article 477 CC would apply, and he would be ordered to present

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[49] Article 467, 1, c) CPC provides that on the petition that initiates the lawsuit, a plaintiff must present facts and reasons in which he/she basis his/her claim.

[50] Article 467, 2 CPC.

the missing documents in reasonable period. Only if the applicant failed to obey such order the application would be dismissed.

An application for bankruptcy would be preliminarily dismissed on the grounds of article 474 CPC read with article 193, 2 CPC, and 1141 CPC.

CHAPTER 3: THE NEW REGIME OF INSOLVENCY AND BUSINESS REORGANISATION (RJIREC)

I. Aims of the RJIREC

With the objective of achieving a more efficient financial system to enhance economic growth, the government of Mozambique has in recent years backed the World Bank and the African Bank of Development in ushering a process of legislative reform. The new regime of insolvency and business reorganisation is part of the legal reform.

Article 1 of the RJIREC provides the aims of the new regime and reads as follows:

> '1. The juridical Regime of Insolvency and Business Reorganisation has the aim of enabling the overcoming of companies', and all those entities referred to on the next article, inability to fulfil due obligations, to allow the maintenance of the source of jobs of their employees and the interest of creditors, thus promoting and preserving its economic activity and social function.
>
> 2. If the impossibility of fulfilling due obligations cannot be overcome, this juridical regime aims for an economic and socially efficient liquidation of the business as well as an efficient distribution of the insolvent's assets amongst his creditors.'

There are some significant takeaways from article 1: the regime safeguards companies that are unable to pay their due obligations; it aims to establish a process and measures that will allow such companies to overcome their inability to meet their due obligations and enabling such companies to continue to be a source of employment and their creditors' interests to be protected. Hence, business reorganisation proceedings allow successfully rehabilitated companies not only to continue its economic activity but also to perform a social function.

If the business is in such a state of financial difficulty that rehabilitation is no longer possible, the RJIREC will promote an economically and socially efficient liquidation and distribution of the company's assets among its creditors.

Accordingly, the chief aim of the RJIREC is to reorganise or rehabilitate businesses facing financial distress — where such action is possible, appropriate, and cost-effective. The RJIREC will provide for the liquidation of those companies where rehabilitation is not viable. In such cases, the regime provides for a process that permits an efficient distribution of the company's assets among its creditors.

Separate provisions of the regime provide for protection of employees' rights: article 1 provides for the maintenance of the business as a source of employment and the preservation of economic activity due to its social function to be major objectives of the regime; the plan of reorganisation may stipulate a deadline no longer than a year for payment of credits arising from labour legislation and workplace accidents due until the date of admission of reorganisation proceedings;[51] the plan cannot stipulate more than 30 days for payment of credits arising from salaries lower than five minimum salaries;[52] although creditors may lodge complaints, apply for recognition, modification and exclusion of credits arising from labour relations on insolvency proceedings, labour lawsuits are processed by the specialised court until such credits are established. Those credits are then enrolled on the schedule of credits for the amount stablished on a final decision of the labour court;[53] and

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[51] Article 53, 1 RJIREC.

[52] Article 53, 2 RJIREC.

[53] Article 6, 3 RJIREC.

besides the principle of sufficiency[54] of insolvency proceedings, jurisdiction to determine the existence and amounts of credits arising from labour relations is subtracted from the court of insolvency and given to the labour court. Those actions are not affected by the moratorium, hence are not suspended (article 6,3).[55]

II. An overview

The RJIREC provides for three different proceedings: judicial business reorganisation[56] and out-of-court reorganisation[57] that intend to prevent insolvency of indebted companies, and insolvency that intends to liquidate companies that cannot be reorganised. This dissertation is focused on the commencement of judicial reorganisation proceedings and the role played by judges thereon.

It is understood that only judges, by acting swiftly, may scrutinise the existence of fraudulent applications for business reorganisation; the appropriateness of the proceedings; the intentional simulation

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[54] Insolvency and reorganisation proceedings are sufficient because it ought to resolve all important questions which resolution is essential to the decision even if the question is not one of Insolvency law field.
See Acórdão nº 2559/16 Tribunal da Relação de Lisboa avaliable in www.dgsi.pt/trt.nsf/33182fc75231603980258e90032a912.

[55] Article 6 JIREC.

[56] Judicial Reorganisation proceedings are regulated on Chapters III and IV, articles 46 to 68 RJIREC. Chapter III has common provisions to judicial reorganisation and insolvency.

[57] Out-of-court business reorganization is an informal scheme regulated on chapter VI RJIREC and processed under the rules for conciliation and mediation provided by the law 11/99 of 8 of July.

of financial distress; or the intention of abusing court proceedings on the commencement of reorganisation proceedings.

Because the new regime does not follow a unitary approach that '…establishes an interim period for review of the business prospects before deciding on whether to liquidate or rehabilitate the business',[58] the petitioner (if the debtor) must - before applying for the proceedings - make the decision on whether to apply for business reorganisation or to apply for insolvency.

Only the debtor[59] can apply for business reorganisation, for he/she is the only person who possesses real information about the state of his/her business.[60]

Creditors may only apply for insolvency of the debtor and, consequently, for the liquidation of the debtor's business.[61] Judges play a very limited role. This, however, does not mean that judges

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[58] Westbrook, Jay Lawrence and others, *A Global View of Business Insolvency Systems*, (2010) the World Bank, Martinus Nijhoff Publishers, Boston. pp. 51. available online in: https://openknowledge.worldbank.org/bitsream/handle/10986/13522/68423.pdf?sequence=1&isAllowed=y.

[59] According to Fábio Ulhoa Coelho, only those companies that face the risk of insolvency may apply for judicial reorganization because reorganization aims to prevent insolvency. (Coelho, Fábio Ulhoa, *Comentário à Lei de Falências e de Recuperação de Empresas,* (2014), Saraiva, São Paulo, pg. 168.

[60] Article 47, 1 RJIREC provides for the criteria for an application for judicial reorganization. In terms of this provision, only debtors may apply for reorganization proceedings.

[61] Article 93 RJIREC.

do not intervene to prevent malicious proceedings or to stop proceedings with no prospect of success, as will be discussed later.

Mozambican judicial reorganisation similarly to the Brazilian reorganisation proceedings is,

> 'under the presidency of a judge who resolves all conflicts between the parties, calls general creditors' meetings, confirms (or does not confirm) the plan and, should it be the case, converts the reorganisation into liquidation.'[62]

and most importantly, decides which applications to admit and which to dismiss.

The RJIREC is applicable to juridical persons, such as companies, associations, foundations, and cooperatives and to natural persons. State-owned companies, banks, finance companies and other regulated businesses are expressly excluded from the scope of the regime.

The new regime is a network of juridical norms. It contains both substantive and adjectival law. Besides civil law, commercial law, economic law, company law and criminal law (substantive law), the new regime also contains civil procedural law and criminal procedural law (adjectival law).[63]

By its very nature, the new regime of insolvency and business reorganisation is part of civil law. Concepts, principles, and

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[62] Faber, Dennis, Vermunt, Niels, Kilborn, Jason and Richter, Tomás, *Commencement of Insolvency Proceedings*, (2012) Oxford Press, Oxford, 84.

[63] Leitão, Luís Manuel Teles de Menezes, *Direito da Insolvência,* (2015) Almedina, Coimbra, pp.15-21.

provisions of civil law apply to the regime. The CPC is subsidiary law, hence applicable in situations not provided for by the regime to the extent that it provisions are not in conflict with the new regime.[64] Accordingly, the new regime is a specific and purpose-built type of law, specialized law, and the principle of *Lex specialis derogat legi generali* applies.

III. Judicial business reorganisation proceedings

Judicial reorganisation proceedings are regulated in Chapter II, articles 5 to 45[65] and in the chapter III, Section I, articles 46 to 68 RJIREC. It is a mechanism to prevent insolvency of companies that are facing financial distress. Because it is a preventive measure to avoid insolvency, the application for judicial business reorganisation must be presented while the debtor's business, although facing financial distress, is salvageable.

Judicial reorganisation under the RJIREC contrasts with most of the European reorganisation proceedings insofar it is not a hybrid proceeding. Companies that apply for judicial reorganisation proceedings have no legal obligation to negotiate with its creditors before submitting their application to the court of law. In fact, the law contemplates a different institute where debtors approach their creditors to propose and approve a plan of reorganisation without the intervention of the court of law.

According to M. Bacharova:

> '... the new approach in the European countries includes improvement of the statutory regulations by implementing

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[64] Article 176.

[65] Chapter II contains common regulations to insolvency and judicial reorganization.

mechanisms for early prevention of insolvency at a stage preceding the formal litigation proceedings.'[66]

Similarly, Catarina Serra defends the view that most European countries are adopting hybrid proceedings with the intention to reduce the resistance of creditors to reaching consensus and to reduce the costs of judicial insolvency proceedings.[67] Such proceedings encompass two phases. The first phase is informal and involves negotiations to an agreement without the intervention of the court. The second phase consists of a formal proceeding where the court ratifies the agreement reached out of court.[68]

The Portuguese *Processo Especial de Revitalização* (Special Revitalisation Process) that regulates business reorganisation is hybrid to the extent that it is mandatory for debtors to negotiate an

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[66] Bacharova, N, (2017), *Contemporary Tendencies in the Evolution of Insolvency Law*, ISJ Theorical & Applied Science, 01(45), pp. 67-71, available online http://s-o-i.org/1.1/TAS-01-45-12.

[67] Serra, Catarina, *O Processo Especial de Revitalização na Jurisprudência*, (2016), Almedina, Coimbra, pg.13.

[68] Serra, Catarina, op. cit.

agreement with their creditors before applying for judicial proceedings.[69] [70]

Although Mozambique follows a Portuguese tradition in most of the statutes approved under the legislative reform, the RJIREC follows a Brazilian tradition. Companies are not obliged to negotiate and agree to a plan of reorganisation with their creditors before approaching the court. Negotiations between the indebted company and its creditors occur within the judicial proceeding and is supervised by the court that has the power of ratifying (or not) the agreement therein reached.[71]

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[69] Fátima Reis Silva defends the view that Portuguese rehabilitation proceedings are hybrid processes because it is a process that starts out of court and requires intervention of courts of law in three moments. She states that Portuguese reorganization proceedings allow two modalities: a debtor may approach the court to initiate negotiations with his/her creditors (articles 17.º -A to 17.º -G Lei nº 16/2012, de 20 de Abril), or may negotiate an agreement with no intervention of the court and apply for ratification (article 17.º I, Lei nº 16/2012, de 20 de Abril).

[70] See Silva, Fátima Reis, *Processo Especial de Revitalização – Notas práticas e jurisprudência*, (2006), Porto Editora, Porto.

[71] Article 52, 1 RJIREC provides that the plan of reorganisation is presented to the court within nighty days from day in which the application for reorganization was admitted. From this provisions two things result: first, the company presents the plan of reorganisation to the court (not to its creditors); second, the plan of reorganization is presented after the application for reorganization is approved, hence, actions and executions are suspended.

Judicial reorganisation proceedings are applicable if the company is not insolvent but is in such financial distress that — without an intervention through reorganisation proceedings — payment of matured debts would be impossible. The company will thus be in a state of pre-insolvency which is defined by Catarina Serra as:

> 'The generic name given to the situations that precede insolvency and that are presumable not as serious and severe as the insolvency. Therefore, as a matter of principle, insolvency proceedings, with all juridical effects that are attached to it, are not justifiable nor required.'[72]

Fábio Ulhoa Coelho is also of the view that only pre-insolvent companies can enjoy reorganisation proceedings:

> '…debtors must present the causes of their state of pre-insolvency, that is, the reasons that led to its economic and financial difficulties.'[73]

José M. G. Machado states that situation of eminent insolvency originates from the German concept "*Dro-hende Zahlungsunfahigkeit*", introduced to the German insolvency law with the aim of anticipating company's ability to apply for the declaration of insolvency. He also states that practical interest of the eminent insolvency (and pre-insolvency) is fundamentally to verify active

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[72] Serra, Catarina, *Lições de Direito da Insolvência*, (2018), Almedina, Coimbra. pg. 309.

[73] Coelho, Fábio Ulhoa, *Comentários á Lei das Falências e de Recuperação de Empresas*, (2014), Saraiva, São Paulo, pg. 205.

legitimacy and the compliancy with the duty to present the application for insolvency proceedings in good time.[74]

Accordingly, a state of pre-insolvency has juridical relevance and differs from a state of insolvency, where rehabilitation of an embattled company is no longer possible.

To ascertain the state of pre-insolvency, an accurate analysis of the company and business economic and financial status[75] is required. This is stipulated by article 46 RJIREC, which provides for the aim of judicial reorganisation — that is, to make viable the overcoming of the debtor's impossibility of paying his/her matured debts. If the business is already insolvent, and reorganisation is not viable, the appropriate measure and procedure is insolvency, which will lead to the liquidation of the company's assets.

For these reasons, the deduction is that a company can enjoy reorganisation proceedings if it finds itself in a situation where it is not paying its due debts. Moreover, the company is not fulfilling its obligations because it does not want to but because it is unable to do so. However, by undertaking certain measures (provided under article 49), and receiving assistance and collaboration from its creditors, the company may overcome its economic and financial difficulties. Thus, the company is not in a state of proper insolvency

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[74] Machado, José Manuel Gonçalves, *O Dever de Renegociar no Ãmbito Pré-Insolvencial, Estudo Comparativo sobre os Principais Mecanismos de Recuperação de Empresas*, (2017), Almedina, Coimbra, pg. 128.

[75] Lucas, Fernando Pompeu, Asp*ectos Gerais e Princípios*, in Carnio Costa, Daniel, *Comentários Completos à Lei da Recuperação de Empresas e falências, Volume II* – Recuperação Judicial e Extra-judicial, (2015) Juruá Editora, Curitiba.

but in a state of pre-insolvency; that is, the company's impossibility of paying due debts is obvious but still preventable.

While the Portuguese legislator included a definition of 'difficult economic situation' (*situação económica difícel*),[76] Brazilian and Mozambican legislators opted for a different approach.

Article 47 of the Brazilian law provides for the aim of judicial reorganisation and refers to economic and financial distress or difficulties. It reads as follows:

'Judicial reorganisation aims to enable the overcoming of the situation of economic and financial distress of the debtor, so that the source of production and employment can be maintained, and creditors' interests can be protected, thus promoting preservation of the company and stimulating its social function and economic activity'.

Although the Mozambican RJIREC is almost a duplicate of the Brazilian law, its article 46 RJIREC, which states the aim of a judicial reorganisation proceeding, does not mention financial and economic difficulties. It refers to the impossibility of meeting due obligations. It reads: 'Judicial reorganisation aims to enable the overcoming of the debtor's impossibility to fulfil due obligations.'

The impossibility to fulfil due obligations relevant for reorganisation proceedings is associated with the risk that failure to intervene early leads to the insolvency of the company. Article 50, a) RJIREC, in substantiation of this, reads as follows:

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[76] Article 17ºB CIRE reads: For purpose of this code, a company is in difficult economic situation if it faces serious difficulties to fulfill its obligations punctually because it does not have liquidity or cannot obtain credit.

'The petition to enter reorganisation proceedings must be presented with a thorough description of the specific causes of the applicant's assets position and of the specific reasons of his economic and financial distress'.

Therefore, the concept of pre-insolvency must be deduced from the fact that although the company is facing financial difficulties, hence it is not meeting its due obligations, there is a fundamental difference between the stage where liquidation is the only possible and applicable solution and the stage where the business is still salvageable, and insolvency can (and must) be prevented. Determining if the business is salvageable is a critical task in deciding whether reorganisation proceedings are appropriate or not. The onus of ensuring the correct interpretation of the degree of financial difficulty is primarily on the company because it must present a thorough description of its financial difficulties and the causes of such distress.

Insolvency proceedings and reorganisation proceedings are mutually exclusive. Thus, a company that finds itself in economic and financial distress should choose which procedure to apply for. Owing to the principles of supremacy of reorganisation and recoverability, it is up to the company wishing to apply for insolvency proceedings to recognise that it is facing financial distress and to prove (by presenting substantial evidence) that, due to the said distress, the business is no longer salvageable. The burden of proof lies with the debtor, who must either present evidence that the business is salvageable —– and therefore eligible for reorganisation proceedings — or show evidence that there are no measures that, with reasonable sacrifice by creditors and other affected parties, could effectively lead to the reorganisation the business, thus eligible for insolvency and liquidation.

However, no sanction is provided for companies that do not comply with the determination of applying for reorganisation as soon as it

is aware of the financial difficulties or do not use the recourse in good time which one can only attribute to the fact that it is given the faculty of applying directly to liquidation.

Companies are expected to act in good faith and to refrain from applying fraudulent business reorganisation proceedings as well as from applying for reorganisation when the proceedings are not appropriate.[77]

IV. Characteristics of judicial reorganisation proceedings

Article 9 of the CC provides that the interpretation of the law must consider the letter of the law and must recreate - from the text of the law - the legislator thinking, the unity of the legal system and the circumstances in which the law was made as well as the specific circumstances of the time in which the law is applied.

Since the RJIREC does not provide for preliminary dismissal of an application for business reorganisation, the provisions of the CPC that regulate preliminary dismissal of a civil law application apply. This results from article 176 RJIRC that provides that the CPC is subsidiary law to the regime. On applying the subsidiary law, judges must take in consideration the idiosyncrasies and the aim of the RJIRC.

To interpret and apply the general law to applications for judicial reorganisation, a judge must have profound knowledge of the

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[77] Article 264 CPC provides that parties to a civil action have the duty of, in conscience, not to present illegal claims; not to present facts that are contrary to the truth and not to request dilatory proceedings. This is a general principle that applies to the law of insolvency as the CPC is subsidiary law in terms of article 176 of the RJIREC.

characteristics and idiosyncrasies of the RJIREC specifically of the judicial reorganisation proceedings. That knowledge will allow him/her to ascertain the thinking of the legislator and adapt the applicable general (subsidiary) law to the specific circumstances as ordered by article 9 CC.

The new regime of insolvency, to the extent that reorganisation proceedings are concerned, has the following characteristics: speciality; voluntariness; consensus; transparency; due process; stability; supremacy of reorganisation; universalism; speed and debtor's initiative.

(a) Speciality

Article 460 CPC reads:

> '1. Civil process can be common or specialized.
>
> 2. Specialized process applies to the cases specifically designated by the law; common process applies to all the cases to which a specialized process is not designated.'

The RJIREC regulates only matters related to insolvency (which includes reorganisation) of companies in financial difficulties. It is part of civil law that regulates a narrow scope of matters of the same nature — that is, civil law — in so far as these norms differ from the CC and the CPC.

As insolvency law is a specialized branch of law the *Lex specialis* principle applies in the case of conflict or concurrence of general law (the CPC) and specialized law (the RJIREC).[78] In terms of article 176

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[78] On the *Lex specialis* principle see Zorzetto, Silvia, *The Lex Specialis Pricnciple and Its uses in Legal Argumentation. An Analytical Inquire,*

RJIREC, the CPC is the subsidiary law — that is, it shall apply to every situation not specifically regulated by the regime to the extent that the particular provision does not conflict with and is not contrary to the regime.[79]

Judicial reorganisation proceedings are also special insofar there is no defendant *strictu sensu*. The application for judicial reorganisation is not presented against a specific defendant. In fact, it is not presented against anybody.

(b) Voluntariness

Judicial reorganisation is a voluntary proceeding that can only be triggered by the debtor. Debtors cannot be forced to enter reorganisation proceedings.[80]

On the other hand, creditors must voluntarily agree to the reorganisation of their debtor's company by approving (proposing amendments if needs be) the plan of rehabilitation or by not impugning it. Approval of the plan by the majority of a debtor's creditors is a *conditio sine qua non* for judicial reorganisation

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in EURONOMIA, Revista en Cultura de la Legalidad, nº3, (September2012-Feb2013) pp 61-87. Availiable in: http://ojs2017.uc3m.es/index.php/EUNOM/article/view/2093.

[79] That the provision of general law shall not contradict the specialized law refers not only to the letter of the law, but also to the spirit of the specialized law seen as a coherent system of norms. The application of the general law shall not bring disruption to the principles and to the systematization of the specialized law.

[80] Article 47 RJIREC red in conjunction with article 93 RJIREC.

proceedings.[81] Approval guarantees the involvement of creditors of all classes and increases the likelihood of successful proceedings.

(c) Consensus

The plan of rehabilitation is approved and modified by the majority of creditors of all classes voting on the manner provided by the regime.[82]

However, no alteration can be made to the plan without the debtor's explicit consent. There is a need for consensus not only among creditors but also between a debtor and his/her creditors.

(d) Transparency

Information regarding the company's financial situation or status; documents related to its business; its balance sheet; accounting records; and all documental evidence appended to the petition must circulate. In addition, access to such information must be granted to any of its creditors at any time during the proceedings.[83]

All relevant information must be supplied to intervenors and be made available by means of publication and deposition in court (where any interested party will be able to consult at any time).[84] The onus to keep interested parties informed lies chiefly with the debtor.

Orders that appoint the administrator and the list of creditors must be publicised.[85]

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[81] Article 56, 1 RJIREC.

[82] Article 56 RJIREC read with article 44 RJIREC.

[83]Article 7, 2 RJIREC.

[84] Article 7; 35, 1, c); 52, 2; 51,1 and 52, 2 RJIREC.

[85] Article 7,3 RJIREC.

Convocation of the Assembly of Creditors must be publicised in the official gazette and in the local newspaper.[86]

The court must publicise a note informing creditors of the reception of the plan of insolvency so that they may learn and exercise their right of impugnment.[87]

(e) Due process

Citizens have the constitutional right to approach courts about acts which violate their rights and interests — that is, rights and interests recognised by the Constitution and by law.[88] Furthermore, judges are independent, immovable, and irresponsible when adjudicating.[89] This assures due process and fairness of all court proceedings.

Due process also signifies *adequate* process, for proceedings must guarantee a fair and effective decision within a reasonable period. Reasonable time must be understood as the necessary time to make the decision considering the complexities of the elements and the idiosyncrasies of the proceedings before the judge.

In the RJIREC, due process and fair defence manifests, among other things, as follows:

> any creditor may impugn the list of creditors or present any complaint;[90]

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[86] Article 35 RJIREC.

[87] Article 52, 2 RJIREC.

[88] Article 70 CRM.

[89] Article 217 CRM.

[90] Article 8 RJIREC.

creditors may oppose the plan of reorganisation, apply for its non-ratification by the judge and appeal the decision that ratifies it;[91]

creditors may appeal from the decision that homologates the role of credits;[92]

creditors may be part of the committee of creditors and enjoy the right of voting on the composition of said committee;[93]

creditors are part of the Assembly of Creditors, which possesses the important functions provided by the article 3; and

the plan of reorganisation must be approved by all classes of creditors, as provided under article 44.

(f) Stability

For the company to concentrate on the recuperation of its business, the optimal environment must be created (by the State). There are limitations on the creditors' rights — by means of the suspension of all actions, executions, and limitation periods (positive prescription) — which occur alongside the decision that admits reorganisation proceedings or declares the insolvency of the debtor.[94]

As all actions and executions are suspended, debtors can concentrate on taking measures to salvage their business instead of delaying the process by responding to various individual executions filled by their different creditors.

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[91] Article 54, 1 and article 55, 4 RJIREC.

[92] Article 17 RJIREC.

[93] Article 26 RJIREC.

[94] Article 6 RJIREC.

Contrastingly, creditors understand that the period of suspension of their actions and executions is limited and cannot be prorogued, which brings certainty to the proceedings.[95]

While the moratorium is in place, new actions and executions to collect debts from the debtor cannot be admitted.

Debtors must present their plan of reorganisation to the court within 90 days from the date of which the decision to admit reorganisation proceedings is made public.[96] If the debtor fails to do so, the judge issues, by virtue of his/her office, an order declaring the extinction of proceedings.[97] The natural consequence of such an order is the revocation of all acts taken by the judge under article 51, 1, a) to c), as stated under article 52, 3. Hence, the moratorium will be revoked.

An additional element of stability is that judges must reject, by virtue of their office, any plan that is manifestly in opposition to imperative norms, juridical orders or any other violation that cannot be ignored.[98]

Once a debtor's request for entering reorganisation proceedings is admitted by the judge, the debtor cannot withdraw the request without the approval of the General Assembly of Creditors.[99]

(g) Supremacy of reorganisation

Supremacy of reorganisation over liquidation means that all business that can be reorganised *should* be reorganised, and that

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[95] Article 6, 5 RJIREC.

[96] Article 52, 1 RJIREC.

[97] Article 52, 3 RJIREC.

[98] Article 156, 1 CPC.

[99] Article 51, 4 RJIREC.

only those businesses able to be reorganised are subject to the proceedings.

Reorganisation proceedings are the precept. A debtor can only apply for liquidation proceedings if reorganisation is impossible or not cost-effective and would thus impose unnecessary sacrifices on the involved parties. A debtor who applies for insolvency must present evidence of his/her business is not being salvageable.[100] [101]

If a creditor applies for insolvency of his/her debtor, the indebted company may oppose his/her application by applying for reorganisation and proving that, although facing financial distress, its business is salvageable hence, not insolvent.[102] In that case, the company must present evidence that the business meets all requirements for judicial reorganisation.

If a company applies to enter reorganisation proceedings, it must supply evidence that the business is salvageable. Creditors may propose amendments or reject the plan. The consequence of the rejection of the plan by the assembly of creditors is the immediate declaration of insolvency by the judge.[103]

Supremacy of reorganisation is intrinsically connected with the principle of salvageability of the indebted companies.

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[100] Article 102 RJIREC.

[101] Article 102 RJIREC states that a debtor who faces financial difficulties and who does not think that he/she qualifies to apply for judicial reorganisation must apply for liquidation presenting the reasons for the impossibility of continuing doing business.

[102] Article 91 RJIREC.

[103] Article 55, 5 RJIREC.

(h) Universalism

Reorganisation is a universal proceeding that presupposes involvement of all creditors of all classes.[104] Creditors, in a general meeting, must approve the plan of reorganisation.[105] Although a court may concede the right to enter reorganisation proceedings after a rejection of a plan of reorganisation by the Assembly of Creditors, it is not at the court's discretion but rather the pronouncement of the law. Article 56, 2 RJIREC provides for the requirements for the approval of plan (by the court) of a plan rejected by the majority of the company´s creditors. All the following requirements must be fulfilled:

a) in a general meeting of creditors, the plan must receive a favorable vote by more than half of all creditors present at the meeting, regardless of the classes which they belong to;
b) an approval by two classes of creditors, in the terms provided by article 44, and if there are only two classes of creditors, the approval of at least one of them; and
c) from the class that rejected the plan, there must be a favorable vote by more than one-third of creditors computed as prescribed by nº 2 article 44, nº 2 and 3.

Approval of the plan of reorganisation on the grounds set on article 56, 2, can only occur if the plan of reorganisation does not imply differential treatment among creditors belonging to the class that rejected it.

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[104] Even if a company has a single creditor, reorganization proceedings still being universal because that single creditor is the universality of the companies' creditors. Plurality of creditors is not a requirement to enter judicial reorganization.

[105] Article 44 RJIREC.

Article 56, 2 RJIREC intends to limit the power of creditors to block reorganisation proceedings either for the sake of blocking or to defend personal interests over interests of the collectivity (of creditors and others who may be affected by the insolvency of the company). The above mechanism still constitutes a universal mechanism, for the cumulative requirements provide for a wide range of creditors from different classes to vote for the reorganisation of the company.

Efficiency of reorganisation proceedings is better when a significant number of relevant and interested subjects are involved, since those not involved in the process of negotiating the plan are equally affected by it.

(i) Speed

Insolvency and reorganisation proceedings in all forms are urgent. One can read on the preamble of the law that, because of the need for speed, the new regime is autonomous from the CPC.

As mentioned above, when a legislator uses 'speed of process' as justification for the new regime to include provisions of different branches of law, it invites the question of whether speed is an objective of the new regime.

In discussing speed of the Portuguese Special Revitalisation Process,[106] which deals with the reorganisation of businesses facing

[106] In Portuguese jurisdiction, reorganisation of business in financial difficulties is regulated under a special procedure which is freely translated as specialized process for business rehabilitation.

eminent insolvency, Serra[107] defends that speed is not an objective of the law but merely a form of the process.[108]

Like Mozambican proceedings, Portuguese proceedings are urgent and time limits are shorter than those provided by the Code of Civil Proceedings. To Serra, by not being an aim, speed should yield to other values of the proceedings and their aims. Speed must concede to modifications because of the objectives of the proceedings.[109]

Serra also defends the view that speed is not the only form but *one* of the possible forms of the rhythm and pace of the proceedings, because while there are phases in which speed is justifiable, there are phases in which speed is not desirable. In such phases what is desirable is a slower pace. A slower pace will assure a fair process which will guarantee the effective judicial protection of constitutional rights, such as the right to free and total access to law and justice and the right to free access to a court of law.[110]

The principle of due process is a fundamental principle of the civil law. Hence, all parties must be afforded the opportunity to present their views, arguments, and evidence to support their claims. Creditors — those who applied for insolvency as well as those who

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[107] See Serra, Catarina, *O Processo Especial de Revitalização na Jurisprudência*, (2016), Almedina, Coimbra, pg. 31.

[108] Form seen as a particular way in which the proceedings take course. This way is different from the normal course of civil proceedings insofar deadlines are shorter and more flexible than those of the common civil action and the proceeding as a whole is supposed to take less time to be concluded.

[109] Serra, Catarina, *Lições de Direito da Insolvência*, (2018), Almedina, Coimbra, pg. 336.

[110] Serra, Catarina, op. cit., pp 16-17.

did not — indeed have the right to participate in the proceedings.[111] During the phase where creditors are called upon to claim their credits, speed must yield to the principle of due process.

Owing to the principle of speed, court rulings throughout the process must be issued in good time to avoid or diminish economic and social damages to creditors and other interested parties.[112] According to Daniel Carnio Costa, judicial reorganisation requires an extreme agility from courts so that all processual steps occur within a reasonable period, making possible an effective economic recovery of the debtor's business.[113]

Summing up, while for insolvency proceedings to be efficient and to achieve their aim(s) it must be more expeditious than ordinary civil proceedings, speed itself is not an aim of insolvency proceedings; it is one of the possible forms of the proceedings that, in some stages, must relinquish to a slower pace. The fact that insolvency

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[111] Article 3 CC states that courts of law cannot make decisions without an application from a party and without calling the other party to oppose the demand. This is a corollary of the principle of private autonomy, the constitutional principle of equality and the adversarial principle.

[112] Article 2, 1 CC provides that juridical protection of parties trough the court of law implies that such parties have the right to obtain a final decision or to see a judicial decision enforced (res judicata) in a reasonable amount of time.

[113] See DC, Costa, 'O Novo Método da Gestão Democrática de Processo de Insolvência', in Cezeratti, Sheila C. Neder and Maffioletti, Emanuelle Urbano, D*ez anos da Lei nº 11.1.1/2005 - Estudos Sobre a Lei de recuperação e Falências*, (2015) Almedina Brasil, São Paulo.

proceedings must be swift does not apply to a case that would sacrifice other values and principles of law. Specifically, speed cannot be achieved at the cost of the fundamental rights of those involved.

Speed in the new regime contains, among other things, the following manifestations:

the administrator of insolvency must be appointed in a short period — that is, when the judge in charge of the proceedings issues his/her first decision; [114]

a specific time limit is not given but, owing to the principle of speed in insolvency proceedings, reorganisation proceedings precede all other actions and executions[115] (excluding proceedings for provisional measures, due to their nature. Those proceedings are used to prevent violation of rights recognised and protected by law.[116]) Therefore, judges must issue the first decision as soon as

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[114] Article 51 RJIREC.

[115] The fact that jurisdiction to insolvency proceedings is given to the commercial court means that those proceedings concur with all commercial proceedings, specifically interim proceedings.

[116] See articles 381°/A and 381°/B CPC: proceedings for provisional measures can be brought before or during the lawsuit and are considered urgent. They precede all non-urgent claims. Judges must issue a decision within thirty days. Because they intend to prevent violation of recognized rights, judges can adjudicate on it, before hearing the other party.

they are satisfied that the requirements of article 50 have been met;[117]

the deadline to claim credits is shorter than those provided by the CPC. Creditors must present their claims within 10 days from the publication of the role of the creditors and credits by the administrator of insolvency;[118]

the deadline for the impugnment of credits is 10 days;[119]

creditors whose credits have been subject to impugnment can respond within five days from the day that they receive such notification;[120]

the applicant has five days to respond to the impugnment, [121], and the administrator of insolvency has five days to produce an opinion on the application;[122]

there is no specific time limit for the issuing of a judicial decision on the request to impugn the role of credits but,[123] as per the nature of the proceeding, a decision must be made as swiftly as possible to guarantee effective judicial protection of the business; and

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[117] The principle of adequate process that guarantees the right to access a court of law for protection of juridically recognized rights and to obtain a res judicata decision in good time applies.

[118] Article 7, nº 2 RJIREC.

[119] Article 8, 1 RJIREC.

[120] Article 11 RJIREC.

[121] Article 12, 1 RJIREC.

[122] Article12, 2 RJIREC.

[123] Article 15 RJIREC.

impugnments of the role of creditors are processed separately, although appended to the process of reorganisation. [124]

There are fewer instances of appeal than the standard instances provided by the CPC, and appeals do not have suspensive effects.[125]

Although at present the number of insolvency proceedings remains extremely low, speed may be undermined in the future, as jurisdiction for insolvency matters has been transferred to commercial courts. Speed would be better achieved if special courts were created to deal specifically and solely with insolvency matters. Judges of commercial courts all have other commercial matters and disputes to adjudicate**.**

(j) Debtor's Initiative

Business reorganisation proceedings can only be triggered by the debtors who find themselves in financial distress and who believe that their business is salvageable. Creditors, workers, and other interested parties cannot apply for reorganisation of their debtor's business, nor they can present a plan of reorganisation to the court.

Article 47 RJIREC provides for the requirement to apply for judicial reorganisation and stated that only debtors who have been conducting business regularly for more that twelve months prior to the application and cumulatively meet the requirements set on 47, 1 a) to c) can apply for judicial reorganisation.

It is worth to note that article 47, 2 RJIREC allows that surviving spouses, heirs, and administrators of the estate of debtors apply for

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[124] Article 8, 2 RJIREC.

[125] Article 17 RJIREC.

the company's reorganisation which does not change the fact that the initiative belongs to the debtor.

VI. Conclusion

Although the RJIREC is part of the civil law, it specifically regulates insolvency.

Judicial reorganisation proceeding is one of the proceedings regulated by the RJIREC. It is a specialized process that applies specifically to the situation of pre-insolvency. Not all companies facing financial distress can enjoy judicial reorganisation proceedings. Only companies that are salvageable can enjoy reorganisation proceedings.

The principles of reorganisation proceedings - specifically the principle of salvageability and the principle of supremacy of reorganisation- as well as its characteristics inform the interpretation and the application the RJIREC as well as the interpretation of the relevant provisions of the CPC on the commencement of reorganisation proceedings.

CHAPTER 4: COMMENCEMENT OF CIVIL LAW ACTIONS

I. Introduction

Judicial Business reorganisation proceedings are civil actions. Although judicial reorganisation is a specialized action, it shares the philosophy and principles of common civil actions. Pursuant to article 176 RJIREC, the CPC is subsidiary law to the RJIREC that apply to all unregulated matters to the extent that such provisions are not contrary to and do not conflict with the RJIREC. Therefore, it is critical to understand how a civil action commences and what the formal requirements of the petition are in order to discuss the commencement of reorganisation proceedings,

II. Commencement of civil law actions

A civil law action commences with the plaintiff, represented by a lawyer, presenting a petition where essential facts and reasons in law that serve as the foundation for the action are presented. Such a petition must fulfil formal requirements provided under article 467, 1 CPC.

On the petition, plaintiffs must indicate the court seized; identify parties to the action by indicating their names and addresses;[126] indicate the form of process;[127] state the facts and legal reasons on which the action is based; [128]formulate a claim and ask for a specific remedy or release;[129] and declare a value for the claim.[130]

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[126] Article 467,1, a) CPC.

[127] Article 467,1, b) CPC.

[128] Article 467,1, c) CPC.

[129] Article 467, 1, d) CPC.

[130] Article 467,1, e) CPC.

A plaintiff can present alternative claims if the rights in question are alternative or can be granted alternatively;[131] he/she can also present subsidiary claims[132] or multiple claims.[133] [134] On the petition the plaintiff must present documents, indicate witnesses who may have any relevant knowledge about the facts being presented and request that other means of evidence be produced.[135] All documents are appended to the petition and form a file that is called *processo* ('under civil process'). The judge to whom the case is assigned will examine both the petition and appended documentation and issue his/her first decision.

III. First decision on a civil action

Upon receipt of the plaintiff's application, the judge examines the petition and appended documents and decides either for the admission thereof;[136] for preliminary dismissal [137]or, if the petition has deficiencies that could compromise the progress of the cause provided that such deficiencies are remediable, for the invitation of the plaintiff to amend the petition in a reasonable time.[138]

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[131] Article 468, 1 CPC.

[132] Under article 469, 1 CPC subsidiary claim is a claim presented to the court to be resolved only if a claim previously presented is not granted.

[133] Article 470, 1 CPC.

[134] Article 470, 1 CPC reads: 'A plaintiff can present multiple claims against the same defendant in the same action if the claims are not incompatible'.

[135] Article 467, 2 CPC.

[136] Article 478, 1 CPC.

[137] Article 474 CPC.

[138] Article 477, 1 CPC.

(a) Admission of a civil law petition

Article 478 CPC provides that if the petition is not preliminary dismissed and can be received by the court, the defendant will be cited to present his/her contestation, in writing, within the next 20 days.[139] The defendant must respond to each fact presented by the plaintiff and should also present documents, a list of witnesses and request to adduce other means of evidence that he may deem necessary. The defendant's response, which follows the same form as the plaintiff's petition, will also be appended to the file.[140]

(b) Amendment of the application

Article 477 CPC provides that if there are no grounds to dismiss an application, but it cannot be received owing to the absence of legal requirement; absence of essential documents or if the application presents irregularities or defects that may compromise the success of the action, judges my invite the applicant to amend or complete his/her application.

(c) Preliminary dismissal of a civil law petition

Preliminary dismissal of a civil action is an institute that intends to prevent waste of time and resources with judicial actions that inutile.[141]

According to Antunes Varela, preliminary dismissal of an application for a civil action is a pre-judgment that intends to protect the

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[139] Article 486 CPC.

[140] Article 486 CPC.

[141] See, Reis, Alberto, *Código de Processo Civil Anotado*, *Volume II*, 3ª Edição de 1948, (2005), Coimbra Editora, Coimbra, pg. 373.

defendant against unfunded claims and to protect the right of action to claims that have an apparent minimum viability.[142]

For Abílio Neto, preliminary dismissal of an application for civil action presupposes that such application presents formal or essential vices that make impossible the success of the applicant's claim.[143]

By preventing that actions with no prospect of success are entertained by the court, preliminary dismissal is an important instrument to guarantee a reasonable use of court resources and to prevent of abuse of process or bad faith litigation.

Judges may only preliminarily dismiss[144] a plaintiff's application on the grounds of article 474 CPC. Article 474 is a command, which means that if the judge verifies any of the grounds set out, he/she has no option other than to dismiss the petition. Nonetheless, there is room for discretion, since it is for the judge to subsume facts presented therein to the law and make the decision to receive or not to receive the application.

Article 474 CPC reads as follow:

'1. A petition is preliminary dismissed:

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[142] See Varela, Antunes, *Manual de Processo Civil*, (1985), Coimbra Editora, Coimbra.

[143] See notes to the article 480 CPC (1939) that corresponds to article 474 CPC in Reis, Alberto, *Código de Processo Civil Anotado*, *Volume II*, 3ª Edição de 1948, (2005), Coimbra Editora, Coimbra, pg. 359.

[144] The Portuguese term *indeferimento liminar* is being translated as preliminary dismissal.

(a) when it is inept;

(b) when it manifestly presents a dilatory plea[145] that the judge must make sense of, *ex officio*, except for the dilatory plea provided by article 494, e);

(c) when the civil action is presented out of time, having the judge to make sense of the caducity of the action, ex *officio*, or, if for any other motive, it is evident that the plaintiff's claim has no prospect of success;

(d) in terms of article 152, 3 *in fine*.'

In terms of article 193, 1 CPC, a civil action is a nullity if the petition that initiates it is inept. The ineptness of the petition leads to the preliminary dismissal of the action as per article 474,1, a) CPC. Article 193, 2 CPC defines ineptness of the petition, and reads as follows:

'A petition is inept:

(a) when it lacks a claim or a cause of action, or when the claim and the cause of action are unintelligible;

(b) when the claim contradicts the cause of action;

(c) when multiple claims that are substantially incompatible are presented.'

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[145] *Excepção dialtória* is being translated as dilatory plea since it seems to be the closest equivalent to the legal concept on common law. Under the Mozambican CPC, there are *excepções dilatórias* and *excepções peremptórias*. Excepção *dilatória* is a threshold questions not related to the merit of the case. Those questions impede that the court proceed to the decision of the merits of the case.

An application may, therefore, be dismissed preliminarily in the following circumstances: when the plaintiff fails to demonstrate, *prima facie* his/her right and interest to demand; the petition presents formal and substantial vices that will clearly prevent a decision on its merit; or if the plaintiff's claim is unequivocally not viable.

Preliminary dismissal is not a judgment on the merits of the case for at this stage judges only have access to the plaintiff's version of the facts in dispute.

Although the responsibility to commence, conduct and terminate a civil action belong to the parties, as provided on article 264,1 CPC, judges may, by their own motion, collect or order adducing of evidence that they deem necessary to establish the truth of the facts presented by the parties to a civil lawsuit.[146]

There is no time frame for the exercise of such power; therefore, it may be exercised at any stage of the procedure. Although not frequently practised, judges may, before issuing their first order — being admission, preliminary dismissal, or invitation to amend the petition — order the presentation of evidence and request that experts examine the petition and appended documents to be satisfied that the content of the documents reflects the facts that are

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[146] Article 264, 2 and 3 grants inquisitor powers to judges. Judges may gather evidence, perform proceedings that they deem necessary to discover the truth of the facts presented to them so that they can lawfully become aware of said facts. This power is, however, limited to the facts that are presented to them and that are essential to the cause.

being alleged in the petition. Hence, the truthfulness of the facts alleged as cause of action needs to be tested.

Not only is this instrument of judges ordering adducing of evidence significant for preventing abuse of court proceedings and bad faith litigation, but it also enables greater judicial certainty; that is, lawsuits with no prospect of success can be detected at the outset.

CHAPTER 5: THE ROLE OF JUDGES ON THE COMMENCEMENT OF JUDICIAL REORGANISATION PROCEEDINGS

I. Introduction

Judicial reorganisation proceedings, as the name suggests, occur in a court of law under the presidency and supervision of a judge. Although it is a specialised procedure, judicial business reorganisation is a proper judicial procedure and must be treated as such. Judges have the same powers, and they exercise and discharge their duties on the same way they do in any judicial procedure.

This chapter elaborates on the role of the judges on the commencement of judicial business reorganisation proceedings and intends to respond to the following question: what is the role of judges on the commencement of reorganisation proceedings?

Such question is important because there are different views on the matter. For some scholars, judges should have minimal intervention that do not include the authority to dismiss an application for judicial reorganisation proceedings on grounds other than lack of *locus standi* and lack of essential documents that must be presented with the application.

For other scholars, judges have the duty of guaranteeing that only those applications that satisfy the requirements of reorganisation proceedings must be admitted. That is to say that before admitting an application for judicial reorganisation proceedings, judges must be satisfied that there is a high probability that the company is in financial distress, on one hand, and that there is a prospect of the company being rehabilitated if given the opportunity of entering the proceedings on the other hand.

We will start by elaborating on the first decision that a judge makes on receiving the application and proceeding to elaborate on the

decision of preliminary dismissal of an application for judicial reorganisation proceedings and the grounds on which such decision is taken. We will then elaborate on the importance and the reason for the decision to be taken on the grounds of the company not being pre-insolvent or not being salvageable.

We will finalise by elaborating on the judges' authority to adduce evidence on their own motion with the aim of identifying and preventing bad faith litigation on judicial reorganisation proceedings. For that, we will elaborate on the concept of bad faith litigation and abuse of process and on the way it operates on reorganisation proceedings.

II. First decision in judicial reorganisation proceedings

As it occurs in any judicial procedure, on receiving a company's application for judicial business reorganisation judges must issue a first order that may grant the applicant the right to enter reorganisation proceedings. This order is not to be confused with the declaratory order that grants reorganisation. The declaratory order that grants reorganisation is issued on a later phase, after the plan of reorganisation proposed by the applicant has been approved by his/her creditors, as stated under article 56, 1 RJIREC.[147]

The first order that may grant the right to enter reorganisation proceedings is provided by the article 51 RJIREC, which reads as follows:

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[147] Article 56 RJIREC provides that the judge grants judicial reorganization to the applicant whose reorganization plan has not been impugned by any creditor or has been approved by his/her creditors in terms of article 44 of the RJIREC.

‘1. If the claim and documentation required under article 50 are correct, the judge must admit the application for reorganisation and under the same act does as follows:

a) appoints the administrator of insolvency, observed what is regulated under the provision of article 21;

b) orders suspension of all actions and executions, including tax executions, against the applicant in terms of article 6. Those actions and executions remain in the court where the proceedings are taking place;

c) orders that the applicant presents his/her monthly financial statements for the duration of reorganisation proceedings. Failure to comply with this provision leads to the dismissal of the company’s directors;

d) orders citation of the representative of the MºPº (National Prosecuting Authority) and communication to all organs responsible for credits owned by the State;

e) orders citation, by letter, of all creditors on the addresses provided by the applicant; through the official gazette; and publication of the widely circulated newspapers of the jurisdiction. Such citation must contain:

i. a summary of the applicant’s claim, and of the decision that admits the application;

ii. the role of creditors, with discrimination of actual amounts and classification of each credit;

iii. an advisement concerning the deadline for credit claims, in terms of article 7, 2 and for a presentation of the impugnment of reorganisation plan presented by the applicant in terms of article 54.

2. If the application for judicial reorganisation is admitted, creditors or the administrator of insolvency — at any time — can request that

the judge summons the Assembly of Creditors for the appointment of the creditors' committee, or for the replacement of its members observed what is provided under 35, 3.

3. In relation to 1, b) of this article, the applicant is responsible for the communication of the suspension of actions and executions, to which the company and its shareholders are parties to the competent courts where the application is being processed.

4. The applicant cannot drop the application for business reorganisation proceedings after it has been admitted, unless the action obtains approval from the creditors' assembly.'

The epigraph of article 51 RJIREC is 'Order of admission of the application for judicial reorganisation' and the article itself does not provide for an action to be taken if either the claim or the documents are not correct, nor it provides for the action to be taken if the applicant presents only part of the documents that are compulsory or does not present any document at all. It is clear, however, that only those applications presented with documents that are correct must be admitted. A *contrario sensu* an application presented with documents that are not correct or presented with no documents at all must be dismissed.

Being judicial reorganisation proceedings civil court proceedings, provisions of the CPC on the commencement of the civil proceedings apply because such provisions do not contradict and do not conflict with the RJIREC in letter and in spirit.[148] However, on applying

[148] Article 76 RJIREC provides that the CPC is the law applicable in unregulated matters insofar its provisions do not contradict and do not conflict with the RJIREC.

relevant provisions of the CPC, judges must consider the aim and specific characteristics of reorganisation proceedings.

The first decision of a judge is a pre-judgement on the viability and the prospect of success of the case.[149] Judges have, therefore, the duty of assuring that only lawsuits with minimal viability and reasonable prospect of success are admitted and entertained by the court of law.

The admission of baseless and unsubstantiated applications of any court procedure imposes unnecessary costs to the State and all those involved and may cause harm to the respondent. The harm may be even greater on the case of judicial reorganisation proceedings because the admission of an application by itself suspends all executions and debt collection actions against the applicant.[150] Note as to be given to the fact that the suspension occurs even before the applicant's creditors have knowledge of the existence of their debtor's application as their citation is ordered on the same act that orders the suspension.[151]

The suspension of actions for debt collection, executions and limitation period constitute limitation to other intervenors rights. Therefore, it is up the judge to whom the case is assigned to ensure that the limitation of the rights of other intervenors only occurs if

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[149] This results from the grounds to dismiss a civil law application provided by article 474 CPC.

[150] Article 501, 1, b) RJIREC read with article 6 RJIREC.

[151] Unlike the order of suspension of actions and executions that produce immediate effects, the order of citation is processed by court officials and may take considerable time. The effects of the order of citation, therefore, are not immediate and do not occur simultaneously with the effects of the order of suspension.

the application has minimum viability and there is a reasonable probability that the outcome of the proceedings outweighs the harm that may be caused by such suspension.

If the documents presented with the application are not correct in terms of article 51,1 RJIREC read with article 50 RJIREC, the application shall not be admitted. This, we understand, is not contentious. The application, however, may only be dismissed if the judge is satisfied that it contains vices that cannot be corrected or that the application has no prospect of success. Therefore, the first decision may be one of the following: admission, order to amend or dismissal of the application in terms of articles 480 CPC, 477 CPC and 474 CPC respectively.

III. Preliminary dismissal of the application for reorganisation proceedings

The new insolvency law does not expressly provide for preliminary dismissal of the debtor's application to enter judicial reorganisation proceedings, nor does it provide for an order to amend or ameliorate the petition. However, a pre-judgment that intends to protect creditors and other interested parties against unfounded insolvency or reorganisation proceedings, as well as to prevent abusive use of court proceedings by debtors, is vital and must be diligently exercised upon receiving an application for business reorganisation.[152]

We understand that the legislator deliberately abstains from regulating preliminary dismissal of an application for judicial reorganisation because the matter is sufficiently and comprehensively regulated by the CPC (general law), and such regulation is not contrary to the letter and to the spirit of the

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[152] See Finch, Vanessa, *op. cit.* pg.243 and ff.

regime.[153] It is therefore up to the judge to find and apply the appropriate provision from the subsidiary law, hence, from the CPC.

On receipt of the application, judges must satisfy themselves that the petition fills all the requirements of a civil action petition; that the requirements specific to judicial reorganisation proceedings are met; that the claim is presented with all documents listed under article 50; and that there is no fact that precludes the debtor from presenting his/her claim, or the court from admitting it.[154]

(a) Grounds for preliminary dismissal

1. Introduction

There are different views on the grounds for the dismissal of an application for judicial reorganisation.

Fátima Reis Silva is of the view that judges cannot arrive at a conclusion - by simply reading the documents presented with the application - that the debtor's business is facing economic and financial difficulties, or that the business is already insolvent. it is the author's view that judges cannot be hasty to draw conclusions,

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[153] According to Catarina Serra, although insolvency law may be considered an autonomous branch of law with specific interests such as interests of the credit and interests of the economy, insolvency law is part of civil law. Therefore, civil law is a permanent reference to insolvency law. In Serra, Catarina, *Lições do Direito da Insolvência*, (2018), Almedina, Lisboa, pg. 18.

[154] Article 50, e) RJIREC provides that debtors can apply for a concession of 30 days renewable for equal period to present missing documents provided thereon. Such concession should not apply on essential documents that are evidence of locus standi or of the real situation of the business. i.e., on documents that are essential for the decision on receiving or not the application.

as the documents have myriad technical complexities. Therefore, judges can only preliminarily dismiss an application for reorganisation proceedings if the applicant does not present essential documents after being ordered to amend the petition, or if the applicant has already been declared insolvent by a court of law in a final decision.[155]

Fábio Ulhoa Coelho upholds a similar view: the first decision of the judge can only take into consideration two requirements that are if the applicant has or has no *locus standi* and if he/she presented all the documents required by law. It is his view that judges cannot dismiss an application for judicial reorganisation if the debtor presents all documents on the form prescribed by law even if such documents show clear evidence that the applicant's business is not viable or is already insolvent.[156]

For Fábiol Ulhoa Coelho, if any document is missing, the applicant should be ordered to complete the application presenting the missing documents.[157] Only if the applicant disobeys the order or declares that he/she is unable to present any document required by law, can the application be dismissed.[158]

Maria do Rosário Epifânio is of the view that, although on receiving the application for reorganisation proceedings, judges can admit the proceedings, order amendment of the petition or preliminary dismiss the application, judges cannot verify material requirements. They

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[155] Silva, Fátima Reis, *Processo Especial de Revitalização – Notas Práticas e Jurisprudência*, (2014) Porto Editora, Porto, pp. 25-26

[156] See Coelho, Fábio Ulhoa, *Comentários à Lei de falência e de Recuperação de Empresas*, (2014), Saraiva, São Paulo, pg. 216.

[157] See Coelho, Fábio Ulhoa, op. cit. pg. 211.

[158] See Coelho, Fábio Ulhoa, op. cit., pg. 211.

can only preliminarily dismiss the claim if it is obvious that the application cannot succeed.[159] It is her view that an application for reorganisation proceedings may only be dismissed at a later stage if the dismissal is requested by the administrator of insolvency, or when the judge is to issue an order to ratify the plan of reorganisation previously approved by creditors.[160]

The conclusion to be drown from the views of these authors is that judges cannot at the preliminary stage dismiss an application for reorganization proceedings based on the financial state of the company. At this stage, judges cannot examine if the applicant's company is facing financial distress or if it is in a such distress that reorganization is no longer possible. These views are informed by the understanding that reorganization proceedings have a contractual nature because it is materialized by the plan of reorganization that is contract between the indebted company and its creditors.

By contrast, Catarina Serra defends the view that judges must examine essential requirements to enter reorganisation proceedings as the principle of salvageability and the principle of preservation presuppose that debtors who do not find themselves in the state of pre-insolvency, or whose businesses can no longer be saved should not be allowed to apply for reorganisation proceedings.[161]

it is the author's view that although the law of insolvency provides that judges must issue their first decision immediately, 'immediately' should be interpreted as 'within a reasonable amount

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[159] On the RJIREC that would be if the applicant does not fulfill the requeriments of article 47.

[160] See Epifâneo, Maria do Rosário, op. cit., pp. 23-26.

[161] See Serra, Catarina, op. cit., pp. 43-48.

of time', as such a decision needs to take account of the aims, functions and complexities of the proceedings.[162] Serra defends the view that judges should take the necessary time to be satisfied that there is a probability that the applicant is pre-insolvency and that the proceedings may lead to the reorganization of the company.[163]

Daniel Carnio Costa is of the view that the applicant is ought to present his/her application with documents that are evidence of financial situation of the business and the real position of the applicant's assets. It is the author's view that before making their first decision, judges must examine such documents to ascertain if the applicant's business is probably facing financial distress, on one hand, and if the business may be salvageable, on the other hand because by doing so they will be satisfied that only those applications that fulfill the requirements of reorganization proceedings and have prospect of being successful are admitted.[164]

It is the view of the authors, therefore, that judges may guarantee that the proceedings are not used for aims other than those provided by law that are to allow reorganisation of pre-insolvent businesses (not yet insolvent or in such financial distress that the business is beyond any possibility of being saved) with prospect of, by virtue of the proceedings, being reorganised.

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[162] See Serra, Catarina, op. cit.

[163] See Serra, Catarina, idem.

[164] See Costa, DC, 'Novas Teorias Sobre Processos de Insolvência e Gestão Democrática de Processos', in Carnio Costa, Daniel, *Comentários Completos à Lei da Recuperação de Empresas e falências, Volume II – Recuperação Judicial e Extra-judicial*, (2015) Juruá Editora, Curitiba, pp 17-62.

In terms of article 102 RJIREC the requirements for an application for insolvency (liquidation) are that the company finds itself in financial distress on one hand and that such distress is so severe that it does not fulfil the requirements for an application for judicial reorganisation, on the other hand. Those companies must, with the application for insolvency, state the reasons for the alleged impossibility of continuing doing business and present documental evidence to support such allegation. That is to say that because of supremacy of reorganisation, a company that applies for insolvency must present evidence that its business cannot be saved, and the company does not meet the requirements for reorganisation.

From article 102 RJIRJ read with article 47, 1 RJIREC financial distress and the viability of the company are essential requirements to enter reorganisation proceedings. We are of the view that companies that are not pre-insolvent (either because are already insolvent or are not facing financial distress) are not eligible for reorganisation proceedings and its applications shall be dismissed. We are also of the view that companies that are pre-insolvent but for any reason cannot be saved are not eligible for judicial reorganisation proceedings, therefore, its applications shall be dismissed.

Judges are not expected to act as mere bureaucrats and admit any court applications where the cause of action is absent and, therefore, has no prospect of success. The mere possibility of a judge having to admit an application that has no prospect of success would be contrary to general principles of law, would undermine stability and due process and would fail to provide adequate judicial protection of the rights of creditors and other interested parties in due course. Neither would the judge be protecting the rights of companies that apply for reorganisation not knowing that judicial reorganisation is not the adequate mean to resolve their financial

difficulties. The delay in rejecting proceedings that are not viable could lead to the worsening of the debtor's financial and economic distress, or lead to the insolvency of the business, which otherwise, could have been prevented.

Although the plan of reorganisation is a contract between the indebted company and its creditors, judicial reorganisation proceedings are court proceedings and must be treated as such. The plan of reorganisation is negotiated and approved on a later stage only if the judge is satisfied that the application has prospect of success.

Moreover, the legislator provided for an out-of-court reorganisation proceeding that is contractual by nature since it starts with a process of negotiation and approval of the plan by the debtor and his/her creditors. Those companies that are not willing to subject themselves to the authority of the court can resort to out-of-court reorganisation.

It is our view that application for judicial reorganisation can be dismissed on various grounds.

Article 474 CPC defines the grounds for preliminary dismissal of civil law action. In terms of article 474 CPC, an application for a civil action is dismissed when the petition is inept; when there are manifest (clear) dilatory pleas that the judge must have knowledge of on his/her own motion; if the action is proposed after the expiry of the right to propose it; and if it is manifest that for any other reason the plaintiff's pretention cannot succeed.

2. Lack of locus standi

On receiving an application for a civil action, the judge must be satisfied that the applicant has *locus standi*. Lack of *locus standi* (the capacity or right to bring an action or to appear in a court) is a

dilatory plea[165] that must be raised by the judge *ex officio*.[166] If a plaintiff has no *locus standi*, his/her action shall be immediately dismissed. [167]

Article 47 RJIREC provides the requirements for a company to apply for reorganisation. Such requirements are that the company must have been regularly conducting business for at least twelve months and simultaneously not have been declared insolvent by a court of law or, if that is the case, resultant liabilities must have been extinguished by a final court decision; the company may not have enjoyed judicial reorganisation within the two years preceding the application; and the company shall not have been sentenced and may not have a manager or controlling partner who has been sentenced for any of the crimes provided by articles 167 to 173 RJIREC.

Accordingly, article 47 defines who has *locus standi* for reorganisation proceedings; that is, the article defines who has an interest in applying for reorganisation, provided that reorganisation is the (most) adequate means to achieve rehabilitation of a company in economic and financial distress.[168]

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[165] Article 494, 1, b) CPC.

[166] Article 495 CPC.

[167] Article 474, 1, b) CPC.

[168] In terms of article 26 CPC, a plaintiff is a legitimate party to the action if he/she has direct interest in proposing a legal action and a defendant is a legitimate party if he/she has direct interest to contradict the claim. On judicial reorganisation proceedings, a company that finds itself in financial difficulties, meets the

The consequence of not having *locus standi* is the dismissal of the application. This results from article 494, 1. b) CPC.[169]

3. Ineptness of the petition

In terms of article 193 CPC, a plaintiff's petition is inept in the following scenarios: the claim is absent or is unintelligible; the cause of action is absent or is unintelligible; the claim is in contradiction with the cause of action; and cumulative claims are substantially incompatible.

Under the RJIREC, a debtor can either apply for reorganisation or for insolvency. If the debtor applies for both simultaneously, he/she will be presenting incompatible claims; hence, his/her application will be dismissed with fundament on article 193, 2, c).

If one or more documents listed under article 50 is not presented, applicants will be given a reasonable amount of time to present the missing document(s). If they fail to do so, the consequence will be the dismissal of the claim. Not only does the burden of proof lie with applicants, but applicants also have the duty not to stop or delay actions and executions by omitting steps which they know are

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requirements of article 47 and has, if awarded the opportunity of entering the proceedings, prospect of being reorganized. It has direct interest to propose reorganization proceedings, hence, has *locus standi*.

[169] See Teixeira de Sousa, Miguel, *As Partes, o Objecto e a Prova na Acção Declarativa*, (1995), Lex, Lisboa, pp. 47 and ff.

Locus standi refers to the relationship between parties and the object of the lawsuit. Both parties must have interest (direct or indirect) on the action.

essential. Applicants have the legal obligation to cooperate with the court, as provided by article 265 CPC.

According to Antunes Varela, the cause of action are the specific factual circumstances giving rise to the legal claim and that are the base for the desired judicial effects.[170] The cause of action for reorganisation proceedings are the facts that show evidence of the impossibility of meeting due obligations (the company is facing financial distress), on the one hand, and the facts that show evidence of the viability of the company (by applying the appropriate measures the company can be rehabilitated), on the other hand. Cause of action for judicial reorganisation proceedings can only be tested by the examination of the documents presented with the application as evidence of the alleged facts.

Article 50 a) provides that the company must present a thorough description of its assets and of the real reasons for its financial distress. Article 50 b) further provides that the company must present its accounting statements for the previous two years. By presenting a thorough description of its assets and the reasons for its financial distress, the company intends to prove that it has a legitimate interest in making use of the proceedings and that the proceedings are the most adequate means to achieve legal protection of its rights. The company will be demonstrating and convincing the

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[170] See Varela, Antunes, *Manual de Processo Civil, (1985),* Coimbra Editora, Coimbra, pg. 245.

court that it is making a licit and legitimate use of court processes.[171] [172]

Accounting documents are presented to the court as evidence for the following: that the company's business is in distress and that it is unable to fulfil its due obligations; that the causes of distress are those invoked on the application; and that, with the cooperation of its creditors and by applying any of the measures provided under article 49 RJIREC, rehabilitation of the business is possible and cost-effective.

By presenting evidence of the state of the business and of the prospect of rehabilitation, if given access to the proceedings, the company is presenting cause of action.

For judges to be satisfied that there is cause of action,[173] they must first be satisfied that the documents presented by the debtor as

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[171] Texeira de Sousa, Miguel, op. cit.

[172] A debtor may have a legitimate interest in entering reorganisation proceedings, but judicial business reorganisation may not be the most adequate mean to archive protection of his rights. Out of court reorganisation, for instance, can be in a specific case, the most adequate and effective mean.

[173] Cause of action encompasses facts that are necessary to individualize a legal situation alleged by the party and to substantiate its claim. On *Acórdão* de 2017-11-14, Tribunal da Relação de Coimbra *Processo* : 7034/15.9T8VIS.CI, cause of action is defined as 'specific juridical act or juridical fact from which the right alleged or asserted by the plaintiff emerges.' available online : https://dre.pt/pesquisa-avancada/-

evidence of those facts are formally correct and that the content of such documents most probably concurs with the arguments presented — that is, that there is apparent coherence between the facts presented by the applicant and the evidence intended to demonstrate the truth of said facts. At this stage, judges are not seeking certainty as they are not yet adjudicating on the merits of the cause.

Owing to the speciality of the insolvency regime, a company's claim is not presented against any person. There is no respondent or defendant *strictu sensu*. Creditors' intervention occurs at a later stage, only once proceedings have been admitted and the stay of actions and executions is in place — hence, only once the acceptance of the debtor's application produces juridical effects on rights creditors and other intervenors.[174]

Having no responded or defendant (*strictu sensu*), it is understood, increases the need for careful and swift intervention of judges on commencement of the proceedings. Judges must ensure that debtors are not acting in bad faith; that they are not knowingly presenting unfounded proceedings; and that they are not intentionally altering or omitting facts to archive reorganisation, buy

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/asearch/1162832535/details/maximized?emissor=Tribunal+da+Relação+de+Coimbra&types=JURISPRUDENCIA&search=pesquisa. On this matter, see also Teixeira de Sousa, Miguel, op. cit. pg. 122 e ff.

[174] In an ordinary civil action, the first decision of the judge does not suspend lawsuits. If there is no reason to preliminary dismiss the application, the judge orders the citation of the defendant to the terms of the lawsuit (article 474 CPC).

time to dispose their assets or cause harm on creditors' rights — that is, that they are acting in good faith.[175]

A court decision must be not only fair and just but must also conform with procedural law. Therefore, we are of the view that – because documents presented with the application for reorganisation proceedings are complex and judges have no expertise on the accounting and management - to ensure that preliminary dismissal of a debtor's application for reorganisation proceedings is the only just decision in a particular set of circumstances, judges may exercise their inquisitor power provided by article 266 CPC. By doing so, judges can perform proceedings deemed necessary to find the truth of facts attested by the documents presented with the debtor's application.

Moreover, preliminary dismissal would not only prevent the continuation of proceedings with no prospect of success but would also allow earlier detection of fraudulent claims, for debtors may abuse these proceedings by falsely claiming that their business is in distress, that their business is viable or that reorganisation is necessary, when their actual objective is to make use of the moratorium to deplete their assets and close the business without having to fulfil their obligations. Another objective of dishonest companies could be to postpone payments to their creditors in order to use their cash flow for what they consider more important.[176]

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[175] Costa e Silva, Paula, *A Litigância de Má Fé*, (2008), Coimbra Editora, Coimbra.

[176] On simulation of juristic acts see Alves Trindade, Cláudia Sofia, *A Prova de Estados Subjectivos no Processo Civil,* (2016), Almedina, Coimbra.

4. Unviability of the claim for any other manifest reason

Under this ground the reason for the unviability of the claim must be manifest on one hand and cannot be any of the reasons provided by article 474 CPC. We understand that it refers to any indispensable condition for the claim to be successful that the judge, on the specific application, finds. Judges have a high degree of discretion.

II. Juridical effects of preliminary dismissal

Preliminary dismissal of the application for judicial reorganisation prevents the applicant from enjoying the stay of executions, actions for debt collection and the suspension of limitation periods. It also prevents the applicant from enjoying the measures provided by the proceedings.

Article 475 CPC provides the juridical effects of preliminary dismissal of a civil action. It is significant that the decision can be challenged regardless of its fundamentals or reasons. The appeal, which is immediately sent to the court of appeal (article 734, 1, a) CPC), will have suspensive effects (article 740 CPC).

A final decision of preliminary dismissing a civil action (or execution) will result in termination of the lawsuit.

In relation to reorganisation proceedings, if documents presented with the application indicate that the debtor's business is facing economic and financial distress, but reorganisation proceedings are not the most effective means to overcome such difficulties, proceedings are terminated. Like all jurisdictional decisions, the decision to dismiss an application for business reorganisation must contain the rationale and its legal grounds as well as facts. Jurisdictional decisions cannot just adhere to the arguments presented by the parties (article 158 CPC).

A debtor may be facing financial distress but all that his/her documentation indicates is that the business is already insolvent, and that reorganisation is no longer possible. In this case, shall the judge dismiss the application for reorganisation and convert reorganisation proceedings into insolvency proceedings?

The answer to this question is the negative.

Insolvency proceedings are civil actions. Parties to a legal dispute decide when to initiate, how to conduct and how to terminate litigation. Before bringing an application to a court of law, plaintiffs must ensure that they have the right that they intend to claim, that they have evidence to support such facts and that their claim is presented against the correct person — that is, a person with interest to respond to it.

In terms of article 3 CPC, courts of law cannot rule on conflicts of interest identified in a lawsuit if none of the parties has requested such adjudication. This is to say that even if a judge identifies a conflict of interest in the lawsuit, if neither party refers to it nor requests a judgment, the judge cannot rule on it. That conflict must be ignored, and the ruling should only cover what was requested. Likewise, judges cannot refuse to adjudicate on facts presented to them by any of the parties (article 156, 1 CPC read in conjunction with article 3, 1 *Estatuto dos Magistrados Judiciais* approved by law nº 7/2009).

A company that applies for reorganisation proceedings may not present alternative claims such as reorganisation or insolvency. The company must decide prior to the application which claim to present. The court is obliged to adjudicate only on what is requested. Even if all elements and information before the judge point to the insolvency of the business, insolvency cannot be declared, as the applicant never requested it and creditors had not been notified to

be party to the proceedings. If the court hastily declared insolvency in such a case, it would be overstepping its authority.

Besides the matter of principle, legal reasons prevent judges from converting reorganisation proceedings into insolvency proceedings. Article 67 RJIREC provides that during reorganisation proceedings a judge can convert reorganisation into insolvency only on the following grounds: creditors in a General Assembly of Creditors deliberate by majority (as defined on article 41RJIREC) for the declaration of insolvency; the plan of insolvency is rejected in terms of article 55,5 RJIREC; and the debtor fails to comply with the obligations arising from the plan of reorganisation (article 59,2).

It is possible for a company to present reorganisation proceedings while being unaware of the fact that its business is insolvent and not pre-insolvent. In such a case, the company may be acting negligently but not in bad faith. Other companies may apply for reorganisation proceedings knowing that they are ineligible. These companies know that if they are granted access to the proceedings their creditors may suffer prejudice and that they may be defeating the course of justice. In such cases, companies may be litigating in bad faith, or intentionally abusing court proceedings.

Although judges cannot declare insolvency of the debtor's business, they can verify if the application for reorganisation proceedings was presented in *mala fides* (bad faith*)*, thus preventing abuse of court proceedings. They can also verify the existence of elements of crimes of insolvency.

In summary, preliminary dismissal of an application for judicial reorganisation terminates the proceedings. Judges cannot convert reorganisation proceedings into insolvency proceedings after preliminary dismissing the first. However, judges can verify the

existence of bad faith litigation and abuse of process as well as the presence of indication of crimes of insolvency.

III. Bad faith litigation and abuse of process

Due to the nature of reorganisation proceedings, baseless applications and proceedings initiated in bad faith may cause irreversible damages to the rights, to the credit, to the good name and to the assets of the creditors.[177] It is therefore important that bad faith litigation on judicial reorganisation proceedings is identified at the commencement of the proceedings and before the application is admitted.

Bona fides is a major principle in civil law jurisdiction. It is an undetermined concept found in various provisions of the CPC and of the CC, and it must be filled by judges who verify a set of acts which characterise it.[178] We will deal with *bona fides* and *mala fides*

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[177] On this matter see Albuquerque, Pedro, *A Responsabilidade Processual por Litigância de Má Fé, Abuso de Direito e Responsabilidade Civil em Virtude de Actos Praticados no Processo,* (2006), Almedina, Coimbra and Cordeiro, António Menezes, *Litigância de Má-Fé, Abuso de Direito de Acção e Culpa "In Agendo"*, (2016), Almedina, Coimbra.

[178] The concept of bona fides is an undetermined concept that is difficult to fill. It has a strong etic and moral content. Those who do not act in bona fides do not have legitimate interest or *iusta causa litigandi*. Interest to litigate is a *conditio sine quanon* to a civil action and judges must test its existence before addressing the matter before them.

in court procedures, as the institute of procedural *mala fides* substantiates abuse of process[179].

In terms of article 264, 2 CPC, parties to a civil action have the duty of (knowingly) not to formulate illegal claims; not to present facts that are not true; and not to lodge applications with the intention of delaying proceedings. A party that respects this provision is said to be acting in good faith. [180]

Article 456 CPC, which provides for the notion of bad faith litigation and its consequences, reads as follows:

> (Responsibility in case of bad faith. Notion of bad faith)
>
> 1. A Party that litigates in bad faith is sentenced to a fine and monetary compensation to the counterparty if such compensation is asked for.
>
> 2. A party litigates in bad faith if it presents or opposes to a claim knowing that his pretension is unfunded; if it knowingly alters the truth of essential facts; and if it makes a manifestly reproachable use of the process or of means of process to archive an illegal aim, to obstruct justice or to prevent that the truth is known.

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[179] According to Pedro Albuquerque, bad faith litigation is an illicit based on the violation of procedural duties and positions. Such violations, if confirmed, result in an immediate sanctionable unlawfulness regardless of the existence of an offense to positions regulated by substantive law. In Albuquerque, Pedro, *Responsabilidade Processual por Litigância de Má Fé, Abuso de Direito e Responsabilidade em Virtude de Actos Praticados no Processo*, (2006), Almedina, Coimbra, pp.52-53.

[180] See Aranguren, Arturo Muñoz, *La Litigacion Abusiva: Delimitación, Analisis y Remedios*, (2018), Marcial Pons, Madrid.

3. The winning party can be sentenced as a bad faith litigant, even in the main cause, if it has acted with instrumental *dolus*.

Verification of bad faith litigation *ex officio* by judges is, therefore, an instrument that intends to guarantee an immediate monitoring of the use of court processes.[181] When adjudicating, a significant component of bad faith to be tested by the judge is that of *intent* in performing any of the acts therein provided.[182]

According to Paula Silva, *intent* refers not only to *dolus*[183] but also to gross negligence because parties have the duty of exercising caution and ponderation by researching if they meet all the requirements to enter the proceedings, before they take any legal action.[184] It is her understanding that a party that should not ignore (ought to know) that the claim he/she is presenting is unfounded is omitting the duty of acting with minimal diligence that is required to every person who intends to take legal action, is litigating in bad faith.[185]

Because procedural bad faith refers to a behaviour that substantiate abuse of process, such behaviour must occur within the process and must be inferred from the application, facts, documents, and

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[181] On bad faith and abuse of the right to a court action see Cordeiro, Menezes, L*itigância de Má-fé, Abuso do Direito de Acção e Culpa In-agendu*, (2016), Almedina, Coimbra, pp. 10 and ff.

[182] See article 456, 2 CPC.

[183] See Acórdão da Relação do Porto de 12/07/2018, Relator Rita Romeira and Acórdão da Relação de Guimarães de 30/01/2020, Relator Paulo Reis.

[184] See Silva; Paula Costa, *A Litigância de má Fé*, (2008), Coimbra Editora, Coimbra, pg. 346.

[185] See Silva, Paula Costa, op. cit. pg. 392.

argumentation which were — at any stage — presented by the party. Demonstration of the intention to litigate in bad faith is not a simple task, as it comes down to a subjective state of the transgressor. It must be drawn from logical reasoning and what is called 'rule of experience.' The intention to litigate in bad faith is unknown and must be presumed from known and proven facts. Bad faith litigation is, therefore, proved by indirect evidence.[186]

In the context of reorganisation proceedings, a company may have the intention of deceiving its creditors so that it can enjoy the suspension of actions and executions as well as of prescription periods. A company may also act with gross negligence by not researching and confirming that it is facing financial distress on one hand or that it is not beyond rehabilitation, on the other hand.

Because the bad faith conduct is being examined at the commencement of the proceedings, the bad faith intent must be reflected on the application[187] — hence, on the facts, arguments and evidence presented to prove the right to apply for reorganisation.

Verifying the intention to abuse court proceedings may be easier in some cases than in others. For instance, a company that conceals documents which prove that it had enjoyed judicial reorganisation less than two years prior to the date of the application most likely has the intention of hiding such information so that it can enjoy reorganisation proceedings, as it knows that it enjoys the presumption of good faith.

In other cases, the exercise may be more complex because there are not enough procedural steps to evaluate a consistent behaviour.

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[186] See Trindade, Cláudia Sofia Alves, op.cit.

[187] On the petition and on the documents that are presented with it.

In complex cases — and because of the technicality of the documents presented as evidence of the economic and financial state of the company, as well as of its right to enter such proceedings — we are of the view that judges may appoint experts to examine evidence.[188] The written report presented by the experts is evidence and must be treated as such. The primary aim of the report is not to adduce evidence of the presence of bad faith litigation; it is to give the judge elements that may allow him/her to form the conviction that the company fills the requirements to enter reorganisation proceedings, hance that it has (or has not) a cause of action — that, is that its business is facing economic and financial difficulties and that it is still salvageable with reasonable costs to all those involved. However, on analysing the report and applying logical reasoning and rules of experience, the judge may find the existence of the intention to deceive the ends of justice or to cause harm to creditors and other intervenors that is an element of bad faith litigation. Such intention may be evident in a lack of coherence between facts alleged and the content of the documents presented to prove said facts. If the company presents facts that it knows to be untrue, if it deliberately or with gross negligence omits relevant facts, if it alters essential facts or evidence knowingly to mislead the court, the bad faith intention is proved.

Unlike with common actions, at the commencement of judicial reorganisation proceedings only the judge may, by virtue of his/her office, raise and investigate the bad faith litigation. Because of the preliminary stage at which such an investigation occurs, the investigation is a preventive measure. If bad faith is confirmed and the requirements for preliminary dismissal are met, the debtor's

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[188] Documents provided by article 50 that are presented as evidence of the requirements to enter judicial reorganization proceedings.

application is dismissed and the stay of actions and executions against the debtor does not take place, there is no interference with creditors' rights, and above all creditors will not suffer damages.

In conclusion, abuse of court proceedings and bad faith litigation, on commencement of reorganisation proceedings, can and should be prevented by the court. Judges should exercise their inquisitor powers, conferred by article 266 CPC, to investigate if the debtor is not applying to the proceedings in good faith. They can conduct such an investigation by appointing an expert who will examine all documental evidence presented by the applicant to see if there are discrepancies or inconsistencies between evidence presented and the claim, and if there is an indication that the company does not meet the requirements to enter reorganisation proceedings. Such an investigation must be done in a reasonable time frame to prevent the worsening of the applicant's financial distress. If the company is found to be litigating in bad faith, it will be fined.

IV. Producing evidence *ex officio* before the first decision

As discussed above, preliminary dismissal is ordered based not on the merit of the case but on formal and material requirements of the proceeding.[189]

Article 341 CC provides that evidence is produced with the aim of demonstrating the accuracy of the facts presented.[190] The weight attributed to the means of evidence presented is not pre-set by law.

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[189] Being material requirements, inter alia, that the company is pre-insolvent and viable.

[190] Miguel Teixeira de Sousa defines evidence as a jurisdictional activity (in the process) that intends to have the judge satisfied with the truthiness of the facts in dispute. (in Teixeira de Sousa, Miguel, op. cit.).

Judges freely evaluate the evidence and means of evidence by respecting logical reasoning and rules of experience.[191]

The burden of proof lies with the party that alleges certain rights. Such party must present evidence that proves constitutive facts of such rights[192]. In terms of article 517, 1 Code of Civil Proceedings, evidence cannot be admitted or produced without the other party or parties to the process being notified and given an opportunity to articulate on it. The obligatoriness of hearing the opposing party before making any decision is a corollary of the principle of disposition.

With reorganisation proceedings, the burden of proof lies with the company (applicant) that presents the evidence to convince the court that it, with no shadow of doubt, has the right to enter reorganisation proceedings (article 342, 2 CC), as its claim is constitutive[193] by itself. A company also must present evidence to prove that it has *locus standi* and that it meets all formal and material requirements to enter the proceedings.

The burden of proof for facts that modify or extinguish the right alleged by the applicant lies with the party or parties against whom the right is claimed — thus, the party with interest to oppose the

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[191] Evidence is regulated on article 341 to 396 CC and 516 to 657/B CPC.

[192] Article 342 CC.

[193] It is constitutive because it causes a change on the juridical order. With the debtor application, creditors are stopped from enforcing their rights; there will be a delay on payment of debts at least for the period in which the suspension of actions and executions is in place; creditor's may, in consequence, face difficulties with cash flow and default on payment of their own debts.

claim[194]. In reorganisation proceedings cases, the burden of proof for facts that would modify or extinguish a debtor's right to enter the proceedings lies with creditors, as they have an interest in contradicting or opposing the claim either because they do not believe that the debtor's business is pre-insolvent; they do not believe that the business is salvageable; or, although they believe that the business is pre-insolvent and it is salvageable, they are convinced that the cost imposed on them is too high — hence, reorganisation is not cost-effective.

Since creditors will be cited to the proceedings after a company's evidence is admitted and the stay or suspension of lawsuits and prescriptions deadline is in place, article 517, 1 CPC, which provides for the adversary principle of civil procedure, does not apply and judges must adjudicate on the admission of the proceedings without hearing them.

The onus is on judges to guarantee that only genuine and legitimate proceedings with a prospect of success are admitted. Admission of pretence or fraudulent reorganisation proceedings, as well as of those with no prospect of success, may cause irreversible harm to creditors' rights, assets, and businesses. Moreover, there is public interest in preventing the abuse of court proceedings. Court proceedings are expensive and time-consuming. To ensure the correct, licit, and legitimate use of courts and court proceedings, judges may produce or order production of evidence, by virtue of their office. We consider this an important instrument for judges to play their role diligently and effectively.

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[194] Article 342, 2, CC reads: the burden of proof facts thar impede, modify or extinguish the right that is alleged lies on the party against which such facts are invoked.

According to Jordi Fennol, some scholars are of the view that judges should not adduce evidence on their own motion as it will impair the guarantee of their impartiality while others are of the view that the assurance of a judge's impartiality is not diminished because, by producing evidence, judges intend to clarify facts before them, and such facts are presented by the parties. Judges do not know the result of such evidence in advance; hence they do not know if such evidence will benefit one or both parties.[195]

Jordi Fennol upholds the view that there is no conflict or incompatibility between seeing evidence as a defence opportunity to the parties and seeing it as an activity that intends to generate judges' intimate conviction of the existence of the facts before them. Accordingly, it is only reasonable that all actors involved — that is, the relevant parties and judges — can adduce evidence.[196] Fennol also expresses that, to avoid judges disregarding evidence presented by parties and to avoid judges paying attention only to the evidence produced by them *ex officio*, it is convenient that *ex officio* evidence is not produced at the commencement of proceedings.

In spite of the fact that judges are not parties to the proceedings and cannot replace them (as judicial reorganisation is a special process), it is tenable that — on their own motion, and upon receiving an application — judges produce or order production of evidence that will lead to a fair and just decision to grant (or not) the right to enter

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[195] See See Fennol, Jordi Nieva, *La Valoración de la Prueba*, (2010), Marcial Pons, Madrid, pp- 184 and ff.

[196] See Fennol, Jordi Nieva, op. cit.

reorganisation proceedings.[197] The simple act of admitting the proceedings may impose economic and social costs on creditors and other intervenors.

Evidence ordered or produced by judges in the above instance is not of the same nature as evidence presented by the debtor. Judges are not seeking to content themselves with the degree of certainty that the debtor is pre-insolvent; they are seeking to content themselves that there is a probability that the facts contained on the application presented before them are truthful and that there is a prospect of success for the proceeding. They are also seeking to content themselves with a certain degree of probability that the applicant is not already insolvent and that his business is not beyond any possibility of rescue. The risk of disregarding the company's evidence is absent, as the objective is to probe the facts alleged by the debtor as well as to probe the evidence of the alleged facts.

We understand that production of evidence ex officio on the commencement of reorganisation proceedings is an important instrument to guarantee that the aim of the RJIREC is archived, hence that insolvency of companies that are pre-insolvent and passible of rehabilitation is prevented.

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[197] Acording Fernando Pompeu Lucas judges must be very cautious on applying the law of insolvency to ensure that only business that are effectively rescuable enjoy the protection of the law. They also must find a balance between parties and interests involved so that no unreasonable concessions are asked to any party. In Costa, Daniel Carnio, op. cit. pg.20.

[197] See AI nº 01944342.2012 – São Paulo

V. Appointment of experts

Judges can order or produce all sorts of legally admissible evidence to the extent that the evidence is adequate to ascertain the viability of the proceedings.

Although they adjudicate on a variety of matters, judges are obliged to apply only specific knowledge of the law. They are not expected to have specific knowledge on other (even if they are relevant) matters, such as accounting and management, for instance. Even if a judge has specific knowledge of the field in which he/she is adjudicating, he/she cannot apply such knowledge or expertise, because his/her position must be neutral. The judge cannot be seen as acting as a witness or expert in the process.[198]

Because most of the documents presented with the petition are accounting documents, appointing an expert in accounting to examine such documents and the facts therein laid, and to produce a technical report, is the best option. In fact, it is the only way that a judge can guarantee the efficacy of the proceedings and the consistency of the facts and documents presented with the requirements of judicial reorganisation.

In this regard, Daniel Carnio Costa is of the view that the appointment of an expert before the admission of an application for reorganisation proceedings intends to guarantee that the proceedings are effectively enjoyed by companies that meet the

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[198] Experts are not witnesses. They are considered court aid and their task is to help the court reach the truth of the facts and of the evidence presented so that judges may form their inner conviction.

requirements and it is done on public interest, in the interest of the community and in the interest of creditors.[199]

Judges will make their own decisions based on the report produced by the appointed expert(s). The report, which will be read critically, is expected to be coherent, objective, concise and intelligible. Judges do not ratify the report and its conclusions. Furthermore, the principle of free evaluation of evidence applies[200].

Weight of the evidence and the means of evidence to be used for each fact are not pre-set by law. Judges, however, must present the rationale for the weight that they assign to the report or the rationale for dismissing it as a whole or partially.

Adduction of evidence to guarantee that only legitimate claims are entertained by the court is a crucial tool for accountability. Adduction of evidence is an exercise of supervision of reorganisation proceedings by the court, for 'acceptable levels of supervision and approval should be instituted so that opportunistic behaviours are

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[199] See Costa, Daniel Carnio, *A Perícia Prévia em Recuperação Judicial de Empresas – Fundamentos e Aplicação,* (2018) in Migalhas, http://www.migalhas.com.br/coluna/insolvemcia-em-foco/277594/a-pericia.previa-em-recuperacao-judicial-de-empresas---fundamentos-e-aplicacao-pratica.

[200] According to António Augusto Viente Russo, the principle of free appreciation of evidence means that judges are free to decide on their reasoning process about facts presented before them. They are not bound to a pre-set system of valuation of evidence. Therefore, they have the duty of presenting the rationale of their decision. In Russo, António Augusto Vicente, *Prova na Formação da Convicção do Juiz,* (2019), Almedina, Coimbra, pg.36.

curtailed....'[201] When adducing evidence, courts are playing '... an important role in ensuring that the procedure, which brings with it a stay of the rights of creditors, is not abused and that the rights of interested parties are properly protected.'[202]

Because at the commencement of reorganisation proceedings creditors and other interested parties have not yet been called to the proceedings, the urgency of the first order should be centred around the protection of business and community interests. It is critical to ensure that production of evidence occurs within a time frame that will not cause or contribute to the worsening of the financial and economic distress of the debtor's business. Experts, therefore, must be given clear instructions and fair deadlines to produce their reports (article 572, 4 and 594 CPC).

Appointment of experts is not the only means of evidence that judges can make use of at this stage. If judges find discrepancies and inconsistencies between the set of documents presented, they can request information not only from the debtor but from any other person or institution, such as the fiscus, for example.

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[201] See Finch, Vanessa, op. cit. pp 249.

[202] Ziegel, Jocob S., op.cit.

CHAPTER 6: CONCLUSION

Judicial reorganisation proceedings are specialized civil actions regulated under the RJIREC. General law, CPC, is subsidiary law to the regime to the extent that it is applicable on all matters not specifically regulated on the RJIREC.

The role of judges on the commencement of reorganisation proceedings is to guarantee that the aims of the proceedings are archived; to prevent abuse of process and bad faith litigation and to protect creditors and other intervenor's rights.

Beside dismissing an application for reorganisation proceedings on the grounds of lack of *locus standi*, absence of essential documents or absent of documents at all, judges must dismiss applications which documents show evidence that the company is not in financial distress or, if it is, it is not passible of rehabilitation, hence the application has no prospect of success.

Because of the technical complexity of the documents presented with the application as evidence of the financial status of the company, judges must appoint experts to examine the documents and produce a report that will support the decision on whether to admit or dismiss the application. Such report will be critically and freely evaluated by the judge. The report will also help to ascertain if the applicant is acting in bad faith, abusing court process, or intending to cause harm to its creditors.

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