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Oi S.A.: The Saga of Latin America's Largest Private Sector In-court Restructuring

By **JESSE W. MOSIER**

After a nearly 2-year long process, creditors of Oi S.A. ("Oi") and certain of its subsidiaries approved a plan of reorganization at a creditors meeting on December 19, 2017, held in a former Olympic boxing venue on the outskirts of Rio de Janeiro, to restructure nearly US$20 billion in claims, the largest corporate restructuring in the history of Latin America (and potentially any emerging market), and the first truly public Brazilian company to go through judicial restructuring since Brazil reformed its insolvency laws in 2005.

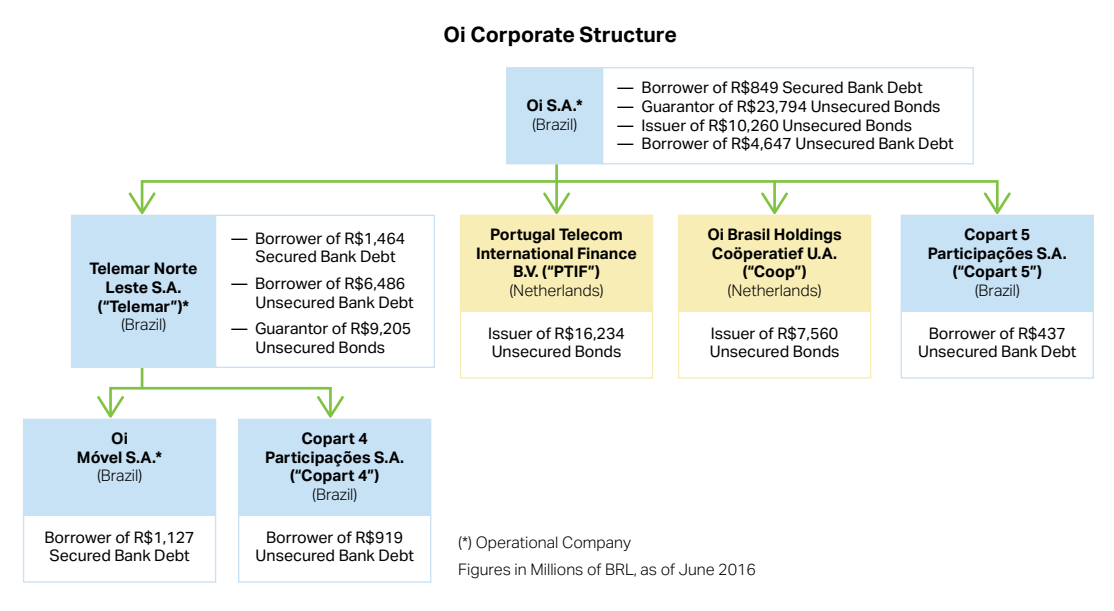
Oi is one of the most important companies in Brazil, and is one of the largest Brazilian integrated telecommunications providers, with over 60 million customers throughout Brazil and over 138,000 direct and indirect employees. Oi also has operations in a number of other Portuguese speaking countries around the world, including Angola, Cape Verde and Timor Leste.

The size and complexity of Oi's restructuring resulted in a number of interesting and precedent setting aspects, and has been extensively litigated in Brazil, the Netherlands and New York. Among the more interesting aspects of the restructuring are: (i) potential limits to the ongoing trend in Brazil of substantively consolidated restructuring plans, (ii) the attempt (ultimately abandoned) by certain creditors to use the existence of intercompany claims by off-shore finance subsidiaries to improve their recoveries, (iii) potential limits on abusive behavior by Brazilian shareholders and their board representatives and (iv) the treatment of regulatory claims in Brazilian restructuring proceedings.

Background

In the wake of its unsuccessful acquisition of Portugal Telecom, structural problems resulting from its concessions, substantial underinvestment in its assets and a general downturn in the Brazilian economy, by early 2016 Oi was facing an unsustainable debt burden. Oi and its subsidiaries' debt consisted of nearly US$15 billion in financial debt, including approximately US$10 billion in New York and English law governed bond debt,[1] in addition to sizeable regulatory fines and tax and other contingencies.

After initially considering an attempted out-of-court exchange in the spring of 2016, Oi and certain of its subsidiaries filed for judicial reorganization



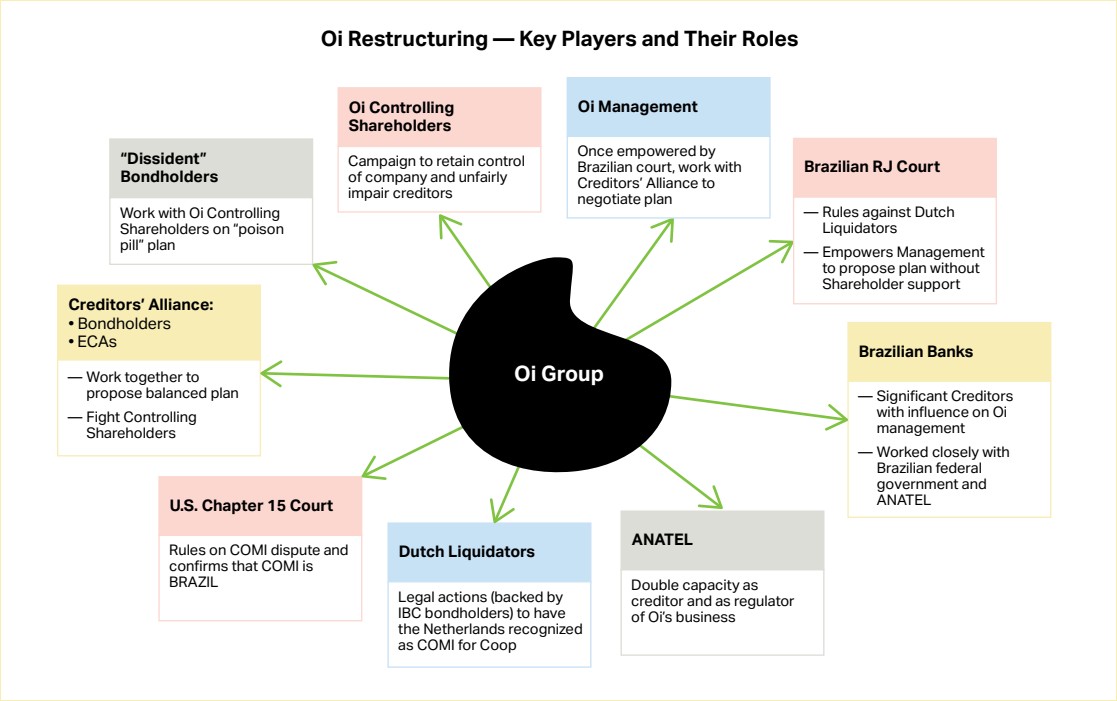
in Brazil in June 2016, and the Brazilian reorganization court accepted jurisdiction over each of the debtors, including Oi's two Dutch finance subsidiaries, Oi Brasil Holdings Coöperatief U.A. ("Coop") and Portugal Telecom International Finance B.V. ("PTIF"). Shortly thereafter, Oi and/or certain other of the debtors in Brazil filed for additional protection in ancillary proceedings in New York and the United Kingdom, as well as separate proceedings in the Netherlands.

Substantive Consolidation

In Brazil, as in most countries, the bankruptcy law respects the corporate separateness of debtors, and therefore it is the general rule that, within a corporate group restructuring, creditors' claims will not be treated *pari passu* with those of creditors of other members of the corporate group. However, particularly since the *Rede Energia S.A.* restructuring in 2014, Brazilian courts have increasingly confirmed restructuring plans for Brazilian corporate groups that substantively consolidate creditor claims, even over the objections of creditors. Oi's initial proposed restructuring plan, presented in September 2016, took a substantively consolidated approach. Various creditor groups opposed such substantive consolidation (albeit for different reasons), and filed motions against substantive consolidation with the restructuring court.

An appeals court in Rio de Janeiro ultimately decided that the question of substantive consolidation was one that should be determined by creditors by vote at a creditors meeting. Importantly, the judge ruled that this vote should occur on an entity-by-entity basis, thereby providing the creditors of Oi and its debtor-subsidiaries with an important protection by ultimately leaving the decision on whether to accept substantive consolidation in the hands of creditors – if creditors at any particular entity were to reject substantive consolidation, it would present significant difficulties for the rest of the Oi Group to restructure on a substantively consolidated basis. If this decision is adopted more widely as precedent in Brazil, it could represent an important step in the right direction towards protecting creditors' interest against unfettered substantive consolidation. In Oi's case, a consensual deal with creditors was eventually reached, and creditors of each debtor entity voted in favor of substantive consolidation.

It is, however, worth mentioning that in the course of deciding that the substantive consolidation vote



should be counted on an entity-by-entity basis, the court also determined that guarantees on the bonds (e.g., Oi's guarantee of bonds issued by Coop or PTIF, and Telemar Norte Leste S.A.'s ("Telemar") guarantee of bonds issued by Oi) should not be counted for voting purposes, despite being due and payable at the time, and therefore should not be entitled to vote on whether to accept substantive consolidation. We understand that this ruling is inconsistent with existing Brazilian law, and it is also troubling from a lender's perspective and could have implications on the Brazilian financing markets if it is followed by other judges in Brazil.

Attempt by Certain Creditors to Use the Existence of Intercompany Claims to Improve Their Recoveries

Like companies in many emerging markets, Brazilian companies routinely issue bonds in the international markets using off-shore finance subsidiaries for tax and other reasons. In Oi's case, it has two Dutch finance subsidiaries, Coop and PTIF, which were used to issue a majority of Oi's bond debt. Such offshore financing arrangements gave rise to intercompany loans between the finance subsidiaries and Oi (and guarantees of the bonds by Oi), so that the cash obtained from the sale of bonds could be on-shored to Brazil, used in operations, and, upon maturity of the bonds, off-shored back to the finance subsidiaries for payment to the bondholders in a tax efficient manner. Generally, and in the case of Coop and PTIF, the ability of finance subsidiaries to repay bonds depends fully on the credit worthiness of the operating companies that are counterparties to the intercompany loans and that guarantee the bonds. In Oi's case, as is market practice, this was made abundantly clear in the disclosure documents related to the bonds.

Brazilian restructuring law provides no specific treatment for intercompany claims (other than prohibiting debtors from voting such claims at any creditors meeting) and, as a matter of practice in Brazilian restructuring plans, intercompany claims are generally either ignored entirely or treated as subordinated to third-party debt.

Nevertheless, the existence of certain intercompany claims of Coop against Oi and Oi Móvel S.A., another Brazilian operating company (but not other intercompany loans or transactions among other Oi Group companies) became the focus of a group of bondholders known as the International Bondholder Committee ("IBC"), who sought to use the existence of these intercompany loans to improve the recoveries of creditors of the finance entities. The strategy manifested itself in a litigation strategy in the Netherlands, Brazil and the U.S.

In particular, in the U.S., the Coop judicial administrator, at the urging of the IBC, petitioned the U.S. Chapter 15 court to find that Coop's Dutch proceedings, rather than the Brazilian proceedings, should be considered Coop's foreign main proceeding, despite the Chapter 15 court having already recognized the Brazilian proceedings as Coop's foreign main proceeding nearly one year prior. If the Coop judicial administrator were successful, he could replace Coop's foreign representative (at that point, an Oi appointee) in the Chapter 15 proceedings, and generally control Coop's actions in the Chapter 15 proceedings going forward. He could also use his status as judicial administrator for Coop to seek to block the Chapter 15 court from enforcing any plan of reorganization for Coop confirmed in Oi's Brazilian proceedings.

Coop's judicial administrator (and the IBC in supporting filings) contended, *inter alia*, that the conversion from Dutch suspension of payments proceedings (a debtor-in-possession regime) to bankruptcy liquidation proceedings (where the administrator would have increased control) shifted Coop's "center of main interest" or "COMI" from Brazil to the Netherlands.[2] Oi, supported by the Steering Committee of an Ad Hoc Group of Bondholders (the "AHG Steering Committee"),[3] opposed the requested relief. After extensive discovery and depositions and an expedited four-day bench trial, Judge Sean H. Lane of the United States Bankruptcy Court for the Southern District of New York, in early December 2017, issued an opinion in favor of Oi and the AHG Steering Committee's position, and against Coop's judicial administrator, finding that Coop's COMI remained in Brazil, and therefore that the Brazilian proceedings remained the foreign main proceeding for Coop. The decision took issue with the attempt by creditors to "weaponize Chapter 15 to collaterally attack" legitimate ongoing foreign restructurings to serve their own purposes, undermining "the goals of maximizing the chapter 15 debtors' assets and assisting in the rescue of their financially troubled business."[4] As is further described in the table, the decision is likely to have an important precedential effect, as it may provide more certainty for creditors and debtors alike regarding Chapter 15 courts' COMI analysis with respect to finance subsidiaries in multi-jurisdiction restructurings, and in particular their willingness to revisit earlier COMI determinations. The

Other Key Takeaways from Oi Chapter 15 Decision

Creditor Behavior and COMI Manipulation

— Chapter 15 court found that creditors' behavior can be taken into account in the Chapter 15 COMI manipulation analysis

— Previous decisions had focused only on the behavior of debtors and their representatives

Standard For Modifying Existing Recognition Order

— Chapter 15 court found that the appropriate standard for modifying or terminating an existing recognition order is that the court may do so, in its discretion, upon a finding that the grounds for its entry were fully or partially lacking or have ceased to exist

Independent Obligation to Make COMI determination

— Even where foreign jurisdictions (such as the Netherlands) have comprehensive restructuring regimes, where such jurisdictions have ***not*** adopted the UNCITRAL Model Law (basis for Chapter 15), the findings of such foreign courts do ***not*** replace the Chapter 15 court's obligation to make an independent COMI determination

decision is currently subject to a pending motion for reconsideration by the IBC and appeals by the IBC and the Dutch judicial administrator. Ultimately, the IBC and the AHG Steering Committee agreed that their respective claims would receive *pari passu* treatment, which agreement helped cement a coalition of creditors that managed to negotiate a consensual restructuring with Oi.

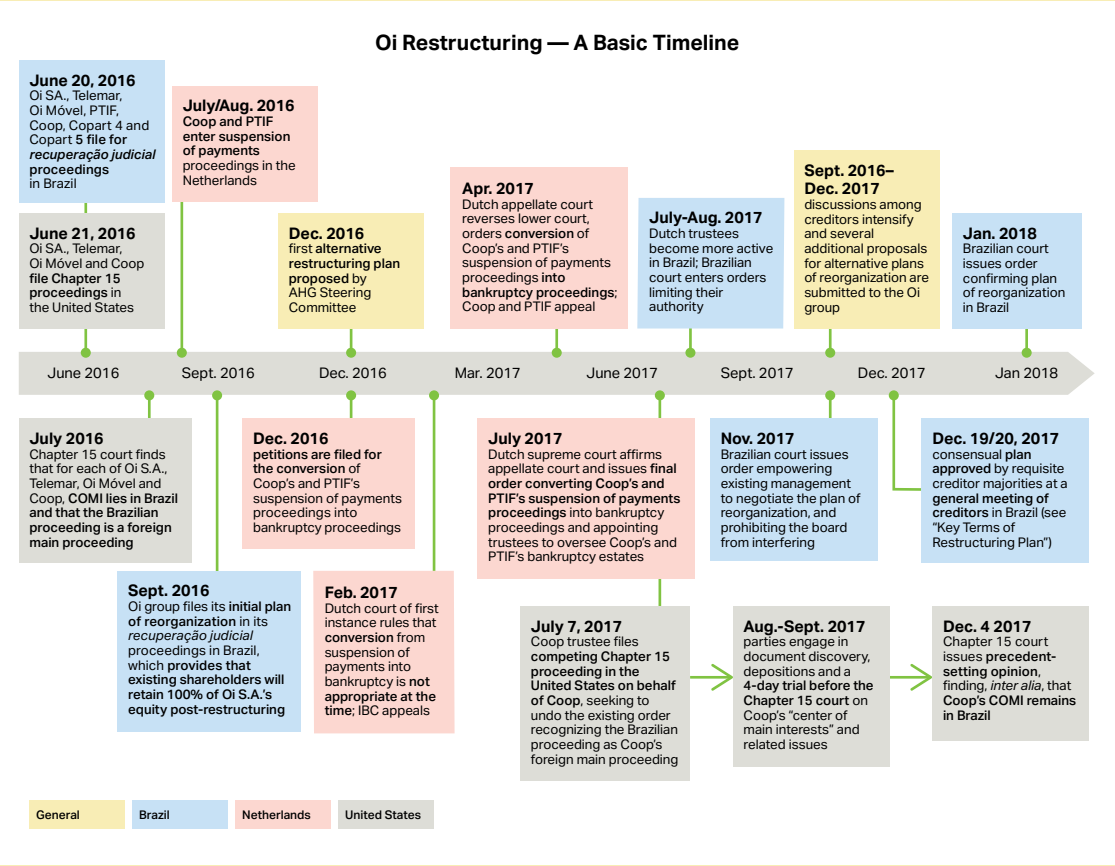
Limits on Abusive Behavior by Shareholders and their Board Representatives

Brazil's restructuring law does not allow creditors to formally propose alternative restructuring plans, instead leaving that power in the hands of a company's board and its management.[6] That said, the basic premise of the law is that debtors and creditors will negotiate in good faith in order to approve a restructuring plan that is in the best interest of the debtors and creditors in an expeditious manner,[7] and that creditors have the right to reject any proposal put forward by the debtors. However, in general, Brazilian restructuring proceedings are considered more debtor-friendly than in many jurisdictions, and recent court decisions in Brazil, notably the *Grupo Schahin* case, have determined that creditors can have their right to vote on a restructuring plan disregarded if they are found to have acted "abusively" during the restructuring negotiations.[8] Shareholders also typically play a large role in Brazilian restructurings, particularly given that most Brazilian companies do not have independent boards.[9]

In Oi's case, it had two minority, but effectively controlling, shareholders that were actively involved throughout the restructuring process – the investment vehicles of Pharol, SGPS S.A., the legacy owner of Portugal Telecom, and Nelson Tanure, a well-known activist shareholder in Brazilian restructurings who acquired his interests in Oi on the eve of its judicial restructuring. Pharol and Tanure exerted pressure on Oi's board throughout the process and ensured that each restructuring plan proposed by Oi's board, over the course of nearly 18 months under judicial restructuring, would have effectively resulted in existing shareholders retaining 100% of Oi's shares immediately post restructuring, while forcing creditors to either take massive principal haircuts or significant maturity extensions and interest rate cuts.

While creditors are not able to formally propose alternative restructuring plans in Brazil, the AHG Steering Committee, and in the later stages of the restructuring, together with the IBC, developed and publicly presented multiple alternative proposals, which were supported by a group of international export credit agencies ("ECAs"), for restructuring Oi in a far more viable and equitable way. In each case they had their proposals either ignored or rejected by Oi's board. Nevertheless, the AHG Steering Committee, IBC and ECAs continued to attempt to engage the company's management in negotiations, and throughout the process were in regular communication with Oi's other key stakeholders, including Brazilian state and private banks and key government actors, in the hope of advancing a consensual and viable restructuring plan.

By November 2017, nearly 18 months after entering judicial restructuring proceedings, and immediately following some particularly egregious actions by the minority controlling shareholders and their board representatives, the AHG Steering Committee and the IBC filed a motion seeking to remove the voting rights of Pharol and Tanure and their board members in response to their abusive actions. The Brazilian court quickly ruled that the board could no longer have any role in formulating or negotiating a restructuring plan for Oi, and that instead that power was vested solely with Oi's existing management. This important and precedential decision held that shareholders (and their board representatives) could also be deemed to have acted abusively and therefore have their rights disregarded, essentially subordinating Brazilian corporate law to Brazilian restructuring law and creating a shareholder-side analogue to the *Grupo Schahin* creditor abusiveness case. The decision potentially goes a long way towards restoring some balance between creditors and debtors in judicial restructuring negotiations. Most immediately, in



Oi's case, the decision freed Oi's management to finally engage in *bona fide* negotiations with Oi's creditors, and significantly accelerated the process of agreeing on a consensual restructuring plan, using the various alternative creditor-proposed plans as a framework.

Treatment of Regulatory Fines in Brazilian Judicial Restructurings

Part of the Oi Group's financial and operational difficulties resulted from the fact that Brazil's existing concession-based telecommunications regime is significantly outdated. For example, the terms of Oi's concessions impose on Oi the obligation of maintaining public phones and land-lines in some of the most remote and poorest parts of Brazil, even when residents in those areas are already overwhelmingly served by wireless service, and imposed heavy fines whenever Oi was not in compliance with such requirements.

As a result, when Oi filed its initial creditors list it included approximately R$10 billion in fines levied by ANATEL, the Brazilian telecommunications regulator, resulting in part from non-compliance with its concession obligations.

Brazil's restructuring law does not explicitly allow for regulatory fines to be restructured as financial debt, nor does it explicitly disallow it. Tax claims, on the other hand, are generally explicitly excluded from restructuring. ANATEL predictably took the position that its claims were not subject to restructuring, and were more properly characterized as tax-like claims. Throughout the restructuring process, then, ANATEL was wearing a dual hat as regulator and creditor, albeit resisting its characterization as a creditor whose claims could be impaired

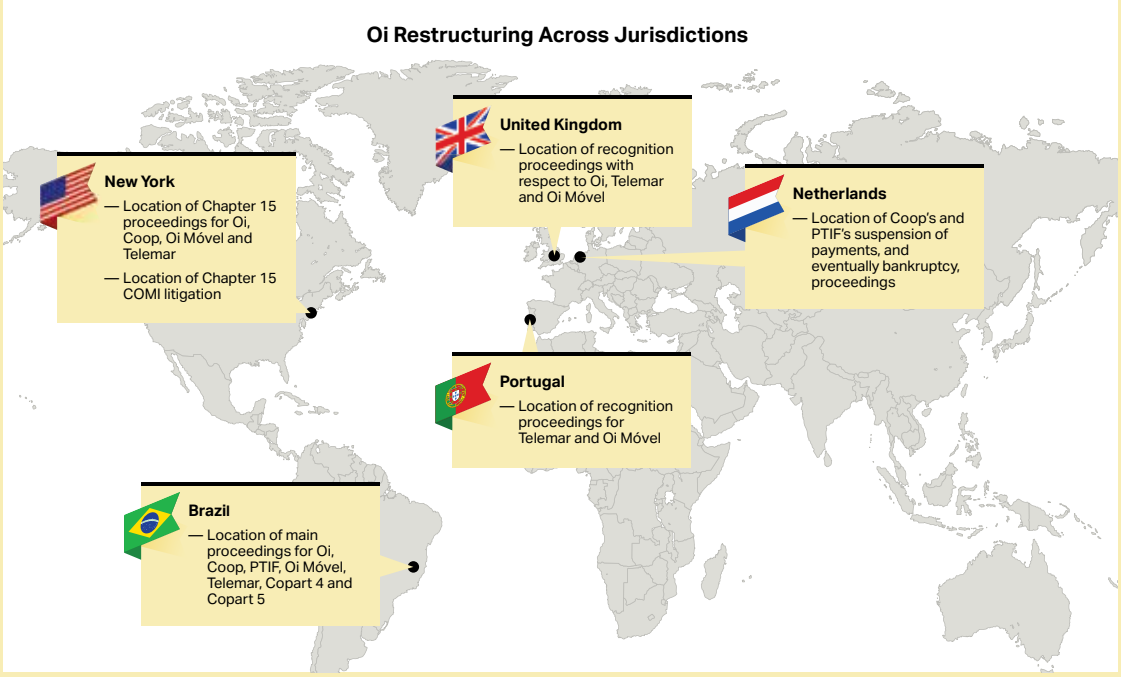
by judicial restructuring. The Brazilian presidential administration and other government actors faced massive political pressure not to provide Oi (or its international creditors) any sort of a bailout with respect to its ANATEL claims, particularly given the dire state of the Brazilian economy. Brazilian state-owned banks, such as Banco do Brasil, Caixa Economica and BNDES were also among Oi's largest creditors, and were also facing potential write-downs with respect to their Oi claims, further exacerbating the political issues and drawing extensive coverage in the Brazilian business and popular press.

Nevertheless, throughout the restructuring proceedings, ANATEL's claims remained on Oi's creditors list, and both the judicial restructuring court and an appeals court sitting in Rio de Janeiro have sided with Oi. The restructuring plan that was ultimately approved provides specific treatment for ANATEL's claims, with crystalized amounts to be restructured and paid over a 20-year period and gave Oi the ability to use cash sitting in judicial deposits for the initial installments. Non-crystalized amounts that are subsequently finally determined are to receive the far less generous general payment option, entailing an 85% haircut and no cash payments for the first 20 years. The plan also contains a provision whereby if a law change or regulation allows for an alternative means of settling the ANATEL claims, the debtors may do so.

ANATEL continues to dispute the characterization of its claims in the courts, and went so far as to describe (on the eve of the creditors meeting that approved the plan) its treatment as illegal. If the treatment of ANATEL's claims is not overturned, it would be a significant development as it would provide a framework for dealing with regulated entities with significant regulatory fines in Brazilian judicial restructurings, potentially providing more clarity for creditors and debtors alike.

Key Terms of Restructuring Plan

Existing Debt	Restructuring Consideration
US$10 billion NY and English law bonds	— Reinstated NY Bonds w/ 80% haircut: • Amortization: 7-year bullet; Non-callable • Interest: 8% cash + 4% PIK or 10% cash during the first 3 years; then 10% cash — Shares/warrants for up to 75% of Oi's equity
US$4.2 billion unsecured Brazilian bank and foreign ECA debt	— No haircut — 17 year tenor — Non-linear amortization starting in year 6 — Interest: 80% of CDI for Banks; 1.75% for ECAs
US$1 billion secured Brazilian bank debt	— No haircut — 15 year tenor — Non-linear amortization starting in year 7 — Interest: TJLP + 2.946%
General Payment Option	Creditors not affirmatively electing a specific payment option to receive take-back debt on the following terms: — 25 year tenor — Linear amortization starting in year 21 — Interest: TJ for R$ debt; 0% for US$ and € debt — Pre-payable at any time by Oi for 15% of principal
ANATEL Claims	— 20 year tenor — No principal haircut; 50% haircut on accrued interest; 25% haircut on accrued late charges — Non-linear amortization starting in year 1 — Initial payments to be made using judicial deposits — Adjusted monthly by SELIC — ANATEL claims still subject to appeal paid pursuant to General Payment Option
Other Key Features	
New Money Capital Increase	— R$4 billion new money capital increase pursuant to rights offering — Fully backstopped by large financial institutions
Governance Reforms	— Substantial changes to Oi's governance structure to improve transparency and increase independence of board



Conclusion

Oi's restructuring plan was approved, on a substantively consolidated basis, on December 19, 2017, after a nearly two-year process. The plan was confirmed by the Brazilian restructuring court in January 2018 and, while there are ongoing appeals pending, the plan is expected to be implemented over the course of 2018. ■

1. Oi's bond debt consisted of the Brazilian *reais* equivalent of approximately R$16.2 billion in notes issued by PTIF and guaranteed by Oi, R$7.6 billion in notes issued by Coop and guaranteed by Oi, R$9.2 billion in notes issued by Oi and guaranteed by Telemar, and R$1.0 billion in notes issued by Oi without a guarantee. Oi's other financial debt consisted mostly of debt owed to banks and export credit agencies, and its only secured creditor was the Brazilian Development Bank (BNDES).
2. A Chapter 15 debtor can only have one "foreign main proceeding," which must be located in the same jurisdiction as its COMI.
3. Cleary Gottlieb is international counsel to the AHG Steering Committee in connection with the Oi Group's restructuring. Pinheiro Neto Advogados and Moelis & Company served as Brazilian counsel and financial advisors, respectively, to the AHG Steering Committee.
4. *See In re Brasil Holdings Coöperatief U.A.*, 578 B.R. 169 (Bankr. S.D.N.Y. 2017).
5. The Oi Group will still need to comply with Dutch restructuring law in order to allow Coop and PTIF to exit Dutch bankruptcy liquidation proceedings.
6. For a more fulsome discussion of the debtor-creditor dynamics in Brazilian restructuring proceedings, *see* Richard J. Cooper, Francisco L. Cestero & Daniel J. Soltman, Insolvency Reform in Brazil: An Opportunity Too Important To Squander, Cleary Gottlieb Emerging Markets Restructuring Journal Issue No. 4 (Fall 2017), *republished* with certain updates and modifications in Pratt's Journal of Bankruptcy Law, Jan. 2018.
7. The Brazilian Bankruptcy Law provides for an automatic stay of 180 days, though such period is routinely extended at the request of debtors, which has had the effect of diminishing the pressure on debtors to negotiate with their creditors in a timely manner.
8. The *Grupo Schahin* decision determined that a secured creditor should have its votes disregarded at the creditors meeting, because it was behaving "abusively" – an unclear and judicially created concept in Brazil – because the proposed restructuring plan would have provided the creditor with a higher recovery than a liquidation.
9. Article 47 of the Brazilian Bankruptcy Law states the purposes of judicial restructuring, which explicitly does not include the interest of shareholders, but does specifically mention the interest of creditors: "The object of judicial reorganization is to make it possible for the debtor to overcome his economic and financial crisis in order to be able to maintain the production source, employment of workers and interests of the creditors, thus contributing to preserve the company and its social function and to foster economic activity."

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