Pratt's
Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

APRIL/MAY 2016

Editor's Note: Anticipating the Next Downturn
Victoria Prussen Spears

Chapter 9 Revisited: Preparing for the Next Downturn
David L. Dubrow

Lifestyles of the Rich and Not So Famous in Bankruptcy Proceedings
Michael J. Lichtenstein

50 Cent: You Love Him in a Bentley, But Would You Love Him on a Bus? 50's Creditors Have 21 Questions, and They're All About U.S. Bankruptcy Law
David J. Cohen

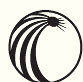
Recent Decisions Have Shed Light on General Jurisdiction, But Ambiguity Remains for Defendants That Are Members of Affiliated Groups
Joseph Cioffi and James R. Serritella

Let Me Be Clear: Fifth Circuit Holds Generic Plan Release Language Lacks Specificity to Discharge Creditor's Claims Against Officer of the Debtor
Matthew Goren

The Seventh Circuit Ups the Ante in an Instructive Decision Affirming the Power of Bankruptcy Courts to Stay Litigation
Michael T. Benz, James P. Sullivan, and Bryan E. Jacobson

Third Circuit Permits Purchaser in Section 363 Sale to Make Payments to Interested Parties, Deviating from Bankruptcy Code Priority Scheme
Brad Eric Scheler, Alan N. Resnick, and Michael R. Handler

The Brazilian Insolvency Regime: Some Modest Suggestions—Part II
Richard J. Cooper, Francisco L. Cestero, Jesse W. Mosier, and Daniel J. Soltman



LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D. at 415-908-3207

Email: .... kent.hanson@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . (800) 833-9844

Outside the United States and Canada, please call . . . . (518) 487-3000

Fax Number . . . . (518) 487-3584

Customer Service Web site . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call

Your account manager or . . . . (800) 223-1940

Outside the United States and Canada, please call . . . . (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] Pratt's Journal of Bankruptcy Law [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 Pratt's Journal of Bankruptcy Law 349 (2014)

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a registered trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2016 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt® Publication

Editorial Office
630 Central Ave., New Providence, NJ 07974 (908) 464-6800
www.lexisnexis.com

(2016-Pub.4789)

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF
Steven A. Meyerowitz
President, Meyerowitz Communications Inc.

EDITOR
Victoria Prussen Spears
Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Scott L. Baena
Bilzin Sumberg Baena Price & Axelrod LLP

Thomas W. Coffey
Tucker Ellis & West LLP

Robin E. Keller
Lovells

Leslie A. Berkoff
Moritt Hock & Hamroff LLP

Michael L. Cook
Schulte Roth & Zabel LLP

Matthew W. Levin
Alston & Bird LLP

Ted A. Berkowitz
Farrell Fritz, P.C.

Mark G. Douglas
Jones Day

Patrick E. Mears
Barnes & Thornburg LLP

Andrew P. Brozman
Clifford Chance US LLP

Timothy P. Duggan
Stark & Stark

Alec P. Ostrow
Stevens & Lee P.C.

Kevin H. Buraks
Portnoff Law Associates, Ltd.

Gregg M. Ficks
Coblentz, Patch, Duffy & Bass LLP

Deryck A. Palmer
Pillsbury Winthrop Shaw Pittman LLP

Peter S. Clark II
Reed Smith LLP

Mark J. Friedman
DLA Piper

N. Theodore Zink, Jr.
Chadbourne & Parke LLP

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company, Inc. Copyright 2016 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844.

Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz,

Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 718.224.2258. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 630 Central Avenue, New Providence, NJ 07974.

The Brazilian Insolvency Regime: Some Modest Suggestions—Part II

By Richard J. Cooper, Francisco L. Cestero, Jesse W. Mosier, and Daniel J. Soltman[*]

This two-part article is loosely organized chronologically according to the typical life of a Brazilian restructuring. The first part of the article, which appeared in the February/March 2016 issue of Pratt's Journal of Bankruptcy Law, *focused on (i) the need to improve the recuperação extrajudicial process and ensure specialized knowledge of courts overseeing recuperação judicial proceedings, (ii) the need to expand the reach of the courts to approve and facilitate debtor-in-possession financing, and (iii) a debtor's relationship with its vendors and its need to have the ability to (A) prefer critical vendors over other creditors in order to ensure continued service and operations and (B) extract itself from overly burdensome contracts. This second part of the article focuses on the plan of reorganization, where the authors recommend (i) creditor-focused standards for substantive consolidation, (ii) allowing creditors to propose a plan of reorganization, (iii) simplifying the process for bondholder voting on a plan, and (iv) scaling back the restrictions against repeated reorganization filings.*

SUBSTANTIVE CONSOLIDATION

An additional source of confusion and uneasiness for international investors regarding the Brazilian Insolvency Regime is the possibility that a court will allow plans of reorganization for related entities to be substantively consolidated. Absent explicit statements or understandings to the contrary, when a lender makes a loan to a company, the lender has the reasonable expectation that it is lending only to the company, that corporate separateness will be

[*] Richard J. Cooper, a partner based in the New York office of Cleary Gottlieb Steen & Hamilton LLP, focuses his practice on domestic and international restructurings, mergers and acquisitions, and leveraged finance (including project and acquisition finance). Francisco L. Cestero, a partner based in the firm's São Paulo office, focuses his practice, among other things, on corporate and financial transactions, including corporate restructuring. Jesse W. Mosier, an associate based in the firm's São Paulo office, focuses his practice on corporate and financial transactions with an emphasis on the firm's Latin American clients. Daniel J. Soltman, an associate based in the firm's New York office, focuses his practice on bankruptcy and restructuring. The authors may be contacted at rcooper@cgsh.com, fcestero@cgsh.com, jmosier@cgsh.com, and dsoltman@cgsh.com, respectively.

respected and that its debt will not be treated *pari passu* with that of other members of a corporate group. This issue is, of course, not unique to Brazil—substantive consolidation is a possibility in many jurisdictions—but recent Brazilian case law has raised concerns for lenders and investors because it has introduced uncertainty as to when and how a court will allow substantive consolidation.

For example, in the *recuperação judicial* of Rede Energia S.A., *et al.*, the court approved the substantive consolidation of assets and liabilities of five debtors for voting and distribution purposes, finding that substantive consolidation was appropriate because the Rede group was "in fact organized as a corporate group, with a common controlling company and credit inter-dependence, as loans exist between the companies that comprise the group, and cross-corporate guarantees to honor obligations to third parties. Moreover, the plan is based on the joint cash flow of the companies, in such a way to find an effective means of reorganization."[1] Despite objections raised by creditors to this standard for substantive consolidation, the Brazilian appeals court denied an injunction and the Brazilian bankruptcy court confirmed the substantively consolidated plan of reorganization.[2]

Going forward, it would be helpful to have a more precise, creditor-focused standard for substantive consolidation, since creditors are the group that is potentially harmed by a substantive consolidation, and to have the same standard apply throughout the Brazilian judicial system. In the United States, for example, "[b]ecause of the dangers in forcing creditors of one debtor to share on a parity with creditors of a less solvent debtor, we have stressed that substantive consolidation is no mere instrument of procedural convenience . . . but a measure vitally affecting substantive rights, to be used sparingly . . . [in considering whether substantive consolidation is appropriate, we consider] two critical factors: (i) whether creditors dealt with entities as a single economic

---

[1] *See* Fact Stip., *In re Rede Energia*, Case No. 14-10078 (SCC) (Bankr. S.D.N.Y. May 2, 2014), ECF No. 26, ¶ 58.

[2] *Id.* ¶ 59. The United States Bankruptcy Court for the Southern District of New York (the "SDNY Bankruptcy Court") granted Chapter 15 recognition to the *Rede* debtors, notwithstanding arguments from creditors that the Brazilian courts' allowance of substantive consolidation was contrary to U.S. public policy and inappropriate as a matter of law, since it allowed substantive consolidation where a U.S. court would not. *See In re Rede Energia S.A.*, 515 B.R. 69, 100–01 (Bankr. S.D.N.Y. 2014). In its opinion, the SDNY Bankruptcy Court did not take a view on the propriety of substantive consolidation under the circumstances, but instead explained that where creditors had been afforded due process and the Brazilian courts made specific findings, "it is not appropriate for this Court to superimpose requirements of U.S. law on a case in Brazil or to second-guess the findings of a foreign court." *Id.* at 100.

unit and did not rely on their separate identity in extending credit or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors."[3]

Other jurisdictions go even further, disallowing the possibility of substantive consolidation entirely, such as Mexico and the United Kingdom (absent fraud or other or other extraordinary circumstances). Such a drastic change to the Brazilian Insolvency Regime is not necessary, as substantive consolidation is both appropriate and helpful under certain circumstances. However, some modification to the existing approach would likely be beneficial to the Brazilian economy, since investors will likely feel more comfortable investing in Brazilian companies that are part of a corporate group if they could do so with the confidence that their debt would not be treated *pari passu* with that of other members of the group upon a *recuperação judicial* filing unless doing so would be in the interest of all creditors (including themselves). As such, we would suggest (i) clarifying the standard for substantive consolidation to, at a minimum, ensure that the impact on all creditors is examined closely in connection with a decision to allow substantive consolidation and (ii) uniformly applying such standard throughout Brazil. What clearly should not be permitted, is for the debtor to be able to use substantive consolidation as a tool to force creditors to obtain substantially less than what they would otherwise have received, or favor one group of creditors over another in circumstances where the underlying facts suggest that different entities within the corporate group operated separately and creditors could not have anticipated such a result.

LACK OF CREDITOR PROPOSED PLANS OF REORGANIZATION

Like many Latin American jurisdictions, in Brazil, creditors may not propose their own plans of reorganization to compete with debtors' plans or offer amendments to debtor proposed plans. For creditors, this is a major problem because, apart from voting against a debtor-proposed plan or appealing a confirmed plan, creditors have very little leverage with which to influence either the overall contours of a plan or their specific treatment thereunder. Both voting against a plan and appealing a confirmed plan increase the risk of the debtor ending up in liquidation, inevitably resulting in lower creditor recovery rates.

Creditors' inability to propose competing plans contributes to the general perception, by no means unique within Latin America, that, in Brazil, equity effectively stands ahead of debt in insolvency proceedings. While under the

[3] *In re Augie/Restivo Banking Co., Ltd.*, 860 F.2d 515, 518 (2d Cir. 1988) (internal citations omitted).

Brazilian Insolvency Regime, the number of reorganization plans that have been court-approved has increased, the percentage of debtors that actually emerge from reorganization proceedings (as opposed to being converted to liquidation proceedings) remains below fifty percent.[4]

While Brazil is certainly not alone amongst Latin American jurisdictions in preventing creditors from proposing alternative reorganization plans, recent reforms in Mexico and Argentina have provided creditors with opportunities to have a greater role in formulating reorganization plans. In Argentina, the in-court reorganization process (*concurso preventivo*) is similar to the U.S. Chapter 11 proceeding, in that debtors initially have an exclusivity period (90 days, extendable for up to 30 additional days), during which only the debtor may propose a reorganization plan. Following expiration of the exclusivity period, other interested parties, including creditors, may propose their own plans. Creditor-proposed plans can be approved with the same majorities as debtor-proposed plans, but do not need the approval of the debtor itself.

The Mexican approach differs somewhat, but still allows creditors significant influence over the development of the reorganization plan. After entering the reorganization proceedings, the parties pass to a conciliation phase, during which a mediator works with both the debtor and the creditors to elaborate and negotiate the reorganization plan. During this period, which can last up to a year, any party may propose their own plan to the others or amendments to debtor-proposed plans. Unlike the Argentine process, a creditor-proposed plan cannot be approved over the objection of the company.

In Brazil, instituting a framework that allows for creditors to have a greater role in developing reorganization plans and encourages negotiation would go a long way to dispelling the perception that the Brazilian Insolvency Regime is excessively equity-friendly, and more importantly, further reducing unnecessary and costly liquidations.

BONDHOLDER VOTING

Closely related to the disadvantages creditors face in their inability to independently propose plans of reorganization is the potential for bondholder disenfranchisement. In contrast to a Chapter 11 proceeding in the United States, where a bondholder has a clear path to voting its claim, a bondholder that beneficially holds a New York or English law governed bond through a central depositary outside Brazil (such as DTC, Euroclear or Clearstream) (a

---

[4] Jeffrey M. Anapolsky, & Jessica F. Woods, Pitfalls in Brazilian Bankruptcy Law for International Bond Investors, 8 J. Bus. & Tech. L. 397 (2013).

"Bondholder") faces an uphill battle to cast its vote in a *recuperação judicial* proceeding.

Brazilian law contemplates that, in the case of Brazilian law governed debentures, the trustee votes on behalf of all debenture holders upon a majority direction from the debenture holders. However, the law does not contemplate that a trustee could split the vote among debenture holders, and instead must cast one vote affirmatively or negatively on behalf of all the debentures. This is wholly inconsistent with a Chapter 11 proceeding in the United States (where beneficial owners may *always* vote their individual claims), and, for this reason, the New York Law Model Indenture, on which most of the New York law governed indentures used by Brazilian issuers is based, is not tailored to address the unique circumstances in Brazilian markets, neither providing explicit authorization for the trustee to vote on behalf of the bonds nor contemplating the right or procedures for Bondholders to vote individually.

Without explicit authorization, trustees have generally been hesitant to vote on behalf of Bondholders. At a minimum, as they are permitted to do under most New York law governed indentures, they have required an indemnity and instruction from the majority Bondholders. In some cases, Brazilian courts have given individual Bondholders the right to vote, but the practice is not uniform and Bondholders have had to comply with, or receive specific exemptions from, "individualization" procedures for documenting and verifying claims prescribed by the law for all creditors that are burdensome to comply with for bonds held through central depositaries and clearinghouses outside Brazil. Further, a Bondholder that has individualized its claim must attend the general meeting of creditors, in person or by proxy or counsel, in order to submit a vote, adding expense and complexity to the process.

The *Rede Energia* decision in Brazil further complicated the discussion. There, the Brazilian bankruptcy court held that a trustee of a New York law governed bond is not allowed to vote in a *recuperação judicial* proceeding without the explicit consent of 100 percent of Bondholders to the extent the plan of reorganization contemplates a fundamental change to the underlying securities. The court relied on a provision typical in New York law indentures that prohibits amendments regarding certain reserved matters without the consent of all holders,[5] holding that a trustee could not vote without the consent of 100 percent of Bondholders, because such a vote by the trustee

[5] "However, without the consent of the Holder of each outstanding Security affected thereby, an amendment or waiver may not: (1) change the date upon which the principal of or the interest on any Security is due and payable; (2) reduce the principal amount of any Security; (3) reduce the rate of interest on any Security (including Additional Amounts) or any premium payable

would impermissibly consent to a change in the principal or interest on the securities. As a practical matter, obtaining 100 percent consent is next to impossible, and judicial restructurings often result in changes to terms that would otherwise require the consent of 100 percent of Bondholders under New York law indentures. While practitioners would not generally consider this provision as applicable to votes cast in judicial proceedings, this precedent, combined with the inability of trustees in Brazilian judicial proceedings to cast votes in accordance with individual holder instructions, have heightened the risk and concerns of trustees.

Post-*Rede Energia*, litigants have reexamined the rights of Bondholders to vote in *recuperação judicial* proceedings. In OGX's restructuring, with these challenges to Bondholder voting in mind, the bankruptcy court approved a specific procedure by which Bondholders could elect to individualize their claims to vote on the plan of reorganization at the general meeting of creditors (the "Individualization Procedure"),[6] designed to accommodate the realities of holding securities through foreign central depositaries and clearing houses. The Individualization Procedure was challenged by two non-Bondholder creditors based on contractual arguments. Although the appeals were eventually withdrawn, the appellants had obtained a preliminary injunction on Bondholder voting at the general meeting of creditors that could have further increased the risk of Bondholder disenfranchisement.

The outcome in the OGX case was ultimately correct—individual Bondholders were able to attend and vote, personally or by proxy, at the general meeting of creditors. The risk of disenfranchisement, however, remains. A different judge, debtor or venue could have resulted in another outcome. To decrease the risk of disenfranchisement, some combination of the following reforms should be considered: *First*, Brazilian bankruptcy law could clearly establish standardized procedures for individualizing claims by Bondholders, thus eliminating any remaining ambiguity. In implementing these suggested reforms, the Brazilian legislature could look to recent reforms in Mexico. The Mexican reforms automatically provide the trustee with the right to vote, but also provide mechanisms for bondholders to individualize their claims and vote separately; the weight of the trustee's vote is then reduced pro-rata by the amount of Bondholders that individualize their claims.[7] *Second*, Brazilian

upon the redemption thereof. . . ." Rede Energia Indenture § 9.02 ("With Consent of Holders").

[6] The court overseeing the *recuperação judicial* of OAS S.A., *et al.* also recently approved procedures for individual bondholder voting.

[7] *See* Ley de Concursos Mercantiles, *as amended*, art. 122, Diario Oficial de la Federación

bankruptcy law could allow a trustee to vote on behalf of any instructing Bondholders in proportion to their holdings, effectively allowing the trustee to vote pro-rata on behalf of the Bondholders. With respect to non-instructing, non-individualizing Bondholders, the law could provide either that they are deemed to not vote or that they are deemed to have voted pro-rata in proportion to the other Bondholder instructions received.[8]

REPEAT FILINGS

In Brazil, debtors may not avail themselves of the *recuperação judicial* process if they have done so within the past five years (or eight years, in the case of small enterprises). They also may not utilize a *recuperação extrajudicial* if they have been through either the *recuperação extrajudicial* or *recuperação judicial* process within the past two years. A company with otherwise incurable insolvency problems prior to the expiration of those time periods would therefore face liquidation.

It is not clear why these time requirements exist or what benefits they provide, if any. Perhaps they are a holdover from the philosophy of earlier insolvency regimes that took a more moralistic approach towards insolvency. Perhaps they are designed to encourage debtors to get their reorganization plans right the first time, rather than having incremental repeated restructurings, though in that case it does not make sense to have a five year threshold for *recuperação judicial* applications, but only a two year threshold for *recuperação extrajudicial.*

At any rate, creditors are at least as likely as debtors to be harmed by these requirements. Having made the determination that court supervised reorganizations are beneficial, that reasoning should also apply to repeated reorganizations. If a debtor finds itself insolvent, but with sufficient support from its creditors to reorganize its debt and operations, the creditors should be free to support that plan, and it should not matter whether the debtor has already restructured in the recent past. Creditors, of course, are always free to push a

---

[DO], 12 de Mayo de 2000 (Mex.). However, the Mexican system does not contemplate that a trustee can split its own vote pro-rata in the event of conflicting instructions.

[8] We are aware that this issue is already on the minds of Brazilian scholars and practitioners. In March 2015, the 2nd Commercial Law Journey of the Federal Justice (II Jornada de Direito Comercial—Conselho da Justiça Federal), in an exercise analogous to the American Bankruptcy Institute's report on Chapter 11 reform, took the view that fiduciary agents or trustees should vote in recuperação judicial proceedings in accordance with the relevant documentation, without prejudice to the right of Bondholders to vote individually after seeking and obtaining specific court approval.

debtor into liquidation simply by not approving the reorganization plan, though the relatively low recovery rates from liquidation are a powerful incentive not to do so.

Time restrictions on reorganizations seem particularly anathema for a country like Brazil, where many prominent companies operate in the commodities industries, which are notoriously subject to business cycles. Many Brazilian companies that are otherwise objectively well run can find themselves facing regular liquidity and operational constraints when their industry's cycle hits its trough.

In the United States, such repeat filings are not considered controversial, and have earned the informal moniker "Chapter 22 filings," a reference to the provision of U.S. law under which companies may reorganize, Chapter 11. Subject to a lack of bad faith, there are no restrictions on repeat Chapter 11 filings. The situation is similar in Mexico. In Argentina, the time requirement is a much more reasonable one year from the date of fulfillment of the earlier reorganization plan.

CONCLUSION

On the tenth anniversary of the Brazilian Insolvency Regime, it is appropriate to look both to the past and the future. Reflecting on the last ten years, it is obvious that the Brazilian Insolvency Regime has come a long way. It is hard to imagine that, back in 2005, insolvency specialists could have envisioned cases like OGX or OAS S.A., *et al.*—multi-billion dollar cross-border cases with proceedings both inside and outside Brazil, where international investors provided DIP financing, assets were sold after a competitive auction process with American style bid protections, businesses underwent operational as well as balance sheet restructurings, and there were contentious proceedings involving U.S style litigation tactics. Looking to the future, however, many reforms could be implemented to foster a more predictable, reliable and transparent system that protects expectations and increases further the chances of a successful restructuring without liquidation. In this paper, we have discussed a few areas that would benefit from further improvement. They are by no means exclusive, but ones that are based on actual experiences and that, in our own opinions, would provide significant benefit to the process without the need for substantial policy changes. No doubt there are more fundamental changes one could suggest, and from a narrower U.S. centric perspective there is much that could be studied and potentially applied from the U.S. insolvency regime (e.g., imposition of an absolute priority rule, more rigorous mechanisms to pursue prior fraudulent and preferential transactions, more open and transparent disclosure and court processes, and clearer and more effective rules

regarding the roles of committees) and other insolvency regimes across the region.