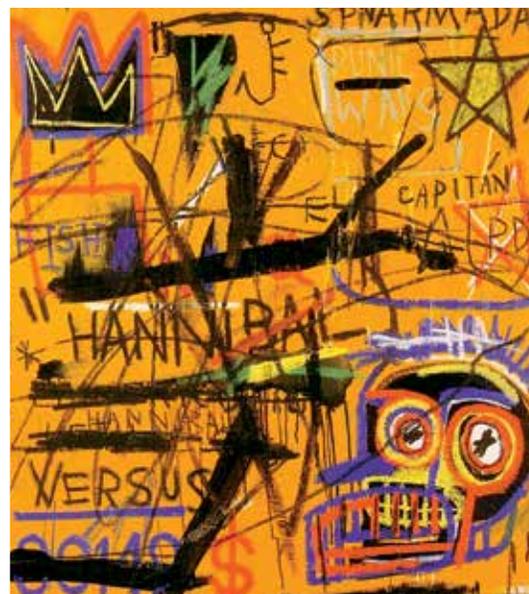


# Novel Structures to Solve Lengthy Liquidations in Brazil: The Banco Santos Case

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Given the remarkable events that took place in Brazil's financial and political scenarios within the last couple of years, notably the impeachment of former president Dilma Rousseff and the countless developments of Federal Police's Car Wash Operation (*Operação Lava Jato*) which involve high ranked politicians and businessmen, it comes as no surprise that, in the aftermath, the number of companies filing for judicial reorganization and bankruptcy liquidation or even having their bankruptcy liquidation requested by their creditors has grown significantly in Brazil. A survey conducted by the consulting firm *Serasa Experian* indicates that the requested filings for judicial reorganization proceedings in Brazil in 2016 increased 44.8% in comparison to 2015. Likewise, in 2016 there were 1,852 requested petitions for bankruptcy liquidation, against the already alarming number of 1,783 petitions requested in 2015.<sup>1</sup>

## Insolvency Statistics in Brazil – 2015-2016

	Judicial Reorganization Proceedings	Liquidation Proceedings
<b>2015</b>	1,287	1,783
<b>2016</b>	1,863	1,852

Source: Serasa Experian Study

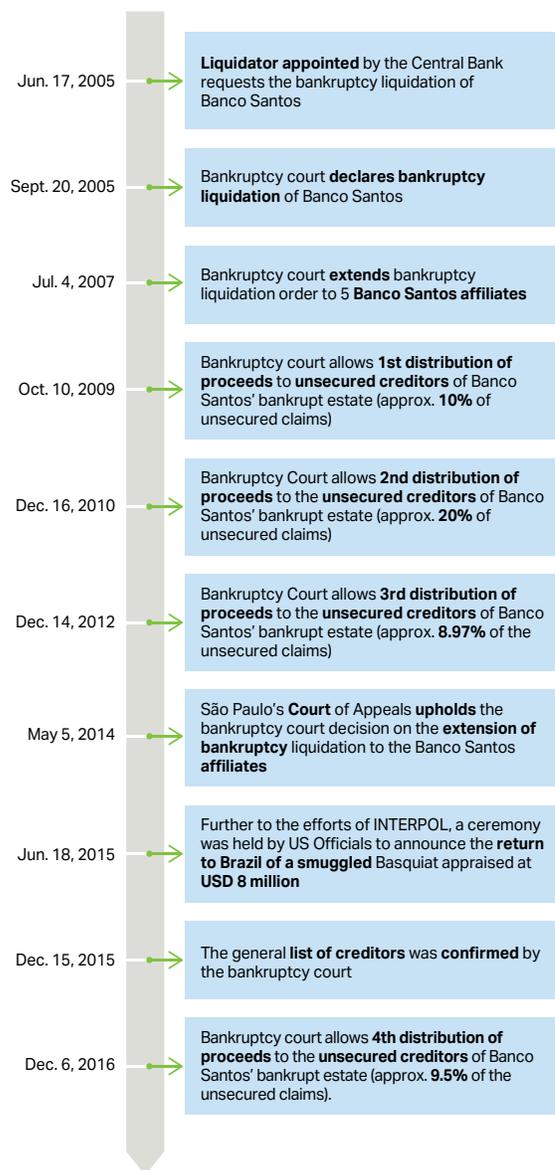
Against this backdrop, it has become increasingly necessary for creditors and debtors to negotiate outside-of-the-box solutions to overcome all sorts of issues related to bankruptcy liquidation proceedings before the Brazilian courts, from the lack of assets available to satisfy high levels of debt to the courts' backlog and countless procedural issues. One of the most remarkable ongoing proceedings on Brazil's track record thus far is the 12-year bankruptcy liquidation of Banco Santos S.A., a Brazilian medium-sized financial institution.<sup>2</sup>

The proceeding began on September 20th, 2005 when the 2nd Bankruptcy Court of Sao Paulo declared Banco Santos's bankruptcy, pursuant to the then-newly enacted Brazilian Bankruptcy Code of 2005. Ever since then, it has been one rocky road: criminal lawsuits against the former CEO of the bank, Mr. Edegar Cid Ferreira, internationally missing works of art (including an USD 8 million Jean-Michel Basquiat) and even the involvement of INTERPOL have marked this particular bankruptcy proceeding.

In spite of such setbacks, the court-appointed trustee has indeed managed to find, collect and appraise assets of Banco Santos's, as well as distribute the proceeds of their sales *pari passu* to the debtor's unsecured creditors. In December 2016, Banco Santos's bankrupt estate distributed approximately BRL 150.3 million (approximately USD 45.5 million)<sup>3</sup> to the unsecured creditors, and since 2009 approximately 40% of the claims held by the unsecured creditors were paid through four distributions.

Now, on the verge of its twelfth anniversary, Banco Santos's bankruptcy liquidation is still pending: claims of all classes amounting to approximately BRL 2.1 billion (approximately USD 636 million) remain outstanding, the high maintenance costs of the court-appointed trustee (approximately USD 90,000 per month) continue to accrue, the search for hidden assets remains ongoing in Brazil and abroad, over 400 lawsuits (mostly enforcement and collection claims) against debtors with low chances of recovery remain unsettled, and the interventions of Mr. Ferreira himself<sup>4</sup> and of some coordinated and

## Key Dates in Banco Santos's Liquidation Proceeding: 2005-2016



Although the bankruptcy proceeding has been ongoing since 2005, the first payments to unsecured creditors only took place in 2009. Within the first years of the bankruptcy, all efforts were concentrated on procedural measures for enlisting of creditors, collection of assets and in-court discussions in connection with legal issues such as settlements between the bankrupt estate and its creditors, compensation, whether Mr. Ferreira should be held accountable with his own assets, amongst others.

independent blocks of creditors defending their own interests continue to permeate the proceedings.

Against this backdrop, earlier this year the Brazilian asset management company *Jive Investments*, a very active player in the distressed asset market in Brazil, has started a process

that could be a light at the end of the tunnel for Banco Santos’s bankruptcy liquidation: an offer addressed to all holders of unsecured claims for the acquisition of all unsecured claims already confirmed by the bankruptcy court and included in the general list of creditors, which amounts to around BRL 1.8 billion (approximately USD 545 million – the “**Target Claims**”) held by approximately 2,000 creditors – which represent a significant amount of all outstanding claims of approximately BRL 2.1 billion. It is important to emphasize that, in spite of the assignment of claims within an insolvency proceeding being a common practice, a massive purchase of claims through an organized proceeding and overseen by a bankruptcy court in an effort to find a solution for a liquidation proceeding is indeed a novel mechanism.

Striving through a territory where others have previously failed (*Banco Paulista, Opus Gestora de Recursos and Credit Suisse*)<sup>5</sup>, Jive proposed a competitive and transparent proceeding, notably in order to avoid future challenges by the bankruptcy court, the Public Prosecutors’ Office, creditors or other interested parties.

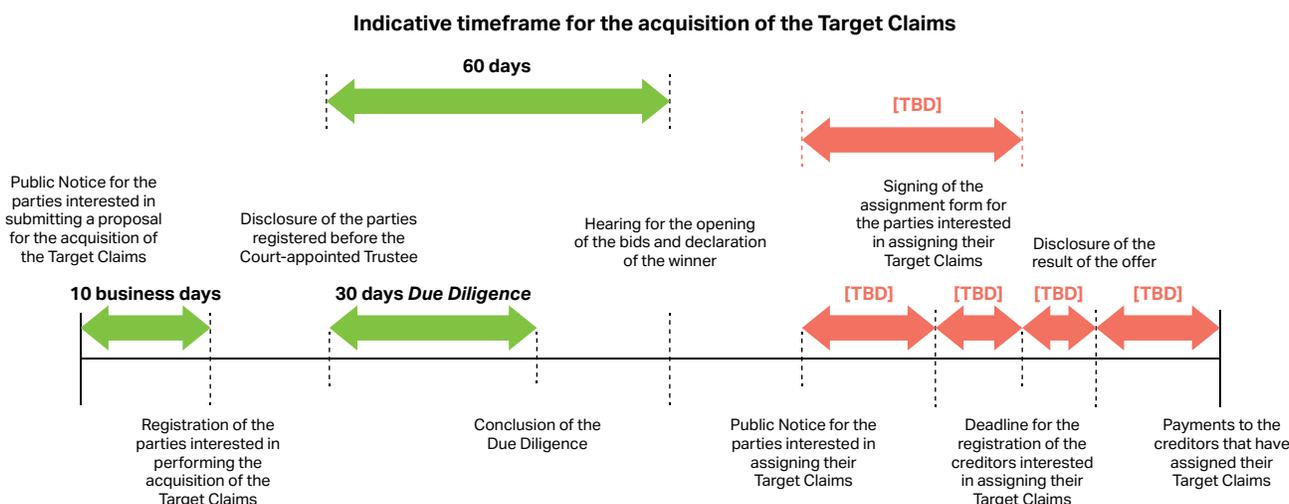
The outline of Jive’s structure submitted before the bankruptcy court is relatively simple: any party interested in acquiring the Target Claims under the same terms and conditions proposed by Jive (except for the “haircut” level and payment term) will be able to submit its bid (after proper due diligence) in a competitive bidding process overseen by the bankruptcy court.

The bids will mainly be with respect to the different variations of payment terms and haircut towards the Target Claims. Hence,

the party that offers the best payment conditions will be declared the winner of this competitive bidding process and thus allowed to launch an offer for the acquisition of the Target Claims within the original framework proposed by Jive (which shall comply with the further described timeframe). However, the completion of the offer may be conditioned to the acquisition of a minimum percentage of the Target Claims (the “**Minimum Amount**”). Secured or unsecured claims above the Minimum Amount that are not resolved will remain in the bankruptcy liquidation under its original conditions.

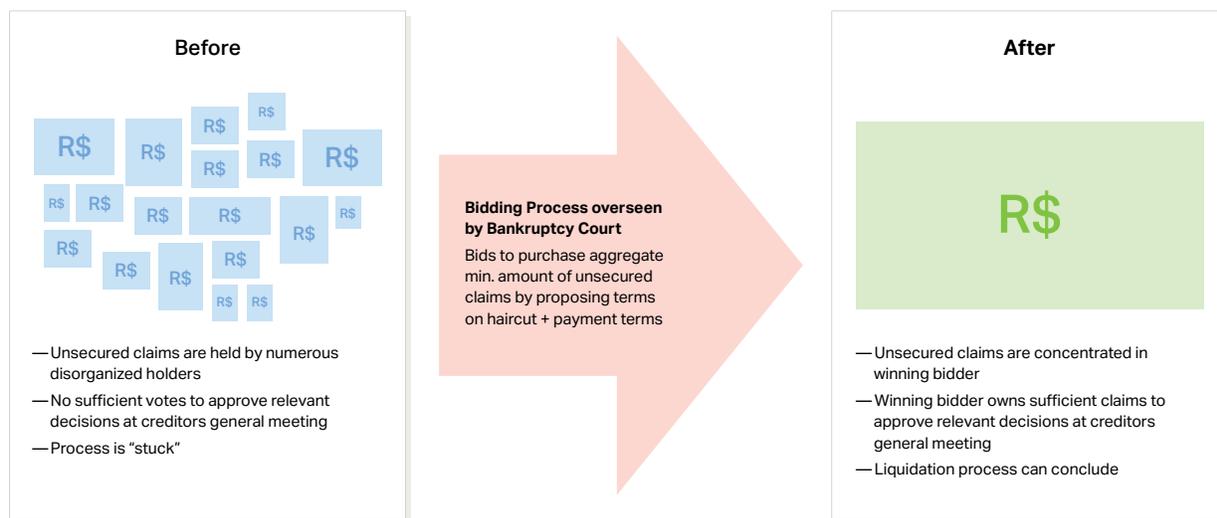
The party that succeeds in this competitive bidding process and manages to acquire the Minimum Amount will gain considerable influence over the bankruptcy proceeding with respect to all matters that are decided at the general meeting of creditors, even becoming able to approve alternative methods for the liquidation of assets — a solution that could result in the termination of the bankruptcy proceeding upon the approval of creditors representing two-thirds of the voting claims attending at the general meeting of creditors.

A structure that could be adopted for purposes of closing the bankruptcy proceeding is the incorporation of a civil law structure where assets are jointly owned (a “condominium”, which is a joint-ownership of assets (in rem) regulated by the Brazilian Civil Code, in which each holder (*condômino*) owns a notional fraction of such asset<sup>6</sup>), or the formation of Brazilian-regulated investment funds (e.g., credit rights funds, real estate funds, or equity interest funds) to which the Target Claims acquired would be transferred. Amongst other advantages,



[TBD] Deadlines to be determined in accordance with the terms of each party interested in performing the acquisition of the Target Claims.

## Target Unsecured Claims



moving claims outside of the bankruptcy process and utilizing this type of innovative structure would allow the acquirer of the Target Claims to liquidate the assets of Banco Santos's estate with much more flexibility and without the excess of formality inherent to the bankruptcy proceedings in general.

The initiative sponsored by Jive is still on its early stages and it may be subject to some adjustments along the way. Although expectations are high, there will be certainly challenges ahead, including obtaining the approval by the bankruptcy court, dealing with labor and tax claims, discussing terms with interested parties, reaching the Minimum Amount and contending with opposing parties.

Currently, the bankruptcy court has rendered a procedural order allowing all interested parties to submit comments and concerns on Jive's initial proposal. Further, the bankruptcy court has also ordered the Public Prosecutor's Office to submit its opinion as to whether or not the competitive bidding process should be indeed authorized.

In spite of its initial stage and of the long road ahead, this is clearly a noteworthy initiative that offers an optimistic prospect for the Banco Santos's creditors and the bankruptcy court, due to its realistic potential of both satisfying unsecured creditors

on a short-term basis and finally bringing closure to a proceeding that has been lingering before the Brazilian courts for the past 12 years. Moreover, if such structure is successfully implemented, it will have a positive impact in mitigating the stigma that a liquidation proceeding is a never-ending nightmare in Brazil with near-to-zero chances of recovery for most of the creditors, mainly unsecured creditors, once the resolution to Banco Santos's bankruptcy liquidation becomes a leading precedent in terms of investments in distressed assets under a court supervision for bankruptcy proceedings in Brazil. ■

1. The survey results can be accessed at <http://noticias.serasaexperian.com.br/blog/2017/01/03/recuperacoes-judiciais-batem-recorde-historico-em-2016-revela-serasa-experian/>.
2. Lefosse Advogados represents Jive Investments in connection with Banco Santos's liquidation proceeding.
3. Exchange rates used for calculations herein are as of July 3, 2017 (BRL:USD equal to 0.3029).
4. Mr. Ferreira has filed motions and appeals challenging several aspects of the bankruptcy proceeding, notably those related to the disposition of assets (e.g., auctions and appraisal of assets, the trustee's fees, settlements between the bankruptcy estate and its creditors, etc.).
5. These parties have proposed sophisticated structures aiming at managing Banco Santos's portfolio of lawsuits, through funds or civil condominiums. Creditors then chose the proposal made by Credit Suisse. However, the bankruptcy court annulled such option under the argument that this structure could allow Mr. Ferreira to receive assets from the bankruptcy estate even before all unsecured claims were paid.
6. In the Brazilian legal system, condominium does not have itself legal personality, but it may assume duties and obligations, as well as sue and be sued.



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