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ALERT MEMORANDUM

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# S.D.N.Y. Bankruptcy Court Grants Chapter 15 Recognition to Large Brazilian Bankruptcy Proceeding

On July 13, 2015, Judge Stuart M. Bernstein of the U.S. Bankruptcy Court for the Southern District of New York (the "Court") issued a decision recognizing the Brazilian bankruptcy proceedings of OAS S.A. ("OAS") and certain of its affiliates as a foreign main proceeding under chapter 15 of the U.S. Bankruptcy Code (the "Bankruptcy Code"). In re OAS S.A., Case No. 15-10937 (SMB), 2015 WL 4197076 (Bankr. S.D.N.Y. July 13, 2015) (the "Decision"). The Decision provides important guidance for foreign debtors with respect to the definition of "foreign representative,"[1] determining a foreign debtor's center of main interests ("COMI")[2] and chapter 15's public policy exception to recognition.[3]

## Background and Procedural History

OAS and its affiliates comprise the OAS Group, which consists primarily of infrastructure and investment companies. Id. at *1. In 2012 and 2013, an Austrian OAS affiliate, OAS Investments GmbH ("OAS Investments") issued two series of 8.25% senior notes due 2019 (the "2019 Notes," and the holders of such notes, the "2019 Noteholders"), in each case guaranteed by three Brazilian entities: OAS, Construtora OAS S.A. ("OAS Construtora") and OAS Investimentos S.A. ("OAS Investimentos") Id. at *2.

In the wake of financial hardship stemming in part from connections to the Brazilian Lava Jato investigation (the "Investigation"), on March 31, 2015, OAS, OAS Construtora, OAS Investments, OAS Finance Limited ("OAS Finance") and certain other affiliates (the "Brazilian Debtors") filed petitions for judicial reorganization under Brazilian bankruptcy law (such proceedings, the "Brazilian Bankruptcy Proceedings"). Id. at *4. Shortly thereafter, the Brazilian bankruptcy court issued a decision approving the filings and the substantive consolidation of the Brazilian Debtors' reorganization. Id.

[1] "[F]oreign representative" is defined in 11 U.S.C. § 101(24) as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

[2] Whether a foreign proceeding is taking place in a debtor's COMI will determine whether a U.S. court will recognize the foreign proceeding as a "foreign main proceeding" or a "foreign nonmain proceeding." This distinction is important because greater protections are extended to a debtor whose foreign proceeding is recognized as a "foreign main proceeding."

[3] Chapter 15's public policy exception to recognition, contained in 11 U.S.C. § 1506 , states that "[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

Certain of the 2019 Noteholders (Aurelius Capital Management, LP ("Aurelius"), Alden Global Capital LLC ("Alden," and together with Aurelius, the "Dissenting Noteholders") and Turnpike Limited ("Turnpike") filed a motion for reconsideration with the Brazilian bankruptcy court, arguing that the prepetition merger of OAS Investimentos into OAS (together with certain other prepetition transfers from 2019 Notes guarantors to non-guarantors, the "Prepetition Transactions") prejudiced the 2019 Noteholders by eliminating their guaranties and therefore structural seniority over OAS' creditors with respect to OAS Investimentos' assets, and asked the Brazilian court to (i) require separate plans and creditor votes for each Brazilian Debtor and (ii) preclude one Brazilian Debtor from using another's assets to pay its debts unless legally required to do so. Id. The Brazilian bankruptcy court declined to reconsider its ruling, and issued a decision affirming the Brazilian Debtors' substantive consolidation (the "Brazilian Reconsideration Decision"). Id. The Brazilian appeals court affirmed, noting that appeal was premature and the Brazilian bankruptcy court's decision remained subject to modification (the "Brazilian Appeals Decision"). Id.

Prior to the Brazilian Bankruptcy Proceedings, Alden and Aurelius both filed actions in New York State Court, seeking to recover amounts owed on the 2019 Notes, and Huxley Capital Corporation (an Aurelius affiliate) brought a fraudulent conveyance action in the District Court for the Southern District of New York, seeking to avoid the Prepetition Transactions as fraudulent transfers. Id. at *3.

Immediately following the commencement of the Brazilian Bankruptcy Proceedings, the boards of directors of OAS, OAS Construtora, OAS Investments and OAS Finance granted powers of attorney to Renato Fermiano Tavares ("Tavares"), appointing him as their foreign representative and authorizing him to file chapter 15 recognition petitions on their behalf. Id. at *5. On April 15, 2015, Tavares filed such petitions (OAS, OAS Construtora and OAS Investments together, the "Chapter 15 Debtors").[4] Id.

The Dissenting Noteholders objected to the Chapter 15 Debtors' petition for recognition.

## The Decision

The Court rejected each of the Dissenting Noteholders' objections and recognized the Brazilian Bankruptcy Proceedings as foreign main proceedings.

*Tavares as Foreign Representative*

The Dissenting Noteholders argued that Tavares was not authorized as a foreign representative because (i) he was not authorized by the Brazilian bankruptcy court to serve as the Chapter 15 Debtors' foreign representative, (ii) even if judicial authorization was not

[4] Shortly after the chapter 15 recognition petitions were filed, the Dissenting Noteholders and others filed a petition in the British Virgin Islands, successfully securing the appointment of joint provisional liquidators for OAS Finance (the "Joint Provisional Liquidators" or "JPLs"). As the appointment of the JPLs called into question Tavares' authority to act on behalf of OAS Finance, Tavares only proceeded with the chapter 15 petitions for the OAS, OAS Construtora and OAS Investments; the JPLs have filed a separate chapter 15 petition on OAS Finance's behalf which is not addressed in the Decision. Id. at *5.

required, the Chapter 15 Debtors' boards of directors could not legally appoint a foreign representative since they were not debtors-in-possession and (iii) Tavares himself did not have the power to administer the Chapter 15 Debtors' assets and affairs in the foreign proceeding as required by 11 U.S.C. § 101(24) and, since he represented the Chapter 15 Debtors, he was not neutral and could not be accountable to the Brazilian court, which the Dissenting Noteholders argued was required by 11 U.S.C. § 1509(b)(3) [5] and 1505.[6]

First, the Court explained that Tavares did not need to be appointed or authorized to act by the Brazilian bankruptcy court, noting at the outset that "[i]n *Vitro*, the Fifth Circuit Court of Appeals addressed this very argument at length and rejected it." Id. at *7. Relying again on the Fifth Circuit, the Court reasoned that while the language "'authorized in a foreign proceeding' [in the definition of 'foreign representative'] . . . is 'compatible with appointment by a foreign court . . . it is hardly necessary. . . [and] would be equally compatible with a requirement that an individual be appointed 'in the context of' . . . or in the course of, a foreign proceeding.'" Id. at *8 (quoting Ad Hoc Grp. of Vitro Noteholders v. Vitro S.A.B. de C.V. (In re Vitro S.A.B. de C.V.), 701 F.3d 1031, 1047 (5th Cir. 2012)). The Court further reasoned that such a narrow definition of "foreign representative" was rejected by the drafters of the Model Law on Cross-Border Insolvency (the "Model Law") and U.S. courts routinely grant recognition to debtor-appointed foreign representatives, which requires a determination of the propriety of appointment even when no objections are raised. Id.

Next, the Court made quick work of the Dissenting Noteholders' argument that the OAS Debtors were not debtors-in-possession in light of the appointment of Alvarez & Marsal Consultoria Empresarial do Brasil as trustee in the Brazilian proceedings. Since neither chapter 15 nor the Model Law define "debtor-in-possession," the Court relied primarily on the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency (the "Guide"), and the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (the "Practice Guide"). The Guide defines debtor-in-possession as a debtor that maintains "some measure of control over its assets" and the Practice Guide defines it as a debtor that "retains full control over the business, with the consequence that the court does not appoint an insolvency representative." Id. at *9. Explaining that the duties and responsibilities of a debtor under Brazilian bankruptcy law are consistent with the Guide and Practice Guide and that a foreign debtor need not have identical rights and powers as a U.S. debtor to be considered a debtor-in-possession, the Court found that the Chapter 15 Debtors were acting as debtors-in-possession, since their management retained key substantive powers over the reorganization and they did have the authority to appoint Tavares as their foreign representative. Id. at *9-11.[7]

[5] 11 U.S.C. § 1509(b)(3) states that "[i]f the court grants recognition, . . . a court in the United States shall grant comity or cooperation to the foreign representative."

[6] 11 U.S.C. § 1505 states that "[a] trustee or another entity (including an examiner) may be authorized by the court to act in a foreign country on behalf of an estate created under section 541. An entity authorized to act under this section may act in any way permitted by the applicable foreign law."

[7] The Court noted additionally that the Dissenting Noteholders had made contrary assertions in their successful motion to appoint the JPLs for OAS Finance, and so were precluded by judicial estoppel and comity from arguing that the Chapter 15 Debtors were not acting as debtors-in-possession. Id. at *9-10.

The Court then addressed the Dissenting Noteholders' argument that Tavares could not serve as foreign representative, since he was not authorized to "administer the reorganization." Relying again on the Guide, which explains that "seeking recognition, relief and cooperation in another jurisdiction" is a form of administering the reorganization, the Court concluded that Tavares was "plainly authorized" to administer the Chapter 15 Debtors' reorganization by virtue of his appointment as foreign representative. Id. at *11.

Finally, the Court rejected the Dissenting Noteholders' contention that Tavares was required to be neutral and directly accountable to the Brazilian Court. Analyzing both statutory text and legislative history of sections 1509 and 1505, the Court concluded that such a reading was impossible, not to mention inconsistent with the disjunctive definition of "foreign representative," which requires that the foreign representative be authorized to administer the estate *or* "act as a representative of such foreign proceeding" (emphasis added). Id. at * 12. The Court also rejected the argument that Tavares should be precluded from serving as a foreign representative based on alleged misconduct at the Chapter 15 Debtors' companies, noting that Tavares was not alleged to have any connection to the Investigation or to have committed any wrongdoing in connection with the Prepetition Transactions. Id. at *13.

*COMI of OAS Investments*

The Court similarly found unpersuasive the Dissenting Noteholders' contention that the Brazilian Debtors' chapter 15 proceeding should not be recognized because OAS Investments' COMI was in Austria and thus its Brazilian Bankruptcy Proceeding could not be a "foreign main proceeding." The Court explained that "[t]he COMI analysis permits consideration of any relevant activities, including liquidation activities and administrative functions," and acknowledged that a COMI finding is less straightforward for a special purpose financing vehicle than other operating companies. Id. at *13. In this case, the Court found that OAS Investments is incorporated in Austria and has a post office box and a "handful of trade creditors" in Austria who provide services related to the maintenance of its registered office, but that Brazil is its true "nerve center and headquarters" since OAS (a Brazilian entity), as sole shareholder, has the power to direct OAS Investments, and its only current business, as a special purpose vehicle, was to pay off the 2019 Notes through the Brazilian Bankruptcy Proceedings. Id. at *13-14. The Court noted that its analysis was consistent with creditor expectations based on the 2019 Notes offering memoranda, which focused on the existence of the various Brazilian affiliate guarantors and risk factors associated with the OAS Group's businesses, rather than of OAS Investments alone. Id. at *14-15. As such, the Court ruled that OAS Investments' Brazilian Bankruptcy Proceeding was a foreign main proceeding for purposes of chapter 15. Id. at *15.

*Public Policy*

Finally, the Court dismissed the Dissenting Noteholders' argument that granting chapter 15 recognition would be inconsistent with U.S. public policy and that the Court had the ability to refuse to recognize the foreign proceeding under section 1506 of the Bankruptcy Code. The Court noted that the public policy exception built into chapter 15 – which provides that nothing in chapter 15 "prevents the court from refusing to take an action . . . if the action would be manifestly contrary to the public policy of the United States" – must be read narrowly. Id. The Court concluded that the Dissenting Noteholders were unable to mount a successful

challenge to the general fairness of Brazilian bankruptcy proceedings on a "macro" level, especially where the Brazilian process contained many aspects similar to U.S. bankruptcy law. Id. The Court also addressed and rejected each of the Dissenting Noteholders' specific public policy arguments in turn. Of note, in response to the Dissenting Noteholders' arguments that the substantive consolidation order was entered *ex parte* without due process and that creditors were unlikely to recover anything from the Prepetition Transfers (causing distributions inconsistent with the U.S.' absolute priority rule), the Court explained that such challenges were premature as the plan had not been confirmed, and with respect to substantive consolidation, the *ex post* Brazilian Reconsideration Decision and Brazilian Appeals Decision has provided appropriate due process. Id. at 16. The Court also noted that substantive consolidation, standing alone, was insufficient evidence upon which to base a denial of petition seeking recognition of the foreign proceeding. Id. at *17. Finally, the Court also found that the Dissenting Noteholders' allegations of bad faith against Tavares in the discovery process were not supported by evidence. Id. The Court made clear that its ruling was made without prejudice to the Dissenting Noteholders' right to challenge any further relief which the foreign representative may later seek, including recognition of any reorganizational plans approved by the Brazilian court. Id.

**Significance of the Decision**

The Decision is significant because it builds on a growing body of case law recognizing the procedural and substantive fairness of Brazilian insolvency law. See, e.g., In re Rede Energia S.A., 515 B.R. 69 (Bankr. S.D.N.Y. 2014). It also provides potential chapter 15 debtors with meaningful guidance on who they may appoint as a foreign representative and the different ways that foreign representatives may be empowered to act. The Decision also adds to the body of case law defining how companies may seek recognition of foreign main proceedings and how the COMI analysis should be applied to special purpose entities with limited operations. Finally, the Decision adds a further precedent on the manner and timing of when courts will consider public policy arguments and other substantive and procedural objections to the recognition of a foreign proceeding and further relief that may be sought to recognize and enforce foreign reorganizational plans, similar to the issues that were addressed in the Vitro case. The Decision will likely prove to be a helpful case for foreign debtors hoping to have their foreign insolvency proceedings recognized as foreign main proceedings under chapter 15 of the Bankruptcy Code.

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