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Recommended Citation

Jessica Nowak, *The Power Struggle: Shareholder Rights in Brazilian Corporate Bankruptcy*, 25 U. Miami Int'l & Comp. L. Rev. 339 (2018)
Available at: https://repository.law.miami.edu/umiclr/vol25/iss2/6

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THE POWER STRUGGLE: SHAREHOLDER RIGHTS IN BRAZILIAN CORPORATE BANKRUPTCY

Jessica Nowak

I. INTRODUCTION

Across the globe, those who study bankruptcy recognize that there are several fundamental failures of the system. Each country utilizes a different and specialized bankruptcy code, none of which have yet been perfected. More specifically, the different codes for corporate reorganization generally lead to conflicts between the shareholders and the creditors of insolvent companies. Disagreements between creditors and shareholders can lead to a bevy of problems with plan proposals and acceptance of cram-down. These conflicts are not easily repaired, but each code attempts to lessen these struggles as best as possible.

The most notorious attempt at resolving this problem is the United States' use of the absolute priority rule. Although the absolute priority rule does result in certain complications, the United States has successfully used it to make the corporate restructuring process run more smoothly. On the other hand, other large economic powerhouses, like Brazil, have not adopted statutes similar to the absolute priority rule. Over time, a comparative approach has revealed that the use of the absolute priority rule leads to a shorter plan proposal period[1], but is that really beneficial for the debtor company in the long term?

It seems that many differences in the way corporate reorganizations are treated in the United States and in Brazil hinges on the use, or lack of use, of the absolute priority rule. The absolute priority rule, embedded in the United States Chapter 11 code, was meant to be a standard of fairness.[2] Without fulfilling the fair and equitable requirement, a plan cannot be crammed down.[3] Although the United States implemented this rule as a requirement of treating each class of creditors fairly, it leaves many questions of fairness unanswered. This rule is said to be the proper method of delineating rights for shareholders and creditors, but it does not take into account all situations that landed a corporation into bankruptcy.[4]

Brazil's lack of an absolute priority rule does not mean that the reorganization process is inherently unfair. Brazil allows the corporation, along with its creditors and shareholders, to decide what is fair for the parties involved based on the different circumstances of each individual case. Without a rule requiring each senior class to be paid in full before a junior class can receive benefits allows more room for negotiation. With more negotiation comes a longer period of

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[1] Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 UNIVERSITY OF CHICAGO LAW REVIEW 651–684 (1974), 653.
[2] *Id*. at 651
[3] Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM JOURNAL OF CORPORATE & FINANCIAL LAW 581-606 (2016), 595.
[4] *See* Blum, *supra* note 1, at 652.

time that the creditors and shareholders can squabble over what each party is entitled to. This difference in fundamental rules is one of the main reasons why corporate reorganizations take much more time in Brazil than in the United States.

II. BACKGROUND ON BRAZIL

Brazil is the largest country in South America and in the Southern Hemisphere, sharing a common border with every single South American country with the exception of Chile and Ecuador.[5] In addition to its geographic vastness, Brazil is also the eighth largest economy in the world, even after experiencing the worst recession in the country's history.[6] The world views Brazil as South America's principal economic powerhouse. Investors spend a great deal of money buying shares of and lending to large up-and-coming Brazilian corporations. Until recently, American investors considered Brazilian companies to be lucrative investments.

After experiencing the worst recession in the country's history in 2015 and 2016 the market value for publicly traded shares in Brazil dropped precipitously. The average value went from $1.02 trillion in 2013 before the recession to $490.5 billion in 2016 after the recession.[7] Brazil's latest political scandal and the impeachment of the country's president[8]

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[5] CENT. INTELLIGENCE AGENCY, THE WORLD FACTBOOK: BRAZIL, https://www.cia.gov/library/publications/the-world-factbook/geos/br.html (last updated Nov. 17, 2017).
[6] *Id.*
[7] *Id.*
[8] Matthew DiLallo, *3 Top Brazilian Stocks to Buy in 2017*, THE MOTLEY FOOL, LLC. (June 6, 2017, 2:14 PM),

crushed the stock market even further and has led to crippling effects, the likes of which shareholders of many large Brazilian companies have felt throughout the country.[9] With all of the recent volatility within Brazil, the threat of corporations entering into bankruptcy has become a real fear for shareholders and creditors alike.[10]

New bankruptcy filings for 2017 were expected to surpass the over 227 corporate bankruptcies requested in 2016.[11] In 2016 a record number of companies, ranging from oil equipment to manufacturing to construction firms, requested court protection from creditors.[12] There were about 1,863 companies requesting protection, which was around a forty-five percent increase in requests from the previous year.[13] For Brazilian companies, the past three years have been riddled with uncertainty, lack of funds, and the threat of insolvency; which has ultimately lead to a large number of bankruptcies and judicial reorganizations. This article discusses, with a focus on the discrepancies between Brazilian and U.S. laws, the ever-prevalent power struggle between shareholders and creditors during the corporate

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https://www.fool.com/investing/2017/06/06/3-top-brazilian-stocks-to-buy-in-2017.aspx.

[9] Patti Domm, *These US Stocks have the most at risk from the emerging Brazil crisis* (May 18, 2017, 6:31 PM), CNBC: MARKET INSIDER, https://www.cnbc.com/2017/05/18/these-u-s-stocks-have-the-most-at-risk-from-the-emerging-brazil-crisis.html.

[10] Aluísio Alves, *Bankruptcy filings for big Brazil firms seen hitting another record*, REUTERS (January 30, 2017), https://www.reuters.com/article/us-brazil-restructuring-bankruptcy/bankruptcy-filings-for-big-brazil-firms-seen-hitting-another-record-idUSKBN15E2NG.

[11] *Id*.

[12] *Id*.

[13] *Id*.

reorganization process that begins when companies file for judicial bankruptcy protections in Brazil.

III. GOALS OF CORPORATE BANKRUPTCY

Investors are aware that one of the biggest risks of the lending market is the possibility of corporate insolvency and bankruptcy. Some creditors view bankruptcy as beneficial to their cause while others see it as harmful to their initial investment. The only way to figure out whom the corporate bankruptcy process benefits is to determine the main goals behind filing. Certain safeguards are put in place to protect both creditors and equity holders in a judicial bankruptcy, but what is the central goal of corporations filing for and going through the restructuring process?

Corporations file for bankruptcy when they can no longer keep up with their ongoing short-term and long-term obligations. They need help in order to carry on their regular operations without sinking deeper into debt. The benefit of corporate bankruptcy is conferred to both the secured and unsecured creditors as well as the company's equity holders. But, who is supposed to benefit the most from corporate reorganization: the company itself or its creditors?

In many instances, what the shareholders want to gain from corporate bankruptcy is much different than what the creditors desire from the process. The shareholders want to retain their equity interests and hold onto shares until the company turns things around, even if it comes at the expense of creditors.[14] The creditors, on the other hand, want to seize

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[14] Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 582 (1998).

the company's assets and sell them off as soon as possible in order to repay their debts.[15] Both parties have their own interests in mind when it comes to the insolvent company. The creditors are not concerned if their benefit comes at the detriment of the shareholders and vice versa. In theory, bankruptcy courts are designed to take a balanced approach to corporate reorganization. The court is expected to weigh the options and determine what is best for all parties involved while allowing a seamless reorganization.

The reorganization process provides businesses with a second chance to continue on with their endeavors. Bankruptcy allows insolvent corporations to have a fresh start once the business has paid off all of the agreed upon obligations. Traditional experts ("traditionalists") in the field of bankruptcy believe that reorganization is vital to preserve not just the companies themselves, but also the jobs opportunities that these companies provide to the local communities.[16] Alternatively, there are procedural experts ("proceduralists") who believe that the preservation of companies is not an independent good in itself that comes from the bankruptcy.[17] Does corporate reorganization serve mainly to pay off the creditors and cut losses or to save the corporation from going under?

If corporate reorganization laws serve to protect the company, then an environment where laws give the shareholders more negotiating power in the process is beneficial to the overarching bankruptcy goals. When a corporation enters into bankruptcy the shareholders have the

[15] *Id*. at 581.
[16] *Id*. at 579.
[17] *Id*. at 579-80.

business' viability in mind, they would prefer to see continued growth instead of liquidation. In order to maintain the shareholders' equity stake and capital investment, the company must be successfully reorganized; otherwise shareholders stand to lose their entire investments. This means that the shareholders will attempt to dispose of certain creditors through use of the reorganization plan. Ridding the company of these obligations will facilitate an environment where the balance sheet ultimately shows assets that are larger than liabilities once the fresh start begins. This may come at the expense of the creditors, which, if the main goal of reorganization is to the save the company and allow it to continue on, would be considered an act for the greater good.

On the other hand, if the main goal is to maximize the value of the estate and adequately pay creditors, then giving shareholders more power is not necessarily in the best interest of the process. In order to increase value for creditors, there needs to be at least some dilution of equity and an increase in the value of the estate. The general unsecured creditors would require more power in the process as well as the ability to create a unified creditor's committee. It is in the best interest of the general unsecured creditors to increase the value of the corporation's estate in order to preserve a larger payout and receive higher percentages of their claims after the secured creditors liens are satisfied.

The secured creditors believe that selling off the company's assets is more beneficial to them than allowing the company to continue on its business operations. When a company reorganizes using secured collateral, the collateral tends to depreciate and lose most of its value. The secured creditors need the opportunity to ask for adequate protection and even propose their own plans to the court in order to preserve some of the collateral's value. The interests of shareholders and secured creditors in either process are almost directly averse to each other. It is important to figure out the primary policy behind the Brazilian bankruptcy laws in order to determine whether the shareholders or the creditors should have more say in the process.

The point of reorganization is to allow an insolvent company to continue its operations when the going concern value is viewed as more favorable than liquidation value. Generally, the going concern value is beneficial to most parties involved, unless the corporation ultimately fails. In liquidation, shareholders lose their equity as the company is dissolved and its assets are sold off.[18] Usually, a majority of the company's assets are secured by liens, some of which may have decreased in value over the life of the loan.[19] Once assets are sold off, very little value is left for the general unsecured creditors to recover.[20] In liquidation proceedings, general unsecured creditors' claims are paid pennies on the dollar, if they even see a return at all.[21] Usually, all or most of a company's collateral is encumbered by multiple liens and the remaining value in the estate is minimal. In liquidation sales, collateral sells for the foreclosure value, which is much less

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[18] *Understanding Bankruptcy: The Differences Between Reorganization and Liquidation,* MAXWELL DUNN PLC (July 10, 2015), http://maxwelldunnlaw.com/blog/understanding-bankruptcy-the-differences-between-reorganization-and-liquidation/.

[19]David C. Smith & Mark Jenkins, *Creditor Conflict and the Efficiency of Corporate Reorganization*, 7 (2014), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.445.3920&rep=rep1&type=pdf.

[20] Brook E. Gotberg, *Conflicting Preferences in Business Bankruptcy: The Need for Different Rules in Different Chapters*, 100 IOWA L. REV. 51, 88 (2014).

[21] Harley Hahn, *Liquidation or Reorganization?* SANTA BARBARA INDEPENDENT (2013), https://www.independent.com/news/2013/may/05/liquidation-or-reorganization/.

than market value. This leaves almost every creditor's claim, secured and unsecured, unsatisfied. Conversely, companies who reorganize have a higher probability of satisfying their debts and making creditors more whole than liquidated companies.[22]

In the United States, the main goal of corporate bankruptcy is to maximize the estate.[23] The debtor in possession is required to maximize the amount of value contained within the estate in order to pay back creditors over the course of the plan.[24] Shareholders of bankrupt companies in the United States barely have a voice in the bankruptcy and are the last to recover-after all other classes of creditors have been paid. The absolute priority rule set out in section 1129(b)(2) of the code prevents any junior class from receiving payment if a senior class has not been paid in full.[25] As the most junior class in a chapter 11 bankruptcies, shareholders are at a huge disadvantage. In U.S. chapter 11 cases the creditors have more power because the goal is not to save the company, but to pay back the creditors. Corporations in chapter 11 are almost completely governed by the bankruptcy court, which protects the interests of the creditors and only promotes rehabilitation of the debtor corporation only where it is deemed feasible.[26]

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[22] *See Understanding Bankruptcy, supra* note 18.
[23] David K. Spiro, Robert S. Westermann, & Sheila DeLa Cruz, *Summary of Chapter 11 Procedures and Process*, 4, http://www.hf-law.com/images/uploads/VBA_Summary_of_Chapter_11_Procedures_and_Process.pdf.
[24] *Id*.
[25] 11 U.S.C. § 1129(b)(2) (2017).
[26] *See Spiro, supra* note 23, at 5.

The main goal of Brazilian bankruptcy after the 2005 amendments was allegedly to increase the creditor rights in an attempt to mirror the United States code for chapter 11.[27] This has not created an environment as creditor-friendly as in the United States, because shareholders still have much more of a say in Brazilian corporate bankruptcies. The lack of an absolute priority rule is one of the main factors that differentiate the plan proposal process between both countries. Additionally, under the current judicial reorganization laws, Brazilian corporations have the ability to pay dividends upstream even before repaying their restructured debts once they pass through the reorganization process.[28] Often, money to shareholders is paid out before the already restructured secured bank debts are even marginally repaid.[29]

The Brazilian corporation also enjoys the exclusive ability to propose a plan throughout the entirety of the case, while in the United States the exclusive period is only the first 120 days after filing.[30] Additionally, there are no strictly adhered to avoidance powers in Brazilian corporate bankruptcy. This means that there is less capital coming into the estate to be paid to general unsecured creditors and certain creditors may be treated with a preference over

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[27] John J. Rapisardi & Joseph Zujkowski, *Navigating Judicial Reorganization Under the Brazilian Bankruptcy Law*, 256 N.Y.L.J., Aug. 4, 2016, at 1.
[28] Fitch Ratings, *Fitch: Brazilian Bankruptcy Law Changes May Boost Lending Growth* (April 4, 2017, 8:25 AM), REUTERS, https://www.reuters.com/article/fitch-brazilian-bankruptcy-law-changes-m/fitch-brazilian-bankruptcy-law-changes-may-boost-lending-growth-idUSFit994113.
[29] *Id*.
[30] *See* Rapisardi, s*upra* note 27, at 2.

others.[31] In the United States, the trustee's avoidance powers allow for preferences and fraudulent transfers within a certain period of time before filing to be returned to the estate. Courts and trustees in Brazilian judicial reorganizations do not apply the measures that are utilized by courts in the United States that are meant to maximize the bankruptcy estate.

The difference in priorities between the two countries has an immense effect on the way they treat corporate reorganizations. Although Brazilian bankruptcy laws have attempted to be more creditor-friendly, the shareholders still have a much larger say than in the United States. Majority shareholders have a lot of influence when it comes to the board of directors' decision on accepting any newly proposed plan. The influence that shareholders have in the Brazilian bankruptcy process coupled with the multiple rejections of the creditors' newly proposed plans leads to a more drawn out process and less favorable terms for the creditors.

IV. BACKGROUND ON BRAZILIAN BANKRUPTCY LAWS

On February 9, 2005 Brazil enacted the new Brazilian Bankruptcy and Restructuring Law ("BBL"), also known as Federal Law No. 11.101.[32] This law sought to revitalize the corporate bankruptcy process and did away with the

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[31] *Id*.
[32] *Restructuring & Insolvency* (Nov. 2017), GETTING THE DEAL THROUGH, https://gettingthedealthrough.com/area/35/jurisdiction/6/restructuring-insolvency-2017-brazil/.

outdated bankruptcy laws that had been in use since 1945.[33] The new BBL was modeled after the United States Chapter 11 code, moving the country's corporate bankruptcy laws away from liquidation with a push towards restructuring and reorganization.[34] The new rehabilitation procedures allowed for either (a) an in-court judicial reorganization, (b) a pre-packaged reorganization handled outside the courtroom, or (c) liquidation.[35]

During the in-court judicial reorganization, the debtor is protected against the enforcement of actions throughout a certain period of time, similar to the automatic stay in U.S. chapter 11.[36] The stay period for judicial reorganization in Brazil is a statutorily mandated 180 days, which is triggered once the court accepts the petition for reorganization.[37] During this stay period, the debtor negotiates and prepares its plan for reorganization that the creditors must approve.[38] If the debtor does not file a plan within 60 days of acceptance of the case, the bankruptcy is automatically converted to liquidation instead of remaining a reorganization.[39]

Once the plan is agreed upon and confirmed, pre-petition claims are discharged and the company can continue

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[33] Giuliano Colombo & Thiago Braga Junquiera, *Ten Years of the Brazilian Bankruptcy Law: Some Lessons Learned and Some Wishes for Improvement*, 1 CLEARY GOTTLIEB EMERGING MKTS. RESTRUCTURING J., (Spring 2016), at 11.
[34] *Id*.
[35] *Id*.
[36] *Id*.
[37] *2017 Insolvency and Corporate Reorganization Report: Brazil* (April 25, 2017), INTL. FIN. L. REV., http://www.iflr.com/Article/3712317/2017-Insolvency-and-Corporate-Reorganisation-Report-Brazil.html.
[38] *See* Colombo, s*upra* note 33.
[39] John J. Rapisardi & Joseph Zujkowski, *Bankruptcy Basics Under Brazilian Law*, 252 N.Y.L.J., (July 3, 2014), at 2.

on with its operations.[40] The only way for a company to enter into judicial reorganization is by its own volition, creditors cannot force judicial bankruptcy upon a corporate institution.[41] Additionally, once a debtor files for judicial reorganization it maintains plan exclusivity throughout the entirety of the case.[42] As a result, the only leverage that creditors have in plan negotiation is threatening to vote against the plan or objecting to its approval.[43] This gives the debtor company, along with the controlling shareholders within that company, much more leverage than the creditors during the judicial bankruptcy process.

Once in judicial reorganization, the court appoints a trustee to work with the debtor's directors and officer or whoever remains in charge of the business.[44] All of the debtor's operating activities, the meeting with creditors, the books and records, and performance of administrative duties are supervised by the appointed trustee.[45] As long as the debtor meets all of its deadlines and the plan is accepted, the company can move forward with the repayment of debts and a fresh start. This is a huge change from the overturned 1945 Brazilian bankruptcy laws, where most companies were liquidated instead of given the chance to preserve their going concern value and reorganize.

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[40] *See* Colombo, *supra* note 33.
[41] Paulo Fernando Campana Filho, *The Legal Framework For Cross-Border Insolvency in Brazil*, 32 HOUSTON J. INT'L L. 97, 115 (2010).
[42] *See* Rapsardi, s*upra* note 39 at 2.
[43] *Id*.
[44] Jeffrey M. Anapolsky & Jessica F. Woods, *Pitfalls in Brazilian Bankruptcy Law for International Bond Investors*, 8 J. BUS. & TECH. L. 397, 403 (2013).
[45] *Id*.

The extrajudicial reorganization is intended to be an expedited process where the debtor obtains a quick confirmation of the prepackaged proposed plan.[46] The court does oversee parts of this process, but the courts do not have to intervene much because the plan has already been negotiated and accepted by the majority shareholders and creditors.[47] Both the judicial and extrajudicial restructuring options are used when the debtor company still has a certain amount of going concern value and can feasibly continue on its business operations after reorganization. If the business is deemed non-viable, then bankruptcy liquidation of the debtor will occur.[48]

In order for the judicial reorganization process to move forward, a certain number of creditors must approve the plan. The creditor class system used in judicial reorganizations differs slightly from those in the United States.[49]Just like in the United States, if a creditor class does not accept the terms of the plan there is an option for cram down.[50] In order the successfully cram down the plan, each of the creditor classes must be satisfied through the following: (a) creditors holding more than fifty percent of the credit value must approve, regardless of their creditor class; (b) at least two creditor

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[46] *See* Colombo*, supra* note 33.
[47] *Id*.
[48] *Id*. at 12.
[49]Angela Paes De B. Di Franco & Renato Din Oikawa, *2016 Insolvency and Corporate Reorganization Report: Brazil* (May 9, 2016), MONDAQ, http://www.mondaq.com/brazil/x/489486/Insolvency+Bankruptcy/2016+Insolvency+And+Corporate+Reorganisation+Report+Brazil. (Stating the different class structures and priorities in Brazilian corporate reorganizations.)
[50] *See 2017 Insolvency and Corporate Reorganization Report*, *supra* note 37.

classes must approve the plan by more than fifty percent in both number and value; (c) the class of creditors to be crammed down must approve by at least one third in both number and value; and (d) there is a prohibition of unfair discrimination in the class that rejects the plan.[51] After those requirements are fulfilled, the plan can be crammed down on the rejecting class and the case can move forward. Because there is no absolute priority rule in Brazil, cram down is much easier. A lack of absolute priority rule to regulate "fairness" means that there is no requirement for higher classes to be fully satisfied before any lower classes are paid out. In theory, even if the abovementioned class numbers approve the plan, the shareholders could legally receive payment before any secured or unsecured creditors.

The United States provides for the requirement that a plan be "fair and equitable" in section 1129 of the Bankruptcy Code, which triggers the absolute priority rule. In Brazil, there is no such statutory provision, which means creditor rejection of the plan does not invoke an absolute priority rule.[52] Without an absolute priority rule, Brazil has no stipulations about the order of payments in bankruptcy. In the United States the absolute priority rule provides that no "holder of any claim or interest that is junior to the claim or interest of such [unpaid] class will not receive or retain under the plan on account of such junior interest in property."[53]

In order for a debtor in possession in the United States to cram down a plan, it has to virtually exhaust the estate in order to pay the senior classes. The leftover value in the estate,

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[51] *See* Di Franco, *supra* note 49.
[52] *Id*.
[53] 11 U.S.C. § 1129(b)(2)(A)(i)(II) (2017).

if there is any at all, leaves little to nothing for shareholders. Because Brazils lacks this absolute priority rule, the creditors have no say in the order of class payment. Even though creditors take the time to secure and perfect liens on property in order to have priority, secured creditors in Brazil are not required to be paid to the same extent that they would in the United States. Unsecured creditors and even shareholders have the ability to receive their claims before the secured creditor class is fully satisfied, or even satisfied at all.

Transparency is a fundamental part of the institution of Brazil's new bankruptcy laws. The debtor company's honesty throughout the process allows for the creation of value and a mutual understanding of each party's underlying intentions.[54] When an insolvent company communicates clearly about its liabilities, assets, operations, and goals, judicial reorganization becomes a much quicker process. Before the enactment of the BBL, there were huge inequities between creditor classes, where most secured and unsecured debt took a back seat to tax liabilities and the payment of employees.[55] In theory, the BBL assists unsecured creditors and equity holders in retaining more value than the previous law allowed. Because labor and employment claims have a maximum payout threshold, the secured creditors and unsecured creditors receive a higher percentage of their claims. As a result, the shareholders retain a maximized amount of equity in the firm.

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[54]Luis Fernando Valente de Paiva, *Understanding the Intricacies of Brazilian Bankruptcy Law*, 2011 WL 586859 1, 6.
[55] *Id*. at 2.

V. DIFFERENCES BETWEEN THE UNITED STATES AND BRAZIL

Although the BBL was modeled after the United States Bankruptcy code, there are many differences between the two laws. When Brazil enacted their new laws in 2005, the United States also modified their bankruptcy code that same year. Differences between the codes have led to very different outcomes for both creditors and shareholders, as well as in the length of time the process takes.

The first difference arises from the voluntariness of filing for bankruptcy. Under the new BBL, a debtor corporation has the exclusive right to file for judicial reorganization.[56] Adversely, in the United States, chapter 11 bankruptcy cases can be involuntarily commenced through a filing of the debtor's creditors.[57] This means that in Brazil, creditors are left without the ability to file a reorganization remedy and only have the ability to file for a liquidation of the debtor company.[58] Liquidations are less useful in the case of corporate bankruptcy, as the going concern value of keeping the company alive is larger than the pennies on the dollar received through a liquidation process.

The second difference between the codes concerns plan exclusivity. In the United States, the debtor has the exclusive privilege of filing a chapter 11 plan within 120 days after the commencement of the case.[59] This time of exclusivity can be extended, but only up to 18 months after the commencement of the case.[60] In a Brazilian judicial reorganization, the debtor

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[56] *See* 2017 Insolvency Report, *supra* note 37.
[57] *Id*.
[58] *Id*.
[59] *Id*.
[60] *Id*.

enjoys the exclusive right to file a plan throughout the entirety of the case.[61] The creditors of the Brazilian company may propose alternative plans of their own, but these plans cannot be filed without the consent of the debtor. This exclusivity comes with the caveat that the debtor only enjoys an automatic stay period of 180 days and that the debtor's plan must be proposed within an extremely short 60-day period after commencement of the case.[62] If a plan is not proposed within the first 60 days, then the company's bankruptcy is automatically converted to a liquidation proceeding.[63] Conversion to a liquidation proceeding will also occur if the Brazilian corporation's plan is rejected by more than fifty percent of the creditors (by face value) present at any creditor's meeting.[64]

Within any United States corporate bankruptcy preceding the role of the creditor's committee is very important. Brazil's new BBL statutory scheme provides for the formation of a creditor's committee, but these creditor's committees are rarely formed.[65] Creditor's committees in the United States generally only include representatives from the unsecured creditors parties.[66] Conversely, in Brazil the creditor's committee is made up of one labor creditor representative, one secured creditor representative, and one general unsecured creditor representative.[67] The interests of these three groups almost always differ, which makes it

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[61] *Id*. at 2.
[62] *Id*.
[63] *Id*.
[64] *Id*.
[65] *Id*.
[66] *Id*.
[67] *Id*.

difficult for them to work together in order to adequately represent a common goal for the singular creditor's committee. Additionally, in the United Stated the expenses of the creditor's committee are paid by the debtor's estate, but in Brazil most creditor committee expenses are not reimbursed.[68] The Brazilian creditor's committee also face harsher rules and punishments regarding losses to the estate caused by negligence or malice.[69] For these reasons, ad hoc groups are formed more commonly than creditor's committees in Brazilian corporate bankruptcies.

Voting rights are also different in Brazilian corporate bankruptcies than they are in United States chapter 11 cases. In the United States, individual bondholders have the right to vote on the debtor's proposed plan.[70] In Brazil, unless bondholders commence a claim for separation, an indentured trustee is chosen to vote on the plan on behalf of all the bondholders.[71] In order to avoid this, a bondholder can separate his claim through an elaborate and complex process. The bondholder must file a proof of claim with the judicial trustee within 15 days of the case being noticed to the public.[72] Proofs of claim ownership cannot be submitted via digital copy in Brazil, making it difficult for bondholders to obtain originals in order the separate their claims.

Overall, even though the BBL was based off of the United States chapter 11 code, the differences between them make for large distinctions in the treatment of creditors. In

[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] *Id.*
[72] *Id.*

Brazil, the lack of cohesive creditor committees makes it difficult for all creditors to be satisfied by any one proposed plan. The debtor's large exclusivity period makes it almost impossible for the creditors to vote on a plan that they believe will be beneficial to their interests. The limit of three voting classes lumps bondholder and creditors into less specific unsecured creditor classes to their detriment. Secured creditors have a tougher time gaining benefits from Brazilian corporate bankruptcies without a rule regulating fairness, like he absolute priority rule. In the United States, creditors are treated more equitably with stricter rules on fairness to creditor classes. The Brazilian code tried to replicate the creditor friendliness found in the United States code, but still has work to do if the goal is to make the process as creditor friendly as it is in the United States.

VI. A CASE STUDY OF OI SA

One of the most notable cases of Brazilian corporate bankruptcy in 2016 was the filing of Oi SA ("Oi"), formerly known as Telemar.[73] Oi is the largest telecommunications company in Brazil, with over 74.5 million customers.[74] When the company filed in June of 2016, it was Brazil's largest ever

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[73] Oi S.A., *The Company*, http://ri.oi.com.br/conteudo_en.asp?idioma=1&conta=44&tipo=44088 (Last visited Dec 16, 2017).

[74] Lima Consulting Group, *Ensighten Case Study: Ensignten's Agile Marketing Platform delivers one-to-one Marketing and superior digital experiences to Oi's customer base*, ENSIGHTEN, https://www.ensighten.com/sites/default/files/oi-ensighten-case-study.pdf.

corporate bankruptcy.[75]As a result of Brazil's recession and the ongoing political scandals, Oi ran out of time to reorganize operations and restructure over $19.3 billion dollars of debt, leading to Oi's filing for protection with the bankruptcy court.[76] At the time of filing, Oi's debt consisted of funds that were only 25% from Brazilian currency and 75% from currencies other than the Brazilian real.[77] The creditors whose capital was most at stake were the foreign investors.

Since filing for judicial reorganization, Oi hosted several conversations with creditors about potential plan proposals. Discussions with creditors and bondholders about restructuring the debt ceased shortly after the shareholders realized that an agreement with creditors would result in a dramatic cut of their stake in the company.[78] During settlement talks, former Oi CEO Bayard Gontijo favored a proposal that would give creditors a 95% stake in the company and leave current shareholders with virtually nothing.[79] The struggle between the shareholders of large corporations and their major creditors is a significant issue in current Brazilian corporate bankruptcy cases. Who really has the power when it comes to decision-making during the restructuring process?

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[75] Guillermo Parra-Bernal & Ana Mano, *Oi files for Brazil's biggest ever bankruptcy protection,* REUTERS (June 20, 2016), https://www.reuters.com/article/us-oi-sa-restructuring/oi-files-for-brazils-biggest-ever-bankruptcy-protection-idUSKCN0Z703V.

[76] *Id*.

[77] *This Company Just Filed For Brazil's Biggest Ever Bankruptcy,* FORTUNE (2016), http://fortune.com/2016/06/21/oi-brazil-biggest-bankruptcy/.

[78] *See* Parra-Bernal, *supra* note 75.

[79] *Id*.

From June of 2016 until December 2017 Oi held several discussions with its creditors and shareholders about their reorganization process. The creditors several ad hoc committees submitted a multitude of new plans, but the company's board rejected each creditor proposal for over a year and a half.[80] The Oi board of directors, in return, submitted several of their own proposals, none of which the creditors found to be suitable.[81] Because Oi had plan exclusivity throughout the entire proposal process, it was difficult for creditors to negotiate with equity holders.

Both parties rejected each other's plans because the shareholders and creditors could not agree on a middle ground. The shareholders wanted to keep as much of their equity as possible so that their payout would not be severely impaired or diluted. On November 3, 2017, Oi mistakenly disseminated a notice to the market that the company accepted the creditor's newest plan, leading to a false hope of a resolution after over a year of negotiations.[82] A press release later that week on November 6, 2017 confirmed that the referenced plan was not accepted and that the board members of Oi were still conflicted as to what would be best for the shareholders.[83] The press release accused the Oi board

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[80] *November 6 Press Release,* BUSINESS WIRE (Nov. 6, 2017), http://mms.businesswire.com/media/20171106006301/en/622914/1/November_6_Press_Release_with_Exhibit-_Compiled_FINAL.pdf?
[81] Gram Slattery & Tatiana Bautzer, *Exclusive: Shareholder in Brazil's Oi leans on distressed debt funds for support* (Nov. 1, 2017, 12:20 PM), REUTERS, https://www.reuters.com/article/us-oi-sa-restructuring-exclusive/exclusive-shareholder-in-brazils-oi-leans-on-distressed-debt-funds-for-support-idUSKBN1D158Z.
[82] Oi S.A., *Notice to The Market* (Nov. 4, 2017).
[83] *See November 6 Press Release, supra* note 80.

members of shirking their fiduciary duties and appointing new board members instead of carefully considering the plans they were given.[84]The press release also accuses the "Shareholder Plan" as "being backed by the minority shareholders [who were] exerting control in an attempt to preserve their equity position, and attempt[ed] to do so by enlisting what the Oi Creditor Groups understood to be only a handful of insignificant [equity] holders...who [would be] seeking exorbitant fees at the time the transaction [would] inevitably fail."[85] This somewhat proved that the shareholders were the ones with the power in this situation, pulling strings from behind the scenes in order to maintain their stake in Oi. As a result of this blatant shareholder infiltration of Oi's board of directors, the court effectively removed the board from ongoing debt renegotiations.[86] The board continued attempts at retaining power throughout the process, because without their say an unfavorable plan could have been voted on an approved.

Those who really had the most to power in the company's voting process were the majority shareholders and equity holders of Oi. The largest shareholder of Oi at the time was Bratel S.A. R.L, which owned 22.24% of the 825,760,802 shares on the market.[87] The second largest was Societe Mondiale Fundo de Envestemento em Acoes, holding

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[84] *Id*.
[85] *Id*.
[86] Gram Slattery, *Key Oi shareholder asks judge to declare Aurelius "abusive"*, REUTERS (Dec. 5, 2017), https://www.reuters.com/article/oi-sa-restructuring/key-oi-shareholder-asks-judge-to-declare-aurelius-abusive-idUSL1N1O521Z.
[87] Oi S.A., *Ownership Breakdown*, (Dec. 18, 2017), http://ri.oi.com.br/conteudo_en.asp?idioma=1&conta=44&tipo=43641.

about 5.28% of the total shares.[88] The third and fourth largest shareholder were Goldman Sachs International and Bndes Participacoes S.A. Bndespar, respectively, both holding just under 5% of total shares.[89] The other two majority shareholders, Marathon Asset Management L.P. and Mare Finance Investment Holdings designated Activi, both held between 1.5% and 2% of the total number of shares.[90] The minority shareholders made up the remaining 41.45% of the equity in the company.[91] Oi's shares were selling at about 4.69 reals per share in 2017, which equates to $1.45 per share in U.S. currency.[92] When doing the calculations, the largest shareholder owned about $266,291,343 U.S. dollars' worth of shares in Oi. There was a lot of money at stake for these majority shareholders. They realized that their shares would most likely become diluted, but by how much?

Oi claimed that the proposed creditor plans treated its stakeholders unfairly and the company's own proposals included a debt to for equity swap of 25%.[93] The creditor's

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[88] *Id*.
[89] *Id*.
[90] *Id*.
[91] *Id*.
[92]Oi S.A., *Share Prices*, (Dec. 18, 2017), http://ri.oi.com.br/conteudo_en.asp?tipo=43747&id=232615&idioma=1&conta=44.
[93] *Brazilian phone carrier Oi to amend terms to creditors: filing,* REUTERS (Nov. 4, 2017), https://www.reuters.com/article/us-oi-sa-restructuring/brazilian-phone-carrier-oi-to-amend-terms-to-creditors-filing-idUSKBN1D40UW; *See also* Alberto Alerigi & Bruno Federowski, *Brazil Oi's creditors reaffirm commitment to alternative plan*, REUTERS (Oct. 2 2017), https://www.reuters.com/article/us-oi-sa-restructuring/brazil-ois-creditors-reaffirm-commitment-to-alternative-plan-idUSKCN1C72TT.

plans also "provided for the discharge of third party claims against the Company and its subsidiaries on customary terms, provided that such discharge shall not waive or release of any claims against shareholders, officers and directors of the Company."[94] Although Oi rejected the plan, the creditors still believed that it was in their best interest to continue with negotiations instead of moving forward with a liquidation of the company.[95]

Regardless of the removal of Oi's board of directors from the voting process, it was still difficult to approve a creditor-friendly plan. Even though the board and its shareholder influencers were removed from power, they did joined together in an attempt to partner with public sector creditors in order to pass Oi's restructuring plan in the face of the opposition by the bondholders.[96] With a push from certain shareholders, the board was offering deals to state banks in exchange for votes.[97] The deals included a repayment of the banks claims at full nominal value, but over a longer period of time.[98] Oi's deal contained provisions that allowed for the company to have a six-year grace period before requiring it to make payments to the banks, and then a ten-year period in which to pay off the value of the loans.[99] Oi's board offered

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[94] *Id*. at 23.
[95] *Id*.
[96] Gram Slattery, *Oi seeks to woo public banks, export credit agencies-sources*, REUTERS (Nov. 23, 2017), https://www.reuters.com/article/oi-sa-restructuring/oi-seeks-to-woo-public-banks-export-credit-agencies-sources-idUSL1N1NR02U.
[97] *Id*.
[98] *Id*.
[99] *Id*.

similar deals to investment banking units and international credit agencies.[100]

The board required not only the support of the public sector creditors, but approval by 20-25% of the bondholders in order to pass Oi's final plan.[101] The major bondholders also wanted to avoid liquidation at all costs because they had more to gain from Oi's reorganization than from the company's liquidation.[102] Oi viewed some of their major bondholders as hostile entities, and moved to remove the bondholder's vote during the process.[103] Without a rule for fairness, the Oi plan negotiations lasted over a year and a half. This is valuable time that could have been spent repaying debts instead of racking up more bills during the negotiations.

The real question here is: when will a plan be satisfactory to all parties in a Brazilian bankruptcy? In a bankruptcy proceeding this large, there is no way for all sides to be completely happy, but they do need to come to an agreement. In the end, the courts practically had to force a plan onto the board in December 2017. After a 15 hour meeting, three of the four creditor classes voted to approve a plan on December 19, 2017.[104] Because Brazil doesn't have an absolute priority rule, the plan was accepted even though one of the largest creditors voted against it. As for creditors from the United States, the bankruptcy court offered little to no

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[100] *Id.*
[101] *Id.*
[102] *Id.*
[103] *See* Slattery, *supra* note 86.
[104] *Oi creditors approve largest-ever Latin American Restructuring,* REUTERS (Dec. 19 2017), https://www.reuters.com/article/us-oi-sa-restructuring/oi-creditors-approve-largest-ever-latin-american-restructuring-idUSKBN1ED2VK.

relief. United States bankruptcy judges stated that the fight over Oi's future "must be fought in the Brazilian courts, not in the U.S. courts."[105] In cases like these, the lack of absolute priority rule was a large reason why the plan proposal period took so long, but it was also the reason why a plan was ultimately put into place. The parties had a longer amount of time to negotiate and find a mutually-beneficial breakdown of debt repayments.

VII. THE FUTURE OF BRAZILIAN CORPORATE BANKRUPTCY

Where is Brazilian corporate bankruptcy headed in the future? Brazilian officials are discussing further amending the 2005 bankruptcy code.[106] With the biggest recession in the country's history leading to a surplus of insolvent companies, the proposed reforms are attempting to alleviate some of the economic pressure on corporations and lift Brazil out of the recession. Under the current code, it takes several years for an insolvent corporation to approve a plan and then some additional years to actually complete the plan.[107] The process is excruciatingly long and the Brazilian government wants to make the time frame more compact.[108] The changes would allow indebted corporations to emerge from bankruptcy more quickly and begin their fresh start even earlier.[109] The

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[105] *See* Slattery, *supra* note 86.
[106] *Brazil plans changes to bankruptcy law to bolster recovery, paper say*, REUTERS (May 9, 2018), https://www.reuters.com/article/brazil-economy-bankruptcy/brazil-plans-changes-to-bankruptcy-law-to-bolster-recovery-paper-says-idUSL1N1IB0AR.
[107] *Id.*
[108] *Id.*
[109] *Id.*

average length of a judicial reorganization for Brazilian corporations is around eight years and the proposed changes would quarter the time it takes to get through the process.[110] In addition to limiting the bankruptcy protection to only two years, the proposed amendments would make it easier for the debtor corporation to borrow funds and maintain operations.[111] The proposed changes also purport to help creditors by granting them stronger powers in the plan negotiations.[112]

According to Fitch Ratings, a change recently proposed by the Temer administration has the ability to improve the ability to obtain credit.[113] The proposed changes will provide additional comfort to banks, which will ultimately support future lending growth.[114] Brazilian banks currently have around ten million real in repossessed assets as collateral from unpaid loans.[115] It is unclear if the proposed new laws will allow banks to continue their practice of repossession. Right now, the code gives banks the right of fiduciary alienation.[116] Fiduciary alienation allows the banks to repossess collateralized property, even if the defaulting corporation has filed for judicial reorganization.[117] If banks lose their right to fiduciary alienation and their right to collect collateral, these loans will come at a higher cost to corporations. Although the 2005 amendments were created to

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[110] *Id.*
[111] *Id.*
[112] *Id.*
[113] *See* Fitch Ratings, s*upra* note 28.
[114] *Id.*
[115] *Id.*
[116] *Id.*
[117] *Id.*

make the judicial reorganization process more creditor-friendly, the pending bankruptcy legislation puts more emphasis on debtor's rights.

Out of the 6,586 Brazilian corporations that applied for judicial reorganization since 2005, only five percent have recovered from the process.[118] Brazil is in need of amendments to their bankruptcy code in order the better help the insolvent corporations that file for bankruptcy protections. As of now, the very small percentage of corporations that actually recover from judicial reorganization in Brazil is a red flag that their system is not working. In addition to the abovementioned reforms, the Brazilian government has also been discussing changing the way taxes are treated during judicial reorganization.[119]

Right now, there are no specified bankruptcy courts that deal with corporate filings; all bankruptcies are handled by the main court system in whatever district the company headquarters is located. Discussions about creating specialized courts would make a significant difference in how bankruptcy cases are handled.[120] Judges with superior knowledge of the inner workings and technicalities behind bankruptcies would expedite the process and create fairer results for all parties involved. Fitch, a United States based credit rating service, believes that these changes will have a positive impact on the judicial reorganization process as a whole.[121] If the changes are announced and implemented quickly, they may save hundreds, if not thousands of

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[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] *Id.*

corporations and creditors from falling into the prolonged and treacherous judicial reorganization system.

VIII. CONCLUSION

Even though the Brazilian government tried to adopt a bankruptcy code similar to the United States chapter 11, it has not made the process as creditor-friendly as in the U.S. Brazil's attempt at increased creditor rights turned the judicial restructuring processes into one that is still majorly controlled by shareholders rather than creditors. The Brazilian government did adopt the measures used in United States courts to maximize the estate and overall disbursements to creditors, but the amendments need further modification if the goal really is to increase creditor's rights. The limited exclusivity period, the absolute priority rule, the trustee's avoidance powers, the creditor's committee for unsecured creditors, the first priority of secured creditors, adequate protection, and specialized bankruptcy courts are all tools used by the United Stated to maximize the estate. Brazil, on the other hand, does not use those but still expects to keep creditor's interests in mind. Ultimately, Brazil needs to further amend their bankruptcy code and add more safeguards to protect creditor's rights and facilitate the continuation of the corporation.

One option is to add a rule that regulates fairness, similar to U.S. chapter 11's absolute priority rule. In cases where an entire company along with its creditors and shareholders are at stakes, there should be some regulation of debt payout. As shown through cases in the United States, with the addition of an absolute priority rule comes a shorter plan proposal period. This means that the debtor company loses less money during the negotiation phase, which it can then use to reorganize more efficiently and effectively. Brazil needs to define their main goals of corporate bankruptcy so that better safeguards can be put in place to uphold those goals. "Fairness" is very subjective, but as seen in the Oi case, a lack of regulations regarding fair and equitable plan proposals leads to longer negotiations, disgruntled parties, and time spent on lofty goals instead of reaching more grounded offers.