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Pitfalls in Brazilian Bankruptcy Law for International Bond Investors

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Abstract

This Article is a comparison of insolvency law in Brazil and the United States focusing on the perspective of international bondholders. It contains a discussion of Brazilian bankruptcy law reform, recognition of individual bondholders in reorganization proceedings, organizing creditors, debtor exclusivity, plan confirmation and voting rights, disclosure requirements, and asset sales.

I. Introduction

The Federative Republic of Brazil is the largest nation in South America and the fifth largest in the world by geography and population.[1] As it prepares for the 2014 World Cup and 2016 Summer Olympics, the Brazilian government is seeking nearly $500 billion to invest in roads, ports, dams, and other infrastructure projects.[2] In addition, Brazilian corporations are issuing a record amount of bonds globally, regularly comprising about 50% of total global bond issuance for Latin American corporations (Chart 1).[3] In 2012, Brazilian corporations issued a record $47 billion of bonds, up from $6 billion in 2008, and are expected to comprise over 50% of Latin American bond issuance in 2013.[4]

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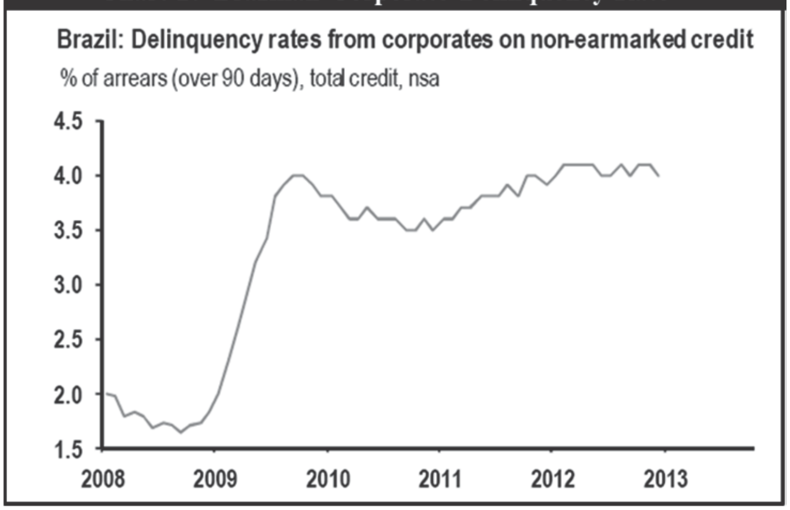
1. CENT. INTELLIGENCE AGENCY, THE WORLD FACTBOOK: BRAZIL, https://www.cia.gov/library/publications/the-world-factbook/geos/br.html (last updated Mar. 28, 2013).
2. Brian Winter, *Brazil's Olympics Will Be Fine. As for the World Cup. . .*, REUTERS, Aug. 29, 2012, *available at* http://www.reuters.com/article/2012/08/29/us-brazil-olympics-odebrecht-idUSBRE87S10H20120829.
3. J.P. Morgan, *Latin America: 2012 Review and 2013 Outlook* (Jan. 2013), at 19; *see infra* Chart I.
4. *See supra* note 3.

While relatively high yields on Brazilian corporate debt appear attractive to international investors, these investors may assume that, in the event of default, Brazilian insolvency laws are similar to those in the U.S. In 2005, the Brazilian government replaced its outmoded insolvency laws with an entirely new regime, which bases its procedures for reorganization on chapter 11 of the U.S. Bankruptcy Code.[6] This reform has led to several positive developments with respect to creditor recoveries in Brazilian corporate restructurings.[7] However, there continue to be several noteworthy differences between the U.S. and Brazilian insolvency systems that may generate unwelcome surprises to U.S. holders of Brazilian corporate bonds, including discrepancies surrounding: (i) the recognition of individual bondholders' claims;[8] (ii) the ability of creditors to organize and retain legal and financial professionals;[9] (iii) the process and timeline for negotiating, voting on, and confirming a plan of reorganization;[10] (iv) the disclosure requirements for a debtor;[11] (v) the procedure for selling the debtor's assets;[12] and (vi) the roles of courts and trustees in facilitating the insolvency process.[13] Although investors may

5. J.P. Morgan, *Latin America: 2012 Review and 2013 Outlook* (Jan. 2013), at 21.
6. *See* 11 U.S.C. §§ 101–1532 (2006); *see also infra* Part II.
7. *See infra* Part II.
8. *See infra* Part III.
9. *See infra* Part IV.
10. *See infra* Part V.
11. *See infra* Part VI.
12. *See infra* Part VII.
13. *See infra* Parts III–VII.

understand that Brazil is experiencing corporate delinquency rates approaching 8.5% (Chart 2) as inflation remains around 5.5%,[14] they may be overestimating their rates of recovery after their investments become distressed. In addition, they may not appreciate the out-of-pocket costs for professional fees and expenses as well as the time commitment necessary for negotiating with insolvent debtors. This Article will attempt to articulate some of the core differences between the U.S. and Brazilian insolvency laws that have an adverse effect on international bondholders and will suggest reform measures that would ameliorate these effects, thereby encouraging growth in the Brazilian debt capital markets and overall economy.

Chart 2: Brazilian Corporate Delinquency Rate[15]



II. Background on Brazilian Insolvency Law: 2005 Reform

After more than a decade of legislative debate, the Brazilian government revamped its insolvency laws by enacting the *Nova Lei de Falências e Recuperação de Empresas*, Lei No. 11.101 (the "Brazilian Bankruptcy Law") on February 9, 2005.[16] The new law sought to modernize Brazil's former insolvency statute, Decreto-Lei 7.661

14. Cent. Intelligence Agency, *supra* note 1; *see also infra* Chart 2.

15. J.P. Morgan, *Brazilian Large Cap Banks: A Recap of Recent Trends and Outlook* 9 (May 2013); *see also* Banco Central do Brasil, https://www3.bcb.gov.br/sgspub/localizarseries/localizarSeries.do?method=prepararTelaLocalizarSeries (last visited June 19, 2013).

16. Lei No. 11.101, de 9 de Fevereiro de 2005, Diário Oficial da União [D.O.U.] de 9.2.2005 (Braz.), *translated in* Turnaround Management Association do Brasil-TMA Brasil, *Brazilian Bankruptcy Code* (Feb. 9, 2005), http://tmabrasil.org/en/articles-and-news/brazilian-bankruptcy-code.

(1945),[17] which was highly criticized for stunting economic growth and contributing to interest rates that were among the highest in the world.[18] The pre-2005 law involved alternative legal frameworks for reorganization (known as *concordata*)[19] and liquidation (bankruptcy or *falência*).[20] However, distressed companies were rarely able to reorganize under the rigid *concordata* procedures, and, as a result, many potentially viable companies were forced into bankruptcy.[21] Once in bankruptcy, procedural inefficiencies led to protracted cases,[22] and successor liability discouraged the development of a meaningful market for the sale of assets in liquidation.[23] Furthermore, the pre-2005 law prioritized claims in the following

17. Decreto-Lei No. 7.661, de 21 de Junho de 1945, Diário Oficial da União [D.O.U.] de 21.6.1945 (Braz.) (repealed 2005), *translated in* http://www.translation-source.com/posts/brazilian-legislation-available-in-english).

18. *See, e.g.*, Joaquim de Paiva Muniz & Ana Tereza Palhares Basílio, *The New Brazilian Bankruptcy Law*, 16 Int'l Co. & Com. L. Rev. 225, 225 (2005) ("The inefficiency of [the prior] Brazilian insolvency rules ha[d] severe negative impacts on the economy, to the extent that they adversely affect[ed] the spread in the interest rates charged by financial institutions, which are among the highest in the world."); *see also* Gordon W. Johnson & Daniel Alonso, Impact of Global Market Developments on Latin America: Reexamining the Foundations of Trust (Feb. 1, 2003), http://siteresources.worldbank.org/GILD/ConferenceMaterial/20168306/LA%20Corporate%20Insolvency%20(Johnson).pdf (explaining the importance of insolvency laws for a stable domestic economy and enumerating the shortcomings of Brazil's former bankruptcy law).

19. Decreto-Lei No. 7.661, tit. X.

20. *Id.* tits. I–IX.

21. In a *concordata*, the debtor's repayment plan had to be one prescribed by the bankruptcy statute; any negotiation with creditors would result in any other creditor having the right to force the company into bankruptcy, regardless of the debtor's financial condition. *Id.* art. 150. A *concordata* applied only to unsecured creditors. *Id.* art. 147. In its plan, the debtor could offer to pay its unsecured creditors either: 50% of its debt immediately, 60% over six months, 75% over 12 months, 90% over 18 months, or 100% over 24 months, in exchange for the full release of the debtor's unsecured debt obligations. *Id.* art. 156. If the debtor submitted the proper documentation and its plan met these legal requirements, the judge granted the *concordata*; creditor consent was not at issue. *Id.* art. 161. If the debtor then failed to comply with the repayment plan, it was declared bankrupt. *Id.* art. 150. Because a company filing for *concordata* could rarely pay 50% of its debts upfront and negotiation between the parties was not permitted, often the *concordata's* only effect was to postpone payments, resulting in high default rates despite the company's potential viability. Aloisio P. Araujo et al., *The Brazilian Bankruptcy Law Experience*, 18 J. Corp. Fin. 994, 996 (2012); *see also* Luiz Fernando Valente de Paiva, *Understanding the Intricacies of Brazilian Bankruptcy Law*, *in* Bankruptcy Law Client Strategies In South America: Leading Lawyers on Navigating the South American Bankruptcy Process, Working with Local Governments, and Developing Successful Strategies 21, 24 (Michaela Falls ed., 2011), *available at* 2011 WL 586859. As a result, the former law was enormously unsuccessful at providing corporate debtors with a meaningful chance at reorganization. Indeed, 80% of companies in *concordata* were eventually declared bankrupt and liquidated. Muniz & Basílio, *supra* note 18, at 231.

22. Under the former regime, bankruptcy proceedings in Brazil took an average of 10 years, more than twice the average for Latin America. Muniz & Basílio, *supra* note 18, 225 n.2 (citing data gathered by economist Gesner Oliveira, former President of the Brazilian Antitrust Agency); *see also* Araujo et al., *supra* note 21, Fig.1, at 996.

23. Under the former regime, tax, labor, and other liabilities of an insolvent company were transferred to the buyer of an asset sold in liquidation. The full amount of such liabilities was generally not known or able to be estimated at the time of sale. *See, e.g.*, Paiva, *supra* note 21, at 24–25. Successor liability made the acquisition of a bankrupt company extremely unattractive to otherwise interested buyers, and depressed sale prices reflected this risk. *See, e.g.*, Muniz & Basílio, *supra* note 18, at 231 (explaining that "it was, in practice, unfeasible to transfer troubled business[es] to healthier entities"). In addition, successor liability led to disposal of the

order: (i) labor claims, (ii) tax claims, (iii) secured claims,[24] and (iv) unsecured claims.[25] Due to high labor and tax rates in Brazil, the debtor rarely had assets left over to satisfy secured creditors, let alone unsecured creditors.[26] In most insolvency cases, secured creditors received nothing.[27] As a result of these challenges, the average recovery rate under the prior insolvency regime for creditors who did not hold tax or labor claims was 0.2%, as compared with a 26% average creditor recovery rate for Latin America as a whole[28] and a 43% historical average senior unsecured creditor recovery rate in the U.S.[29] Investors demanded higher interest rates to account for this inordinate amount of risk, eventually motivating the 2005 reform.[30]

The 2005 reform sought to rectify many of these fundamental defects, and thereby improve Brazil's credit market and overall economic health.[31] To do so, the 2005 reform introduced a legal framework for debtors to negotiate directly with creditors to restructure debts, eliminated successor liability,[32] and demoted tax claims to a priority level below that of secured creditors.[33] The 2005 reform replaced the *concordata* with two distinct methods of reorganization: *recuperação judicial* (judicial reorganization), which involves a court-supervised insolvency

debtor's assets in a piecemeal fashion, which generally translated to decreased proceeds and reduced recovery for creditors due to the loss of, for example, value in the form of goodwill. *Id.* at 230.

24. There are generally three types of secured claims in Brazil: mortgage (real property), pledge (personal property), and chattel mortgage (either real or personal property). *See* Thomas Felsberg, *Rehabilitation and Composition Schemes in Brazil*, *in* COLLIER INTERNATIONAL BUSINESS INSOLVENCY ¶ 16.02[1][a] (Alan N. Resnick et al. eds., 2011).

25. Decreto-Lei No. 7.661, arts. 102, 124.

26. *See, e.g.*, Paiva, *supra* note 21, at 25 ("Because labor claims and tax claims are frequently enormous in Brazil, there were generally few assets remaining in a debtor's estate to satisfy secured claims. As a result, Brazilian lenders incurred tremendous losses due to loan defaults in bankruptcy."). *See generally* Christopher Andrew Jarvinen et al., *The International Scene: Bankruptcy Reform Coming to Brazil*, 23 AM. BANKR. INST. J. 67, 67 (2005).

27. Muniz & Basílio, *supra* note 18, at 230.

28. Araujo et al., *supra* note 21, at 996 (defining the Latin American and Caribbean block as including Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela for the purposes of this study).

29. STANDARD & POOR'S RATINGS SERVS., RATINGS DIRECT: DEFAULT, TRANSITION, AND RECOVERY: U.S. RECOVERY STUDY: RECENT POST-BANKRUPTCY RECOVERY LEVELS DISAPPOINT SENIOR UNSECURED BONDHOLDERS 3, 5 (2012), *available at* http://www.standardandpoors.com/spf/upload/Ratings_US/US_Recovery_Study_Recent_Post_Bankruptcy_Recovery_Levels.pdf.

30. *See supra* note 18 and accompanying text (discussing high interest rates in Brazil); *see also* Araujo et al., *supra* note 21, at 996 (low creditor recovery rates in bankruptcy was "the main reason for the extremely high interest rate spread in Brazil before the new law").

31. *See* Jarvinen et al., *supra* note 26, at 69 (discussing legislative intent behind the reform).

32. Lei No. 11.101, arts. 60, 141, de 9 de Fevereiro de 2005, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 9.2.2005 (Braz.).

33. *Id.* art. 83. In addition, the new law caps the priority position of creditors with labor-related or occupational accident claims at a value equivalent to 150 months of minimum wages per creditor; the remainder of such claims are considered unsecured. *Id.*; *see also* Felsberg, *supra* note 24, ¶ 16.03[9][e].

proceeding;[34] and *recuperação extrajudicial* (extrajudicial reorganization), which involves an out-of-court insolvency proceeding.[35] With respect to judicial reorganizations (the focus of this Article), the 2005 reform retained the *concordata*'s basic structure comprised of three creditor constituencies: labor creditors (Class I), secured creditors (Class II), and a catch-all class generally populated by unsecured creditors (Class III).[36] The new law largely retained Brazil's traditional framework for bankruptcy (*falência*), which is analogous to a chapter 7 liquidation in the U.S.[37] The new law also retained its pre-2005 concepts of fraudulent transfers, setoff, preferences, automatic stay, and discharge, which are somewhat similar to those found in the U.S. Bankruptcy Code.[38]

To initiate an insolvency proceeding, a debtor must file a petition with the Brazilian state civil court located in the jurisdiction of the debtor's principal establishment.[39] In addition, for a Brazilian insolvency proceeding involving bonds issued in the U.S., the debtor will likely need to initiate a chapter 15 proceeding in conjunction with its filing of a petition for judicial reorganization in order to gain U.S. recognition of the Brazilian court order.[40] Brazilian creditors have a legal right to initiate a bankruptcy proceeding, but not a judicial reorganization proceeding.[41] Unlike in the U.S. where there are specialized federal bankruptcy courts in every jurisdiction,[42] most Brazilian states direct insolvency petitions to a court of general subject matter jurisdiction.[43] In such situations, which often occur outside the capital of São Paulo, the judge may be superficially familiar with insolvency law generally, have little experience with the 2005 reform, and have no experience with a complex business insolvency involving international bondholders.

34. Lei No. 11.101, arts. 161–67 (Braz.).

35. *Id.* arts. 47–69. Extrajudicial reorganization is conceptually similar to a prepackaged chapter 11 proceeding in the U.S (though with many practical differences). Because extrajudicial reorganizations have been extremely rare since the 2005 reform, this Article will focus on the more common process of judicial reorganization.

36. *Id.* art. 41; *see* Felsberg, *supra* note 24, ¶ 16.04[7][b]. It is worth noting that the debtor must submit tax liability clearance certificates before the judge may approve the reorganization plan. Lei No. 11.101, art. 57. Thus, in effect, the government is not subject to a judicial reorganization, because a reorganization plan can only be implemented if the debtor either has no tax liabilities or has negotiated an installment plan with the government. *Id.* art. 68.

37. *Compare* Lei No. 11.101, ch. V, *with* Decreto-Lei No. 7.661, tits. I–IX, *and* 11 U.S.C. §§ 701–84 (2006); *see also* Felsberg, *supra* note 24, ¶¶ 16.02[2][c], 16.03.

38. *See* Felsberg, *supra* note 24, ¶¶ 16.03[1][a], [7], [8], [9][i].

39. Lei No. 11.101, art. 3; *see* Felsberg, *supra* note 24, ¶¶ 16.03[2], 16.04[2].

40. Enacted in 2005, chapter 15 of the U.S. Bankruptcy Code covers ancillary and other cross-border cases. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109–8, § 801, 119 Stat. 23, 134–45 (2005) (codified at 11 U.S.C. §§ 1501–32).

41. Felsberg, *supra* note 24, ¶¶ 16.03[3], 16.04[3] .

42. *See* 28 U.S.C. § 1334(a) (2006) (granting exclusive bankruptcy jurisdiction to federal district courts); *see also Understanding the Federal Courts: Bankruptcy Courts*, U.S. Courts, http://www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/BankruptcyCourts.aspx (last visited Apr. 11, 2013) (noting that each of the 94 federal judicial districts handles bankruptcy matters).

43. *See* Felsberg, *supra* note 24, ¶ 16.03[2].

Once in judicial reorganization, the court appoints a judicial trustee[44] to work with the debtor's directors and officers, who remain in control of the business.[45] The judicial trustee monitors the debtor's operating activities, presides over the general meeting of creditors, provides summaries of the debtor's books and records, and performs other administrative duties.[46]

Thereafter, the debtor, its creditors, the judicial trustee, and the court must observe several milestones for judicial reorganization that are subject to a strict timeline as a matter of law.[47] Chart 3 illustrates the overall timeline, which will be discussed in detail herein.

Chart 3: Judicial Reorganization Timeline[48]

Case/ Outcome	Petition Filed/ Accepted by Court	Publication of Notice	Deadline Creditors' Proof of Claim	Deadline Plan Filing by Debtor	Deadline Object to Creditors' Claims	Deadline Court Approves Claims	Deadline Creditor Objection to Plan	General Meetings of Creditors	Deadline End of Stay Period	Court Confirms Plan	Deadline Case Closed
Deadlines	--	0	+15	+60	+70	+80	+90	+135	+180	--	+720
Varig, S.A. *sold to investment consortium*	6/17/05 *ancillary case filed in U.S.on same date* 6/22/05 *accepted by Court*	7/12/05	7/27/05	9/12/05 *plan filed at deadline*	9/20/05	9/30/05	10/10/05	10/13/05 *adjourned* 10/19/05 *adjourned* 10/26/05 *adjourned* 10/31/05 *adjourned* 11/24/05 *deadline* 12/19/05 *plan approved* 02/23/06 *amendment approved*	1/8/06	12/28/05	7/2/07
Independência S.A. *creditors funded reorganization*	2/27/09 *Ch. 15 filed on same date* 5/12/09 *accepted by Court*	5/13/09	5/28/09	7/13/09 *plan filed at deadline*	7/22/09	8/3/09	8/11/09	9/25/09 *deadline* 9/28/09 *inadequate attendance* 10/5/09 *adjourned* 10/19/09 *adjourned* 11/5/09 *plan approved*	11/9/09	11/19/09 *Ch. 15 order 2/24/10*	5/3/11 *liquidated after missed coupon in 2010*
Centrais Elétricas do Pará (CELPA) *sold to Equatorial Energia S.A.*	2/28/12 2/29/12 *accepted by Court* 11/9/12 *Ch. 15 filed*	3/7/12	3/22/12	5/7/12 *plan filed on 5/4/12*	5/16/12	5/26/12	6/5/12	7/20/12 *deadline* 7/9/12 *adjourned* 8/3/12 *adjourned* 9/1/12 *plan approved*	9/4/12	9/4/12 *Ch. 15 order 12/12/12*	2/25/14

Although the new law fails to address certain contemporary issues in insolvency law, such as cross-border insolvencies,[49] the 2005 reform represented a giant leap

44. Lei No. 11.101, art. 22; *see also* Felsberg, *supra* note 24, ¶¶ 16.03[2][a], [4][b].

45. Lei No. 11.101, art. 64. However, officers and directors may be removed for cause. *Id.*

46. *Id.* art. 22; *see* Felsberg, *supra* note 24, ¶ 16.03[4][b].

47. Lei No. 11.101, arts. 5, 7, 53–74 (providing the requirements and timeline for judicial reorganization).

48. *Id.*; *see In re* Varig, S.A., No. 05-14400 (RDD) (Bankr. S.D.N.Y. June 17, 2005); *In re* Independencia S.A., No. 09-10903 (SMB) (Bankr. S.D.N.Y. Feb. 27, 2009); *In re* Centrais Elétricas do Pará S.A. — Em Recuperação Judicial, No. 12-14568-scc (Bankr. S.D.N.Y. Nov. 9, 2012); Judicial Reorganization Proceedings of Centrais Elétricas do Pará S.A., No. 0005939-47.2012.8.14.0301 (13th L.C. Belém, Pará Feb. 29, 2012); *Judicial Reorganization in Brazil*, Indapendência, http://ir.independencia.com.br/independencia/web/conteudo_en.asp?idioma=1&conta=44&tipo=25968 (last updated Nov. 13, 2009).

forward in modernizing Brazilian insolvency law. A 2012 empirical study led by Aloisio P. Araujo, Professor at the National Institute of Pure and Applied Mathematics in Rio de Janeiro, found that the overhaul led to a number of positive developments.[50] The number of liquidation requests significantly decreased immediately following the reform, creditor recovery rates increased from 0.2% to 17% by 2009, and the average time to close a business fell from 10 to 4 years.[51] The same study also determined that the 2005 reform materially reduced the cost of debt financing due to the improved treatment of lenders[52] and increased access to debt financing for Brazilian companies.[53] Data from the Brazilian Central Bank (Chart 4) illustrates the following trends, which suggest that Brazilian companies and their creditors increasingly recognize the 2005 reform to be a constructive solution for corporate restructurings: (i) the number of judicial reorganizations is growing in absolute numbers as well as relative to the number of bankruptcies; (ii) for large businesses with revenues over 50 million Brazilian reais, which are most relevant to international bondholders, 2012 insolvency filings were comprised of approximately 80% judicial reorganizations and 20% bankruptcies (the proportion for small and medium businesses was approximately 35%/65% and 67%/33%, respectively); (iii) courts are most familiar with judicial reorganization cases involving small and medium businesses with revenues under 50 million Brazilian reais, but case law for large companies is steadily creating a foundation of applicable legal precedent; and (iv) the judicial reorganization process is resulting in more court-confirmed debt restructuring plans (as opposed to conversions to bankruptcy for liquidation), although the percentage remains consistently below 50%. Furthermore, a general rise in judicial reorganization filings since 2005 (Chart 4) suggests that Brazilian companies and their creditors are increasingly recognizing the 2005 reform to be a constructive solution for corporate restructurings.[54] While the 2005 reform dramatically improved Brazilian insolvency laws, several aspects require further improvement to address practical capital market realities and conform to international best practices.

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49. Brazil did not adopt the UNCITRAL Model Law on Cross-Border Insolvency endorsed by the United Nations Commission on International Trade Law in 1997. Felsberg, *supra* note 24, ¶ 16.05[4]; *see also* Thomas Benes Felsberg & Paulo Fernando Campana Filho, *Corporate Bankruptcy and Reorganization in Brazil: National and Cross-border Perspectives in* NORTON ANN. REV. OF INT'L INSOLVENCY 275, 299 (2011) (urging Brazil to adopt laws regarding cross-border insolvencies).

50. Araujo et al., *supra* note 21, at 1000, 1004.

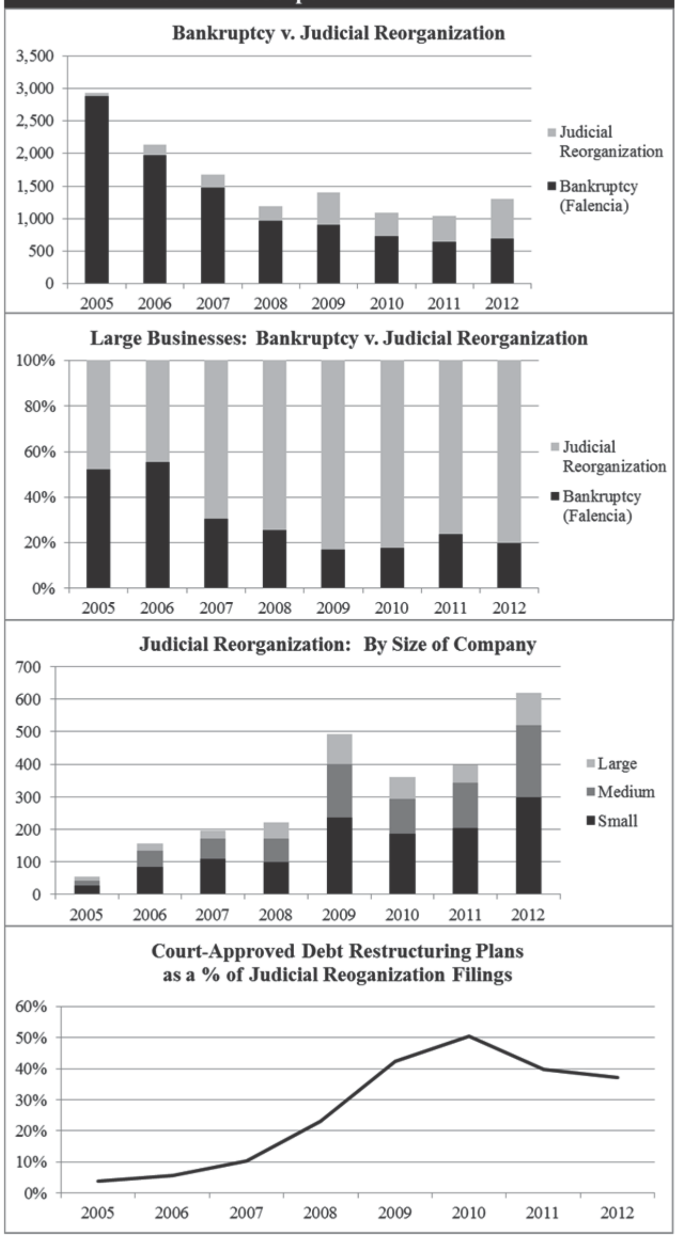
51. *Id.* at 996, 998.

52. *Id.* at 1004.

53. *Id.* at 995, 1004.

54. *Indicador Serasa Experian de Falências e Recuperações*, SERASA EXPERIAN, *available at* http://www.serasaexperian.com.br/release/indicadores/falencias_concordatas.htm (last accessed June 19, 2013). *See, e.g.*, Felsberg & Filho, *supra* note 49, at 279 ("By recognizing that insolvency is first and foremost an issue to be resolved by debtor and creditors, the new law has become an efficient instrument to deal with many varied and complex situations and has been applied in numerous cases in a constructive manner. The number of cases that have been filed since the new law was enacted bears witness to the positive impact of the new law." (internal citations omitted)).

Chart 4: Brazilian Corporate Insolvencies 2005-2012[55]



55. *Indicador Serasa Experian de Falências e Recuperações*, Serasa Experian, *available at* http://www.serasaexperian.com.br/release/indicadores/falencias_concordatas.htm (last visited June 19, 2013).

III. Claim Separation

The treatment of bondholders in a Brazilian insolvency case diverges sharply from the rights afforded bondholders under U.S. bankruptcy law. In the U.S., bondholders are considered individual creditors with separate voting rights and standing.[56] An indenture trustee serves as a type of agent who is appointed to act on behalf of bondholders collectively, but its discretion to so act is limited by the Trust Indenture Act of 1939 (TIA)[57] (when applicable), as well as the U.S. Bankruptcy Code.[58] These limitations prevent the indenture trustee from taking an active role in U.S. bankruptcy cases by, for example, voting on behalf of the bondholders for or against a chapter 11 plan of reorganization.[59] Brazilian law, by contrast, treats a bond issue as a single creditor and therefore does not automatically recognize the preferences and opinions of individual bondholders.[60] Instead, Brazilian law requires the bond issue to vote — or not vote — as a whole, either entirely for or entirely against a debt restructuring plan.[61] Without the cooperation of the indenture trustee to vote on their behalf, bondholders in a Brazilian insolvency proceeding must go through the time-consuming and expensive process of separating their claims.[62] When considering the cost of claim separation, individual bondholders should first determine how much voting power they can exert over Class III creditors if they were to successfully separate their claims. Even when some bondholders successfully separate their claims from the bond issue, bondholders' overall influence in the case may be marginalized when the indenture trustee and large numbers of other individual bondholders do not participate. Further, it may be impossible even to identify large numbers of other bondholders to solicit their participation.

Filings include requests submitted by potential debtors (requeridas for both bankruptcy and judicial reorganization) that were accepted by the court and ordered to be processed (decretadas for bankruptcy and deferidas for judicial reorganization). Small companies are defined as businesses with revenues up to BRL250,000; medium companies are defined as businesses with revenues between BRL250,000 and BRL50 million; and large companies are defined as business with revenues over BRL50 million. Court-approved debt restructuring plans as a percentage of judicial reorganizations filings uses an average of the total judicial reorganization filings for the prior and current years. *See id.*

56. *See infra* notes 75–78 and accompanying text.

57. *See infra* note 74 and accompanying text.

58. 11 U.S.C. § 1126(a) (2006) ("The holder of a claim ... may accept or reject a plan."); Fed. R. Bankr. P. 3018(a) (explaining who may accept or reject a plan); *cf.* 11 U.S.C. § 501(a) (2006) ("A creditor or an indenture trustee may file a proof of claim."); *see infra* Part III.A.

59. *See infra* notes 74–78 and accompanying text.

60. *See* Peter J.M. Declercq, *Restructuring European Distressed Debt: Netherlands Suspension of Payment Proceeding . . . The Netherlands Chapter 11?*, 77 Am. Bankr. L.J. 377, 396, 400–02 (2003) (contrasting the right to vote on reorganization plans in the Netherlands to indentured trustees' rights to vote in United States). *See generally* Mark M. Polebaum et al., *One Creditor or Many? Bondholder Standing in Foreign Insolvencies*, Financier Worldwide, May 2005, at 46; *see infra* Part III.B.

61. *See infra* note 79 and accompanying text.

62. *See infra* Parts III.B–C.

A. Automatic Recognition of Individual Bondholders under U.S. Law and the Role of an Indenture Trustee

The TIA, which supplements the Securities Act of 1933 (Securities Act),[63] governs the distribution of certain debt securities, such as public bonds. The TIA mandates the appointment of an independent, qualified trustee (known as an "indenture trustee") to act for the benefit of all holders of a particular bond issue.[64] An indenture is the contract that governs a bond issue[65] and is accompanied by a registration statement that contains the details necessary for the bonds to be registered under the Securities Act.[66] The indenture defines the relationship between an identified indenture trustee and the bondholders.[67] Specifically, the indenture will describe the indenture trustee's responsibilities and potential liabilities, as well as establish how bondholders can vote to instruct the indenture trustee to act.[68] An indenture trustee's administrative duties may include distributing interest and principal payments, monitoring redemptions, providing notice of default to bondholders, and filing a proof of claim on the bondholders' behalf should the issuer enter bankruptcy.[69] Beyond such administrative acts, the indenture trustee traditionally plays a passive monitoring role, even when the company defaults, an event that generally triggers ordinary fiduciary duties on the part of the indenture trustee.[70]

63. 15 U.S.C. §§ 77a–mm (2006).

64. *Id.* § 77jjj(a)(1), (a)(4); *id.* § 77ooo(a)–(d).

65. *Id.* § 77ccc(7).

66. *Id.* § 77eee(a); *see also* Thomas Lee Hazen, *Debt Securities and Protection of Bondholders—The Trust Indenture Act of 1939*, 6 Law Sec. Reg. § 19.1 (2013).

67. 15 U.S.C. §§ 77bbb, ooo.

68. *Id.* §§ 77bbb, ooo, ppp.

69. *See, e.g.,* Steven L. Schwarcz & Gregory M. Sergi, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59 Ala. L. Rev. 1037, 1044–49 (2008) (describing the typically "ministerial" duties of the indenture trustee that are set forth in the indenture).

70. Prior to default, indenture trustees generally do not owe fiduciary duties to bondholders except to the extent that they must avoid conflicts of interest. *See id.* at 1044–45; 18A Am. Jur. 2d *Corporations* § 470 (2d ed. 2004). Instead, their pre-default obligations are defined by the terms of the indenture. 15 U.S.C. § 77ooo(a)(1); *see, e.g.*, Lorenz v. CSX Corp., 1 F.3d 1406, 1416 (3d Cir. 1993); Meckel v. Continental Resources Co., 758 F.2d 811, 816 (2d Cir. 1985); BNP Paribas Mortg. Corp. v. Bank of America, N.A., 778 F. Supp. 2d 375, 396 (S.D.N.Y. 2011) ("The question is whether [the indenture trustee] performed its express duties under the contract, and [the indenture trustee] is strictly liable for any breach of these duties as a matter of basic contract law."). *But see* AG Capital Funding Partners, L.P. v. State Street Bank & Trust Co., 11 N.Y.3d 146, 156–57 (N.Y. 2008) (noting that some courts have found indenture trustees to owe a pre-default "extracontractual duty to perform basic, nondiscretionary, ministerial functions redressable in tort if such a duty is breached"). Post-default, however, the TIA introduces a heightened standard of care, requiring the indenture trustee to exercise "the same degree of care and skill . . . as a prudent man would exercise or use under the circumstances in the conduct of his own affairs." 15 U.S.C. § 77ooo(c). In addition, U.S. courts have generally held that an event of default triggers ordinary fiduciary duties on the part of the indenture trustee. *See* Gresser v. Wells Fargo Bank, N.A., No. CCB-12-987, 2012 WL 5250553, at *5 (D. Md. Oct. 22, 2012) ("[A] broad, fiduciary-like duty to protect noteholder interests seems to be what the TIA intended to vest in indenture trustees during defaults."); Beck v. Manufacturers Hanover Trust Co., 632 N.Y.S.2d 520, 527–28 (N.Y. App. Div. 1995) ("[S]ubsequent to the obligor's default . . . it is clear that the indenture trustee's obligations come more closely to resemble those of

Due to uncertainty surrounding their role and duties in a chapter 11 case,[71] indenture trustees often act in a manner that prioritizes minimizing liability for themselves over advocating the best interests of the bondholders.[72] For example, they may refuse to act without approval by a majority of bondholders, so as to fit within the TIA's safe harbor for actions taken "in good faith in accordance with the direction of [a majority of] the holders . . . ."[73]

Furthermore, the indenture trustee's role in a chapter 11 case is limited by both the TIA and the U.S. Bankruptcy Code. The TIA prevents "all binding bondholder votes that would modify any core term — principal amount, interest rate, and maturity date — of a bond indenture."[74] This provision thus prohibits the indenture trustee from voting on any proposed plan of reorganization that would alter the principal, interest, and maturity of a non-consenting bondholder. The U.S. Bankruptcy Code also prevents the indenture trustee from voting on a plan of reorganization. Because the Bankruptcy Code limits those entitled to vote on a plan of reorganization to "holder[s] of a[n allowed] claim or interest"[75] and defines "claim" as a "right to payment,"[76] courts have held that "it is the beneficial holder

an ordinary fiduciary, regardless of any limitations or exculpatory provisions contained in the indenture."). However, due to ambiguity in the TIA and case law surrounding the extent of such post-default duties, indenture trustees are often uncertain of their role in a bankruptcy case, leading them to be wary of taking any action that could lead to future liability. *See, e.g.*, Schwarcz & Sergi, *supra* note 69, at 1040 ("Although a prudent-man standard is widely used and well-developed in other legal contexts, it has received scant attention in the trust-indenture context. Indenture trustees for defaulted bonds therefore face the conundrum that they are required to act prudently but lack clear guidance on what prudence means.").

71. *See supra* note 70.

72. Schwarcz & Sergi, *supra* note 69, at 1041–43 (explaining this phenomenon and advocating application of the business judgment rule in the trust-indenture context as a solution).

73. 15 U.S.C. § 77ooo(d)(3); *see also* Schwarcz & Sergi, *supra* note 69, at 1046; 7 COLLIER ON BANKRUPTCY ¶ 1126.02[2], at 1126-6 n.15 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2012) ("As a practical matter indenture trustees do not exercise powers not granted to them in their enabling indentures and generally a trustee will not undertake a trust where such language might be present. The standard indenture gives an indenture trustee the right only to file a proof of claim, but not to vote, for the bondholders or debenture holders."); Wolcott B. Dunham, Jr. & Peter L. Borowitz, *The Role of the Indenture Trustee in Reorganization Cases Under the Bankruptcy Code*, 102 BANKING L.J. 436, 440 (1985) ("Beyond [the TIA's authorization for the indenture trustee to file proofs of claim], however, the TIA does not mandate that any specific discretionary powers be exercised by the indenture trustee 'as a prudent man . . . under the circumstances' of a reorganization case." (footnotes omitted)).

74. 15 U.S.C. § 77ppp(b); Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 232 (1987) (referring to the requirements of the Trust Indenture Act § 316(b), 15 U.S.C. § 77ppp(b) (2006)); *see also* George W. Shuster, Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 AM. BANKR. INST. L. REV. 431, 437 (2006) ("Section 316(b) was adopted with a specific purpose in mind—to prevent out-of-court debt restructurings from being forced upon minority bondholders."). *But see* 15 U.S.C. § 77ppp(a)(2) (indenture may contain provisions authorizing the indenture trustee to postpone interest payments for a maximum period of three years with the consent of the holders of at least 75% in principal amount of the indenture securities).

75. 11 U.S.C. § 1126(a) (2006); *see also* FED. R. BANKR. P. R. 3018 ("[A]n equity security holder or creditor whose claim is based on a security of record shall not be entitled to accept or reject a plan unless the equity security holder or creditor is the holder of record of the security on the date the order approving the disclosure statement is entered or on another date fixed by the court, for cause, after notice and hearing.").

76. 11 U.S.C. § 101(5)(A).

[i.e., the individual bondholder], not a holder of record (i.e., the indenture trustee), who has the 'claim' and the 'right to payment,'" and, thus, the right to vote on a plan of reorganization.[77] Thus, while preventing indenture trustees from voting on behalf of bondholders, U.S. bankruptcy law automatically recognizes each bondholder as an individual creditor who is authorized to vote its respective claim separately.[78]

B. Lack of Automatic Recognition of Individual Bondholders and the Necessity of Pursuing Claim Separation under Brazilian Law

In contrast, Brazilian law treats a debtor's bond issue as a single claim, thus denying individual bondholders the automatic voting rights they enjoy under the U.S. system. Instead, Brazilian Bankruptcy Law expects the indenture trustee to express the voices of all bondholders, by rendering it the only party capable of acting on their behalf.[79] For certain actions, such as filing a proof of claim on behalf of all bondholders within the fifteen-day deadline in a judicial reorganization, this expectation is reasonable.[80] In other instances, however, the onus on the indenture trustee conflicts with its conventional role, which, as discussed, is characterized by an inability to vote on a plan of reorganization in a U.S. chapter 11 case[81] or modify central terms of an indenture (such as principal, interest, and maturity) absent the consent of affected bondholders,[82] and a reluctance to act where discretion is permitted absent majority approval to shield it from liability under the TIA's safe harbor.[83] Moreover, the likelihood of gaining consensus among bondholders —

77. *In re* Pioneer Fin. Corp., 246 B.R. 626, 633 (Bankr. D. Nev. 2000); *In re* Southland Corp., 124 B.R. 211 (Bankr. N.D. Tex. 1991).

78. *See, e.g.*, *In re* Shilo Inn, Diamond Bar, LLC, 285 B.R. 726, 730 (Bankr. D. Or. 2002) (discussing the relationship between the issuer, indenture trustee, and bondholders and explaining that bondholders "are like holders of promissory notes evidencing debt of the issuer corporation . . . . [T]he indenture trustee is not the holder of the claim and, accordingly, is not entitled to accept or reject a plan. The bond holders are entitled to vote their own claim or interest") (internal citations and quotation marks omitted).

79. In this regard, the Brazilian Bankruptcy Law likens the indenture trustee to its Brazilian counterpart — the fiduciary agent (*agente fiduciário*) — established under the Brazilian Corporation Law to represent bondholders and whose enumerated duties (unlike the indenture trustee) include representation of bondholders in bankruptcy proceedings. Lei No. 6.404, arts. 66 (appointment), 68 pará. 3(d) (duties), de 15 de dezembro de 1976, Diário Oficial da União [D.O.U.] de 15.12.1976 (Braz.).

80. Lei No. 11.101, art 7 pará. 1, de 9 de Fevereiro de 2005, Diário Oficial da União [D.O.U.] de 9.2.2005 (Braz.); *see also* Felsberg, *supra* note 24, ¶¶ 16.03[9][a][iii], 16.04[7][a][iii] ("The time limit for creditors to file their claims or submit their opposition to the debts listed by the debtor is 15 days. If the creditor fails to file his claim during such period, the claim may be subsequently admitted as a late claim. In such case, the creditor will have no voting rights in the general meeting of the creditors." (footnote omitted)). In U.S. bankruptcies, indenture trustees routinely file a proof of claim on behalf of all bondholders pursuant to Bankruptcy Rule 3003. Fed. R. Bankr. P. R. 3003(c)(5); *see also* 15 U.S.C.A. § 77qqq(a)(2) (2010) (authorizing indenture trustee to "file such proofs of claim and other papers or documents as may be necessary or advisable in order to have the claims of such trustee and of the indenture security holders allowed in any judicial proceedings").

81. *See supra* notes 75–78 and accompanying text.

82. *See supra* note 74 and accompanying text.

83. *See supra* notes 72–73 and accompanying text.

who are made up of multiple institutions and perhaps hundreds of individuals, each with unique priorities, interests, and decisionmaking processes — is remote. Indeed, it may be impossible, as a practical matter, to communicate with a sufficient number of bondholders to induce the indenture trustee to act (*e.g.*, a majority), much less to garner votes from the requisite 100% of those affected in order to participate in acceptance or rejection of a plan.[84] Thus, the convergence of the U.S. and Brazilian legal frameworks seriously impedes individual bondholders' ability to participate in a Brazilian judicial reorganization. In addition, it may create disputes between U.S. bondholders and their indenture trustee.

If bondholders wishing to participate in a Brazilian judicial reorganization face an indenture trustee who refuses to act on their behalf, they may attempt to separate their individual claims from the claim of the bond issue by filing a proof of claim with the judicial trustee within fifteen days of public notice of the case.[85] Once separated, bondholders gain the rights of a creditor to vote on a debt restructuring plan at the general meeting of creditors. Although claim separation is not explicitly laid out in the Brazilian Bankruptcy Law, Brazilian courts have authorized bondholders to obtain individual recognition under the court's general power to admit or alter claims.[86] To actually separate their claim so as to gain voting rights, however, bondholders must go through a time-consuming, expensive, and convoluted process of filing cumbersome and labor-intensive forms to prove their ownership.[87] For institutions that manage many separate funds and accounts, each fund and account must fill out separate forms that explain and prove its identity, legal status, and authorization in extensive detail.[88] Fund managers may require burdensome cooperation from their clients to gather this information, including a power of attorney, by-laws, certificate of incorporation, certificate of incumbency, and management agreement. Each form must be properly consularized,[89] notarized, sworn, and translated into Portuguese.[90] Any mistake or omission may disqualify

84. *See, e.g.*, Steven L. Schwarcz, *Intermediary Risk in a Global Economy*, 50 DUKE L.J. 1541, 1547–49 (2001) (describing the complexity of the indirect holding system used in U.S. and global securities markets).

85. Lei No. 11.101, art. 7, pará. 1.

86. *Id.* art. 39; *see, e.g.*, Judicial Reorganization Proceedings of Centrais Elétricas do Pará S.A., No. 0005939-47.2012.8.14.0301 (13th L.C. Belém, Pará Feb. 29, 2012) (approving the claim separation of Barclays Bank PLC, Nomura Securities International, Inc., J.P. Morgan Securities Ltd. and other individual bondholders).

87. Lei No. 11.101, art. 7, pará. 1, art. 9.

88. *See generally id.*

89. A document is deemed consularized when executed before and notarized by a foreign notary. José Henrique Lamensdorf, *Almost Everything You Wanted to Know About Certified (Sworn) Translations in Brazil*, http://www.lamensdorf.com/br/faqs.html (last visited Apr. 4, 2013).

90. *See* Paulo Fernando Campana Filho, *The Legal Framework for Cross-Border Insolvency in Brazil*, 32 HOUS. J. INT'L L. 97, 140–41 (2009) (explaining that foreign creditors in Brazilian bankruptcy cases face bureaucratic obstacles to efficiently solving cross-border cases due to the 1973 Brazilian Code of Civil Procedure's requirement that all foreign documents be officially translated into Portuguese for recognition in court).

the application, causing the bondholder further delay, at which time critical deadlines may have passed.[91]

Proving ownership of bonds in a modern world of online transactions can be especially challenging. Debt capital markets transactions regularly rely on electronic information provided by the Depository Trust Company (DTC), but such digital evidence is inadequate for Brazilian courts considering claim separation.[92] The Brazilian Bankruptcy Law requires "financial instruments and documents that legitimize the claims [to] be submitted in the original or by certified copies if attached to other proceedings."[93] The DTC annually settles over US$1 quadrillion in securities transactions throughout 120 countries in which investors rely on the integrity of its data.[94] Nevertheless, Brazilian law does not acknowledge such realities; instead requiring documentation to which bondholders may not have prompt access. This antiquated level of detail may embolden a debtor to file frivolous objections regarding a bondholder's claim separation application in order to create strategic delays in the expedited insolvency process.[95]

Moreover, even if bondholders are able to separate their claims successfully in order to gain voting rights in a Brazilian insolvency proceeding, their voting power may be inconsequential to the overall vote of Class III creditors. Since the indenture trustee will likely abstain from voting for non-separated bondholders, only the separated bondholders' voices will be heard.[96] Without aligning with other similarly situated creditors, bondholders with separated claims will likely face an uphill battle to negotiate a favorable outcome for bondholders overall. Accordingly, the debtor may cater to other creditor groups with more influence on the outcome of the proceeding, such as labor or tax creditors.[97]

C. Claim Separation in Practice

In practice, claim separation can become a time-consuming, costly distraction for international bondholders who could otherwise focus on the debtor's operational performance, prospects for selling the company's assets to one or more acquirers,

91. *See* Lei No. 11.101, art. 7 pará. 1, art. 19.

92. Article 9 of the Brazilian Bankruptcy Law enumerates the documentation that a creditor must submit in a proof of claim, which includes documents evidencing the claims. *Id.* art. 9(III).

93. *Id.* art. 9, pará. único.

94. *About DTCC: Our Business,* DTCC (2012), http://www.dtcc.com/about/business/. The DTC is a subsidiary of the Depository Trust & Clearing Corporation. *See About DTCC: Subsidiaries & Joint Ventures*, *The Depository Trust Company (DTC)*, DTCC (2012), http://www.dtcc.com/about/subs/dtc.php.

95. The Brazilian Bankruptcy Law permits the debtor or any creditor to file an opposition to any claim, alleging lack of a claim or challenging its lawfulness, amount, or rating. Lei No. 11.101, arts. 8, 13. The bondholder must then file an answer, attaching any additional evidence considered necessary. *Id.* art. 11. An opposition creates a separate case record, which must be decided by the judge who may order an evidentiary and judgment hearing if necessary. *Id.* arts. 13, 15.

96. *Id.* art. 45 (only the votes of creditors who are represented at the general meeting count towards obtaining the requisite percentage of assenting creditors for plan approval).

97. *See* Paiva, *supra* note 21.

and establishing alliances with bank lenders and other creditors. A recent example of these challenges is the 2012 Brazilian insolvency case involving Centrais Elétricas do Pará S.A. (CELPA). In June 2011, CELPA issued US$250 million of 10.5% notes due 2016 to qualified institutional buyers in accordance with Rule 144A of the U.S. Securities Act of 1933, as amended, and outside the United States in accordance with Regulation S of the U.S. Securities Act of 1933, as amended.[98] After paying one coupon in December 2011, on February 28, 2012, CELPA suddenly filed for judicial reorganization before the Thirteenth Civil Court of Belém in Pará, Brazil.[99] At the time of CELPA's filing, eight institutional investors, all of whom wished to participate in the reorganization proceedings, held approximately 45% of the bonds.[100] Repeated efforts to identify the other 55% of the bondholders via the DTC, underwriters, listing exchange, trading exchange, clearinghouses, and advertisements were unsuccessful. With only 45% of holders providing direction, the indenture trustee refused to take action for fear of being held liable to undiscovered holders who could later sue the indenture trustee for taking action without first obtaining majority or unanimous approval, as the case may be.[101]

Without the indenture trustee's support, CELPA's bondholders were immediately confronted with the issue of claim separation following the commencement of the judicial reorganization. In order to be heard on issues before the court and to get the debtor's attention in negotiations, the bondholders needed to establish individual standing in the case via claim separation. The eight institutional bondholders represented approximately 39 individual funds and accounts with respect to CELPA bonds.[102] After weeks of preparing claim separation

98. *Latin America: Brazil*, Troubled Co. Rep., Mar. 19, 2012, *available at* http://bankrupt.com/TCRLA_Public/120319.mbx.

99. Judicial Reorganization Proceedings of Centrais Elétricas do Pará S.A., No. 0005939-47.2012.8.14.0301 (13th L.C. Belém, Pará Feb. 29, 2012).

100. *Id.*

101. *See* discussion regarding role of U.S. indenture trustee in insolvency proceedings *supra* Part III.A.

102. Judicial Reorganization Proceedings of Centrais Elétricas do Pará S.A., No. 0005939-47.2012.8.14.0301 (13th L.C. Belém, Pará Feb. 29, 2012) (approving the separation of claims of Thornburg Investment Income Builder Fund; Thornburg Strategic Income Fund; TRP SICAV Global Emerging Markets Corporate Bond Fund; Sumitomo Trust Emerging Markets Bond Mother Fund; TRP Global Emerging Markets Bond Fund (DSBI Global Investment Trust); Nordea 1 Emerging Market Corporate Bond Fund; John Hancock Funds II - Spectrum Income Fund; T. Rowe Price Fixed Income Trust; T. Rowe Price Emerging Markets Bond Fund; T. Rowe Price Institutional Emerging Markets Bond Fund; T. Rowe Price Emerging Markets Bond Trust; T. Rowe Price Strategic Income Fund, Inc.; Franklin Templeton Emerging Market Debt Opportunities Fund PLC; FTIF - Templeton Global High Yield Fund; Franklin Global Trust - Franklin Templeton Emerging Market Debt Opportunities Fund; Franklin Templeton Emerging Market Debt Opportunities (Master) Fund Ltd.; FT Opportunistic Distressed Fund, Ltd.; Pennsylvania Public Employee's Retirement System; The JBUT Master Investment Partnership, LLP; The Harry L. Bradley Jr. Trusts Master Investment Partnership LLP; John Hancock Investors Trust; John Hancock Strategic Income Fund; John Hancock Fund II Strategic Income Fund; John Hancock Trust Strategic Income Trust; Kentucky Retirement Systems Pension; Manulife Am Strategic Income Pooled Fund; Manulife Emerging Markets Debt Fund; Manulife Global Emerging Market High Yield Fund; Manulife Strategic Income Fund (159); Public Employees Retirement of New Mexico; Moneda Deuda Latinoamericana Fondo De Inversión; Moneda Retorno Absoluto Fondo De Inversion; Moneda Absolute

forms for each fund and account, their counsel submitted the applications to the court.[103] Seeing an opportunity to gain an advantage in negotiations, CELPA's counsel objected to the claim separation in order to silence the voices of bondholders.[104] Nearly 20 weeks after the commencement of CELPA's judicial reorganization, the court ruled in favor of bondholders, approving the claim separation.[105] CELPA's counsel then appealed this ruling to create further delay and to gain additional negotiating leverage.[106] Weeks later, the appellate court affirmed the claim separation. CELPA's counsel *again* appealed to maintain its perceived advantage.[107] While ultimately the bondholders were able to vote on CELPA's debt restructuring plan, the debtor's delay tactics distracted the bondholders throughout nearly the entire 180-day time period for the judicial reorganization.

D. Potential Solutions

These issues could be ameliorated by amending the Brazilian Bankruptcy Law such that bondholders' claims are recognized as independent from that of the bond issue. It is difficult to imagine who would be prejudiced by such a change, and, with little to no cost to other parties to the judicial reorganization, the benefit to bondholders would be significant. Bondholders could focus their efforts on negotiating a fair and equitable plan rather than on separating their claims. In addition, it would be constructive to amend the Brazilian Bankruptcy Law to loosen the technical requirements of proving claim ownership by recognizing the DTC's record as sufficient for that purpose.

Alternatively, these issues could be resolved by amending the TIA for future U.S. bond issuances involving foreign issuers from countries like Brazil.[108] First, the TIA

Return Fund; Moneda Latin America Corporate Debt Fund; and Fondo Larraín Vial Renta Fija Lationoamericana FI).

103. *Id.* (approving the motion for claim separation of Barclays Bank PLC, Nomura Securities International, Inc., J.P. Morgan Securities Ltd. and other individual bondholders).

104. *Id.*

105. *Id.*

106. *See* Interlocutory Appeal Nomura Securities International, Inc., State Court of Appeals of Pará State (case no. 2012.3016.5917); Interlocutory Appeal J.P. Morgan Securities Ltd., State Court of Appeals of Pará State (case no. 2012.3016.5909); Interlocutory Appeal Bondholders, State Court of Appeals of Pará State (case no. 2012.3016.5925); Interlocutory Appeal Barclays Bank PLC, State Court of Appeals of Pará State (case no. 2012.3016.5933).

107. *Supra* note 106.

108. Academics have criticized the TIA for inhibiting the indenture trustee's ability to effectively advocate the best interests of bondholders. *See, e.g.*, Schwarcz & Sergi, *supra* note 69, at 1042 ("These deficiencies in the post-default governance of public bond issues by indenture trustees contrast unfavorably with the increasingly sophisticated post-default behavior of lenders on private debt. Although it is possible that these private-lender actions may benefit public bondholders, the interests of private lenders are by no means perfectly aligned with the interests of bondholders. Frequently, private lenders and public bondholders are competing creditors, such as when the bonds are subordinate to the company's other debt. Bondholders then may need an effective indenture trustee to protect their rights, especially since aggressive bargaining by private lenders can systematically advantage them over the public bondholders.") (footnotes omitted); *accord* Marcel Kahan, *The*

could authorize an indenture to provide for a lower threshold than the affirmative vote of 100% of those affected by a proposal, such as a simple majority, for directing the indenture trustee to modify central terms of an indenture such as principal, interest, and maturity in an insolvency proceeding. A lower threshold would acknowledge the practical reality that it is rarely possible to locate every single bondholder, especially in the 180-day timeframe of a Brazilian judicial reorganization.

Second, when calculating whether the threshold has been reached for taking action in insolvency proceedings, the TIA could authorize indentures to provide that only bondholders who indicate direction should be counted, assuming adequate notice to all bondholders was given beforehand. For example, in the CELPA case where only 45% of bondholders were ever located, a unanimous direction by these bondholders would satisfy a 100% threshold if the unknown bondholders were excluded. This approach also acknowledges the practical reality that it is rarely possible to locate every single bondholder and, accordingly, uses a unanimous vote of the known bondholders as a proxy for the remaining bondholders.

Third, the TIA could authorize the indenture trustee to act in the best interests of bondholders in the absence of direction by 100% of bondholders.[109] The TIA already includes a prudent man standard for governing the actions of an indenture trustee.[110] The indenture could refer to this standard when authorizing the indenture trustee to negotiate with a debtor and other creditors, object to motions of the debtor, and cast a vote approving or denying a debt restructuring plan in a Brazilian judicial reorganization. Empowering the indenture trustee with this authority would motivate the indenture trustee to act in order to avoid potential liability from inaction.

Qualified Case Against Mandatory Terms in Bonds, 89 NW. U. L. REV. 565, 569 (1995). These structural disadvantages between public bondholders and private lenders in U.S. cases are exacerbated when foreign bondholders face local banks in an insolvency proceeding outside of the U.S. Local banks are likely to have closer ties with the local management, owners, and directors of local debtors than foreign bondholders. Moreover, local banks are more likely to do business with local debtors after the insolvency proceeding is resolved; whereas foreign bondholders are more likely to try to sell their investments as soon as the insolvency proceeding concludes. Furthermore, the advisors of local banks are more likely to have preexisting relationships with the local debtor's advisors although foreign bondholders can try to hire well-connected local advisors as well. Finally, local banks are more likely to have local government connections than foreign bondholders.

109. *See, e.g.*, Schwarcz & Sergi, *supra* note 69, at 1041–43 (advocating application of the business judgment rule in the trust-indenture context to protect indenture trustees from liability when acting on behalf of bondholders in a bankruptcy case).

110. *See* 15 U.S.C. § 77ooo(c) (2006).

IV. Organizing Creditors in an Insolvency Proceeding

There are many reasons why similarly situated creditors should organize when confronted with the insolvency of a common borrower. Most importantly, united creditors can negotiate the best overall outcome by focusing on maximizing the value of the debtor's assets. As a result of joining forces, creditors can resist a debtor's efforts to divide and conquer by pitting some creditors against others. Organized creditors can share costs for professional advisors to assist in negotiation, litigation, appraisals, and, if necessary, liquidation. They can also work together to disseminate information and minimize fraud, misrepresentation, and self-dealing by the debtor. Finally, organized creditors can speak with one voice to the debtor in order to streamline negotiations and create a more efficient process.

A. Creditors' Committees Under U.S. Law

The U.S. Bankruptcy Code requires the U.S. trustee to appoint an official committee of unsecured creditors to represent the interests of all general unsecured creditors, including bondholders.[111] The trustee may use its discretion to appoint additional committees of creditors or of equity security holders,[112] though multiple committees are not typical.[113] The U.S. trustee selects which creditors will serve as members of the committee of general unsecured creditors (as well as other committees, if any) at a meeting of all creditors held soon after the filing of the bankruptcy case.[114] In general, the trustee will appoint the creditors holding the seven largest claims against the debtor to serve on the committee.[115] However, the committee should include membership from many categories of unsecured claims (e.g., senior bondholders, subordinated bondholders, trade creditors, union/employee creditors, and unsecured bank lenders) in order to be representative of all interests.[116] Service on a committee is entirely voluntary.[117]

The U.S. Bankruptcy Code authorizes the committee to perform certain tasks in connection with the bankruptcy case.[118] These tasks include: consulting with the

111. 11 U.S.C. § 1102(a)(1) (2006).

112. *Id.* § 1102(a)(1)–(2).

113. *See* Collier on Bankruptcy, *supra* note 73, ¶ 1102.02[4][a] ("The United States trustee should appoint additional committees only if necessary to assure adequate representation of creditors. In the vast majority of chapter 11 cases, a single committee of creditors should be sufficient and multiple committees will be the exception rather than the rule.") (footnote omitted).

114. 11 U.S.C. § 341(a)–(b)(1); Fed. R. Bankr. P. R. 2003.

115. 11 U.S.C. § 1102(b)(1). In the case of a committee of equity holders, the committee will generally consist of the equityholders holding the seven largest amounts of equity securities of the debtor. *Id.* § 1102(b)(2).

116. *See* Collier on Bankruptcy, *supra* note 73, ¶ 1102.02[b][i].

117. 11 U.S.C. § 1102(b)(1)–(2).

118. *Id.* § 1103; *see also* H. Peter Nesvold et al., The Art of Distressed M&A: Buying, Selling, and Financing Troubled and Insolvent Companies 37 (2011).

debtor concerning case administration; investigating the conduct and financial condition of the debtor, the operation of the debtor's business, and the desirability of the continuance of the business; participating in the formulation of a plan, as well as collecting and filing with the court acceptances or rejections of a plan; requesting the appointment of a bankruptcy trustee or examiner; and performing such other services as are in the interest of those represented.[119] In addition, the Bankruptcy Code explicitly gives the committee standing to be heard by the bankruptcy court on any issue.[120]

To aid in its performance of these tasks, the committee, with the bankruptcy court's approval, may employ attorneys, accountants, and other professional advisors, such as investment bankers, appraisers, and turnaround consultants.[121] These advisors' reasonable fees and expenses are not paid by the committee or the creditors that they represent; rather, such costs are paid directly by the debtor following court approval.[122]

B. Creditors' Committees Under Brazilian Law

Although the Brazilian Bankruptcy Law also provides for the formation of a creditors' committee during a judicial reorganization,[123] this committee is very different from an official committee of unsecured creditors formed pursuant to the U.S. Bankruptcy Code. The establishment of a creditors' committee in Brazil is not mandatory and is relatively rare. A committee may be established upon the resolution of any class of creditors at a general meeting of all creditors, which takes place during the initial stages of a judicial reorganization.[124] At the general meeting, the creditors are rigidly divided into three classes, regardless of the amount of their claims or the number or diversity of creditors in each class: (1) labor creditors (Class I), (2) secured creditors (Class II), and (3) and a catch-all class generally populated by unsecured creditors (Class III).[125] Each class votes for a creditor (as well as two alternates) to serve as its representative on the committee.[126] A creditors' committee thus consists of one elected representative from each class of creditors and represents the interests of *all* creditors, not just those of unsecured creditors.[127] Brazilian law does not provide a formal way for bondholders and other unsecured

119. 11 U.S.C. § 1103(c).
120. *Id.* § 1109(b).
121. *Id.* § 1103(a); *see also* Nesvold et al., *supra* note 118, at 173.
122. *See* 11 U.S.C. § 330(a).
123. Lei No. 11.101, art. 26, de 9 de Fevereiro de 2005, Diário Oficial da União [D.O.U.] de 9.2.2005 (Braz.).
124. *Id.*
125. *Id.*
126. *Id.* (composition of committee of creditors consists of one representative from each class and is formed by resolution at the general meeting); *see also id.* art. 44 (specifying that only members of class may vote for its representative).
127. *Id.* art. 26.

creditors to organize separately, creating a significant disadvantage for international bondholders. When a committee is not formed at the general meeting, the judicial trustee (or the judge in the event that the judicial trustee has a conflict of interest) is responsible for fulfilling the duties that would otherwise be assigned to the committee.[128]

When formed, creditors' committees face certain duties under Brazilian law.[129] These duties include, *inter alia*: supervising the activities of the debtor in judicial reorganization or the judicial trustee in bankruptcy; in the case of a judicial reorganization, submitting a report on the debtor's activities every thirty days; monitoring the case proceedings and ensuring legal compliance; informing the judge upon the discovery of any violation of the rights or injury to the interests of creditors; verifying and issuing an opinion on any complaints by interested parties; requesting that the judge call general meetings of creditors; and supervising the performance of a debt restructuring plan.[130] Importantly, however, fees and expenses incurred by the committee in its performance of these duties (e.g., the cost of employing legal counsel and other professional advisors) are not automatically paid for by the bankruptcy estate.[131] Instead, the committee must request reimbursement from the judge, which "shall be [made] in accordance with available cash funds."[132] In addition, committee members may be held liable for any losses to the bankruptcy estate, the debtor, or the creditors caused by the committee's malice or negligence.[133]

These aspects of the Brazilian Bankruptcy Law have negatively impacted the importance and competence of creditors' committees in insolvency cases. While the creditors' committee in a U.S. bankruptcy case constitutes a critical platform for unsecured creditors to advance their interests, the creditors' committee under the Brazilian Bankruptcy Law is rarely established and — when established — replete with conflicts of interest that diminish its value.

1. Creditors' Committees Rarely Established

Due to the expenses and potential liability associated with serving on a Brazilian creditors' committee,[134] few creditors are willing to do so. As a result, a creditors' committee is rarely established.[135] Luiz Fernando Valente de Paiva, a Brazilian

128. *Id.* art. 28.
129. *Id.* art. 27.
130. *Id.*; *see also* Felsberg, *supra* note 24, ¶ 16.03[4][c]. Noticeably absent from this list are any tasks related to helping to formulate the plan of reorganization that will ultimately be presented to the creditors for a vote.
131. Lei No. 11.101, art. 29.
132. *Id.*
133. *Id.* art. 32. Any members who disagree with a committee resolution must state their dissent in the committee minutes to avoid liability. *Id.*
134. *See supra* notes 131–33 and accompanying text.
135. *See, e.g.*, Alexandre Couto Silva, *Complying with the Changing Environment of Brazilian Bankruptcy Law, in* BANKRUPTCY LAW CLIENT STRATEGIES IN SOUTH AMERICA: LEADING LAWYERS ON NAVIGATING THE

bankruptcy practitioner, professor, and member of the final drafting committee for the 2005 law, has called for amendments to the Brazilian Bankruptcy Law that would include compensation for professional advisors to the committee and the members' release of liability for negligence, noting that "[w]ithout these changes, the creditors' committee will continue to be an entity existing only on paper and in the imagination of the lawmaker."[136] Paiva's view is in line with the recommendations of the World Bank, set forth in its *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, which explains the important role fulfilled by a creditors' committee as "provid[ing] 'double protection' for creditors, giving them the ability to participate in and monitor the proceedings" and urges that insolvency laws provide for the compensation of professional advisors from the bankruptcy estate to help the committee fulfill this function.[137] The failure to establish a formalized vehicle for creditors to organize creates serious issues concerning transparency, cohesiveness among creditors, and judicial administration.[138] Furthermore, without a committee, the court and judicial trustee are burdened with addressing a fragmented body of creditors, as well as carrying out tasks that would otherwise be assigned to the committee.[139]

Without a committee to utilize as a vehicle for coordinating efforts, unsecured creditors must seek information, monitor the case, and challenge questionable behavior individually. Clearly, many creditors will lack the resources to do so, while others may not have a sufficient stake in the outcome to make individual action worthwhile. From a law and economics perspective, individual decision-making can lead to suboptimal results as compared to collective action. Fernando César Nimer Moreira da Silva, a Brazilian economist, has used game theory to illustrate that when a non-homogeneous, unorganized group of creditors make rational decisions

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SOUTH AMERICAN BANKRUPTCY PROCESS, WORKING WITH LOCAL GOVERNMENTS, AND DEVELOPING SUCCESSFUL STRATEGIES 175 (Michaela Falls ed., 2011), *available at* 2011 WL 586872; *see also* Paiva, *supra* note 21, at 31 ("With the enactment of the [2005 law], . . . it was expected that the creditors would be able to participate actively in overseeing the process by means of a creditors' committee. This has not come about, given the creditors' refusal to assume the post due to the responsibilities that may be imposed on them.").

136. Paiva, *supra* note 21, at 31.

137. WORLD BANK, PRINCIPLES AND GUIDELINES FOR EFFECTIVE INSOLVENCY AND CREDITOR RIGHTS SYSTEMS paras. 102, 107 (2001), *available at* http://www.worldbank.org/ifa/ipg_eng.pdf ("Consistent with the committee's role in monitoring the proceedings and representing the voice of creditors (at least unsecured creditors), the committee must have access to impartial advice to ensure that the rights of creditors are being protected. For this reason, the law should allow creditors to retain an independent professional who will be compensated from the estate or from the proceeds distributed to the creditors represented by the committee.").

138. *See, e.g.*, Silva, *supra* note 135, at 193 ("The creditors' committee gives transparency, security, reliability, and efficiency to the process as desired by the creditors. Without the creditors' committee, the success or failure of the reorganization seems to be difficult.").

139. *See, e.g.*, Silva, *supra* note 135, at 193 ("The failure to timely constitute the creditors' committee can create a great imbalance in the roles of the persons involved in the process of bankruptcy and reorganization, imposing heavy burdens to the courts and to the trustee by overloading them with activities not related to their crafts, which can be highly complex to them. . . . Furthermore, creditors end up taking their individual and disorganized actions to the court, disrupting and delaying the process, which generates endless discussions through request.").

on an individual basis, their decisions often do not maximize gains for creditors as a whole.[140] Rather, advancement of the collective interest of creditors depends on their ability to organize under the rules of the game.[141] Silva explains that the lack of organization exacerbates problems related to inadequate disclosure from the debtor[142] and creates inter-creditor communication barriers, leading to inefficient outcomes — i.e., the liquidation of potentially viable companies or the unwarranted reorganization of failed ones.[143] He cites the Brazilian Bankruptcy Law, which he notes does not provide for the efficient organization of creditors,[144] as an example of this phenomenon.[145]

2. Conflicts of Interest Diminish the Value of Creditors' Committees

The composition of members serving on a creditors' committee formed under the Brazilian Bankruptcy Law — which includes one representative from each of the three classes of creditors[146] — is also problematic. Due to their respective levels of priority, the interests of each class of creditors are inherently in conflict. With inherently conflicting interests among members, the committee could rarely, if ever, act as a cohesive body. Indeed, it is difficult to find a purpose in joining such representatives into a collective entity. Whereas the primary purpose of a committee established pursuant to the U.S. Bankruptcy Code is to maximize returns for its constituency,[147] the purpose of a committee made up of members where a gain to one generally necessitates a loss to another is unclear. Recognizing this issue, the World Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* recommends that "care . . . be taken to avoid potential conflicts of interests of interests on the committee."[148] The *Principles* further state:

> *As a general rule unsecured creditors committees should consist only of unsecured creditors. In some cases a committee of secured creditors might be justified. . . . Often, secured creditors have little in common with unsecured creditors, and their ability to participate in and alter the outcome of decisions by the committee may be inappropriate and not in the best interest*

140. Fernando César Nimer Moreira da Silva, Incentivos á Decisão de Recuperação da Empresa em Crise: Análise á Luz da Teoria Dos Jogos pts. III.1, III.3.1 (2009) (faculty of law dissertation, University of São Paulo), *available at* http://www.teses.usp.br/teses/disponiveis/2/2132/tde-18112009-093516/pt-br.php
141. *Id.*
142. *See infra* Part VI.C.
143. *See* Silva, *supra* note 140, at pts. III.1, III.3.1.
144. *See* Silva, *supra* note 140, at 63 n.201 and accompanying text.
145. *Id.*
146. Lei No. 11.101, art. 26, de 9 de Fevereiro de 2005, Diário Oficial Da União [D.O.U.] de 9.2.2005 (Braz.).
147. *See* 7 Collier on Bankruptcy, *supra* note 73, ¶ 16.03[4][c].
148. *See* World Bank, *supra* note 137, at 33, para. 105.

> *of other creditors. By nature, the interests of secured creditors conflict with those of unsecured creditors.*[149]

3. Organizing Creditors in Practice

For these reasons, international bondholders involved in the recent Brazilian judicial reorganizations of CELPA and Independência S.A.[150] did not organize themselves through creditors' committees. Both cases, however, experienced the creation of ad hoc committees of bondholders outside of the formal insolvency process. Each of these ad hoc committees retained legal advisors. The Brazilian Bankruptcy Law provides that any expenses incurred by creditors in order to participate in a judicial reorganization cannot be enforced against the debtor, and there is no exception for ad hoc committees.[151] However, an ad hoc committee may be able to negotiate with a debtor to reimburse its fees and expenses via a non-debtor affiliate, such as another company controlled by the same family that owns the debtor's equity. The debtor agreed to such an arrangement in the Independência case, but the debtor in the CELPA case did not.[152] When the debtor does not agree, the members of the ad hoc committee may have to pay for the fees and expenses of their attorneys, investment bankers, and other advisors themselves.

Rather than trying to organize disparate creditors, it may prove more effective for international bondholders to buy the claims of local creditors, such as those of Brazilian banks, to gain greater voting control for themselves. However, bondholders may be reluctant to invest fresh capital in a distressed situation where

149. *Id.*; *see also id.* at 33, para. 104 ("The committee serves as a voice for all unsecured creditors and should be representative.").

150. On February 27, 2009, Independência S.A., a Brazilian beef processor based in the state of São Paulo, filed for judicial reorganization before the Lower Civil Court of Cajamar in São Paulo, Brazil. *See* BDO International, Independência S.A. (in Judicial Recovery/Reorganization): Financial Statements for the 9 (Nine) Month Periods Ending 30 September 2009 and 2008 and Limited Review Report 4 (2009), *available at* http://ir.independencia.com.br/independencia/web/arquivos/3Q09%20Financial%20Statements%20anort.pdf. Previously, Independência had issued US$300 million of 9.875% Notes due 2015 and US$225 million of 9.875% Notes due 2017. *See* Press Release, Independência S.A., Independência Commences Consent Solicitation and Cash Tender Offer For Its 9.875% Notes Due 2015 and 9.875% Notes Due 2017 (Jan. 21, 2009), *available at* http://ir.independencia.com.br/independencia/web/arquivos/Notice%20to%20the%20Market%2-%20Independ%EAncia%20commences%20consent%20solicitation%20and%20cash%20tender%20offer.pdf.

151. Lei No. 11.101, art. 5(II).

152. Despite failing to gain the debtor's acquiescence, the ad hoc committee of bondholders in the CELPA case was ultimately able to convince the acquirer and indenture trustee to reimburse a majority of their professional fees and expenses during the chapter 15 process that followed the judicial reorganization. *See In re* Centrais Elétricas do Para S.A., No. 12-14568 (SCC) at ¶ 14 (Bankr. S.D.N.Y. Dec. 12, 2012) (order granting recognition of Brazilian main proceeding and certain related relief and providing for payment of ad hoc committee's professional fees and expenses). As a result of the U.S. court's order, the ad hoc committee received reimbursement of approximately 85% of their fees and 100% of their expenses. *Centrais Eletricas: Brazilian Plan Approved in U.S.*, Troubled Co. Rep. Latin Am. (Dec. 20, 2012), http://bankrupt.com/TCRLA_Public/121220.mbx (noting that the ad hoc bondholder group received as much as $1.2 million in professional fees and expenses).

they have already experienced losses. They may be faced with an uncomfortable decision: invest more or lose more.

V. Negotiating, Voting On, and Confirming a Plan of Reorganization

The dissimilarities in how creditors are organized in the U.S. and Brazil have a direct impact on how plans are negotiated, voted on, and confirmed. There are many differences between a plan of reorganization in the U.S. and a debt restructuring plan in Brazil besides the former being written in English and the latter in Portuguese. Several aspects of the Brazilian Bankruptcy Law – in particular, non-terminating debtor exclusivity and the negotiation and voting processes – create serious challenges for creditors navigating the insolvency process and can lead to poor outcomes for international bondholders.

In both the U.S. and Brazil, certain types of creditors are expressly exempt from a corporate debtor's ability to discharge its debts, but the exemptions differ.[153] In Brazil, exempt creditors include "a creditor holding the position of fiduciary owner of real or personal property, financial lessor, owner or committed seller of real estate whose respective agreements include an irrevocability or irreversibility clause, including under real estate developments, or an owner under a sale agreement with title retention . . . ."[154] In addition, since a Brazilian debtor must submit tax liability clearance certificates before the judge may approve the reorganization plan,[155] a judicial reorganization can only be implemented if the debtor either has no tax liabilities or has negotiated an installment plan with the government.[156]

A. Debtor Exclusivity Under U.S. Law

The U.S. Bankruptcy Code grants the debtor the exclusive right to file a plan of reorganization during the first 120 days of the bankruptcy case.[157] The filing of a plan within that period automatically triggers a "solicitation period," which provides another 60 days of exclusivity for the debtor.[158] Because the debtor can easily file a placeholder plan, which need not be confirmable, within the initial 120-day timeframe, debtor exclusivity in the U.S. is commonly thought of as lasting 180 days.[159]

153. 11 U.S.C. § 1141(d) (2006).
154. Lei No. 11.101, art. 49 pará. 3.
155. *Id.* art. 57.
156. *Id.* arts. 57, 68.
157. 11 U.S.C. § 1121(b). This period of time is known as the "exclusivity period." Nesvold et al., *supra* note 118, at 335–39.
158. 11 U.S.C. § 1121(c).
159. *Id.* § 1121(c)(3).

Any party in interest may request an extension or reduction of the debtor's exclusivity and solicitation periods.[160] The moving party has the burden of demonstrating cause to support its request, which the court may grant after notice and a hearing.[161] Cause to extend may be demonstrated by explaining the burdens of organizing the company's financial affairs, the time-consuming process of assessing its strategic alternatives, and the difficulties of negotiating with various creditor constituencies.[162] Cause to shorten may be very difficult to prove.[163] Multiple extensions are routinely requested and granted in complex chapter 11 cases, which describes many corporate bankruptcies, while motions to shorten are rare and often denied.[164]

If the debtor has not obtained acceptance of the plan by the expiration of the combined exclusivity and solicitation periods, the debtor's exclusivity terminates, and any party in interest[165] may thereafter file a plan of reorganization.[166] Permitting limited exclusivity for the debtor to propose a plan of reorganization reflects a legislative intent to balance the relative power of the debtor and its creditors.[167]

160. 11 U.S.C. §1121(d)(1).

161. *Id.*; *see In re* Borders Grp., Inc., 460 B.R. 818, 821 (Bankr. S.D.N.Y. 2011) (explaining that "[t]he burden of proving cause to reduce or increase exclusivity is on the moving party"). However, "[s]ection 1121 was designed, and should be faithfully interpreted to limit the delay that makes creditors the hostages of Chapter 11 debtors." *In re* Curry Corp., 148 B.R. 754, 755 (Bankr. S.D.N.Y. 1992) (quoting United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 808 F.2d 363, 372 (5th Cir. 1987), *aff'd*, 484 U.S. 365 (1988)).

162. *See, e.g.*, *In re* McLean Indus., Inc., 87 B.R. 830, 834 (Bankr. S.D.N.Y. 1987) (listing factors used by courts to determine whether cause exists to extend exclusivity).

163. *See, e.g.*, *In re* Grand Traverse Dev. Co., 147 B.R. 418, 420–21 (Bankr. W.D. Mich. 1992) (rejecting evidence presented to reduce the exclusivity period). As a result, rather than focusing on exclusivity, a secured creditor who has lost confidence in the debtor's management will more often seek to lift the automatic stay in order to seize its collateral, appoint a bankruptcy trustee, or convert the case to a chapter 7 liquidation.

164. In exercising its broad discretion for whether to grant a motion to extend or shorten exclusivity, a bankruptcy court may consider a variety of factors to assess the totality of circumstances in each case. *See In re Borders Grp., Inc.*, 460 B.R. at 821–22 ("The determination of cause under section 1121(d) is a fact-specific inquiry and the court has broad discretion in extending or terminating exclusivity."); *In re* Adelphia Commc'ns Corp., 352 B.R. 578, 587 (Bankr. S.D.N.Y. 2006) (identifying objective factors courts historically have considered in determining whether cause exists to extend or terminate exclusivity); *see also In re* Dow Corning Corp., 208 B.R. 661, 664 (Bankr. E.D. Mich. 1997) (identifying factors used by courts to determine whether cause exists to extend exclusivity); *In re* Express One Int'l, Inc., 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996) (same); *In re* McLean Indus., Inc., 87 B.R. 830, 834 (Bankr. S.D.N.Y. 1987) (same).

165. A "party in interest" includes: "the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee." 11 U.S.C. § 1121(c).

166. *Id.*

167. The House Committee Report attached to the 1978 Bankruptcy Code states, with respect to section 1121: "The exclusive right [to propose a plan] gives the debtor undue bargaining leverage, because by delay he can force a settlement out of otherwise unwilling creditors, and they have little recourse except to move for conversion of the case to [liquidation]. . . . Proposed chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy. At the same time, the bill recognizes the legitimate interests of creditors, whose money is in the enterprise as much as the debtor's, to have a say in the future of the company." H.R. Rep. No. 95–595, at 6191 (1978); *see also In re* Lake in the Woods, 10 B.R. 338, 340–41 (Bankr. E.D. Mich. 1981) (describing the legislative history behind section 1121 and quoting this House Committee Report at length).

In 2005, the Bankruptcy Code was amended to limit the permissible length of extensions to the debtor's exclusivity and solicitation periods in response to concerns that bankruptcy proceedings were taking too long and that advisors had an adverse incentive to prolong negotiations in order to accumulate excessive fees.[168] Today, the 120-day exclusivity period cannot be extended beyond 18 months from the petition date,[169] and the 180-day combined exclusivity and solicitation periods cannot be extended beyond 20 months from the petition date.[170] Limiting the debtor's exclusivity period works to the benefit of secured creditors, who can pressure the debtor to expeditiously create a viable strategy to fix the company or else surrender collateral. Debtors must now address strict time limits for creating a plan of reorganization and obtaining sufficient favorable votes from creditors for confirmation.[171] Previously, debtors could threaten creditors by endlessly extending the exclusivity period with the approval of sympathetic judges.[172]

B. Debtor Exclusivity Under Brazilian Law

While exclusivity is not an explicit part of Brazilian insolvency law, the structure of judicial reorganization results in exclusivity for the debtor throughout the entire process.[173] When a petition for judicial reorganization is accepted by the court, the Brazilian Bankruptcy Law establishes a 180-day stay of creditors' actions against the debtors' assets.[174] During this period, only the debtor can propose a plan and solicit support from creditors.[175] Absent plan confirmation, this non-extendable stay terminates automatically, converting the case to bankruptcy (liquidation).[176]

Within the 180-day stay, the debtor must observe interim deadlines. The debtor must submit its plan to the court within 60 days of publication of the decision granting the debtor's petition for judicial reorganization.[177] This 60-day period is

168. *See* H.R. Rep. No. 109–31(I), at 55 (2005) ("Section 411 amends section 1121(d) . . . to mandate that a debtor's exclusive period for filing a plan may not be extended beyond a date that is 18 months after the order for relief in the chapter 11 case.").

169. 11 U.S.C. § 1121(d)(2)(A).

170. *Id.* § 1121(d)(2)(B).

171. *See generally id.* § 1121.

172. *See, e.g.*, *In re* Interstate Bakeries Corp., No. 04-45814-JWV, slip op. (Bankr. W.D. Mo. Oct. 3, 2007) (granting eighth extension such that the debtor retained exclusivity for approximately 42 months); *In re United Airlines*, Bk. No. 02-48191-ERW, slip. op. (Bankr. N.D. Ill. June 20, 2005) (granting request for extension such that the debtor retained exclusivity for approximately 35 months).

173. Lei No. 11.101, art. 5, de 9 de Fevereiro de 2005, Diário Oficial Da União [D.O.U.] de 9.2.2005 (Braz.).

174. *Id.* art. 6, pará. 4.

175. *Id.* art. 53.

176. *See* Felsberg, *supra* note 24, ¶ 16.04[1] ("The debtor will be declared bankrupt during the judicial restructuring proceedings if any of the following events occur: (1) the creditors' general meeting does not approve the restructuring plan; (2) the debtor fails to submit the restructuring plan within the sixty day time period provided for in article 53 of the bankruptcy law; or (3) the debtor fails to fulfill the terms of the approved judicial restructuring plan.").

177. Lei No. 11.101, art. 53.

non-extendable, and failure to timely submit a plan also results in conversion to bankruptcy (liquidation).[178]

Unlike under the U.S. Bankruptcy Code, the debtor's exclusivity under the Brazilian Bankruptcy Law never terminates so as to give creditors an opportunity to propose competing plans.[179] While creditors may propose amendments to the debtor's plan at the general meeting of creditors that is convened for voting, any modifications to the plan require the express consent of the debtor.[180]

C. Confirming a Plan Under U.S. Law

The basic objective of every chapter 11 case is to achieve confirmation of a plan of reorganization.[181] Confirmation can be accomplished through *consensual confirmation*, which involves obtaining acceptance of the plan from all impaired classes of creditors or interest holders, or *nonconsensual confirmation* (popularly known as "cramdown"), which permits confirmation notwithstanding rejection of the plan by one or more classes.[182]

For voting and treatment purposes, a plan of reorganization must separate claims and interests into various classes.[183] Each claim or interest may only be included in a particular class if it is "substantially similar" to the other claims and interests of such class.[184] In general, classification is determined based on priority and the nature of the security interest, if any. Thus, the plan will usually create a separate class for each secured creditor,[185] as well as each unsecured creditor granted priority status under the Bankruptcy Code.[186] The plan will typically group all

178. *Id.* art. 73.

179. *Id.* art. 53.

180. *Id.* art. 56; *see also* discussion *infra* notes 221–23 and accompanying text.

181. *See* NESVOLD ET AL., *supra* note 118, at 333.

182. *See infra* notes 197, 204–05 and accompanying text.

183. 11 U.S.C. § 1123(a)(1) (2006). Certain unsecured claims granted priority under the Code need not be classified, including claims described in sections 507(a)(2) (administrative expense claims), (a)(3) (involuntary gap claims), and (a)(8) (unsecured tax and custom duties claims). The Code exempts these claims from the classification requirement because "a specific majority of claimants with such priorities cannot bind a member of the class to less favorable treatment than that provided in section 1129(a)(9)." COLLIER ON BANKRUPTCY, *supra* note 73, ¶ 1122.03[b].

184. 11 U.S.C. § 1122(a). Subsection 1122(b) makes an exception for relatively small unsecured claims, which a plan proponent may classify as a single class with court approval for the purpose of administrative convenience. *Id.* § 1122(b).

185. Unless, for example, certain claims are secured by the same collateral and have equivalent priority.

186. The Code grants priority to certain categories of unsecured claims set forth in section 507. 11 U.S.C. § 507. In addition the court may grant priority to postpetition loans under section 364. *Id.* § 364.

> Priority claims under subsections 507(a)(1), (4), (5), (6), (7), (9), and (10) should be separately classified because such claims are not substantially similar to either general unsecured claims or secured claims. In addition, because each of these categories of priority claims differs from the others in priority rank, the claims in a particular category must be placed in a separate class if impaired under the plan. For example, if the plan proposes to pay [one category] in deferred cash payments [under 1129(a)(9)(B)] and [another] in full on the effective date of the plan, the section 507(a)(4) and section

general unsecured creditors (e.g., bondholders), who are entitled to a *pro rata* share of the debtor's assets after payment of secured claims and other priority claims, into a single class.[187] Finally, the plan will generally provide for a class consisting of equity interests, which may be separated further according to the nature of the interest (e.g., common versus preferred stock).[188]

All individual holders of allowed claims and interests may vote on a plan of reorganization.[189] However, voting is tabulated by class, not by the individual holders of claims or interests. Thus, a class may accept a plan of reorganization, without having the unanimous consent of its members.[190] To achieve acceptance of a particular class, the plan must receive a sufficient percentage of favorable votes from the members of such class. For each class of creditors,[191] a plan is accepted if it receives the favorable vote of members holding at least two-thirds in amount and a majority in number of the allowed claims.[192] Creditors cast votes via mail-in ballot and only class members that actually vote count in determining whether the requisite majorities in number and amount are met. Importantly, classes receiving full recoveries under a plan of reorganization are considered "unimpaired" and are

> 507(a)(7) claims may not be in the same class . . . . However, it is most common for plans to include in the same class any claims entitled to priority under section 507(a), other than subsection 507(a)(2), (a)(3), and (a)(8), and to provide that such claims be fully paid in cash on the effective date of the plan.

Collier on Bankruptcy, *supra* note 73, ¶ 1122.03[b].

187. Collier on Bankruptcy, *supra* note 73, ¶ 1122.01. However, numerous other factors may affect the interests of certain members of a class, warranting their separate classification. For example, section 510(a) provides that subordination agreements are enforceable in bankruptcy. 11 U.S.C. § 510(a). Therefore, courts have permitted the separate classification of senior and subordinated debt, even though the holders of both claims qualify as general unsecured creditors. *See In re* Reid Park Properties, LLC, No. 4:11-bk-15267-EWH, slip op. at 3–4 (Bankr. D. Ariz. Nov. 7, 2012) (requiring that senior secured debt be classified separately from senior subordinated debt). Courts have also permitted the separate classification of union claims from other general unsecured claims, finding the union's interests to be unique given the demand for a future relationship with the debtor. *See In re* Kliegl Bros. Universal Elec. Storage Lighting Co., Inc., 149 B.R. 306, 307–09 (Bankr. E.D.N.Y. 1992) (creating a separate classification for labor union claims). While courts may allow the plan proponent to create additional classes based on reasonable distinctions among claims, attempts to "gerrymander" claims to create a sympathetic impaired class that will vote in favor of a plan of reorganization will usually generate vigorous objections and are largely rejected by courts. *See* Nesvold et al., *supra* note 118, at 359.

188. *See* Acceptance of the Plan of Reorganization, http://bankruptcy.uslegal.com/chapter-11-bankruptcy/acceptance-of-the-plan-of-reorganization (last visited Apr. 2, 2013) (describing the different classes of claim holders).

189. 11 U.S.C. §§ 502, 1126(a). The bankruptcy court may temporarily allow unresolved claims — i.e., those that are disputed or unliquidated — for the purposes of voting on a plan of reorganization. Further, the bankruptcy court may disallow the vote of any holder whose acceptance of rejection of the plan was not in good faith or whose vote was not procured or solicited in good faith or in accordance with the provisions of the Bankruptcy Code. *Id.* § 1126(e).

190. *Id.* § 1126.

191. As opposed to a class of interest holders other than creditors, such as equity holders, who accept a plan if it receives the favorable vote of members holding at least two-thirds in amount of the allowed interests. *Id.* § 1126(d).

192. *Id.* § 1126(c).

conclusively presumed to have accepted the plan.[193] Conversely, classes receiving no recoveries under the plan are deemed to have rejected it.[194] The holders of claims or interests in either situation do not need to go through the mechanics of actually voting. On request of a party in interest and after notice and a hearing, the bankruptcy court may disqualify any acceptance or rejection that was not made or solicited in good faith or in accordance with the provisions of the Bankruptcy Code.[195]

Consensual confirmation occurs when all classes of creditors accept a proposed plan of reorganization.[196] In particular, consensual confirmation requires every "impaired" class to have affirmatively voted to accept the plan.[197] A class is considered impaired "if the plan alters the legal, equitable, or contractual rights to which the holders of such claims are otherwise entitled, unless the only alteration is the reinstatement of the original maturity and curing defaults with respect to an accelerated debt."[198] Because unimpaired classes are conclusively presumed to have accepted the plan,[199] whether a class is considered impaired determines which classes must vote to accept the plan in order to satisfy confirmation requirements.[200] Important additional requirements of confirmation include the best interests test, which guarantees that each individual creditor or interest holder will receive at least as much pursuant to the plan of reorganization as it would if the debtor were to be liquidated under chapter 7,[201] and the feasibility test, which requires a finding that "[c]onfirmation of the plan is not likely to be followed by liquidation, or the need for further financial reorganization, of the debtor . . . ."[202]

If the plan proponent cannot obtain acceptance of the plan by each and every impaired class, then the plan proponent may request nonconsensual confirmation, or cramdown.[203] Cramdown incorporates all of the criteria for consensual confirmation, except the requirement that all impaired classes affirmatively vote to accept the plan.[204] Instead, cramdown requires affirmative acceptance of the plan by *at least one* impaired class, without regard to any acceptance by an insider.[205] Further, cramdown involves two additional requirements: (1) that the plan not

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193. *Id.* § 1126(f).
194. *Id.* § 1126(g).
195. *Id.* § 1126(e).
196. *Id.* § 1129(a).
197. *Id.* § 1129(a)(8).
198. Collier on Bankruptcy, *supra* note 73, ¶ 1124.02; *see* 11 U.S.C. § 1124(1)–(2) (2006).
199. *See supra* note 193 and accompanying text.
200. 11 U.S.C. § 1129(a)(8) (requiring that each class either accept the plan or be unimpaired).
201. *Id.* § 1129(a)(7).
202. *Id.* § 1129(a)(11).
203. *See id.* § 1129(b) (setting forth the procedure for "cramdown").
204. *Id.* § 1129(b)(1).
205. *Id.* § 1129(a)(10). As a result, impaired classes remain critical to the overall confirmation process whether the case involves consensual confirmation or cramdown, and negotiations between the plan proponent and the impaired class(es) and its advisors will usually be the most contentious.

discriminate unfairly against impaired classes that have rejected the plan, and (2) that the plan treat such classes fairly and equitably.[206]

D. Confirming a Plan Under Brazilian Law

Under the Brazilian Bankruptcy Law, once the court grants the debtor's petition for judicial reorganization, the debtor has sixty days to submit a debt restructuring plan to the court.[207] Failure to meet this deadline will result in conversion of the case to bankruptcy (meaning, liquidation).[208] The plan must contain a detailed description of the means of reorganization to be used, a statement of its economic feasibility, and a professionally appraised report on the debtor's assets.[209] The Brazilian Bankruptcy Law provides a list of the means of reorganization that the debtor may invoke, which include, *inter alia*, the granting of special terms and conditions for the repayment of debt, spin-off, merger or consolidation, share assignment, change in control, capital increase, succession or lease, payment in kind, and sale of the company's assets.[210]

Once the debtor submits a plan, the judge orders public notice of the plan to advise creditors of its contents.[211] Creditors then have 30 days to object to the plan.[212] If no one objects, then the judge must grant the judicial reorganization and the plan is put into effect.[213] If any creditor objects, the judge must call a general meeting of creditors to discuss the plan, alter it, and approve or reject a final plan.[214] The meeting must be held within 150 days after the debtor's petition for judicial reorganization was granted.[215] Although the judge sets the timing of the general meeting and provides notice of the meeting,[216] the judge does not preside over this assembly, which does not take place in the courtroom. Instead, the judicial trustee manages the meeting.[217] The debtor may be invited to make a presentation on its proposed debt restructuring plan to the creditors in attendance.

At the general meeting, the creditors are divided into the following three classes: (1) creditors with labor-related claims (Class I), (2) secured creditors (Class II), and

206. *Id.* § 1129(a)–(b). The Bankruptcy Code's condition that a plan be fair and equitable for the purposes of cramdown includes requirements known as the "absolute priority rule" that address the priority of payments to holders of secured claims, unsecured claims, and equity interests. *Id.* § 1129(b).
207. Lei No. 11.101, art. 53, de 9 de Fevereiro de 2005, Diário Oficial Da União [D.O.U.] de 9.2.2005 (Braz.).
208. *Id.* arts. 53, 73.
209. *Id.* art. 53.
210. *Id.* art. 50.
211. *Id.* art. 53.
212. *Id.* art. 55.
213. *Id.* art. 58.
214. *Id.* arts. 36, 56.
215. *Id.* art. 56.
216. *Id.* art. 36.
217. *Id.* art. 37.

(3) a catch-all class generally populated by unsecured creditors (Class III).[218] At first call, the general meeting must have in attendance creditors holding over half of the claims of each class in order to convene.[219] Thereafter, there is no quorum requirement.[220] Creditors at the meeting have the option of voting on the plan or adjourning to continue negotiations.[221] Multiple adjournments are common.[222] The plan may only be altered with the express agreement of the debtor,[223] and any alteration must not exclusively decrease the rights of absent creditors.[224] The final plan must be approved by all three classes of creditors.[225] With respect to Classes II and III, the plan must be approved by creditors representing over half of the total value of the claims present at the meeting, as well as by a simple majority of the individual creditors present.[226] With respect to Class I, the plan must be approved by a simple majority of the individual holders of labor-related claims present, without regard to the amount of their claims.[227] For purposes of calculating voting thresholds, all foreign currency claims are converted into Brazilian reais at the exchange rate prevailing on the day before the general meeting.[228] Unlike in the U.S., creditors may not vote by mail; rather, they must be present at the general meeting in order to have their votes counted.[229] Creditors may be represented at the general meeting by proxy or legal representative, provided that they deliver to the judicial

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218. *Id.* art. 41.
219. *Id.* art. 37, pará. 2.
220. *Id.*
221. Creditors may choose to adjourn the general meeting in order to avoid voting to reject the debt restructuring plan because such rejection could cause the judicial reorganization to convert to bankruptcy. Felsberg, *supra* note 24, ¶ 16.04[1] ("The debtor will be declared bankrupt during the judicial restructuring proceedings if . . . the creditors' general meeting does not approve the restructuring plan.").
222. Paiva, *supra* note 21, at 31 (due to the lack of coordination among creditors, "there have been judicial reorganizations in which over twenty general meetings were held, with countless adjournments, for the negotiations to be concluded"). For example, in CELPA's judicial reorganization, the first call for the general meeting of creditors was on July 9, 2012, the second call was on August 3, 2012, and the third and final call was on September 1, 2012, which was the 180th day of the proceeding. See Minutes of General Meeting of Creditors attached to the main case records for the Judicial Reorganization Proceedings of Centrais Elétricas do Pará S.A., 13th Lower Court of Belém, State of Pará, No. 0005939-47.2012.8.14.0301 (13th L.C. Belém, Pará Feb. 29, 2012).
223. As noted, the debtor maintains the exclusive right to file a plan of reorganization throughout the judicial reorganization proceeding. *See supra* Part V.B. Creditors have no right to file their own plan; rather, they may only propose amendments to the debtor's plan. Because "no modification may be adopted over an objection of the debtor . . . judicial restructuring requires the debtor's cooperation and consent." Felsberg & Filho, *supra* note 49, at 280–81. As a result, if creditors want a plan to be amended, they must voice their objections at the general meeting and hope that the debtor will be forced to make the modifications in order to gain a sufficient number of votes for acceptance.
224. Lei No. 11.101, art. 56, pará. 3.
225. *Id.* art. 45. Note that the approval of a debt restructuring plan does not include a requirement akin to the U.S. Bankruptcy Code's absolute priority rule.
226. *Id.* art. 45, pará. 1; *see also* Felsberg, *supra* note 24, ¶ 16.04[7][b].
227. Lei No. 11.101, art. 45, pará. 2; *see also* Felsberg, *supra* note 24, ¶ 16.04[7][b].
228. Lei No. 11.101, art. 38, pará. único.
229. *See id.* art. 45.

trustee, within twenty-four hours before the date specified in the notice of convocation, legal documentation proving the authority of such agent.[230]

If the creditors do not approve the plan in this manner, the judge may nevertheless grant judicial reorganization pursuant to this plan if: (1) it was approved by creditors holding over half of the amount of all claims (independent of class designation) represented at the meeting; (2) two of the three classes approved the final plan (or, if there were only two classes with voting creditors, the approval of one such class); (3) the plan was approved by over one-third of the creditors in the class that rejected the plan; and (4) the plan does not entail different treatment among the creditors of the class that rejected it.[231] In this sense, the Brazilian Bankruptcy Law imposes its own version of "cramdown," though the rules and voting thresholds differ from those in the U.S. Bankruptcy Code and there is no observance of the absolute priority rule. If the general meeting of creditors rejects the plan and the criteria for a Brazil-style cramdown are not satisfied, the judge must declare the debtor bankrupt, thereby converting the reorganization to liquidation.[232]

Even when a plan is confirmed and goes into effect, the debtor remains under court supervision.[233] Unlike in the U.S., the insolvency process continues until the two-year anniversary of the beginning of the case.[234] The purpose of this elongated period is for the court to make sure that the debtor lives up to its obligations under the plan. During this period, if the debtor defaults on any of its obligations under the plan, the court will declare the debtor bankrupt, prompting liquidation.[235]

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230. *Id.* art. 37, pará. 4.

231. *Id.* arts. 45, 58.

232. *Id.* art. 56, pará. 4, art. 73.

233. *Id.* art. 61.

234. *Id.*; *see* Felsberg, *supra* note 24, ¶ 16.04[10] (2011) ("The debtor shall continue under judicial restructuring until all obligations established in the plan, and also those obligations which become due for up to two years after the concession of judicial restructuring, have been performed. During this period, the nonperformance of any obligation established in the plan will entail the conversion of the restructuring into bankruptcy, in which case the creditors shall have their rights and guarantees reconstituted according to the terms originally contracted.")

235. Lei No. 11.101, art. 61. The Independência case is an example of this outcome. After creditors approved a debt restructuring plan in 2009, the company missed a coupon payment on September 30, 2010 and was declared bankrupt. *See, e.g.*, Lucia Kassai, *JBS Said to Bid 268 Million Reais for Independencia Units*, Bloomberg News (Apr. 23, 2012, 2:23 PM), http://www.bloomberg.com/news/2012-04-23/jbs-said-to-bid-268-million-reais-for-independencia-units.html (reporting Independencia's September 2010 default on bond payments). The company ceased operations in October 2010. Independência then sought a standstill agreement with its bondholders while they tried to negotiate a debt-to-equity conversion. Ultimately, Independência and its creditors agreed to a sale of assets. *See, e.g.*, *Independencia Creditors Agree to JBS Takeover*, Reuters (May 15, 2012, 4:09 PM), http://www.reuters.com/article/2012/05/15/jbs-independencia-idUSL1E8GFFCU20120515 (reporting sale).

E. Plan Negotiation and Confirmation in Practice

As a result of Brazil's fast-track confirmation process, which includes a severe penalty for failing to reach consensus, debtors should be motivated to propose a plan that is attractive to creditors in order to receive sufficient affirmative votes to avoid liquidation. Management should be motivated to save their jobs, and equityholders should want to retain the ability to earn back their investment. However, for complex cases involving international bonds, this is not necessarily the case.

For example, in the CELPA case, while CELPA entered judicial reorganization, its parent company and affiliates did not.[236] Therefore, executives were not worried about job security because they would continue managing those non-debtor operations once the case came to a conclusion. Also, because it was clear that equityholders would receive no financial recovery, the owners' primary motivation was to obtain releases from ongoing liabilities related to CELPA. Accordingly, the equityholders appeared motivated to get the best deal for CELPA's acquirer, not its creditors. Since the law prevented the creditors from proposing their own plan, brinksmanship by the debtor ultimately resulted in the creditors having to choose between a 17.5% recovery under the debtor's plan or prompt liquidation.[237]

In theory, creditors should be motivated to vote for the best plan that the debtor puts forward because their recoveries will likely be much worse in liquidation than reorganization. However, creditors may view their recoveries differently, causing some creditors to vote in favor of a plan that others find inadequate. For example, local creditors may benefit from tax writeoffs under Brazilian law if they accept losses whereas international creditors may not. Under CELPA's proposal for unsecured creditors to receive 17.5% recoveries, some Brazilian financial institutions viewed this proposal as 50.5% recoveries after accounting for a tax shield of up to 40% of their 82.5% losses.[238] It is difficult for creditors to mobilize to oppose a plan when they view the same proposal differently.

Moreover, there may be non-financial motivations for creditors to vote for a suboptimal plan, rather than threaten the debtor with liquidation unless the debtor

236. *See, e.g.*, Denyse Godoy, *Rede Energia Advances After Closing Sale of Bankrupt Celpa Unit*, BLOOMBERG NEWS (Nov. 5, 2012, 9:53 AM), http://www.bloomberg.com/news/2012-11-05/rede-energia-advances-after-closing-sale-of-bankrupt-celpa-unit.html (reporting increase in stock price of CELPA's parent company, Rede Energia S.A., after concluding the sale of CELPA to Equatorial Energia S.A.).

237. *See* Declaration of Mauro Chaves de Almeida at ¶ 21, *In re* Centrais Elétricas do Pará S.A. – Em Recuperação Judicial, No. 12-14568-scc (Bankr. S.D.N.Y. Nov. 9, 2012) (noting transfer of equity interests to Equatorial); *see also* Mario Sergio Lima, *Rede Energia Units Given Ultimatum by Brazilian Regulator*, BLOOMBERG NEWS (Aug. 31, 2012, 5:36 PM), http://www.bloomberg.com/news/2012-08-31/rede-energia-units-given-ultimatum-by-brazilian-regulator.html (reporting that if CELPA creditors failed to approve Equatorial Energia's takeover bid, the company would be declared bankrupt and the government would auction CELPA's concessions).

238. *See* Brief for Foreign Representative's Motion for Order Granting Relief in Aid of Foreign Proceeding, *In re* Centrais Elétricas Do Pará S.A.– EM Recuperação Judicial, No. 12-14568 (Bankr. S.D.N.Y. 2012).

proposes a plan that provides creditors with more favorable treatment. For example, vendors may value future business with the debtor and be more wary of pushing too hard in plan negotiations. Political pressure may cause local financial institutions to fear government backlash if they threaten liquidation. An acquirer may promise certain creditors special favors in the future to convince them to accept a suboptimal plan proposal. Furthermore, if local creditors in Brazil are more familiar with the *concordata* process and not the 2005 reform, they may be resigned to accepting disappointing recoveries. Finally, some creditors may not have the institutional sophistication or risk tolerance for the brinksmanship involved with threatening to liquidate the debtor, which requires a substantial investment of time and professional fees. The process and outcome of liquidation in Brazil is confusing and risky, making creditors wary of making even empty threats during plan negotiations. Such lack of clarity is aggravated when the debtor has not provided sufficient disclosure, such as a detailed list of its assets and recent monthly financial performance.[239] Fear of the unknown gives the debtor a substantial negotiating advantage when crafting a debt restructuring plan.

VI. Bondholders' Access to Information

When investing in Brazilian corporate bonds issued in the U.S., international bondholders likely review a prospectus or offering memorandum that is governed by the Securities Act. Although this document is intended to contain all of the facts that each investor needs to make an informed decision to invest in the borrower's business, the borrower may nevertheless become insolvent. When this happens, these investors may be surprised that Brazilian insolvency law does not require the same sort of disclosure that the borrower was required to provide pursuant to the Securities Act at the time of issuance.

A. Disclosure Required Under U.S. Law

In the U.S., creditors in a chapter 11 case employ a variety of means to collect extensive information regarding the debtor's financial health. The estate-funded creditors' committee and its central role in plan negotiations and plan support, monthly reporting requirements, and rules of discovery have led to a culture of creditor diligence. In addition, the U.S. Bankruptcy Code requires that a written "disclosure statement," approved by the court after notice and a hearing, accompany any plan of reorganization sent to holders of claims or interests.[240] Whereas the plan of reorganization explains the treatment and resolution of creditors' claims and equity interests, the disclosure statement provides information about the debtor and the debtor's estate so that even non-negotiating parties can

239. *See infra* Part VI.B.
240. 11 U.S.C. § 1125(b) (2006); *see also* Nesvold et al., *supra* note 118, at 343–45.

make informed votes on the plan.[241] The disclosure statement is a highly useful tool because it typically contains current and detailed information regarding financial projections for the company's operations and conclusions about the company's valuation, including disclosure of reports done by the company's advisors, appraisers, and consultants.[242]

The U.S. Bankruptcy Code requires that the disclosure statement contain "adequate information," which is defined as: "information of a kind, and in sufficient detail . . . that would enable . . . a hypothetical investor of the relevant class to make an informed judgment about the plan."[243] The bankruptcy judge is given wide discretion in determining whether the disclosure statement contains adequate information, and such decisions are made on a case-by-case basis.[244] However, the Bankruptcy Code does provide some guidelines with respect to this issue. For example, in determining the adequacy of information, the court must consider "the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information."[245] In addition, adequate information includes "a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case."[246] Under the Bankruptcy Code, adequate information does not require "information about any other possible or proposed plan,"[247] and "[t]he court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets."[248] Although a valuation of the debtor is thus not

241. 11 U.S.C. § 1125(a)(1).

242. *See* Jason Cornell, *What Information is Required in a Chapter 11 Disclosure Statement?*, DELAWARE BANKRUPTCY LITIGATION (June 11, 2009), http://delawarebankruptcy.foxrothschild.com/2009/06/articles/bankruptcy-law-basics/what-information-is-required-in-a-chapter-11-disclosure-statement/.

243. 11 U.S.C. § 1125(a)(1). The Code defines an "investor typical of holders of claims or interests of the relevant class" as an "investor having (A) a claim or interest of the relevant class; (B) such a relationship with the debtor as the holders of other claims or interests of such class generally have; and (C) such ability to obtain such information from sources other than the disclosure required by this section as holders of claims or interests in such class generally have." *Id.* § 1125(a)(2). In other words, the adequacy of disclosure is measured against the *typical* creditor within a class. Thus, for example, if one creditor within a class is an insider, but other members of the class are not, that creditor may not be used as the benchmark against which the adequacy of information is measured. *See* H.R. REP. NO. 95–595, at 408–09 (1977) (characterizing an insider as an "extraordinary" investor who would generally not qualify as an "investor typical of holders of claims or interests of the relevant class" under section 1125(a)(2)).

244. *See* H.R. REP. NO. 95–595, at 408–09 (1977) (noting that, in determining the adequacy of information in disclosure statements, "[c]ourts will take a practical approach as to what is necessary under the circumstances of each case, such as the cost of preparation of the statements, the need for relative speed in solicitation and confirmation, and, of course, the need for investor protection . . . [and that] [t]here will be a balancing of interests in each case").

245. 11 U.S.C. § 1125(a)(1).

246. *Id.*

247. *Id.*

248. *Id.* § 1125(b).

technically required, it is usually included. The Senate Judiciary Report regarding the disclosure provisions of the Bankruptcy Code explains:

> *A plan is necessarily predicated on knowledge of the assets and liabilities being dealt with an [sic] on factually supported expectations as to the future course of the business sufficient to meet the feasibility standard [to confirm a plan]. It may thus be necesasry [sic] to provide estimates or judgments for that purpose. Yet it remains practicable to describe, in such detail as may be relevant and needed, the basis for the plan and the data on which supporters of the plan rely.*[249]

In *In re A.C. Williams Co.*,[250] the Bankruptcy Court for the Northern District of Ohio created a frequently-cited list of facts to be disclosed in order to provide adequate information.[251] This list included: the events which led to the filing of the bankruptcy petition; a description of the available assets and their value; the anticipated future of the company; the source of information stated in the disclosure statement; a disclaimer; the present condition of the debtor while in chapter 11; the scheduled claims; the estimated return to creditors under a hypothetical chapter 7 liquidation; the accounting method utilized to produce financial information and the name of the accountants responsible for such information; the future management of the debtor; the chapter 11 plan or a summary thereof; the estimated administrative expenses, including attorneys' and accountants' fees; the collectability of accounts receivable; financial information, data, valuations or projections relevant to the creditors' decision to accept or reject the chapter 11 plan; information relevant to the risks posed to creditors under the plan; the actual or projected realizable value from recovery of preferential or otherwise voidable transfers; litigation likely to arise in a non-bankruptcy context; tax attributes of the debtor; and the relationship of the debtor with affiliates.[252]

Inasmuch as they help interested parties make informed decisions and avoid fraud, disclosure statements are similar to the Form S-1 filings required by the Securities and Exchange Commission for public companies issuing new securities under the Securities Act.[253] However, the Bankruptcy Code explicitly preempts otherwise applicable law with respect to the issue of adequate information.[254] Thus, disclosure statements submitted in connection with a plan of reorganization are

249. S. REP. NO. 95–989, at 120–22 (1978).
250. 25 B.R. 173 (Bankr. N.D. Ohio 1982).
251. *Id.* at 176.
252. *Id.*
253. *Compare In re* A.C. Williams Co., 25 B.R. 173 (Bankr. N.D. Ohio 1982) (listing several facts to be considered when determining whether a disclosure statement has satisfied the adequate information requirement), *with* Registration Statement under the Securities Act of 1933 (Form S-1) (listing pieces of information required to be submitted in conjunction with Form S-1 prospectus).
254. 11 U.S.C. § 1125(d) (2006).

exempt from the disclosure requirements of federal and state securities laws.[255] The Bankruptcy Code also protects individuals from liability under otherwise applicable securities laws who, in good faith, rely on a court-approved disclosure statement in soliciting or participating in the offer, issuance, sale, or purchase of a security under the plan.[256]

Until a court-approved disclosure statement and plan summary are distributed to all eligible parties, the plan proponent may not solicit acceptances or rejections of the plan.[257] Improper solicitation may result in the disqualification of the improperly obtained votes,[258] in addition to an injunction preventing the party from disseminating materials and/or sanctions against the party.[259] Furthermore, improper solicitation involving an offering of securities could expose the plan proponent to liability under federal or state securities laws for disclosure, registration, and other violations.[260]

B. Disclosure Required Under Brazilian Law

The Brazilian Bankruptcy Law requires limited disclosure in connection with the filing of a petition for judicial reorganization, as well as upon the debtor's submission of a debt restructuring plan. Further disclosure, however, is left to negotiations between the debtor and its creditors.

First, the debtor's petition for judicial reorganization must be accompanied by certain documentation, including:

> (1) a statement of the material causes of the debtor's equity condition and the reasons for the economic and financial crisis;

255. *Id.*; H.R. REP. NO. 95–595, at 408–09 (1977). This exemption is very important because securities laws are often implicated in soliciting support for plans of reorganization, which frequently involve an offering of securities in exchange for claims or interests. S. REP. NO. 95–989, at 120–22 (1978). If plan solicitors were obligated to comply with the very strict disclosure requirements of federal securities law, such offerings could become prohibitively expensive. *See, e.g.*, Public Service Co. v. Consol. Utils. & Commc'ns, Inc., 846 F.2d 803, 808 (1st Cir. 1988) ("Without [section 1125(b)], the court . . . would be required in every case to require a full proxy statement or prospectus. . . . The cost of developing a prospectus or proxy statement for a large company often runs well over $1 million. That cost would be nearly prohibitive in a bankruptcy reorganization. In addition, the information normally required under section 14 [of the Securities Exchange Act of 1934] may simply be unavailable, because of the condition of the debtor. Finally, court supervision of the contents of the disclosure statement will protect the public investor from any serious inadequacies in the disclosure statement.") (quoting H.R. REP. NO. 95–595, at 227–28 (1977)).

256. 11 U.S.C. § 1125(e). Without this safe harbor, such individuals could be liable, for example, under the antifraud provisions that enforce the securities laws from which subsection (d) excuses compliance. H.R. REP. NO. 95–595, at 227–29 (1977).

257. *Id.* § 1125(b).

258. *Id.* § 1126(e).

259. *See* COLLIER ON BANKRUPTCY, *supra* note 73, ¶ 1125.05, at 2.

260. *See id.*; *see also* 11 U.S.C. § 1125(e) (showing that the safe harbor provided in 1125(e) protects individuals soliciting acceptances or rejections of a plan from liability under otherwise applicable securities laws *only if* such solicitation was performed in good faith and *in reliance on a court-approved disclosure statement*).

(2) accounting statements for the last three financial years and those drawn up especially to support the petition, prepared in strict compliance with applicable corporation law and consisting necessarily of: (a) the balance sheet, (b) accrued income statement, (c) income statement as from the last financial year, (d) management report on cash flow and projection thereof;
(3) full nominal list of creditors, including those under an affirmative covenant or covenant to give, stating the address, kind, rating and updated amount of the claim, and specifying its origin, the system for the respective maturity dates and the accounting records on each pending transaction;
(4) full list of employees, stating the respective functions, salaries, indemnities and other amounts to which they are entitled, with the corresponding accrual months, and specifying amounts pending payment;
(5) certificate of regular standing of the debtor at the Company Public Registry, updated Articles of Incorporation and minutes of appointment of current officers;
(6) list of private assets of the debtor's controlling partners and officers;
(7) updated statements of debtor's bank accounts and of any financial investments of any kind, including those in investment funds or on stock exchanges, issued by the respective financial institutions;
(8) certificates of the protest offices in the judicial district of the debtor's domicile or headquarters and branches; and
(9) list, signed by the debtor, of all legal actions to which he is a party, including labor-related suits, with an estimate of the respective amounts claimed.[261]

This documentation is made available to the court, the judicial trustee, and, by court authorization, any interested party.[262]

Second, the debtor's debt restructuring plan must be accompanied by certain documentation when submitted to the court, including: (1) a detailed description of the means of reorganization to be used and a summary thereof, (2) a statement of its economic feasibility, and (3) an economic-financial and appraisal report on the debtor's assets, signed by a legally qualified professional or specialized company.[263] Again, the Brazilian Bankruptcy Law does not provide for the distribution of this information to interested parties; rather, the judge is merely

261. Lei No. 11.101 art. 51, de 9 de Fevereiro de 2005, D.O.U. de 9.2.2005 (Braz.).
262. *Id.* art. 1, pará. 1.
263. *Id.* art. 53.

required to publish a notice advising creditors of the receipt of the debt restructuring plan and the terms for stating objections to it.[264]

Finally, upon granting the debtor's petition for judicial reorganization, the judge will order the debtor to submit monthly statements of accounting throughout the judicial reorganization term, on pain of the management's dismissal.[265] These accounting reports provide minimal financial information about prior periods and without the level of detail and footnotes necessary to understand what progress, if any, is being made to turnaround troubled operations. Further, they are not intended to be responsive to creditors' inquiries and do not include financial forecasts, liquidation analyses, or valuations. As such, they do not provide the information that creditors are accustomed to receiving in U.S. bankruptcy cases.

C. Lack of Transparency in Brazilian Disclosure

While the Brazilian Bankruptcy Law requires some disclosure in connection with the filing of a petition for judicial reorganization and the submission of a debt restructuring plan,[266] the information available to creditors may be substantially more limited than what would be contained in a disclosure statement distributed pursuant to the U.S. Bankruptcy Code or in SEC filings for a securities issuance. International bondholders may be surprised by the lack of a culture of diligence in judicial reorganizations. Indeed, creditors may be forced to make important decisions without feeling fully informed. One Brazilian practitioner and member of the drafting committee for the current law recently noted: "The lack of transparency . . . is the most common mistake during proceedings of judicial reorganization, especially as this prevents the reconstruction of trust among the parties, and between the debtor and the bankruptcy court, while hindering the process of negotiation."[267] Reforming Brazilian insolvency law could greatly enhance fairness in the negotiation process by arming creditors with the information necessary to make informed decisions, thereby enhancing the integrity and credibility of the judicial reorganization process.

One way that the Brazilian restructuring process creates transparency problems is by motivating the debtor to withhold information for as long as possible. Brinksmanship affords the debtor tactical advantages in negotiations during the judicial reorganization process. Judicial reorganizations operate under a strict 180-day timeline,[268] and debtors maintain the exclusive right to file a plan of

264. *Id.*
265. *Id.* art. 52.
266. *See supra* Part V.B.
267. Paiva, *supra* note 21, at 55.
268. Lei No. 11.101 art. 6, pará. 4; *see also* Carlos Augusto Behrensdorf Derraik, *Bankruptcy Law in Brazil: An Overview and Practical Considerations*, *in* Bankruptcy Law Client Strategies in South America: Leading Lawyers on Navigating the South American Bankruptcy Process, Working with Local Governments, and Developing Successful Strategies 151, 156 (Michaela Falls ed., 2011), *available at* 2011 WL 586868

reorganization throughout.[269] Debtors generally maintain exclusive control over the flow of pertinent information[270] and may obfuscate the financial and operational details of the company to foster disorganization among creditors. The lack of a committee of unsecured creditors complicates consensus-building among unsecured creditors over what constitutes adequate disclosure.[271] Regardless of the level of information received by the 180th day of the proceeding, the creditors must either accept the debtor's plan or reject it and send the company into bankruptcy.[272] As a result, creditors may be manipulated into accepting an indecipherable or otherwise suboptimal plan at the last moment rather than risk an uncertain recovery in liquidation.[273]

A debtor may also resist transparency with its creditors in order to avoid a declaration of bankruptcy and its attendant dire consequences. Even if reorganization is impractical and ultimately unachievable, a distressed company's management, directors, and owners may pursue judicial reorganization anyway as a delay tactic. Lack of transparency allows the debtor to prolong the negotiation process in cases where adequate information would have otherwise prompted creditors to swiftly demand a judicial declaration of bankruptcy. Debtors in Brazil nearly always prefer reorganization to bankruptcy, and voluntary petitions for bankruptcy are extremely rare.[274] Fernando César Nimer Moreira da Silva, Professor of Law at the University of São Paulo, explains some of the incentives associated with reorganization from the debtor's perspective:

> *The debtor prefers reorganization, because the gain from the debt discount is greater than the amount it would receive in the case of liquidation. [The debtor] ignores losses to creditors when making this decision. The less privileged creditors will receive little or nothing, with redistribution of benefits to the debtor. . . . The managers of inefficient businesses [i.e.,*

(noting that "such incredibly short and inflexible time frames make it almost impossible for a court to reorganize a major business when the court enforces the law as written").

269. Lei No. 11.101 art. 53; *see also* Fernando César Nimer Moreira da Silva, *supra* note 140, at 112 (2009) (allowing creditors to produce alternative plans could help reveal information kept secret by the debtor).

270. Lei No. 11.101 art. 64; *see also* Silva, *supra* note 269, at 97–98 (noting that the debtor "maintains absolute control over the business and the information" for the entire 180-day period of reorganization).

271. *See supra* Part IV.B; *see also* Paiva, *supra* note 21, at 30 (noting importance of the participation of creditors for transparency).

272. Lei No. 11.101 art. 6, pará. 4.

273. *See* Silva, *supra* note 269, at 102–03 ("[The Brazilian Bankruptcy Law] does not always facilitate the disclosure of information. The law is severe in defining creditor classes . . . [and] deadlines for presenting a plan of reorganization and the legal term of bankruptcy, without leaving discretion for the judge to adjust the deadlines and conditions to the case at hand and to avoid the practice of opportunistic behaviors.").

274. Silva, *supra* note 135, at 189 ("In Brazil, the bankruptcy claim is mostly requested from the creditor despite the fact that the debtor can request bankruptcy. The debtor in crisis still carries the stigma of failure or collapse. Often in Brazil, the debtor exhausts its assets until there is no feasible solution."); *see also* Felsberg & Filho, *supra* note 49, at 286 ("Voluntary bankruptcy filings are very rare in Brazil."); Silva, *supra* note 269, at 92 n.257 (noting that voluntary bankruptcies are much more common in the U.S. than in Brazil).

> *businesses that should be liquidated] always have incentives to require reorganization in order to be kept in business during the crisis. They will try to use the assets to pay current debts and stay as long as possible away from bankruptcy, squandering assets and reducing the possibility of paying a higher share of debt.*[275]

Furthermore, a declaration of bankruptcy prompts a civil liability suit against the directors and officers of the insolvent company,[276] as well as a criminal investigation.[277] Until the liability action has been adjudicated, the judge, on his own initiative or at the request of an interested party, may freeze the directors' and officers' personal assets.[278] Although the concept of limited liability would appear to protect directors and officers in the long run, experts have noted that:

> *[W]ithin the current business reality, there exists a system of unlimited liability as a general rule [especially with respect to labor and tax claims*[279]*]. . . . Today in Brazil partners and former partners, managers and former managers — including those engaged in activity only to guide the company as board members — have been held liable for the total value of the company's labor debts. The situation is so unusual that today even legal counsels holding powers of attorney to act on behalf of the partners have repeatedly been held liable for the full amount of labor debts of insolvent companies.*[280]

With respect to the potential criminal consequences of a bankruptcy declaration, the judicial trustee in bankruptcy has a duty to investigate and submit a report to the judge regarding "the causes of the bankruptcy, the debtor's procedure, before and after the decision, and other detailed information regarding the conduct of the debtor and of other persons, if any, liable for acts that may typify a crime related to the judicial reorganization or the bankruptcy, or any other offense related thereto."[281] Upon finding evidence of criminal liability, the trustee must transfer

275. Silva, *supra* note 269, at 92.
276. Lei No. 11.101 art. 82.
277. *Id.* arts. 22(III)(e), 186.
278. *Id.* art. 82, pará. 2.
279. Note that, historically, labor and tax claims have often made up the bulk of an insolvent company's indebtedness in Brazil. *See supra* notes 26–27 and accompanying text.
280. Bruno Meyerhof Salama, Professor of Law, Fundação Getulio Vargas in São Paulo, Panel Discussion at Harvard Law School: The End of Limited Liability in Brazil (Jan. 25, 2012) (transcript available at http://www.law.harvard.edu/news/2012/02/related-content/end-of-limited-liability-in-brazil.pdf). *But see* Felsberg & Filho, *supra* note 49, at 289 ("As a rule of thumb, officers and directors are not personally liable for obligations incurred by virtue of administrative acts performed in the normal course of business on behalf of the corporation, unless they act recklessly, negligently, incompetently, fraudulently, or beyond the scope of their powers . . . .").
281. Lei No. 11.101 arts. 22(III)(e), 186.

such information to the Public Attorney's Office,[282] which then must either file a criminal suit against the implicated party or open a police investigation.[283] Bearing in mind these potential consequences, one practitioner has noted: "Clients only opt for bankruptcy when the economic activity performed has ceased to be viable or is beyond recovery. Even so . . . , we recommend self-declared bankruptcy in exceptional cases."[284] By so strongly discouraging bankruptcy, the legal regime may prompt debtors to withhold information in order to pursue fruitless negotiations with creditors, imposing even greater losses.[285]

Creditors' access to information is further hindered by the procedural hurdles associated with requesting additional disclosure. In order to request additional disclosure, creditors must petition the court, which is time-consuming and expensive.[286] Even when a debtor is compelled to provide additional disclosure, the debtor may comply only superficially. If the creditors continue to be dissatisfied, their only remedy is to repeat the process of petitioning the court, causing further costs and delay. The strict deadlines in the fast-paced judicial reorganization process[287] exacerbate the detrimental effect of having to seek such relief.

Another way that the Brazilian restructuring process causes transparency problems for international bondholders relates to Brazilian accounting and corporate governance norms, which are far less sophisticated and stringent than their U.S. counterparts. As a result, the information provided tends to be less reliable and less useful for analyzing a distressed company's turnaround potential. In recent years, the Brazilian National Congress has taken substantial steps toward improving financial and accounting transparency in an effort to make Brazilian capital markets more competitive.[288] Significantly, all companies were required to conform to International Financial Reporting Standards (IFRS) by 2010.[289] However, such changes will take time, and remnants of former norms — which have been described as "inimical to the production of high quality accounting reports"[290] — remain common.[291]

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282. *Id.* art. 22, pará. 4.
283. *Id.* art. 187.
284. Paiva, *supra* note 21, at 47.
285. *See* Silva, *supra* note 269, at 100–01.
286. *See, e.g.*, Paiva, *supra* note 21, at 38 ("Although it is a great step forward in relation to the former preventative bankruptcy, the process of judicial reorganization entails a high cost, may be time consuming, and still generates a whole series of uncertainties, as the law is relatively new and has been little tested in certain aspects . . . .").
287. *See supra* notes 268, 272 and accompanying text.
288. *See generally* Lúcia Lima Rodrigues et al., *The Origins of Modern Accounting in Brazil: Influences Leading to the Adoption of IFRS*, 24 Res. Acct. Reg. 15 (2012).
289. *Id.* at 15.
290. Alexsandro Broedel Lopes & Martin Walker, *Asset Revaluations, Future Firm Performance and Firm-Level Corporate Governance Arrangements: New Evidence from Brazil*, 44 Brit. Acct. Rev. 53, 54 (2012).
291. *See* Rodrigues, *supra* note 288, at 23 (noting resistance to the new accounting methodology and concluding that: "[C]onsidering the increasing global economic and financial integration of Brazil, the convergence of national GAAP with IFRS was considered of upmost importance to improve the financial

The prior accounting model in Brazil developed amid conditions that "reduce[d] the value relevance of published accounting numbers."[292] Because state-operated banks accommodated the capital needs of most businesses, accounting and financial reporting was not designed to induce outside investment.[293] The confluence of tax and financial accounting,[294] as well as a lack of adequate enforcement mechanisms,[295] also contributed to the diminished quality of such reports. Alexsandro Broedel Lopes, an accounting professor at the University of São Paulo, describes the transition to the IFRS accounting model as a "major revolution," noting:

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reporting of Brazilian corporations. . . . However, it is expected that the acceptance of the new paradigm . . . will take time, its assimilation will require 'the reconstruction of prior theory and the revaluation of prior fact, an intrinsically revolutionary process that is seldom complete[d] by a single man and never overnight.'") (internal citations omitted). For example, a 2012 study on Brazilian businesses' cost of capital in relation to their use of derivatives points out the continuing dearth of disclosure, finding that: "[T]he overriding takeaway is criticism of the lack of data in the Brazilian market, mainly in terms of the level of disclosure of information in companies' balance sheets and explanatory notes . . . . In addition, no systematic procedure to register company information about dividend policy and credit rating also reduced the sample size." João Ricardo Ribeiro Coutinho et al., *The Use of Fx Derivatives and the Cost of Capital: Evidence of Brazilian Companies*, 13 EMERGING MARKETS REV. 411, 420 (2012).

292. Alexsandro Broedel Lopes, *Teaching IFRS in Brazil: News on the Front*, 20 ACCT. EDUC. 339, 341 (2011); *see also, e.g.*, Bernard S. Black et al., *Corporate Governance in Brazil*, 11 EMERGING MARKETS REV. 21, 37 (2010) ("Financial disclosure lags behind world standards. Brazilian accounting standard[s] do not require either a statement of cash flows or quarterly consolidated financial statements, and only a minority of firms provide these, generally in connection with a listing on Bovespa Level 1 or higher, or cross-listing on a foreign exchange.").

293. Lopes, *supra* note 292, at 340–41 (explaining Brazil's "bank-oriented (as opposed to market-oriented) financial system" and concluding that "[d]espite the fact that some accounting rules in Brazil were influenced by American standards . . . , the whole of its accounting infrastructure was not based on the production of information for capital markets."); *see also* World Bank, *Report on the Observance of Standards and Codes: Brazil Accounting and Auditing*, ¶¶ 8, 9 (created June 20, 2005, published Sept. 25, 2007), *available at* http://www.worldbank.org/ifa/rosc_aa_bra.pdf [hereinafter World Bank].

294. Under the former accounting model, Brazilian companies often did not distinguish between reporting for tax purposes versus financial purposes. Lopes, *supra* note 292, at 342. Alexsandro Broedel Lopes, an accounting professor at the University of São Paulo, explains: "In Brazil, accounting was basically seen as a tool to calculate taxes and not as an instrument to reduce information asymmetry between investors and firms. The whole subject of disclosures including how to prepare footnotes, for instance, despite being demanded by the Law, were not even taught at universities on accounting courses. . . . Fair value was so distant a concept that most accountants in Brazil used to say that measuring fair value was a step towards other professions' domains (e.g. that of economists)." *Id.* at 344. The problem with failing to separate the realms of tax and finance when reporting information about a company, Lopes explains, is that "value relevance is lower when tax rules significantly influence the financial reporting process, consistent with the assumption that tax rules are influenced by political and economic determinants rather than the needs of equity investors." *Id.* at 342.

295. World Bank, *supra* note 293, at ¶¶ 50–61; *see also* Christopher W. Anderson, *Financial Contracting Under Extreme Uncertainty: An Analysis of Brazilian Corporate Debentures*, 51 J. FIN. ECON. 45, 54 (1999) ("[T]he quality of disclosure by Brazilian firms is perceived to be low. South American accounting practices are dominated by the legal and administrative systems inherited from the Iberian colonizers and the highly political environment that results from such systems. Brazilian annual reports, for example, are used with little effectiveness by corporations that usually comply merely with their legal obligations. Indeed, for the vast majority of firms, financial statements do not correspond to the reality of their operations and the manipulation of financial statements is not restricted to small firms. . . . [A]ncillary disclosure institutions are weak. For example, auditors' reports are of little prominence in the relationship between a corporation and its shareholders . . . .") (internal quotation marks, emphasis and citations omitted).

> *The new rules require[] a new kind of professional very distinct from the traditional record keeper. . . . The situation and the challenges in Brazil are not really about the adoption or not of IFRS* per se. *The main challenges arise with the adoption of an accounting model designed to inform external users and based on judgment, and on the economic substance of transactions, in contrast to the local model, which was designed to attain other ends. . . . The future holds many challenges for the construction of a high quality accounting system in Brazil.*[296]

Moreover, studies indicate that the adoption of IFRS, in and of itself, does not necessarily lead to higher quality in financial and accounting reporting.[297] Rather, increased corporate transparency is the result of "a country's investor protection regime" as a whole, which can be strengthened through "board independence, enforcement of securities laws, protection of minority shareholder rights, enforcement of accounting and auditing standards, judicial independence, and freedom of the press."[298] In this respect, while Brazilian corporate governance norms are also in a state of rapid change, chronic weaknesses persist.[299] For example, Brazilian law does not require director independence.[300] For these reasons, information that creditors receive from a Brazilian company in judicial reorganization may be less reliable than what they would receive from a company reorganizing under chapter 11 in the U.S.

VII. Distressed Asset Sales

One of the sharpest differences between the insolvency processes in Brazil and the U.S. relates to asset sales. International investors may be surprised by the lack of protections for bondholders, who have very limited influence over the asset sale process. When an insolvent company's assets are sold as part of a judicial reorganization, bondholders may find themselves at an unfortunate procedural and informational disadvantage, as occurred in the CELPA and Independência cases.

A. Distressed Asset Sales Under U.S. Law

Section 363 of the U.S. Bankruptcy Code governs the use, sale, or lease of a debtor's property in a bankruptcy case outside the ordinary course of the debtor's

296. Lopes, *supra* note 292, at 346.
297. Muhammad Nurul Houqe et al., *The Effect of IFRS Adoption and Investor Protection on Earnings Quality Around the World*, 47 Int'l J. Acct. 333 (2012).
298. *Id.* at 337.
299. Black, *supra* note 292, at 37.
300. *Id.* ("Board independence is an area of notable weakness: the boards of most Brazilian private firms are comprised entirely or almost entirely of insiders or representatives of the controlling family or group. Many firms have zero independent directors.").

business.[301] When the debtor seeks to sell a business unit, production facility, or the entire company, the bankruptcy court provides substantial oversight of the sale, the process is transparent, and creditors have multiple opportunities to object to the way the debtor proposes to conduct the sale. Section 363 was designed to obtain the highest and best offer for the assets being sold,[302] which is consistent with the Bankruptcy Code's general goal of providing fair and equitable recoveries to creditors. As a result, a sale of a company under section 363 may prove to be a superior alternative to a standalone plan of reorganization.

Congress structured the 363 sale process to attract potential buyers who might otherwise shun asset sales involving insolvent entities. A powerful incentive is that the bankruptcy court has the power to authorize the sale of assets free and clear of liens or other encumbrances.[303] Thus, a buyer may use the bankruptcy court's order approving a sale as a valid and practically impenetrable defense to any later attempts by the debtor's creditors to assert claims against the assets sold to the buyer. Except in limited circumstances,[304] all liabilities remain with the bankruptcy estate and the cash received from the sale. Furthermore, while any party in interest may appeal a bankruptcy court order approving a sale, the Bankruptcy Code provides that reversal or modification of the order on appeal "does not affect the

301. 11 U.S.C. § 363(b) (2006); *see id.* § 363(c) (stating that, unless the bankruptcy court orders otherwise, the trustee or debtor in possession may use, sell, or lease property of the bankruptcy estate in the ordinary course of business without need for a notice or hearing); NESVOLD ET AL., *supra* note 118, at 377–80.

302. NESVOLD ET AL., *supra* note 118, at 377.

303. *Id.*; *see* 11 U.S.C. § 363(f) (permitting sale debtor's assets free and clear of any other interests in the property). In order to sell (or lease) encumbered assets free and clear of all claims and interests, the bankruptcy trustee or debtor in possession must prove at least one of the following conditions to the bankruptcy court:

> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
> (2) such entity consents;
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
> (4) such interest is in bona fide dispute; or
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Id.

304. Examples of potential successor liability might be an environmental claim that was not discovered until after the bankruptcy, or a product liability claim in which the cause of action arose after the date of sale. *See* COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.06[7] ("It seems clear that creditors whose claims accrued before or during the bankruptcy case and who had an opportunity to participate in the bankruptcy case are bound by any plan or distribution in that case. With regard to future claimants, such as product liability claimants whose claims do not arise until after confirmation of a plan, the claims may not be discharged under section 1141. If the debtor's assets have been liquidated, such claimants may seek to recover from a purchaser of the debtor's assets. Courts have sought to provide protection to purchasers of assets, who might otherwise be subject to such claims under principles of successor liability, by approving sales free of all present or future claims against the debtor or the estate. . . . However, the bankruptcy court's ability to override principles of successor liability in bankruptcy sales has been questioned. . . .").

validity of a sale," unless the sale order was stayed pending appeal.[305] As a result of these protections, buyers can bid their highest price without having to discount for potential liabilities, which may be subjective and difficult to calculate.

A 363 sale typically involves an auction or other competitive bidding process, unless there are highly unusual circumstances justifying an expedited sale to a sole bidder.[306] The bankruptcy court will focus mainly on the validity and integrity of the sale process, rather than the ultimate valuation. While soliciting potential bidders, running the auction, and determining a winning bidder are conducted by the debtor in possession and its advisors outside of the bankruptcy court, the overall sale process is governed by the official bidding procedures approved by the bankruptcy judge.[307] When a debtor in possession proposes selling assets, the bankruptcy judge has the discretion to determine whether a 363 sale is appropriate and considers objections by creditors.[308]

A typical 363 sale involves the following steps: (i) the debtor selects an initial bidder, known as a "stalking horse,"[309] (ii) the debtor and stalking horse negotiate an asset purchase agreement that becomes the benchmark against which other potential buyers bid during the formal auction process,[310] (iii) the debtor files a 363 motion with the bankruptcy court to request approval of the bidding procedures,[311] (iv) upon approval, the debtor provides notice of the proposed sale to all parties in interest, which must include a description of the property to be sold, the time and place of sale, and the deadlines for filing objections,[312] (v) the debtor conducts the auction,[313] (vi) the debtor determines a winning bidder and files a motion with the

305. 11 U.S.C. § 363(m). Recently, however, some courts have held that some aspects of a sale order may be undone on appeal, even absent a stay. *See, e.g.*, *In re* PW, LLC, 391 B.R. 25, 29–30 (B.A.P. 9th Cir. 2008) ("[W]e reject the contention that once the sale is consummated, the appeal from the order stripping the junior creditor's liens is moot and immune from scrutiny . . . .").

306. *See* COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.02 (discussing the standard for approval of a sale); *see also* NESVOLD ET AL., *supra* note 118, at 377.

307. *See* 11 U.S.C. § 363(b)(1)(B); *see also* COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.02; NESVOLD ET AL., *supra* note 118, at 378.

308. 11 U.S.C. § 363(b)(1)(B); COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.02.

309. The purpose of a stalking horse bid is to allow the debtor to test the market and set a floor on price at the formal court auction, thereby preventing low-ball offers. In exchange for an early bid, the debtor can offer the stalking horse several advantages, including break-up fees, expense reimbursement, minimum increments for overbids, and qualification requirements and strict deadlines for competing bidders. COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.02; NESVOLD ET AL., *supra* note 118, at 388–89. In addition, the stalking horse may have more time and greater access to conduct due diligence on the distressed entity than subsequent bidders. NESVOLD ET AL., *supra* note 118, at 389.

310. The debtor may make customary representations and warranties in the APA, but they typically do not survive closing. *Id.* at 386. Furthermore, typically the bidding procedures approved by the bankruptcy court do not allow bids to include due diligence, financing, or other contingencies. *Id.* Therefore, it is critical that all bidders complete due diligence and raise sufficient capital prior to submitting their bids. *Id.*

311. NESVOLD ET AL., *supra* note 118, at 381.

312. FED. R. BANKR. P. R. 6004(a) (requiring notice of the proposed use, sale, or lease of property not in the ordinary course of business); FED. R. BANKR. P. R. 2002 (detailing rules of such notice); *see also In re* Condere Corp., 228 B.R. 615, 624–25 (Bankr. S.D. Miss. 1998) (describing the applicability of these rules to §363 sales).

313. NESVOLD ET AL., *supra* note 118, at 381.

court to approve the sale,[314] (vii) the court approves the sale,[315] and (viii) the sale closes.[316]

In considering whether to approve a 363 sale, courts generally consider four factors: "whether the proposed 363 sale reflects: (i) a sound business reason, (ii) accurate and reasonable notice, (iii) adequate price, and (iv) good faith."[317] In addition, the court will be on alert as to whether the 363 sale process is really a *de facto* plan of reorganization because the process runs the risk of rendering certain rights of creditors meaningless.[318] When a debtor requests a 363 sale, it is effectively asking the court to waive the usual disclosure, consent solicitation, voting, and confirmation process involved in a traditional plan of reorganization. Further, a 363 sale is protected from extensive judicial review by the business judgment rule,[319] whereas a plan of reorganization involves a judicial determination that the plan meets the statutory confirmation standards.[320] As a result, some courts will not approve a 363 sale that is tantamount to a plan of reorganization.[321]

Other provisions of section 363 further serve to protect the integrity of the sale process and promote the goal of obtaining the highest and best bid. Section 363(n) is meant to prevent collusion among bidders.[322] Section 363(k) authorizes a secured creditor to submit a bid using some or all of its secured claim (a so-called "credit bid") to protect against its collateral being sold for too low a price.[323] Section 363(e) allows secured creditors to demand adequate protection if their collateral is the object of the sale.[324]

Notably, although all creditors have a right to object to the bidding procedures involved in a 363 sale, the Bankruptcy Code reserves the right to propose a 363 sale to the debtor in possession (or the bankruptcy trustee, as the case may be).[325] If creditors want to encourage a sale of the company, they usually must wait until the

314. *Id.* (noting that the court must approve the winning bid).

315. *Id.*

316. *Id.* at 387.

317. *Id.* at 385–86; *see also* COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.02.

318. However, section 363 also provides certain protections for creditors who have a claim on the asset(s) being sold. For example, upon request by a party in interest, the trustee must provide adequate protection of that interest in the property when seeking to use, sell, or lease the property. 11 U.S.C. § 363(e) (2006).

319. COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.02; NESVOLD ET AL., *supra* note 118, at 384.

320. *Id. See* 11 U.S.C. § 1129.

321. *See In re* Braniff Airways, Inc., 700 F.2d 935, 939–40 (5th Cir. 1983) (stating that "[t]he debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets").

322. *See* 11 U.S.C. § 363(n) ("The trustee may avoid a sale . . . if the sale price was controlled by an agreement among potential bidders . . . .").

323. 11 U.S.C. § 363(k).

324. *See* 11 U.S.C. § 363(e) ("[A]t any time, on request of an entity that has an interest in the property . . . sold . . . or proposed to be sold . . . by the trustee, the court, with or without a hearing, shall prohibit or condition such . . . sale . . . as is necessary to provide adequate protection of such interest.").

325. *See* 11 U.S.C. § 363(b)(1) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . ."); *see also* COLLIER ON BANKRUPTCY, *supra* note 73, at ¶ 363.02 (discussing the function of 11 U.S.C. § 363(b)(1)).

debtor loses exclusivity, at which time the creditors can propose their own plan that involves a sale of the company. Depending upon the debtor's circumstances, there may be other ways that creditors are able to influence a sale as opposed to a standalone plan of reorganization.[326]

B. Distressed Asset Sales Under Brazilian Law

The Brazilian Bankruptcy Law explicitly recognizes spin-offs, mergers, changes of control, partial sales of assets, and other similar transactions as appropriate means of judicial reorganization.[327] It also attempts to encourage a meaningful market for the sale of assets in an insolvency proceeding by providing that the acquirer will not succeed to any of the debtor's obligations, including tax and labor-related debts.[328] In addition, the Brazilian Bankruptcy Law expressly favors the sale of an entire business, as opposed to the piecemeal sale of the debtor's assets, so as to preserve the social and economic value of the unfragmented enterprise.[329] The Brazilian sale process, however, is far less transparent to creditors than the 363 sale procedure conducted in the United States. International bondholders expecting a process similar to a 363 sale will likely face unwelcome surprises.

Brazilian debtors under judicial reorganization may accomplish an asset sale in one of two ways: (1) by including the sale as a means of reorganization in its debt restructuring plan[330] or (2) by requesting judicial authorization of the sale.[331] In the

326. For example, in the chapter 11 case of *In re* AMR Corp., No. 11-15463 (SHL) (Bankr. S.D.N.Y. Nov. 29, 2011), the labor unions and creditors of AMR Corp.'s American Airlines operations helped persuade the debtor to agree to merge with USAirways Group Inc., despite management's intent to file a standalone plan of reorganization. *See* David Koenig, *American, US Airways Announce $11 Billion Merger*, Associated Press (Feb. 14, 2013, 10:14 AM), http://www.news-journalonline.com/article/20130214/WIRE/130219891 ("[C]reditors forced AMR's management to consider the value of a merger compared with a plan for the independent American. Eventually they concluded that the best return for stakeholders, and the best chance to compete with bigger rivals United Airlines and Delta Air Lines, came from a merger."); Sheryl Jean, *Union-driven American Airlines-US Airways Merger Stands Out in Industry,* Dallas Morning News (Feb. 14, 2003, 10:47 PM), http://www.dallasnews.com/business/airline-industry/20130214-union-driven-american-airlines-us-airways-merger-stands-out-in-industry.ece.

327. Lei No. 11.101, art. 50, de 9 de Fevereiro de 2005, Diário Oficial Da União [D.O.U.] de 9.2.2005 (Braz.).

328. *Id.* arts. 60, 141(II); *see also* Lei No. 5.172, art. 133, de 25 de Outubro de 1966, Código Tributário Nacional [C.T.N.] de 25.10.1966 (Braz.); Paiva, *supra* note 21, at 50 ("Legislative history supports the proposition of the conscientious option of incorporating the concept of free and clear sales into the revised insolvency legislation as a mechanism to facilitate the maximization of value of a debtor's assets.").

329. *See, e.g.*, Silva, *supra* note 135, at 195 ("The business should be preserved whenever possible due to its social function that generates economic wealth and creates jobs opportunities and income. This contributes to growth and social development of the country. In addition, the liquidation of the business causes economic loss represented by intangible assets such as name, business location, reputation, brands, customers, suppliers network, expertise, training, prospect of future earnings, among others.").

330. Lei No. 11.101, art. 60.

331. *Id.* art. 142; *see also id.* art. 66 ("Once the petition for judicial reorganization has been distributed, the debtor cannot dispose of or encumber any items or rights of his permanent assets, unless they are of evident utility recognized by the judge after hearing the committee, with the exception of those previously listed in the

latter case, the debtor must demonstrate the "evident utility" of the proposed sale.[332] In either case, the Brazilian Bankruptcy Law provides that the judge should order the sale to be conducted either through auction by oral bidding, sealed bidding, or "public proclamation" (a combination of the two).[333] The debtor must accept the highest bid offered.[334] Creditors may file an opposition within forty-eight hours of the auction.[335] The sale must be preceded by public notice in a "widely circulated newspaper" thirty days in advance of the proceeding.[336] However, the judge can authorize a different modality of disposal if so requested by the judicial trustee or creditors committee[337] or if provided for under the plan.[338] For example, a judge may authorize a private sale, which would likely involve a stalking horse bidder.[339]

In practice, there are many problems with permitting debtors to include a sale proposal as part of the debt restructuring plan. Because the debtor holds the exclusive right to file a plan[340] and creditors are rarely able to act in an organized manner,[341] debtors hold too much control over the sale process. The debtor enjoys broad discretion over which potential acquirers can bid and how the winning bid is determined. Overall, the debtor can avoid including competitive bidding procedures that would be more likely to bring a higher sale price, even if the debtor's motivations are pure. The lack of transparency undermines trust, at best, and invites corruption, at worst.

Moreover, the lack of transparency in the sale process is exacerbated by brinksmanship in the voting process.[342] The debtor may decide to sell the company at the outset, but run down the clock in the voting process toward the 180th day to avoid having to make concessions in negotiations. Since creditors have little input in the sale process and cannot file a competing plan, there is rarely an opportunity for creditors to insist upon an auction or other market test of the sale transaction proposed by the debtor. Presumably, if creditors do not approve of the sale proposal, then they will vote against the plan. However, rather than risk liquidation, disgruntled creditors may feel compelled to vote for the plan even if they feel it is

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judicial reorganization plan."); *id.* art. 140 ("Asset realization shall start independently of formation of the general list of creditors.").

332. *Id.* art. 66; *see also* Paiva, *supra* note 21, at 51 ("[The debtor] is generally prohibited from selling or encumbering any of its permanent assets (except with a prior approval of the courts, any creditors' committee, or the trustee), unless the sale is established in the reorganization plan. Generally, the sale will be approved by the court if and when the need and utility of the proposed sale is properly demonstrated.").

333. Lei No. 11.101, art. 142.

334. *Id.* art. 142, pará. 2.

335. *Id.* art. 143.

336. *Id.* art. 142, pará. 1; *see also id.* art. 129 (permitting revocation suit for any sale of assets effectuated without notice if debtor is ultimately liquidated and its assets are insufficient to settle remaining liabilities).

337. *Id.* art. 144.

338. *Id.* art. 145.

339. Paiva, *supra* note 21, at 52.

340. *See supra* Part V.B.

341. *See supra* Part IV.B.

342. *See supra* Part VI.C.

unfair. Once a creditor votes to approve the plan, including the sale, that creditor might be concerned that a subsequent objection to the sale process would appear inconsistent.

While it is theoretically possible for creditors to attempt to attract alternative buyers or pursue their own brinksmanship strategy by threatening to vote against the debtor's plan unless the debtor chooses a superior bid or elects a more competitive sale process, there are many practical challenges to such approaches. Without an organized committee of creditors,[343] individual creditors may be wary of investing their own resources to oppose the debtor's sale or to attract interest in the sale from other potential bidders.

Furthermore, once a debtor has chosen its favored buyer, interest among other potential buyers will likely be chilled. Other potential bidders know that the debtor has the exclusive right to propose a plan and therefore elect the winning bidder, without necessarily having input from creditors or the court. The lack of up-to-date information about the debtor's finances and operations puts other interested buyers at a competitive disadvantage. Without access to the company to perform the same due diligence as the buyer selected by the debtor, other interested buyers would not have the information necessary to formulate a competing bid. In addition, the favored buyer may be able to negotiate side deals with local creditors to gain their approval even if the bid undervalues the company. For example, a buyer may promise future business. A buyer with ties to labor groups may be able to garner the labor class's support as part of a broader deal. A buyer might make political donations to win the favor of regulators and other political figures. In Brazil's tight-knit business community, international bondholders are at a serious disadvantage.

Likewise, the creditors themselves are at a disadvantage in evaluating the proposed purchase price or in submitting their own competing bid. In submitting their own bid, creditors face obstacles in gaining consensus without the aid of a formal committee, and there is often unwillingness to commit additional capital after an initial investment has soured. Other obstacles include Brazilian laws surrounding equity ownership of banks in companies and debt investors' lack of management experience.

C. Distressed Asset Sales in Practice in Brazil

The judicial reorganization of Brazilian airline Varig, S.A. and its affiliates Rio-Sul Linhas Aereas S.A. and Nordeste Linhas Aereas S.A.[344] exemplifies a consensual asset sale process proposed by the debtors and agreed by the creditors. In December 2005, Varig's creditors approved a split of the company into two segments: (1) VarigLog, which was purchased by Volo do Brasil, an investment consortium, and

343. *See supra* Part IV.B.
344. *In re* Varig, S.A., No. 05-14400 (RDD) (Bankr. S.D.N.Y. Nov. 29, 2005).

reestablished as Varig Logística S.A., and (2) "new" Varig, which became the reorganized company. When the reorganized company's performance continued to decline, Varig's creditors approved an amendment to the debt restructuring plan to pursue a sale of the remaining assets via auction.[345] The debtor then ran a competitive bidding process with NV Participações Ltda., a new company established by former Varig employees, prevailing.[346] When the employees could not finance their bid, the court declared the bid void and authorized the debtor to re-auction the assets.[347] Varig Logística was the sole bidder at the second auction.[348] The court ultimately declared the sale complete in December 2006, thereby reuniting the businesses.[349] In March 2007, Volo do Brasil sold VarigLog to Gol Transportes Aéreos, another airline.[350]

While the Varig case followed a process similar to a 363 sale, CELPA's case illustrates the marked differences between the U.S. and Brazil regarding asset sales in an insolvency proceeding. After initiating judicial reorganization, CELPA announced that it would transfer its assets to Equatorial Energia S.A. (Equatorial), a Brazil-based holding company whose subsidiaries are engaged in the generation and distribution of electricity.[351] Subsequently, CELPA's debt restructuring plan involved a sale of all of its debt and equity interests to Equatorial, such that all distributions to creditors would come from cash received from Equatorial.[352] As such, the plan became a three-way negotiation among the debtor, the creditors, and Equatorial, as the debtor believed it could not concede to any creditor demands without the approval of Equatorial.

CELPA did not conduct an auction for this sale and did not propose bidding procedures to the court.[353] Dissatisfied creditors faced several hurdles in objecting to the sale process, including the lack of an official creditors' committee to mobilize

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345. *In re* Varig, S.A., No. 05-14400 (RDD) (Bankr. S.D.N.Y. Nov. 29, 2005), Notice of Certification of Publication / Notice of Corrected Filing of Restated Reorganization Plan Approved in the Foreign Proceeding 2, ECF No. 359.

346. Notice of Certification of Publication 2, ECF No. 359*; see also Brazil: Judge Approves Varig Offer* (June 13, 2006), http://www.nytimes.com/2006/06/13/business/worldbusiness/13fobriefs-006.html?_r=0.

347. Notice of Certification of Publication 2, ECF No. 359; *see also Brazilian Court Cancels Sale of Varig* (June 25, 2006), http://www.taipeitimes.com/News/biz/archives/2006/06/25/2003315589.

348. *Brazil's Varig Sold in Auction to Former Cargo Unit* (July 21, 2006), http://en.mercopress.com/2006/07/21/brazil-s-varig-sold-in-auction-to-former-cargo-unit; *see also Brazil: Airline Acquired at Auction* (July 21, 2006), http://www.nytimes.com/2006/07/21/business/21fobriefs-005.html.

349. Otto Eduardo Fonseca Lobo et al., *Varig Airlines: Flying the Friendly Skies of Brazil's New Bankruptcy Law with Help from Old § 304*, Am. Bankr. Inst. J., July–Aug. 2007, at 42.

350. Press Release, GOL Announces Acquisition of VRG (Mar. 28, 2007), *available at* http://www.prnewswire.com/news-releases/gol-announces-acquisition-of-vrg-52186942.html; *see also Gol to Resurrect Varig* (Mar. 29, 2007), http://dealbook.nytimes.com/2007/03/29/gol-to-resurrect-varig/.

351. *See* Declaration of Mauro Chaves de Almeida at ¶ 9, *In re* Centrais Elétricas do Pará S.A. – Em Recuperação Judicial, No. 12-14568-scc (Bankr. S.D.N.Y. Nov. 9, 2012) (noting transfer of equity interests to Equatorial).

352. *Id.* at ¶¶ 20–22.

353. *Id.* at ¶ 93.

the voices of various creditors, inadequate financial disclosure to determine whether Equatorial's bid reflected a reasonable valuation for CELPA's assets, the debtor's exclusive right to propose a plan, and the absence of sufficient judicial oversight of the asset sale process. The only way for creditors to object to the sale process was to vote against the plan and demand that it be revised to include a bidding process open to other potential acquirers.[354] However, organizing a sufficient number of opposing votes among creditors proved to be too much of a challenge. Ultimately, the creditors voted to approve CELPA's plan proposing a sale to Equatorial rather than face liquidation.[355]

In Independência's case, bondholders felt that the debtor's proposed plan offered such a patently unfair recovery that they decided to commit new capital to provide the secured exit financing instead of accepting the plan.[356] Even though these bondholders lacked sufficient financial and operational information about Independência, they believed that the company's valuation had to be higher than the debtor proposed. Under Brazilian law, they could not compel the debtor to reveal additional information so that they could become comfortable with the discounts contained in the debtor's proposed plan.[357] Rather than face liquidation, the debtor acquiesced to the bondholders' proposal.[358] Within a year of financing the acquisition of Independência's assets, the company's financial distress resurfaced and the company defaulted on its new financing from the bondholders.[359] Since a judicial reorganization does not close upon the confirmation date of a debt restructuring plan and, instead, remains under court supervision until the second anniversary of the insolvency petition, Independência returned to judicial reorganization.[360] Within the next year, the company ceased operations and proceeded to liquidate.[361] In hindsight, bondholders invested additional capital into

354. *See id.* at ¶ 8 (noting the presence of a vote).
355. *Id.*
356. Press Release, Independência S.A., Independência Paritipações S.A Announces Capital Increase of up to R$450 Million (Nov. 26, 2008), *available at* http://ir.independencia.com.br/independencia/web/arquivos/Notice%20to%20market%20-%2011-26-08.pdf.
357. *See supra* Part VI.C.
358. Press Release, Independência S.A., Independência Announces Submittal of Judicial Recovery Plan (July 14, 2009), *available at* http://ir.independencia.com.br/independencia/web/arquivos/INDEPENDENCIA_Comunicado_Plano_20090714_eng.pdf.
359. Press Release, Independência S.A., Important Information for Creditor Livestock Raisers and Suppliers of Independência and Nova Carne – Debt Repayment Begins in March 2010 (Jan. 15, 2010), *available at* http://ir.independencia.com.br/independencia/web/arquivos/CE0110_Notice%20to%20the%20creditors%20-%20Debt%20repayment%20begins%20in%20March%202010.pdf.
360. *See* Lei No. 11.101, art. 61, de 9 de Fevereiro de 2005, Diário Oficial da União [D.O.U.] de 9.2.2005 (Braz.) (providing two year reorganization period).
361. *Brazilian Meat Manufacturer JBS Acquires Independência*, Food Bus. Rev. (Feb. 4, 2013), http://meatandseafood.food-business-review.com/news/brazilian-meat-manufacturer-jbs-acquires-independencia-group-040113.

Independência and ultimately received less than they would have under the debtor's initial plan.[362]

VIII. Conclusion

The point of this Article is not that the Brazilian Bankruptcy Law should become identical to the U.S. Bankruptcy Code. Rather, the point is to encourage further reform of the Brazilian Bankruptcy Law to address issues having a pronounced adverse effect on international bondholders. While the 2005 reform made significant improvements for many creditors, such as Brazilian banks, vendors, and employees, the reform did not address the distinct issues arising when a debtor has issued bonds to international investors. Specifically, the Brazilian Bankruptcy Law should recognize the standing and voting rights of individual bondholders.[363] This critical first step would at least provide international bondholders with a seat at the negotiating table when their investment in Brazilian corporate bonds becomes distressed, without having to go through the time-consuming and expensive distraction of claim separation. The Brazilian Bankruptcy Law should also provide an adequate mechanism for unsecured creditors to organize separately from other creditors and receive reimbursement for the reasonable fees and expenses of their advisors.[364] In addition, the law can restore the balance of power in plan negotiations by authorizing creditors to file competing plans of reorganization at, for example, the last day of the judicial reorganization.[365] By allowing creditors to cast their votes among plan alternatives, the process would become more democratic. Moreover, in a Brazilian insolvency procedure, all creditors should enjoy the same level of disclosure with which a bond issuer must comply when issuing securities under the Securities Act.[366] Furthermore, when the debtor seeks to sell its business to a third party acquirer, the law should compel review by the court and creditors or require a market test like an auction.[367] As currently enacted, these combined pitfalls in Brazilian law create an unfavorable environment for international bondholders. Rather than reliably establishing a transparent process that results in a fair and equitable outcome, the current law can result in unbalanced negotiations slanted by brinksmanship. Reform in these areas will be critical if Brazil wants to continue raising capital from U.S. markets and elsewhere. Without such further reform, Brazil risks the same high interest rates and limited access to capital that motivated Brazil to overhaul the antiquated *concordata* process.

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362. *See* Revised Judicial Reorganization Plan, D.J.S.P., Case No. 2009.000928-5 (Braz.).
363. *See supra* Part III.B. Alternatively, this problem could be mitigated through reform of the TIA. *See supra* Part III.D.
364. *See supra* Part IV.
365. *See supra* Part V.B.
366. *See supra* Part VI.B.
367. *See supra* Part VII.B.