# ABUSE OF VOTING RIGHTS BY CREDITORS IN BUSINESS INSOLVENCY

Creditors to a Brazilian company undergoing in-court reorganization who are discontent with the restructuring plan submitted by debtor must beware: their ability to oppose the plan may be limited, as their votes against it may be set aside by the insolvency court on the grounds of "abusiveness". The exclusion of votes deemed abusive from the tally is used, in turn, to allow the respective plan to reach the minimum limit for approval.

The Business Insolvency Act ("BIA") does not contain a concept of abuse of voting rights, nor does it lay out specific circumstances that would cause a vote to be lawful or unlawful. However, Brazilian legal system is familiar with the broader concept of "abuse of rights": the exercise of an otherwise legitimate right in a way that is inconsistent with its economic or social purpose or with good faith is considered an unlawful act. Actually, the abuse of voting rights is expressly regulated in the context of the Corporations Act: shareholders must vote having the company's interests at heart, and their vote will be abusive if exercised exclusively to obtain personal advantages at the company's or other shareholders' expense or to harm the company or other shareholders.

The BIA expressly sets forth that in-court reorganizations are subject to the principle of preservation of businesses; it also provides for a "cram down" mechanism, which allows the court to deem a plan approved even if it has not been properly approved by all of the four classes of creditors, as long as certain thresholds have been met. The Superior Court of Justice ("Superior Tribunal de Justiça" or "STJ"), Brazil's highest court for non-constitutional matters, took a step further last year and decided to apply the cram down even to a case where one of those legal thresholds had not been met, allegedly in order to avoid an "abuse" by dissenting creditors. In other words, the higher court found that a literal approach to the cram down requirements would not be in line with the principle of preservation of businesses.

That precedent did not address whether courts can effectively set aside votes against the plan on the grounds of "abusiveness" and under which circumstances they can do so – and in fact the higher court is yet to enter an opinion on such issue. However, this was the first time the STJ resorted to the concept of abuse in the context of a creditors' meeting to vote the plan, so the writing seems to be on the wall that the STJ will feel comfortable to uphold decisions that excluded votes against the plan from the tally.

That debtor-friendly view should be the exception and not the rule. A vote by a creditor and a vote by a shareholder are not the same thing: the latter is bound and driven by the corporate purpose of the company, while the former is not. A shareholder has voluntarily agreed to

own part of the company and is expressly required by the Corporations Act to prioritize the company's interests over its own; a creditor will participate in the creditors' meeting exclusively to have a say on the payment of its claim and is not expressly required by the BIA to prioritize debtor's interests over its own when voting the plan.

When analyzing the subject, one should not disregard three major Brazilian legal principles: legal certainty, best interest of creditors and protection of the market. Indeed, when courts need to disregard votes of rational and relevant creditors in order to enable a plan to be approved, they are giving rise to a scenario of uncertainty that creates incentives for inefficient companies – companies that either are just postponing inevitable liquidation while incurring more debt in the meantime, or can only survive by sacrificing their largest (and therefore more exposed) creditors against their will.

No such abuse should be recognized by courts if the creditor, minority or not, legitimately understands that the company under recovery is financially unviable and/or disagrees with the terms and conditions of the plan. As a rule, creditors are entitled to oppose the plan not only due to the social purpose of the credit market – debts are supposed to be repaid so that lenders can continue to lend – but also the constitutional right of property. They should not be impeded from opposing a plan if it objectively represents to them a worse alternative than debtor's liquidation.

Creditors whose votes have been set aside may appeal against the decision. And in order to preserve their rights and improve their chances in court they should take action way before that. First, they should raise objections to the plan before the court as soon as it is submitted, to set the stage for a future dissenting vote. Second, at the creditors' meeting, more than simply voting "no" they should separately declare their vote in writing and ask that such vote be annexed to the minutes of the meeting; such vote should contain robust economic and legal motivation.

The only true interest of a rational creditor forced to take part in insolvency proceedings is to be repaid to the fullest extent possible, in the most efficient way. Depriving rational creditors of their ability to oppose bad plans sends the wrong signal to the market and could ultimately worsen the whole Brazilian economy by making credit to local companies more expensive and letting unsalvageable businesses survive while healthy businesses foot the bill

Authors:

Rafael Zabaglia
rzabaglia@levysalomao.com.br

Larissa Campos Machado
lmachado@levysalomao.com.br

Rodrigo Dias
rdias@levysalomao.com.br