

THE RIGHTS AND THE ROLE OF BONDHOLDERS IN REORGANIZATION PROCEEDING

Several Brazilian companies have recently filed for court-supervised, debtor-in-possession reorganization (“*recuperação judicial*”) to overcome financial crisis through a restructuring plan submitted to the creditors’ approval. Plans typically consist of grace periods, extension of payment terms, *haircuts* and reduction of interest rates, and may also include other recovery means such as corporate reorganizations, sales of assets and changes in the top management.

Recent reorganization proceedings indicate that one group of creditors tends to represent a particularly important part of the companies’ total pre-petition indebtedness: the holders of bonds issued outside Brazil. For instance, Odebrecht owes approximately USD 3 billion in bonds – almost 20% of its USD 17 billion total pre-petition indebtedness (excluding intercompany loans).

In Brazil, foreign bondholders have the same rights as local creditors within the same class in restructuring proceedings, i.e. bondholders may not be treated differently solely as a result of their nationality or domicile. High-profile cases such as telecom company Oi have made evident that bondholders are usually better off acting as individual claimholders than through the relevant trustee.

According to the law, creditors in a reorganization proceeding are divided into four different classes for the purposes of voting the plan: (i) holders of labor and employment claims; (ii) secured creditors; (iii) unsecured creditors; and (iv) creditors who qualify as small-sized enterprises. Bonds are normally unsecured claims, even if the indenture provides for personal guarantees or seniority over other debts. They may only be listed as secured claims if secured by collaterals defined as in rem rights pursuant to Brazilian statute (such as a pledge or mortgage).

Notwithstanding, bond debt will fall outside the scope of in-court reorganization if, and to the extent that, it is covered by one particular type of in rem guarantee known as fiduciary transfer of assets (“*alienação fiduciária*”). In this case, provided that the insolvency court has not found that the underlying asset is essential in debtor’s continuing activities and prohibited creditors from clawing back on it, trustees will be allowed to enforce the collateral and sell the underlying asset, and then distribute the sale proceeds to bondholders.

Whether bond claims fall into the class of secured or unsecured creditors, the trustee (in its capacity of agent for and representative of the bondholders) will be a very influential creditor within the respective class. In the list of pre-petition claims, the entry relating to each bond issuance will customarily refer to the aggregate amount issued and to the respective trustee as the claimholder,

so trustee will have the standing to appear in court to defend bondholders' interests and to vote the plan. As a result of that, problems may stem from lack of timely instructions from or absence of unanimity among bondholders to take certain measures.

However, Brazilian courts have affirmed that bondholders also have the right to be treated as individual claimholders if they want, pursuant to an individualization procedure, for the purposes of seeking any relief in court and voting their claims at the creditors' meeting.

In-court reorganizations are subject to the principle of *pari passu* treatment, meaning that creditors within the same class should in principle be treated equally. Case law has evolved to allow debtors to submit restructuring plans that contemplate subclasses grouping together creditors with similar interests or types of claims, provided that there is a reasonable economic motivation for that.

Accordingly, bondholders should consider negotiating with debtor the creation of a subclass for bonds within the class of secured or unsecured claims, as the case may be; this could help bondholders secure more favorable payment terms within their respective classes (in the Oi reorganization, for instance, a subclass was created and bondholders were granted a debt-for-equity swap that allowed them to hold a sizable position in Oi).

The extent of bondholders' influence on in-court reorganization can greatly vary depending on how active they elect to be. It seems clear, based on the 15 or so in-court reorganizations of bond issuers in Brazil since 2005, that bondholders gain very little by staying put. By acting as individual claimholders, they are able to devise and implement their own strategy to drive up the price of their papers on the market or achieve any other goal that they may have.

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