The actions of a distressed investor in the restructuring of Brazilian Telecom Group Oi SA assessed - villain or essential contributor to the development of law & practice in cross-border restructurings/insolvencies of groups?

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Introduction

1. On 19 April 2017 the Dutch Court of Appeal converted the Dutch suspension of payment proceeding for the Dutch finance company in the Oi group - Oi Brasil Holdings Cooperative UA ("Coop") – into a Dutch bankruptcy proceeding. INSOL International Fellow Mr Jasper Berkenbosch was appointed as Dutch liquidator of Coop (the "Dutch Liquidator"). On 7 July 2017, the Dutch Liquidator filed a petition for US Chapter 15 recognition of the Dutch Coop bankruptcy proceedings as foreign main proceedings. For the US Court to grant this recognition it would have to modify or terminate its prior decision of 22 July 2016 (the "Prior Recognition Order"). In the Prior Recognition Order the Brazilian reorganization proceedings (or "Brazilian RJ Proceedings") Coop (together with its Brazilian parent company Oi SA ("Oi"), 4 Brazilian Oi group companies and another Dutch finance company Portugal Telecom International Finance BV ("PTIF")) had commenced in Brazil on 20 June 2016 were already recognized as foreign main proceedings. To fund its Chapter 15 action, the Dutch Liquidator had borrowed $5m under a 4 July 2017 credit agreement from the so-called International Bondholders Committee ("IBC"), an ad hoc group of Coop bondholder creditors, including the distressed investor Aurelius Capital Management LP ("Aurelius").
2. In its decision of 4 December 2017 (the "Decision"), the US Court found the actions of Aurelius, to be an independent basis to decline to exercise its discretion to modify or terminate recognition under its Prior Recognition Order pursuant to the second prong of Section 1517(d) US Bankruptcy Code[2]. In the Prior Recognition Order the center of main interest (or COMI) of Coop was found to be Brazil. According to the US Court, case law (including the OAS case[3]) notes that the COMI of a special purpose vehicle (or SPV), such as Coop, turns on the location of its corporate nerve center and the expectations of creditors. The US Court found that the COMI analysis for Coop is essentially the same as it was in OAS and therefore the US Court reached the same conclusion that Brazil is the appropriate place.[4]
3. Reviewing what had happened since the Prior Recognition Order, the US Court was in particular troubled by the fact that, while Aurelius was present at the hearing that resulted in the Prior Recognition Order, Aurelius (strategically) decided to stay silent when the US Court inquired about the COMI of Coop and concluded that Coop's COMI was in Brazil, despite Aurelius being of the view that the COMI of Coop is and always has been in the Netherlands[5]. The US Court characterized the actions of Aurelius as "lack of candor before the Court" and "clearly within the realm of concerns identified in the COMI manipulation cases."[6] While the Dutch Liquidator argued that he cannot be penalized for the actions of Aurelius, the US Court took the position that it is appropriate for it to consider Aurelius' actions in its exercise of discretion under Section 1517(d) US Bankruptcy Code given Aurelius' unique and central role in creating the fact record before the Court.[7]
4. Leaving the appropriateness of the exercise of discretion by the US Court to one side, this note questions whether it can be said (as the US Court does[8]) that Aurelius' actions are at odds with many of the goals of Chapter 15 and inconsistent with the trend in international insolvency law. This note further questions whether – on balance – the actions of Aurelius have served, rather than harmed, the development of the law and best practice in cross-border restructurings/ insolvencies of groups (such as the Oi group), which is clearly still in its infancy. In this context, the US Court did acknowledge that the facts here are novel, and the result reached by the Court certainly not a traditional application of COMI manipulation principles, normally applied to a debtor with only one foreign proceeding.[9]

The so-called "double dip" strategy:

5. When for tax reasons and in order to access the global capital markets, Dutch finance companies are used in a group structure, it is not unusual for bondholders to benefit from both a principal claim against the issuer as well as a guarantee claim against the ultimate parent. The so-called "double dip" occurs when the issuer has lent the proceeds of the bond issuance to its parent and as a result has an intercompany claim against that parent. Therefore, at the level of the parent, the bondholders have a guarantee claim and the issuer

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2 The first prong of Section 1517(d) US Bankruptcy Code directs the Court to determine whether the grounds for granting recognition in the Prior Recognition Order were lacking, while the second prong examines whether the grounds of recognition have ceased to exist.
3 *In re OAS S.A.* 533 B.R. 83 (US Bankruptcy Court S.D.N.Y.), 13 July 2013.
4 Page 19 of the Decision.
5 Page 83 of the Decision.
6 Page 113 of the Decision.
7 Page 115 of the Decision.
8 Pages 116 and 117 of the Decision.
9 Page 118 of the Decision.

has an intercompany claim. The double dip for the bondholders happens at the issuer level, where they have the principal claim against the issuer and they also benefit (in addition to any payment under the guarantee by the parent) from any payment the issuer received from the parent on the intercompany claim.

6. However, in the present case, for a Coop bondholder to benefit from a dip double, it is essential that Coop effectively pursues the intercompany claim against Oi at the Oi level. Outside of a Dutch insolvency of Coop, the Coop bondholders had to rely on the Coop directors to do this. When compared to a Dutch liquidator, who would be appointed, as an officer of the court and fiduciary, in a Dutch bankruptcy of Coop, Aurelius had little faith in the Coop directors. This clearly follows from Aurelius' initial strategy, which was focused on raising concerns at the level of Coop and PTIF about the (in)solvency and directors' liability that could be incurred under Dutch law if intra-group lending continued in the zone of insolvency.[10]

The Brazilian RJ Proceedings

Legal uncertainties

7. From conversations with Brazilian restructuring lawyers, I understand that Brazilian RJ Proceedings - in short - aim to facilitate negotiations amongst stakeholders in order to achieve, within a set period of time, a restructuring plan that can be approved by the requisite threshold percentages of creditors so as to avoid the opening of Brazilian liquidation proceedings.
8. I further understand that, while it is clear in Brazilian liquidation proceedings that intercompany claims by group companies are treated as subordinate to claims of - in essence - external creditors, no such explicit rule exists in Brazilian RJ Proceedings.[11]
9. Another uncertainty under Brazilian law is whether the treatment as subordinate of an intercompany claim would still apply if the claim was pursued (on behalf of the (external) creditors of the group company) by a (foreign) court appointed liquidator of the relevant group company. A further uncertainty in this context is whether the subordination treatment would apply to a damages claim the Dutch Liquidator may have against Oi following a successful avoidance of the transactions that resulted in the intercompany claim based on *actio pauliana* under Dutch law.
10. These uncertainties all have an impact on a double dip strategy. The same applies to the threat of having a substantive consolidation (in addition to administrative consolidation) applied in the Brazilian RJ Proceedings.

Foreign recognition

11. It is further important to note that the Brazilian RJ Proceedings are not recognized in the Netherlands. Unlike the USA, which has implemented the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law") in Chapter 15 of the US Bankruptcy Code, the Netherlands have not implemented the Model Law. Neither has Brazil, which means that the Dutch Coop insolvency proceedings are not recognized in Brazil either, nor is the Dutch Liquidator.

RJ Plan negotiations

12. It must have been clear to all stakeholders that a Brazilian liquidation (instead of a successful Brazilian RJ Proceeding) would be in nobody's (economic) interest. It was further clear that, in view of the (legal) uncertainties in the Brazilian RJ Proceedings identified above, and more generally the absence of Brazilian precedents of other successfully executed cross-border restructurings of high profile complex international groups such as the Oi group, it would increase the negotiating leverage of the IBC (including Aurelius) if Coop, as a Oi group company, would be represented in these negotiations by the Dutch Liquidator, rather than the existing (Brazilian) directors of Coop. At the same time, for the creditors of Oi and the Brazilian group companies in the Brazilian RJ Proceedings (organized in the so-called Steering Committee) an increase of the negotiating leverage of ICB/Aurelius and a stronger case for a "double dip" were clearly against their interests.
13. While the US Court recognized that a creditor like Aurelius is expected to act on behalf of its own interests[12], the US Court used surprisingly strong

[10] In its initial strategy Aurelius attempted to avoid certain transactions it deemed prejudicial based on *actio pauliana* under Dutch law. See footnote 31 on page 81 of the Decision.

[11] For the opening of Brazilian RJ Proceedings by the Dutch finance companies Coop and PTIF, no input from the Coop and PTIF creditors was obtained or required under Brazilian law.

[12] Page 112 of the Decision.

language when it described Aurelius' strategy in terms of: "to undo/designed to reverse the recognition [of the Prior Recognition Order] and block the Brazilian RJ Proceeding"[13]; "undermining the Brazilian RJ Proceedings"[14]; "Aurelius seeks leverage over the Chapter 15 Debtors by attempting to block the Brazilian RJ Proceeding"; and "Aurelius has weaponized Chapter 15 to collaterally attack both the Brazilian RJ Proceeding and the Oi Group's proposed Brazilian RJ Plan."[15] The same strong language is used by the US Court when the intentions of the Dutch Liquidator are described in the following terms: "one of the goals of the Dutch Bankruptcy Proceedings [of Coop] was to block this Court's recognition of the Oi Group's Brazilian Plan", despite testimony by the Dutch Liquidator that blocking the Brazilian RJ Plan was not his goal.[16]

Assessment of Aurelius' actions

14. The trend in international insolvency law is not to promote the application of substantive consolidation in cross-border restructurings/insolvencies of groups. Typically, substantive consolidation is reserved for very exceptional circumstances only and globally its application is rare. The quite liberal approach in Brazil towards substantive consolidation is therefore inconsistent with the trend in international insolvency law. Viewed against this background, it is difficult to see why the actions of Aurelius aimed at protecting itself against the Brazilian risk of substantive consolidation should be considered inconsistent with the trend in international insolvency law.
15. In the present case, a significant reason for additional legal uncertainty is the different approach taken by the US Court to COMI under Chapter 15 in comparison to the European approach to COMI embraced by the Dutch Court in the Dutch insolvency proceedings of Coop. While Aurelius may have been instrumental in creating a situation in which this difference became apparent, it is quite something else to then also conclude that Aurelius has undermined the cooperation between the US Court and foreign courts such as the Dutch and Brazilian Courts, which each have their own different perspective.
16. Both with its initial strategy and the double dip strategy, Aurelius, like the other Oi Group creditors in both the IBC and the Steering Committee, has tried to position itself in the best way possible in the RJ Plan negotiations. That is to be expected and not at odds with any of the goals of Chapter 15.
17. More generally, distressed investors, such as Aurelius, together with their advisors, bring significant restructuring/insolvency expertise & experience to cross-border restructurings/insolvencies. They identify, test and use legal uncertainties to negotiate deals. As such, they keep all participants in a restructuring/insolvency situation honest and on their toes. While not always comfortable, as I see it, this is more a positive, than a negative.
18. In turn, actions of distressed investors (such as Aurelius) allow Courts to provide essential legal guidance and therefore reduce, instead of increase, legal uncertainties.
19. In the present case the Dutch Liquidator has his own independent role to play. The fact that Aurelius has attempted to influence his actions is again to be expected and as such not inappropriate. Mr Berkenbosch is an experienced insolvency professional, well advised, and acting as an officer of the Dutch Court. While he has received funding from the IBG, there does not seem to be (enough) evidence to justify a conclusion that he was merely an instrument used by Aurelius to execute its own strategy.

Conclusion

20. In a complex cross-border group restructuring in which significant local and international legal uncertainties exist (in part identified and tested by Aurelius), it is difficult to see why the US Court found it necessary to hold the actions of Aurelius to be an independent basis to deny the Chapter 15 recognition petition of the Dutch Liquidator. I don't think the US Court should allow the actions of a single Coop creditor to – in effect – weaken the position of the Dutch Liquidator, who acts on behalf of all Coop creditors. In addition, I do believe that the actions of Aurelius have contributed to the necessary further development of law and (best) practice in the area of cross-border restructuring/insolvency of groups and therefore – on balance – may have done more good, than bad.

[13] Pages 104 and 113 of the Decision.
[14] Page 106 pf the Decision.
[15] Page 116 of the Decision.
[16] Pages 109 and 110 of the Decision.