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ALERT MEMORANDUM

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S.D.N.Y. Bankruptcy Court Overrules Bondholder Objections to Enforce Brazilian Reorganization Plan

On August 27, 2014, the U.S. Bankruptcy Court for the Southern District of New York (the "Court") issued a decision enforcing the terms of a Brazilian reorganization plan pursuant to Chapter 15 of the U.S. Bankruptcy Code. *In re Rede Energia, S.A.*, Case No. 14-10078 (SCC) (Bankr. S.D.N.Y. August 27, 2014), ECF No. 35 (the "Decision"). Bankruptcy Judge Shelley C. Chapman rejected challenges by a minority group of bondholders who had alleged that the Brazilian Bankruptcy Proceeding was contrary to U.S. public policy. The Decision is favorable for foreign companies seeking recognition and enforcement of their foreign restructuring proceedings in the United States. It also represents continued validation of the substantive protections and due process aspects of Brazil's insolvency law regime, which underwent a major overhaul in 2005.

Facts and Procedural History

On November 23, 2012, Rede Energia S.A. ("Rede"), one of the largest electricity providers in Brazil, and a group of its subsidiaries (together with Rede, the "Rede Debtors") voluntarily filed petitions for judicial reorganization under Brazilian bankruptcy law (the "Brazilian Bankruptcy Proceeding"). *Id.* at 7. After the submission of multiple reorganization plans and three general meetings of creditors for plan voting, on September 9, 2013, the Brazilian Bankruptcy Court entered its decision confirming the Brazilian Reorganization Plan (the "Plan"). *Id.* at 12–13. In a subsequent decision, the Brazilian Bankruptcy Court clarified that the unsecured creditor class of Rede had narrowly rejected the Plan, and that the Plan had been confirmed under Brazilian cram-down provisions. *Id.* at 13–14. A key constituency opposing the plan in the Brazilian Bankruptcy Proceedings was an Ad Hoc Group of international investors (the "Ad Hoc Group") holding 37% of certain unsecured bonds issued by Rede (the "Notes"). *Id.* at 4. Under the confirmed Plan, the holders of Notes have the option to receive either cash equal to 25% of their claims in return for assigning their claims to a Rede subsidiary, or reinstatement of 100% of their claims paid out over 22 years without interest. *Id.* at 16.

On January 16, 2014, Rede's foreign representative (the "Foreign Representative") commenced a Chapter 15 proceeding in the S.D.N.Y Bankruptcy Court requesting recognition of the Brazilian Bankruptcy Proceeding as a foreign main proceeding, and seeking an order (i) granting full faith and credit to the Brazilian Reorganization Plan and enjoining acts in the U.S. in contravention of the Plan, and (ii) authorizing and directing the indenture trustee for the Notes (the "Indenture Trustee") and the DTC to take further actions to implement the terms of the Brazilian Reorganization Plan, including assigning the Notes to Energisa, a Rede subsidiary, and making associated payments to noteholders (collectively, the "Plan Enforcement Relief"). *Id.* at 22. The Ad Hoc Group objected, arguing that (i) the Foreign Representative was not entitled to relief under §§ 1521 or 1507 of the Bankruptcy Code and (ii) that granting the Plan

Enforcement Relief would be manifestly contrary to U.S. public policy and should be denied pursuant to § 1506 of the Bankruptcy Code. *Id.* at 23.

In particular, the Ad Hoc Group argued that the substantive consolidation of the assets and liabilities of the Rede Debtors for voting and distribution purposes under the Brazilian Reorganization Plan was made without a showing that the applicable standards for substantive consolidation under U.S bankruptcy law were satisfied. *Id.* at 16, 41-42. The Ad Hoc Group also complained that the Plan unduly favored equity holders, state-affiliated investment funds, and unsecured creditor constituencies of Rede's subsidiaries. *Id.* at 18. The Ad Hoc Group challenged the voting procedures for bondholders in the Brazilian proceeding, specifically pointing to the Brazilian Bankruptcy Court's decision to disregard the vote by the Indenture Trustee after determining that the Indenture Trustee did not have the power to vote the Notes without the consent of each beneficial holder of the Notes. *Id.* at 35, 42-43.

The Court's Decision

The Court rejected the arguments of the Ad Hoc Group, finding that the requested Plan Enforcement Relief was proper under both sections 1521 and 1507 of the Bankruptcy Code, and should not be denied pursuant to the public policy exception in section 1506. *Id.* at 29.

Section 1521

Though the Plan Enforcement Relief was not of a type specifically enumerated in the non-exhaustive list set forth in § 1521(a), the Court concluded that such relief was appropriate under that section as a type of enforcement and injunctive relief that courts have previously granted under the former Section 304 of the U.S. Bankruptcy Code (the predecessor statute to Section 15) and other applicable U.S. law. *Id.* at 29-30. Taking into consideration that § 1521 requires the bankruptcy court to "ensure the protection of both the creditor(s) and the debtor(s)," the Court found that the interests of the Rede Debtors and their creditors, including the members of the Ad Hoc Group, were sufficiently protected by the Plan Enforcement Relief. *Id.* at 31. In reaching this conclusion, the Court noted that, the Brazilian Reorganization Plan had already been "substantially consummated," so the Plan Enforcement Relief was necessary to allow the implementation to be completed and distributions to be made to creditors, including to the 63% of noteholders who were not part of the Ad Hoc Group and were not contesting the Plan. *Id.* at 32. The Court also noted that denying the relief would allow the Ad Hoc Group to return to Brazil to renegotiate and seek a higher distribution, or to commence lawsuits against Rede in the United States—essentially giving the Ad Hoc Group a second bite at the apple to litigate the issues it had raised in its objections in the Brazilian Bankruptcy Proceeding and its appeals currently pending in Brazil. *Id.*

Section 1507

Though it did not need to reach the issue of eligibility under § 1507 given the positive finding under § 1521, the Court concluded that granting the Plan Enforcement Relief also met the requirements of "additional assistance" available under section 1507(b).[1] *Id.* at 33. In reaching its decision, the Court concluded that "creditors were given access to information and a meaningful opportunity to be heard in the Brazilian Bankruptcy Proceeding" and that Brazilian law provided for a "comprehensive procedure for the orderly and equitable distribution of the Rede Debtors' assets to creditors." *Id.* at 33. The Court upheld the voting procedures, noting that all holders of Notes who appeared at the creditors meetings in the Brazilian Bankruptcy Proceeding were permitted to vote independently of the Indenture Trustee after submitting verifying documentation; in any event, voting of the Notes to reject the Plan would not have changed the outcome as their class of unsecured claims was already found to have rejected the Plan and was crammed-down. *Id.* at 35. The Court held that Brazilian cram-down procedures provide "meaningful protections that are similar to the protections embodied in U.S. law and the Plan's different treatment of certain unsecured creditors has a reasonable basis and was necessary to consummate the Plan," and thus distributions under the Plan are "substantially in accordance with U.S. law" pursuant to § 1507(b). *Id.* at 37.

Not Manifestly Contrary to U.S. Public Policy

The Court rejected the Ad Hoc Group's argument that the Brazilian Reorganization Plan was manifestly contrary to U.S. public policy. Noting that the public policy exception embodied in section 1506 of the U.S. Bankruptcy Code was intended to be narrowly construed and applied sparingly," the Court addressed each of the five aspects of the Brazilian Reorganization Proceeding the Ad Hoc Group cited as violative of U.S. public policy, rejecting each of the arguments in turn: (i) the "unfair" marketing process; (ii) the use of "phantom consolidation" and an alleged "single insider vote" to cram down the Plan; (iii) "a significant extraction of value for shareholders;" (iv) "disparate treatment of similarly situated creditors"; and (v) "disparate treatment" that was allegedly "targeted" at U.S. creditors, rejecting each of these contentions in turn. *Id.* at 37.

The Court found some substantive aspects of the Brazilian Bankruptcy Law to be similar to the U.S. Bankruptcy Code. For example, the Court noted that the marketing process for the Rede Debtors' assets was similar to section 363 sale processes that take place routinely in U.S. bankruptcies. *Id.* at 40. Similarly, the Court noted that denial of the Indenture Trustee's right to

[1] Section 1507 provides that if recognition is granted, the Court "may provide additional assistance to a foreign representative." 11 U.S.C.A. § 1507(a). Section 1507 further provides that "[i]n determining whether to provide additional assistance the court shall consider whether such additional assistance, consistent with the principles of comity, will reasonably assure—(1) just treatment of all holders of claims against or interests in the debtor's property; (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; (3) prevention of preferential or fraudulent dispositions of property of the debtor; (4) distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by this title; and (5) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns."

vote did not lead to a different outcome than in a U.S. Chapter 11 proceeding, where indenture trustees do not vote. *Id.* at 35. The Court determined that "although Brazilian bankruptcy law does indeed differ from U.S. law in certain respects, the Foreign Representative has successfully demonstrated that the distribution scheme in the Brazilian Reorganization Plan is not manifestly contrary" to U.S. public policy by showing that Brazilian the bankruptcy law's cram-down requirements provide protections against junior stakeholders receiving or retaining value when dissenting senior stakeholders are not paid in full. *Id.* at 49. The Court then concluded that it would "not decline to extend comity and grant additional relief simply because Brazilian bankruptcy law is not identical to U.S. bankruptcy law." *Id.*

The Court granted deference to the Brazilian Bankruptcy Court on issues of Brazilian bankruptcy law, particularly noting that the Brazilian Court had made specific findings to support its decision, and provided a full and fair opportunity for creditors to participate. *Id.* at 41, 51.

Significance of the Decision

The Court's decision bodes well for foreign debtors seeking to have a foreign restructuring plan recognized and enforced in the United States. The Court noted that even where different from what the U.S. Bankruptcy Code might require as substantive matter, the terms of the Plan were reasonable, and to decline to enforce the Plan due to reasonable differences would be contrary to the principle of comity. The Court's focus on procedural fairness is a departure from prior, more creditor-friendly caselaw outside the Second Circuit, in which U.S. courts have refused to enforce foreign restructurings due to substantive differences between U.S. and foreign bankruptcy law. In *Vitro*, for example, the Fifth Circuit declined to enforce a Mexican reorganization plan under either § 1521 or § 1507 respectively on the grounds that non-debtor releases being provided under the plan were not generally available under U.S. law, and that the plan did not provide for a distribution substantially in accordance with the order of priority under U.S. bankruptcy law. *In re Vitro S.A.B. de CV*, 701 F.3d 1031 (5th Cir. 2012). The *Rede* Decision signals that U.S. courts may be increasingly reluctant to provide another forum and a second bite at the apple for dissident creditors who have already made (or had the opportunity to make) their objections heard in a foreign restructuring proceeding that has provided creditors due process and meets fundamental standards of fairness.

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