

Brazil's New Bankruptcy Law: Issues for Investors

PART II: DEPLOYING CAPITAL IN THE RJ PROCESS

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Brazil's New Bankruptcy Law: Series Overview

FEBRUARY

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Panelists

PART II: DEPLOYING CAPITAL IN THE RJ PROCESS



Maurice Blanco | Davis Polk & Wardwell LLP | maurice.blanco@davispolk.com

Maurice Blanco is the co-head of Davis Polk's global Capital Markets Group and one of the founders of Davis Polk's São Paulo office. For over 20 years, Maurice has worked on public and private debt offerings, exchange offers, debt restructurings and other liability management transactions, in addition to IPOs and other equity offerings, by Brazilian and other Latin American issuers in a variety of industries. Maurice also regularly advises corporate clients with respect to general corporate matters, including corporate governance, SEC and Sarbanes-Oxley matters.



Giuliano Colombo | Pinheiro Neto Advogados | gcolombo@pn.com.br

Giuliano Colombo is a partner in the corporate restructuring practice of Pinheiro Neto Advogados. He advises debtors, owners and shareholders, creditors, creditors' committees and ad hoc committees, boards, directors and managers, potential investors and financiers on refinancing, judicial reorganization, prepackaged or pre-arranged reorganizations, out-of-court restructuring, distressed investment and finance, DIP financing and litigation related to insolvency and commercial matters. He participated in the Inter-Ministerial Committee that drafted the final wording of the Brazilian Bankruptcy Law and also participated in multiple groups for discussions and contributions to the legislative amendment and reform of the Brazilian Bankruptcy Law.



Paulo Padis | Padis Mattar Advogados | ppadis@padismattar.com.br

Paulo Padis is a partner at Padis Mattar Advogados. Paulo's practice focuses on cross-border debt and equity transactions, lenders' and bondholders' advisory on restructuring processes, distressed M&A transactions and non-banking structured financings (acting primarily for credit and hedge funds). Among notable engagements, Paulo has advised Mubadala on the restructuring of its investment in the EBX group and the joint acquisition by Mubadala and trading company Trafigura of Porto Sudeste do Brasil S.A. at an enterprise value of over BRL4 billion. On the restructuring front, Paulo has advised the committee of bondholders led by fund Solus, Attestor and Centerbridge in the debt restructuring of Oi S.A., and is currently advising the committee of EPP lenders in the restructuring of Samarco, a Brazilian mining firm.



Robert L. Rauch | Investor | nob@nobrauch.com

Robert Rauch is an investment professional specializing in global emerging markets high-yield and distressed corporate and sovereign debt. With over 40 years of experience, he was most recently a senior partner and portfolio manager at Gramercy Funds Management. He has been a leading creditor in the restructuring of US\$79 billion of the debt of 48 companies across emerging markets, including the recent EJ of Odebrecht Engineering and Construction and RJ of Tonon Bioenergia in Brazil. Prior to joining Gramercy, Robert worked with firms including Weston Group, Lehman Brothers, CS First Boston, First Interstate Bank and Swiss Bank Corporation in a variety of advisory, credit, trading and corporate finance roles. Robert received a master's degree in Finance and International Business from Northwestern University – Kellogg Graduate School of Management and a bachelor's degree in Political Economy from Williams College.



David Schiff | Davis Polk & Wardwell LLP | david.schiff@davispolk.com

David Schiff is an associate in Davis Polk's Restructuring Group. He regularly represents hedge funds, creditor groups, banks, companies, equity sponsors and other strategic parties in a wide range of domestic and cross-border restructurings, bankruptcies, out-of-court workouts and liability management transactions. David has advised creditor groups and other key stakeholders in some of the largest cross-border restructurings of Brazilian companies, including Oi S.A., Odebrecht Engenharia e Construção and Samarco Mineração.

Part II: Deploying Capital in the RJ Process

DISCUSSION MATERIALS



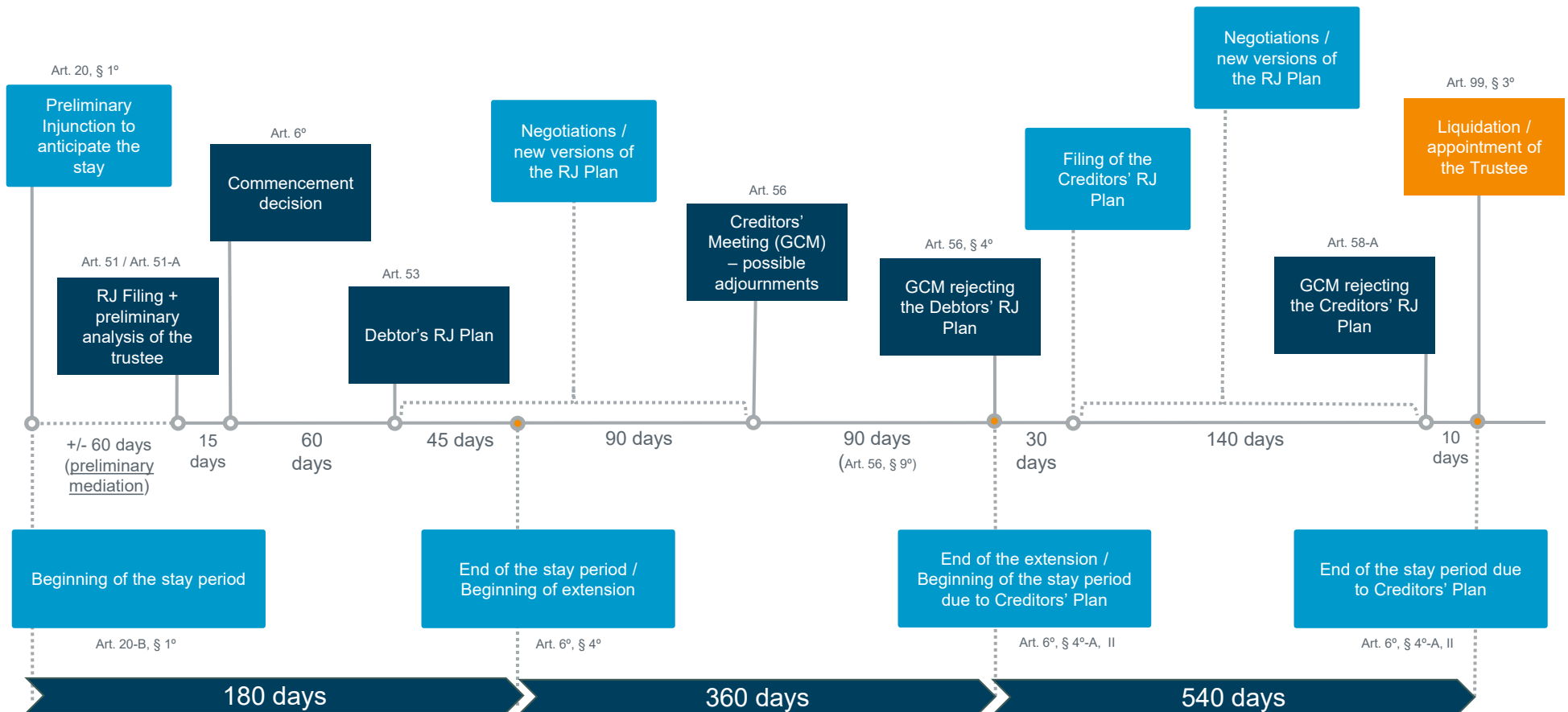
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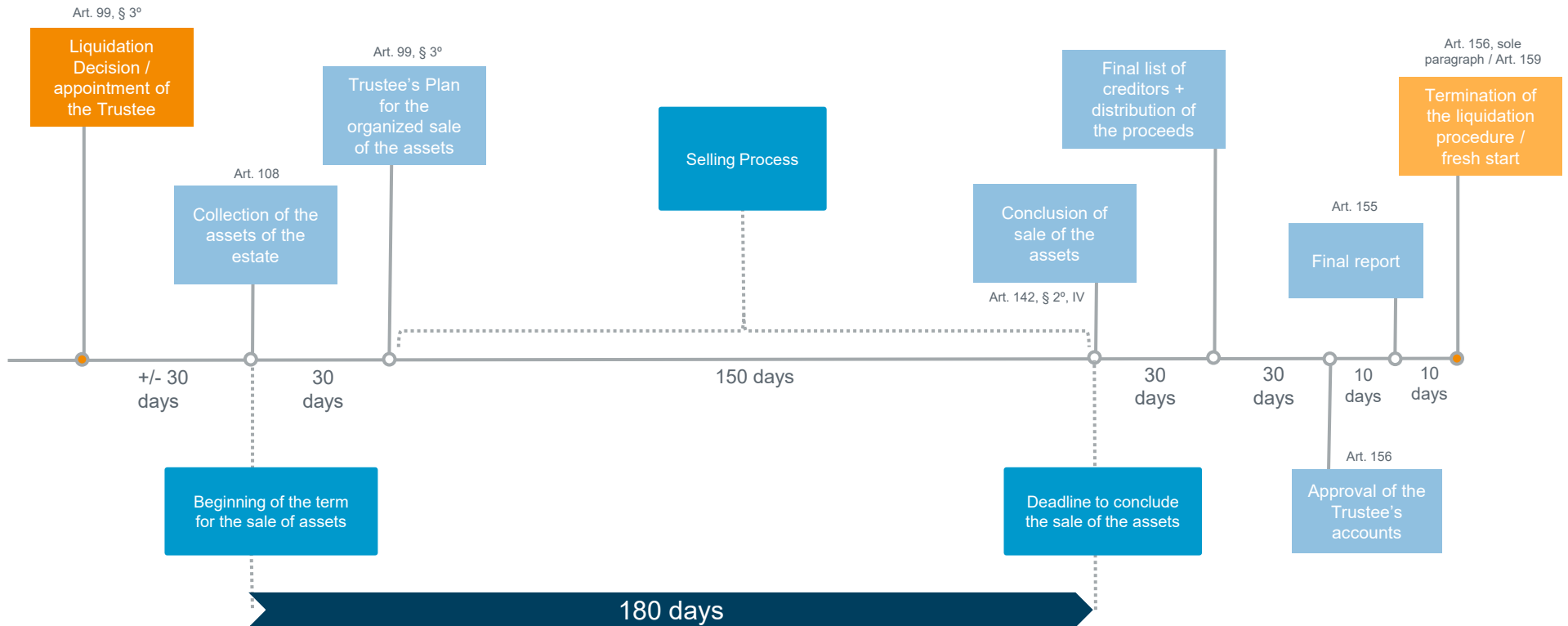
Overview

- On December 24, 2020, Brazil enacted a comprehensive overhaul of its existing bankruptcy statute (the “Brazilian Bankruptcy Law”) for the first time since the Brazilian Bankruptcy Law was implemented in 2005
 - The new law took effect on January 23, 2021
 - Certain key reforms imposed by the new law include, among others:
 - Ability for creditors to propose alternative plans in judicial reorganization (“RJ”) proceedings
 - Criteria for substantive consolidation
 - Standard for disregarding “abusive votes,” notably in connection with deliberations of plans of reorganization
 - Modified (lower) voting threshold for plans in extrajudicial reorganization (“EJ”) proceedings
 - Enactment of a regime for cross-border insolvency
 - Full sale of debtor as an alternative to, or as part of, reorganization
 - Additional protections for DIP Financing
 - Restructuring of tax claims and other tax benefits*
 - Ring-fencing of successor liabilities in connection with the sale of UPIs, assets*
- *Certain aspects of the new law relating to tax exemptions and ring-fencing of liabilities were approved by Brazil’s Congress but vetoed by President Jair Bolsonaro. The Congress is expected to vote on an override of these vetoes by no later than March 2021.*
- This two-part panel discussion will cover the foregoing amendments to the Brazilian Bankruptcy Law, with a focus on potential issues and implications for creditors and investors
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Reorganization/Liquidation Timeline



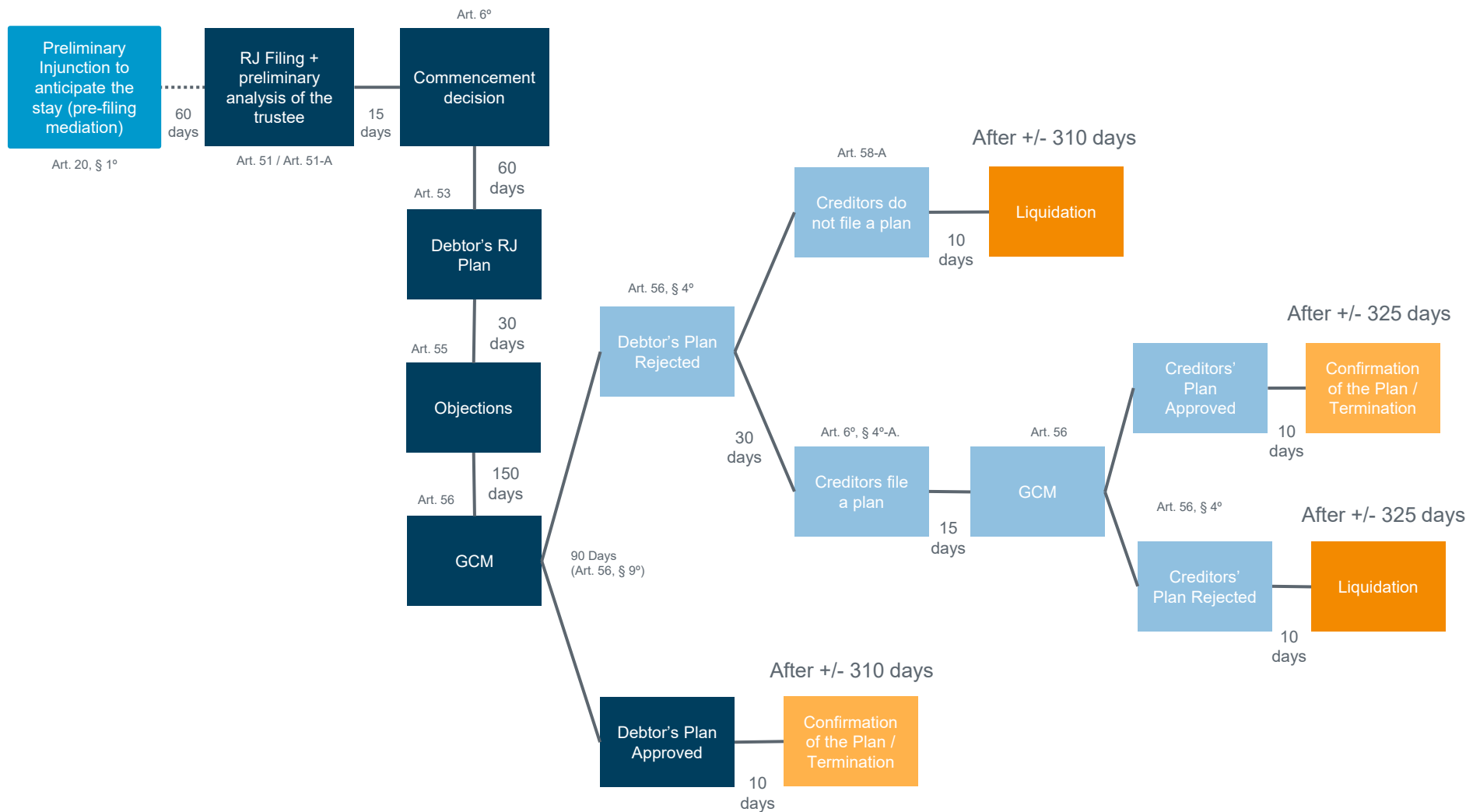
Reorganization/Liquidation Timeline (cont.)



Note: The fresh start (discharge) will automatically occur:

- (i) When the liquidation procedure is terminated;
- (ii) After three years of the liquidation decree, regardless of the termination of the procedure; or
- (iii) Immediately after at least 25% of the unsecured claims are paid.

Judicial Reorganization Workflow



DIP Financing

Pre-2021 Rule

- Prior to enactment of the new law, the Brazilian Bankruptcy Law had limited provisions regulating post-petition and debtor-in-possession (“DIP”) financing. In particular, loans incurred by the debtor during RJ were entitled to receive certain payment priority in liquidation, but the loans would be junior to numerous other statutory senior claims
 - As a result, the vast majority of DIP loans were fully secured through fiduciary liens or pledge/mortgage of assets establishing seniority vis-à-vis other senior claims
- Legal certainty of DIP financing was an issue due to, among other things, the risk that an appellate court would overturn protections or collateral granted/approved by the bankruptcy court to a DIP lender

Amendment

- The new law codifies certain terms for DIP financing, including expressly clarifying that DIP financing can be (a) incurred by a debtor on a superpriority basis, (b) provided by any interested parties, including creditors, as well as shareholders and other affiliates of the debtor and (c) protected against subsequent adverse decisions and appeals up to the amounts already disbursed by the investor(s) (mootness doctrine)
- Notwithstanding these changes, it is anticipated that DIP financing will still be fully or partially secured through the use of fiduciary liens, pledges and mortgages of assets

M&A in the RJ Process

FULL SALE OF THE DEBTOR

Pre-2021 Rule

- Prior to enactment of the new law, there was a debate as to whether a debtor could sell all or substantially all of its assets to a third party in an RJ proceeding, free and clear of liabilities
- Debtors were permitted to sell certain assets in RJ free and clear of liabilities, but not necessarily the entire company or enterprise
- To the extent debtors sold assets, the law permitted them to do so through the use of isolated productive units (“UPIs”), free and clear of all successor liabilities

Amendment

- The new law permits the debtor to be sold in its entirety, provided that the claims not subject to the RJ plan (including tax claims) are given terms of repayment equivalent or better than those that could be obtained in a liquidation
 - In this case, for all purposes, the debtor will be sold as a UPI, free and clear of successor liabilities, other than criminal and government enforcement liabilities (as discussed on the slides that follow)
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M&A in the RJ Process

RING-FENCING OF SUCCESSOR LIABILITIES

Pre-2021 Rule

- Prior to enactment of the new law, insulation from successor liability was only possible for asset purchases structured through UPIs

Amendment

- Under the new law, and subject to the vetoes discussed below, creditors converting debt into equity, investors lending new money and new managers replacing old management do not succeed to any of the debtor's (pre-existing) liabilities
 - Any sale of assets within the context of the RJ proceeding and under a competitive sale process as provided for under the Brazilian Bankruptcy Law (or duly waived by the bankruptcy court) is also protected from risk of succeeding to certain of the debtor's liabilities
 - As approved by the Congress, this ring-fencing applied broadly to protect against environmental, regulatory, administrative, criminal, anti-corruption, tax and labor liabilities
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M&A in the RJ Process

RING-FENCING OF SUCCESSOR LIABILITIES (CONT.)

Presidential Vetoes

- President Bolsonaro vetoed the new law's ring-fencing protections with respect to environmental and government enforcement liabilities (e.g., fines), and, accordingly, these changes have not taken effect
- This veto reflects, in some respects, a step backward given the existing legal framework
 - While the new law attempted to provide more clarity and certainty with respect to the nature of liabilities that an acquirer of assets was protected against, the vast majority of court decisions already provided for ring-fencing
- The Congress is expected to consider veto overrides in March 2021. It is possible the Congress will consider overrides of these vetoes in particular, to give greater comfort and clarity to potential asset purchasers and investors

M&A in the RJ Process

RESTRUCTURING OF TAX CLAIMS

Pre-2021 Rule

- Prior to enactment of the new law, the Brazilian Bankruptcy Law exempted tax claims and enforcements from all effects of an RJ filing by the debtor
- Accordingly, taxing authorities were able to continue with any and all enforcement proceedings and attachment of assets, and debtors had no legal rights in RJ to delay or restructure payments

Amendment

- The new law provides debtors with a few specific options pursuant to which payment of tax claims can be restructured, though there is limited flexibility to haircut tax liabilities:
 - For example, under the new law, a debtor could pay tax claims in up to 120 monthly installments, with 0.5% due upon each of the first 12 installments, 0.6% due upon each of the next 12 installments and the remaining amount due split evenly thereafter
 - Under the new law, the bankruptcy court is also authorized to remove attachments of capital assets that were imposed in tax enforcement proceedings if such assets are considered essential to the maintenance of the debtor's activities
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M&A in the RJ Process

CAPITAL GAINS AND CANCELLATION OF DEBT IN RJ

Pre-2021 Rule

- Debtors are taxed at the standard capital gain rates and can have gains for cancellation of debt in a restructuring or the sale of assets in an RJ proceeding
- As a result, restructurings were often structured to avoid cancellation of debt, creating additional complexity for transactions and post-restructuring balance sheet issues

Amendment

- As passed by the Congress, the new law included exemptions to reduce the impact of these liabilities
- However, President Bolsonaro vetoed these changes, arguing that they would result in undue forfeiture of tax revenue and therefore were fiscally improper at this time
 - While in many instances parties have been able to find structures to mitigate the tax impact of transactions, the new law provided assurance to all parties involved and was a significant progress
 - This veto may also be overridden by the Congress

M&A in the RJ Process

STRATEGIC OPTIONS FOR CREDITORS AND INVESTORS

- A combination of provisions under the new law, including those related to ring-fencing of successor liabilities and the ability of creditors to propose alternative plans, may provide creditors and distressed investors with additional opportunities not previously available in RJ proceedings
 - Specifically, existing creditors and/or opportunistic investors could:
 - Build blocking positions by acquiring claims or forming ad hoc groups
 - Negotiate plan terms aggressively with debtors and their shareholders and refuse to vote in favor of a debtors' plan providing suboptimal treatment
 - If necessary (and after the debtor's plan is voted down or the exclusive period for the debtor to propose a plan lapses), propose an alternative restructuring plan, which could provide for, among other things, the sale of all or substantially all of the debtor's assets, the use of strategic UPIs and/or the conversion of debt to equity
 - If presidential vetoes are overridden, these transactions could also benefit from tax exemptions and additional protections against successor liabilities
 - *See Part I: Reforming the Restructuring Process discussion materials for additional details on the “alternative plan” provisions included in the new law*
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