OAS Group: A Tale of Two Chapter 15 Cases in the United States

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Introduction

Until recently the Brazilian economy experienced a period of significant growth, attracting substantial foreign investment and leading many to believe that Brazil was poised to make the leap from emerging economy to world economic power. However a series of dubious economic decisions, coupled with rampant government spending and troubling corruption scandals, have halted Brazil's growth and dragged the country again into financial uncertainty.

Critical to this scenario has been the so called "Car Wash" operation of the Brazilian federal police, which has been investigating well-publicized corruption involving Petrobras, Brazil's state-controlled oil company, public officials and several of Petrobras' contractors. As a result, a number of these contractors, including some of Brazil's biggest construction companies, have been facing significant financial problems.

Among such troubled companies is the OAS Group, a major Brazilian conglomerate which filed for judicial reorganization under Brazilian law in March of 2015, after a series of unsuccessful efforts to restructure out of court. In the course of those efforts the OAS Group engaged in a series of transactions that made changes to the overall corporate structure and transferred assets among members of the group.

The recent decision of the US Bankruptcy Court in the Southern District of New York to grant recognition of the Brazil proceedings over the fierce opposition of certain US bondholders aggrieved by those transactions sheds further light on the authority of a "foreign representative" to seek cross-border recognition under Chapter 15 and the UNCITRAL Model Law on which it is based, and on questions relating to the "center of main interests" of a foreign entity with no real business operations of its own.[2] In addition, the separate Chapter 15 case arising from the efforts of those bondholders to pursue their claims against a British Virgin Islands member of the OAS Group raises unique issues relating both to cross-border recognition and more fundamentally to the right to control over multi-jurisdictional restructurings.[3]

The OAS Brazil Reorganization and US Chapter 15 Cases

Authority of the "Foreign Representative"

In addition to Brazilian creditors, at the time of filing for judicial reorganization in Brazil the OAS Group owed approximately US$ 875 million to holders of senior notes issued by certain OAS single purpose subsidiaries and guaranteed by other companies in the group. Seeking to maintain the "structural seniority" that they and other holders of those notes enjoyed over general creditors prior to the internal restructuring process, two of the major US noteholders brought litigation against certain members of the OAS Group in the New York state courts and succeeded in attaching liquid assets located in the United States. Additional litigation followed in the state and federal courts in New York as well.

Against this backdrop, it was not surprising that these same noteholders objected to recognition of the Brazil reorganization proceedings in the Chapter 15 cases commenced in respect of four OAS Group entities in the Southern District of New York in April of 2015.[4] The noteholders challenged the recognition of the Brazilian proceedings on several bases, most significantly that the "foreign representative" who commenced the Chapter 15 cases had not been properly appointed in the "foreign proceeding," and such that application for recognition failed to comply with the requirements of section 1515(a) of the Bankruptcy Code.

This controversy arose from the fact that after the Brazilian court had appointed Alvarez & Marsal to the statutory role of judicial administrator in the Brazilian proceedings, the OAS board of directors appointed the legal officer for several of the OAS companies as OAS Group's agent and attorney-in-fact for purposes of seeking recognition in foreign jurisdictions. In support of their objection the noteholders relied on Section 101(24) of the Bankruptcy Code, which defines "foreign representative" as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding." 11 U.S.C. §101(24) (emphasis added). Thus, the noteholders argued, the mere act of appointment by the OAS board was not sufficient, and the Chapter 15 cases were not commenced by an

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[2] In re OAS S.A., et al., Case No. 15-10937 (SMB) (Bankr. S.D.N.Y.) (July 13, 2015).

[3] In re OAS Finance Ltd., Case No. 15-11304 (SMB) (Bankr. S.D.N.Y.)

[4] Separately in April, the noteholders filed a petition in the British Virgin Islands and obtained the appointment of joint provisional liquidators for OAS Finance, a BVI member of the OAS Group. Upon their appointment the JPLs directed that the Chapter 15 petition in respect of OAS Finance be withdrawn. In addition, the JPLs sought recognition of the BVI proceeding by filing separate Chapter 15 case in May, which case remains pending before the same bankruptcy judge in the Southern District of New York.

authorized foreign representative.[5]

In overruling this objection, the Bankruptcy Court focused on the definitional language "authorized in a foreign proceeding" and relied on a previous decision by the Fifth Circuit Court of Appeals holding such language to mean "authorized in the context of or in the course of a foreign proceeding."[6] On this basis, the bankruptcy judge determined first that the Chapter 15 representative need not be appointed specifically by the foreign court — that appointment by the debtor's board of directors will suffice for such purposes when the applicable foreign law permits the company in reorganization to maintain control of its assets and affairs. Looking next to Article 64 of Brazil's bankruptcy law and an affidavit furnished by OAS Group's Brazilian bankruptcy counsel, the Court determined that the role of the judicial administrator under Brazilian law was largely supervisory and not managerial, that OAS management retained full control over the companies' business and affairs subject to the oversight of the administrator, and accordingly that OAS Group was acting in the nature of a debtor in possession. Thus, the appointment of the legal officer as "foreign representative" by the OAS boards of directors was valid and empowered him to seek recognition by filing the Chapter 15 cases in the US.

Determination of the "Center of Main Interests"

The noteholders also opposed recognition of the Brazil case filed in respect of the primary issuer of the notes, an Austrian special purpose entity that had no independent business operations, employees or assets, on the basis that this member of the Group did not have its "center of main interests" in Brazil. The facts were uncontroverted that this entity had no physical location in Brazil, that its address in that country was merely a post office box, and that all of its obligations were represented by notes issued to international investors.

Nevertheless, the bankruptcy judge rejected this argument, finding the COMI to exist in Brazil on multiple grounds, including that the Brazilian guarantors represented the only source of repayment and the Board actions undertaken by the Brazilian directors took place in Brazil. The Court also found it probative that the notes were unconditionally guaranteed by members of the OAS Group in Brazil, and that since the disclosures in the offering documents focused on the Brazilian operations and risk factors investors necessarily analyzed credit risk and formed payment expectations based upon business activities conducted in Brazil. Upon these factors, the Court found Brazil to be the center of main interests for the Austrian entity for purposes of the Chapter 15 recognition.

The OAS Chapter 15 decision showcases some important aspects of complex cross-border reorganizations. By accepting the Boards' appointment of a "foreign representative" during the Brazil reorganization proceedings, the New York court follows and lends support to the Fifth Circuit's flexible internationalist approach in lieu of a more literal reading of section 1515(b) of the Bankruptcy Code. Further, the decision regarding the COMI of the three OAS Group members obligated on the US notes offers significant precedent for investors in other special purpose vehicles utilized to raise funds in international capital markets. In both respects, the decision is consistent with the overall purpose of Chapter 15 and the Model Law on which it is based, to facilitate cross-border recognition of insolvency proceedings commenced in the distressed company's center of main interests.

The OAS BVI Proceeding and US Chapter 15 Case

While the recognition decision in the Chapter 15 cases emanating from Brazil is a matter of significant interest, it should not be lost on the reader that the OAS drama continues to unfold in the separate Chapter 15 case pending before the same bankruptcy judge in respect of the BVI provisional liquidation. At the foundation of that case is the underlying issue of whether the restructuring of the BVI affiliate should be controlled by the joint provisional liquidators in the BVI who filed the petition for recognition, or the incumbent management of the OAS Group in Brazil. More fundamentally, inasmuch as the BVI JPLs were appointed upon application of the US noteholders to begin with, this Chapter 15 case raises a myriad of issues regarding the role of activist creditors in multi-jurisdictional insolvency proceedings.

Indeed, this appears to be the precise issue with which the bankruptcy judge is wrestling as his decision on whether to grant recognition of the BVI proceeding as a foreign main proceeding remains pending. The OAS Group has objected to such recognition on multiple grounds, urging that the restructuring of the BVI entity remains under the control and direction of OAS Group management in the Brazil restructuring proceedings, such that the COMI of the BVI affiliate remains in Brazil. At the final hearing on recognition held this past August, the judge remarked that the COMI dispute arose only because the US noteholders initiated the BVI proceeding in the first instance.

In the meantime, the separate proceedings in Brazil and BVI remain pending, with little apparent coordination between them. The court in Brazil recently approved a financing package intended to provide an infusion of working capital to fuel the reorganization in that country, and the BVI court has been asked to clarify issues regarding the residual authority of the BVI company directors following the appointment of the JPLs. Ultimately, the US court will determine whether to follow the lead of the JPLs in granting recognition to the BVI proceeding commenced by the US noteholders, or uphold the view of the OAS Group directors that notwithstanding the BVI filing and appointment of the JPLs the center of main interests for the BVI affiliate remains in Brazil.

[5] The position of the bondholders finds textural support in the plain meaning of various provisions contained in section 1515(b) of the Bankruptcy Code, which among other things requires that a petition for recognition under Chapter 15 be accompanied a decision or certificate from the foreign court affirming the appointment of the foreign representative, or other acceptable evidence of such appointment. 11 U.S.C. §1515(b).

[6] *Ad Hoc Grp. of Vitro Noteholders v. Vitro S.A.B. de C.V. (In re Vitro S.A.B. de C.V.)*, 701 F.3d 1031 (5th Cir. 2013), *cert. dismissed*, 133 S. Ct. 1862 (2013). Notably, the New York court located in the Second Circuit was not bound to follow this precedent from the Fifth Circuit, but chose to do so in order to reach its result.