INS L WORLD

4TH QUARTER 2017

FOCUS: Latin America

The Quarterly Journal of INSOL International

US$25

companies, such as *Sete Brasil, Schahin Group, Galvão Engenharia*, and others were implicated and all of them used judicial reorganizations.

The OGX, OSX, *Sete Brazil* and *Schahin* groups all had cross-border operations, but Brazilian bankruptcy law has no provisions addressing cross-border insolvency. The Brazilian courts demonstrated commercial sensibility and adaptability in finding ways to enable foreign-incorporated entities to participate in Brazilian insolvency proceedings (even while maintaining proceedings in their jurisdictions of incorporation) and thereby formulate a coordinated solution to each group's financial circumstances and operations worldwide. Had the courts taken a more rigid approach, the value of these integrated enterprises likely would have been diminished. Instead, relevant business of these companies were restructured and sold to investors as going concerns.

These massive insolvency proceedings proved, however, to be only the first wave of casualties from the Petrobras scandal. In 2015, further developments in *Lava Jato* implicated numerous large construction and infrastructure multinational groups, such as OAS, Mendes Junior, UTC Engenharia, Galvão Engenharia, and Odebrecht Oil and Gas in early 2017, caused the near-collapse of what had been one of Brazil's strongest sectors. The same period saw financial crisis in other sectors as well, affecting real estate companies Viver and PDG. With several thousands units sold, Viver and PDG used judicial reorganization proceedings to protect and restructure themselves although a dispute over "segregated" assets and special purpose companies as collateral for financers are still pending final decision. As a result, Brazilian courts and the insolvency profession more broadly were faced with new challenges that required them to innovate to preserve value, enable companies to continue operating and successfully emerge from the temporary (but already long) crisis.

In the OAS proceeding of 2015, the negotiation and restructuring mechanism formulated between the company and one of the investors, established one of the Brazil's most complex and complete programs of DIP financing, court-supervised asset auction, debt and corporate reorganization, credit bidding allowance, and continuity of core activities by the company. It pre-established terms and conditions for the plan: a court auction for the sale of a business unit (holding OAS's Invepar shares); a "stalking horse" bid in the auction to publicly disclose the first proposal and a "right to top" offer to balance the advantage of a third interested party. Furthermore, a DIP finance facility secured by collateral was created with the intention to preserve the company's business while the proceeding developed. Assets were finally sold to creditors (bondholders) through a credit bid in the auction. The DIP financing and restructuring structure allowed OAS to continue construction operations employing tens of thousands of workers in several countries. A similar structure was used in Abengoa's Brazilian judicial reorganization case in 2017.

Also in 2016, Brazil saw the commencement of its largest judicial reorganization yet—the filing by the Oi telecom group. Unlike the other cases discussed, the Oi filing arose from the company's historical business operations. The Brazilian Federal government is taking a leading role in the reorganization due to the thousands of consumers affected, vast territory reached and as one of the major creditors, which is still ongoing.

Through these successive waves of economic and political instability, insolvency proceedings have proven key to managing the effect of large corporate bankruptcies on the Brazilian economy. Although the judicial reorganization procedure lacks formal provisions for dealing with some of the complex issues that have arisen in these cases, Brazilian courts and insolvency professionals have proven themselves willing and able to innovate, both by looking to foreign models and by developing measures tailored to domestic legal and economic conditions. Importantly, developing a mechanism for funding for companies in judicial reorganization has enabled some of Brazil's largest employers to remain in business and forestalled the unrest that massive layoffs would have generated. But ad hoc procedures have also given rise to uncertainty, which may have led to delayed entry into judicial reorganization by some companies and clearly has generated massive litigation. Brazilian insolvency professionals are discussing amendments to the Brazilian bankruptcy law that would codify some recent developments and revise provisions that have proven inadequate. The goal is to create even faster and more efficient restructuring proceedings that will support a rescue culture, to the benefit of the broader Brazilian society and economy.

Substantive consolidation in United States bankruptcy cases

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The problem of closely-related debtors in financial distress is universal. In the US, in appropriate cases courts may substantively consolidate debtors to achieve fairness and equity, even when one of the debtors has not commenced a bankruptcy case.[1] As noted by a leading authority, substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor."[2]

In short, substantive consolidation consolidates two or more entities such that: (1) liabilities and assets are combined; (2) liabilities of the combined entities are satisfied from the assets of the combined entities; (3) distribution priorities are combined; (4)

1 In Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941), the Supreme Court authorized the combination of a non-debtor with a debtor in bankruptcy to prevent fraud.

2 In re Owens Corning, 419 F.3d 195, 205 (3d Cir. 2005) (quoting Genesis Health Ventures, Inc. v. Stapleton (In re Genesis Health Ventures, Inc.), 402 F.3d 416, 423 (3d Cir. 2005)).

intercompany obligations are eliminated; and, in a chapter 11 setting, (5) creditors are combined for purposes of voting to confirm a plan.

There is no statutory authority specifically authorizing substantive consolidation. As described by the Second Circuit:

> The power to consolidate is one arising out of equity, enabling a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of debts of a related corporation.[3]

"A court's ability to substantively consolidate has been found to be within 'the court's general equitable powers as set forth in [Section] 105' of the Bankruptcy Code."[4] In addition, the Bankruptcy Code explicitly permits implementation of plans of reorganization though "merger or consolidation of the debtor with one or more persons."[5] Given the origins of the doctrine in equity and the lack of statutory authority, United States courts are not in agreement with respect to the test to be applied to impose substantive consolidation. Note, however, that while substantive consolidation is often perceived as a remedy available to and commonly invoked by creditors, all three of the leading cases discussed immediately below arose from debtor-driven Chapter 11 plans calling for substantive consolidation.

In the Third Circuit — covering the important venue of Delaware, as well as New Jersey and Pennsylvania — the court stated its test as follows:

> In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.[6]

The Second Circuit — which covers the important jurisdiction of New York — synthesized the prior precedents slightly differently in *Augie/Restivo Baking Co.* It viewed the extensive list of factors cited and relied upon by other courts as being

> merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit, …' or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors …."[7]

Very recently, the bankruptcy court for the influential Southern District of New York recast *Augie/Restivo* as seeking to find:

> whether (i) "creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit"; or (ii) "the affairs of the debtors are so entangled consolidation will benefit all creditors." . . . This test is in the disjunctive and the satisfaction of either prong can justify substantive consolidation. . . . The first prong, whether creditors relied on a separate existence of the debtors, is "applied from the creditors' perspective." . . ."The inquiry is whether creditors treated the debtors as a single entity, not whether the managers of the debtors themselves, or consumers viewed the [debtors] as one enterprise." . . . Under the second prong, courts typically analyze whether the debtors have demonstrated either an operational or a financial entanglement of business affairs.).[8]

Other courts have employed balancing tests, factoring in such elements whether there is substantial identity among the parties sought to be consolidated, or whether the benefits of consolidation outweigh the harms.[9] Others have examined such specific elements as: (1) the degree of difficulty in segregating and ascertaining individual assets and liabilities; (2) the presence or absence of consolidated financial statements; (3) the profitability of consolidation at a single physical location; (4) the commingling of assets and business functions; (5) the unity of interests and ownership between the various corporate entities; (6) the existence of parent and inter-corporate guarantees on loans; and (7) the transfer of assets without formal observance of corporate formalities.[10]

Finally, some courts have ordered substantive consolidation in circumstances that would have justified application of the "piercing the corporate veil" doctrine under applicable nonbankruptcy law, usually the law of the several states.[11]

As a general rule, given the powerful consequences of substantive consolidation, courts have adopted the view that "[t]he power to consolidate should be used sparingly" because of the potential harm to creditors of substantive consolidation.[12] As a result, while substantive consolidation remains a possible weapon to combat the fraudulent and sloppy use of the corporate form, its use is not common. The possibility, however, of this type of enforced merger requires significant consideration at the planning and drafting stage of any endeavor,[13] and vigilance after setup to ensure that separateness, if desired, is known and observed.

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3 In re Continental Vending Machine Corp., 517 F.2d 997, 1000 (2d Cir. 1975).

4 In re Republic Airways Holdings Inc., 565 B.R. 710, 716 (Bankr. S.D.N.Y. 2017) (quoting Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.), 860 F.2d 515, 518 n.1 (2d Cir. 1988)).

5 11 U.S.C. § 1123(a)(5)(C).

6 In re Owens Corning, 419 F.3d 195. 208 (3d Cir. 2005)

7 Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.), 860 F.2d 515, 518 (2d Cir. 1988) (citations omitted).

8 In re Republic Airways Holdings Inc., 565 B.R. 710, 717 (Bankr. S.D.N.Y. 2017) (citations omitted). This case in particular reflects the flexibility of substantive consolidation as a remedy, in that the debtors were "deemed" consolidated only for purposes of plan confirmation, voting and distribution to creditors – the plan did not provide for a permanent merger of the reorganized debtors into a single company. Moreover, the substantive consolidation as ultimately approved was "partial" and not complete, in that the plan offered alternate treatment to a large creditor holding a guaranty that would have been extinguished through substantive consolidation.

9 See, e.g., Reider v. FDIC (In re Reider), 31 F.3d 1102, 1108 (11th Cir. 1994); Eastgroup Props. v. Southern Motel Assocs., Ltd., 935 F.2d 245, 2498 (11th Cir. 1991); In re Snider Bros., 18 B.R. 230, 238 (Bankr. D. Mass. 1982).

10 See, e.g., Kapila v. S&G Fin. Servs., LLC (In re S&G Fin. Servs. of S. Fla., Inc.), 451 B.R. 573, 583–84 (Bankr. S.D. Fla. 2011); In re Raymond Prof'l Grp., Inc. v. William A. Pope Co (In re Raymond Prof'l Grp., Inc.), 438 B.R. 130, 138 (Bankr. N.D. Ill. 2010); In re Vecco Constr. Indus., Inc., 4 B.R. 407, 410 (Bankr. E.D. Va. 1980).

11 See, e.g., In re Gulfco Inv. Corp., 593 F.2d 921 (10th Cir. 1979); In re Baker & Getty Fin. Serv., 78 B.R. 139 (Bankr. N.D. Ohio 1987); In re Stop & Go of America, Inc., 49 B.R. 743 (Bankr. D. Mass. 1985).

12 "[T]here appears to be nearly unanimous consensus that it is a remedy to be used "'sparingly.'" In re Owens Corning, 419 F.3d 195. 205–06 (3d Cir. 2005); see also In re Augie/Restivo Baking Co. Ltd., 860 F.2d 515 518 (2d Cir. 1988).

13 Indeed, in connection with virtually any financing or similar transaction involving a single or special purpose entity that is part of a multi-entity enterprise, closing of the transaction will be conditioned upon the furnishing of a satisfactory legal opinion from counsel that the entity will not be subject to substantive consolidation with affiliates in event of a bankruptcy filing.