CHAPTER 11

Debtor-in-Possession Financing in Brazil: The Oi Case

Marcelo Ricupero, Frederico Kerr Bullamah, Giovanna Campedelli and Bernardo Ferreira Martins da Costa[1]

Overview of debtor-in-possession financing in Brazil

Debtor-in-possession (DIP) financing is widely used as an efficient reorganisation mechanism by companies in distress in several jurisdictions. However, until recently, this type of transaction was not very effective or commonly adopted in Brazilian judicial reorganisation proceedings. As is explained below, prior to its reform in 2020 (the Reform), there was not a structured legal framework for DIP financing in the Brazilian Bankruptcy Law (Law 11,101 of 11 February 2005).

Owing to the lack of specific legal provisions for DIP financing in Brazil, investors feared facing extensive legal disputes and other types of uncertainties, especially when comparing the lack of legal provisions to institutes and mechanisms of other jurisdictions. For example, DIP financing in Brazil would usually require discussions about collateral in situations where the company undergoing judicial reorganisation lacked sufficient available (free and unencumbered) assets,[2]

---

1 Marcelo Ricupero and Frederico Kerr Bullamah are partners and Giovanna Campedelli and Bernardo Ferreira Martins da Costa are associates at Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados.

2 Frigorífico Independência and Infinity Bioenergia are examples of cases in which the granting of collateral to the DIP financing was essential to the success of the transactions. In 2009, the first DIP financing was concluded in Brazil, through which one of the largest meat-packers in the country at the time, Frigorífico Independência, raised US$165 million through issuing bonds. To be able to carry out the transaction, the financing was secured by free assets of Frigorífico Independência, which was later enforced by the DIP lenders, following the default of Frigorífico Independência, and subsequently sold to JBS, providing recovery for the DIP lenders. Without the collateral, this precedent would be a failure,

raising the issue as to whether it would be possible to prime existing liens. Another common example of the uncertainties faced by investors and debtors is in relation to the type of approval that would be required in a DIP financing transaction to avoid further time-consuming questioning before the courts.[3]

Given such a situation, it should not be too surprising that the number of DIP financings in Brazil has remained relatively small since judicial reorganisation was instituted in 2005 (especially when compared with the 15,712 judicial reorganisation requests filed between June 2005 and April 2023).[4] Despite this, a few DIP financings have proven to be successful, but they were more a bridge to an M&A in the sense that the investor would get some sort of advantage in a future competitive process for the sale of an asset in the context of the judicial reorganisation or tools to provide a group of creditors with a better recovery if compared with other creditors.

In this chapter, we first highlight the changes introduced by the Reform, which, in our view, will contribute to an increase in DIP financing in Brazil. We then analyse three financing transactions made in the context of the judicial reorganisations of the Brazilian telecommunications group Oi, which were negotiated and structured both before and after the Reform. This will demonstrate how new features in the Reform led to greater legal certainty and clarity needed for this type of transaction. Such transactions were important for allowing Oi Group to

---

given the debtor default on the repayment of the DIP financing. By contrast, to secure approximately US$70 million in DIP financing, Infinity Bionergia had to rely on its creditors subject to judicial reorganisation – local banks – to waive the seniority of their respective liens over two mills, which were granted via a fiduciary lien to the investor as collateral for the DIP financing, since there was not (and still is not) the possibility of the court priming on existing liens.

3 Creditors' support or the challenge by creditors can be key to the success of a DIP financing in Brazil. In the case of the construction conglomerate OAS, an investor, Brookfield, withdrew from the transaction because of resistance from some creditors. In summary, Brookfield was due to grant 800 million Brazilian reais in DIP financing to OAS through the acquisition of debentures issued by one of its subsidiaries. The DIP financing would be guaranteed by the fiduciary lien of Invepar shares (a subsidiary of OAS) and the fiduciary assignment of all dividends on these shares. In addition, Brookfield would have a right to match the highest bid in the future sale of Invepar, which would be carried out as a competitive sale process. The right to match was heavily challenged by certain creditors. Notwithstanding the approval of the judicial reorganisation plan containing such arrangements of the DIP financing, some creditors appealed to the São Paulo State Court of Appeals, which caused Brookfield to lose interest, given the lengthy discussions around this issue, and the transaction was not completed.

4 See https://www.serasaexperian.com.br/conteudos/indicadores-economicos/ (last accessed 22 May 2023).

raise the necessary cash to maintain its operations and invest in the business while it negotiated with buyers for the sale of its assets, which ultimately allowed the Oi Group to repay certain of its creditors during the its first judicial reorganisation.

Reform of Brazilian Bankruptcy Law

On 24 December 2020, the Brazilian Bankruptcy Law was amended by Law 14,112, with specific provisions designed to regulate DIP financing (i.e., Articles 69-A to 69-F and Article 84). The aim of these provisions was to address several existing concerns within the market for this type of transaction, as described:

- Article 69-A expressly provides that after hearing from the creditors' committee (if installed), the bankruptcy courts may authorise the debtor to execute financing agreements secured by assets and rights belonging to its 'non-current assets' to finance its activities and the expenses of restructuring or preserving the value of its assets. In practice, companies undergoing judicial reorganisation have tended to request the court's authorisation for financing, regardless of whether their related assets are recorded as 'non-current assets' on their balance sheets. (Needless to say, unsecured DIP financings are extremely rare, so discussions about whether court authorisation is necessary in unsecured DIP financings are purely academic.)
- Article 69-B provides that if a decision authorising DIP financing is modified through appeals after the disbursement has been made, the post-petition nature of the DIP financing and related collateral will be maintained. In other words, the reversal or modification of decisions authorising DIP financing and its collateral became theoretically inadmissible after the Reform. This change was inspired by the DIP financing model in the United States (i.e., DIP financing approved by the US Bankruptcy Court under the terms of Chapter 11 of the US Bankruptcy Code cannot be modified by higher courts). The aim of this change was to provide legal certainty to investors in a jurisdiction that is highly litigious with several appeal opportunities and a judiciary that unfortunately is not able to review and decide such appeals within the desired business time frame.
- Article 69-C provides that if a creditor holds collateral (except for liens of a fiduciary nature) that will be granted for the DIP financing, the creditor does not lose priority status, although the debtor can create a subordinated lien over the same asset with the court's approval, regardless of whether the consent of the original holder has been obtained. This change evidently was motivated by the discussions around the possibility of a court priming on existing liens, but it fell short.

- Article 69-D provides additional protection to creditors, stating that if the judicial reorganisation is converted into bankruptcy (i.e., liquidation) before the full disbursement of funds by the creditor, the DIP financing will be automatically terminated. If any amount has already been disbursed prior to the declaration of bankruptcy, all collateral and the priority in payment connected to the DIP financing will be preserved up to the limit of the amounts actually disbursed to the debtor.
- Article 69-E permits any person to finance the debtor in a judicial reorganisation, including creditors (even if subject to the judicial reorganisation themselves), family members, partners and members of the debtor's group. This provides increased clarity regarding authorised persons (e.g., creditors subject to the judicial reorganisation) that can offer to finance the debtor.
- Article 69-F provides that the financing granted to debtors undergoing judicial reorganisation can be guaranteed or secured by any person or entity, including the debtors themselves or other members of their group, regardless of whether they are parties to the judicial reorganisation. This innovation has ensured that companies that are part of an economic group may contribute to the success of the judicial reorganisation by offering guarantees or liens over assets and rights of subsidiaries.

Although DIP financing had a post-petition obligation status before the Reform, it was not given absolute priority in the event of bankruptcy in relation to other post-petition obligations of the same category (i.e., obligations 'validly assumed by the company under reorganization during judicial reorganization', under Article 67 of the Brazilian Bankruptcy Law). The order of priority of payment provided by the Brazilian Bankruptcy Law before the Reform meant that, in practice, DIP financing was paid after several other claims that were also considered post-petition obligations – such as those with fiduciary collateral, a type of security commonly used by financial institutions in Brazil – and was also paid on a pro rata basis with the other claims in this category.

Following the Reform, Article 84 of the Brazilian Bankruptcy Law now gives priority (although not absolute) to paying DIP financing in the event that a judicial reorganisation proceeding is converted into bankruptcy. As such, DIP financing must be paid after bankruptcy expenses and labour claims (limited to five minimum wages per creditor)[5] and ahead of most other post-petition claims. However, DIP financing is still not senior to obligations secured by fiduciary

5 Approximately 1,320 reais as of May 2023.

collateral that is still bankruptcy remote, except in cases where it is not possible to deliver the asset to the holder of the fiduciary collateral, who will receive the value of the security proportionally in cash after payment to the DIP lender.

However, the Reform is not immune from criticism – certain aspects are still open to interpretation by the judiciary. Nevertheless, the aforementioned changes were extremely important for providing greater legal certainty to DIP lenders, as can be seen below.

We now analyse two financing transactions the Oi Group entered into during its first judicial reorganisation – the largest ever seen in Brazil at the time – and one financing transaction the Oi Group entered into during its second judicial reorganisation.

First Oi DIP financing: the mobile services transaction

On 23 December 2019, Oi announced that its mobile services subsidiary, Oi Móvel, would issue a total of 2.5 billion reais in debentures, which at the time represented Brazil's largest DIP financing both in terms of value and in importance to the market. On 4 February 2020, Oi released a notice to inform the market that the issuance of debentures by Oi Móvel had concluded.

The granting of Oi's first DIP financing relied on an approved judicial reorganisation plan, which contained express authorisation for raising up to 2.5 billion reais in new funding. Similarly, the judicial reorganisation plan provided for the possibility of granting collateral to facilitate the DIP financing. However, as Oi Group is a public service concessionaire, the granting of collateral required a careful analysis of regulatory issues and previously existing contracts.

This DIP financing was carried out before the Reform and, given the lack of legal provisions in the Brazilian Bankruptcy Law, it heavily relied on the provisions of the plan that the creditors had approved. The lack of specific legal provision on DIP financing did not directly affect the transaction, as under the pre-Reform version of the Brazilian Bankruptcy Law, DIP financing and granting of collateral were permitted, as long as they were done in accordance with the terms of the reorganisation plan and approved by creditors through the plan.

However, unlike what would happen in Oi's second financing (as detailed below), this did not mean that creditors were unable to challenge any aspect of the transaction (e.g., on the grounds that the terms of the approved reorganisation plan were misinterpreted).

Although the approved judicial reorganisation plan expressly allowed Oi Group to obtain up to 2.5 billion reais in new funding, as well as to encumber assets to secure the operations relating to new funding, Oi still took a series of measures to enable the transaction, including:

- conducting negotiations with its main creditors to ensure their support, as even if the judicial reorganisation plan authorised the raising of new funding, creditors could still have had doubts that would certainly destabilise the security of the transaction;
- studying different structures to carry out the transaction, testing all possible forms of collateral the investors might require in respect of the terms of the approved reorganisation plan; and
- keeping the trustee and the bankruptcy courts up to date[6] with how the transaction was developing, which was essential for ensuring that activities continued and the judicial reorganisation functioned properly.

The purpose of the DIP financing was to provide liquidity to the Oi Group while the sale of Oi Móvel was being negotiated, signed and approved by regulatory authorities.

Second Oi financing: the fibre-optic infrastructure transaction

In early 2021, Oi moved to conduct a second round of financing during its judicial reorganisation. On 8 September 2020, in preparation for this financing and future funding that would benefit the judicial reorganisation, Oi had amended its judicial reorganisation plan, which was backed by its creditors. The amendment was ratified in court on 5 October 2020.

The amended reorganisation plan provided for a series of transactions to enable the sale of Oi Group's assets in the form of isolated productive units (*unidades produtivas isoladas* (UPIs)), as well as to authorise funding for the creation of the UPIs and of several forms of collateral for Oi's assets.

In a similar manner to the first DIP financing, a subsidiary of Oi issued 2.5 billion reais in convertible debentures. On 26 May 2021, Oi announced the conclusion of the debentures issuance, which represented another important financing for the company.

As regards procedure, this second financing followed a similar path to Oi's first DIP financing, as it was carried out in line with the amended and approved reorganisation plan. As the financing and the security package were already approved in the amended reorganisation plan, there was no need for additional

6 The approval of the court was not a condition of the disbursement of the DIP financing, but informing the DIP financing to the court was. This decision was taken to make sure that all creditors would be aware of the transaction and would be given a chance to challenge or dispute it prior to its disbursement. This confirms that the lack of a legal framework generated uncertainties for investors.

approvals by the restructuring court or the creditors of the reorganisation, even though, given the Reform, the need for such approval was no longer in dispute (unlike the first DIP financing).

This time, however, the Reform helped in overcoming many of the challenges faced in the previous deal. The protections for DIP financing creditors introduced by Articles 69-A to 69-F of the Brazilian Bankruptcy Law provided Oi creditors and the DIP lenders with additional legal assurances regarding the post-petition treatment of the new financing in the event of Oi's bankruptcy (which was crucial, given that Oi being a concessionaire, several assets used in the business belong to the government). The new provisions also reassured DIP lenders that their credits would be prioritised ahead of most of the pre-petition and post-petition debts in the payment waterfall. This was because the new Article 69-B sets forth that the authorisation already granted by the creditors and confirmed by the bankruptcy court could not be revoked or modified by any future decision.

The funds raised through the debentures were used to finance Oi's fibre-optic infrastructure to assist with the dropdown of assets from Oi and to establish a UPI responsible for the fibre-optic infrastructure, known as InfraCo. The sale of approximately 12.9 billion reais in UPI InfraCo shares was concluded after being approved by Brazil's antitrust authority CADE. This, together with the sale of Oi Móvel shares for approximately 15.9 billion reais (made possible by the first DIP, that served as a bridge for the Oi Móvel sale), enabled Oi to pay part of its creditors and reduce its indebtedness.

Third Oi financing: the emergency financing

On 14 December 2022, the court ended Oi's first judicial reorganisation and terminated the supervision period established by the Brazilian Bankruptcy Law. Despite the reduction of the indebtedness provided by previous DIP financings, Oi filed a preliminary injunction in preparation for a new request for judicial reorganisation, aiming at (1) anticipating the effects of the granting decision, with the suspension of obligations and enforcement proceedings against Oi; and (2) upholding the decision rendered in the first judicial reorganisation, which established the procedure for payment of claims not subject to the proceeding.

One month after the granting of preliminary injunction, on 1 March 2023, Oi filed a new request for judicial reorganisation. According to Oi, the indebtedness subject to the new proceeding is approximately 44 billion reais.

In the context of the second judicial reorganisation, Oi requested authorisation to enter into a DIP financing as an 'emergency financing', aimed at assuring the maintenance of its operations and its cash flow and, consequently, enabling the continuation of the judicial reorganisation.

Unlike previous DIP financings, the third transaction was entered into with a group of existing financial creditors of Oi, notably noteholders and the buyers of claims resulting from agreements with Export Credit Agencies, in the amount of US$275 million (US$200 million to be initially provided upon court approval and US$75 million to be provided after the approval of the reorganisation plan) and secured by fiduciary sale of shares held by Oi in V.Tal – Rede Neutra de Telecomunicações SA.

On 10 April 2023, the court authorised the DIP financing based on Article 69-A – as in the second DIP financing – which, as mentioned, provides that the court can authorise the raising of the DIP financing independently and prior to the creditors' general meeting. Certain creditors filed appeals against the decision that authorised such DIP financing, but the injunction relief was not granted (i.e., the authorisation is still in force), and the appeals are pending final judgment.

On 21 April 2023, Oi released a material fact informing that it had entered into the Note Purchase Agreement – a document that establishes the terms and conditions of the DIP financing – with the financial creditors that granted the DIP. According to the material fact, the proceeds of the DIP financing will be used to pay Oi's short-term obligations and to ensure the maintenance of its activities during the reorganisation.

After the confirmation of the third DIP financing, Oi presented its judicial reorganisation plan indicating that it intends to raise new funds in the amount of up to 4 billion reais, pursuant to Article 67 of Brazilian Bankruptcy Law.

Conclusion

In light of Brazil's previous experiences with DIP transactions, the Reform introduced a set of rules in the Brazilian Bankruptcy Law that give creditors greater legal certainty. The injection of credit into the capital structure of a company undergoing a judicial reorganisation is an effective way to ensure it can continue to operate and allow it to overcome the crisis.

The Reform establishes a beneficial legal framework that should stimulate further DIP financing in Brazil, as it now provides more clarity to investors, creditors and debtors. The certainty about required approvals is one of the most important innovations. There is also Article 69-B, which prevents an appeal decision from modifying a ruling that confirms the post-petition nature of credit, and of collateral that the debtor puts up in good faith.

Even after the Reform, there are still some flaws and gaps in the legislation that may bring uncertainty to creditors. In this regard, the positive outcome of the DIP financings during Oi's first judicial reorganisation was beneficial not only for Oi but for the insolvency sector as a whole.

Also, the success of the third Oi DIP financing may also open a precedent in Brazil for creditors to finance companies in distress. Oi DIP financings demonstrate that raising new funds may be an alternative mean to make restructurings feasible, confirming that the Reform of the Brazilian Bankruptcy Law helped to create a positive environment for investors willing to invest in distressed assets.

The strengthening of Brazil's insolvency framework and the building of trust with creditors to fund companies in judicial reorganisation proceedings is particularly important currently. In the past years, a number of large Brazilian companies undergoing judicial reorganisation proceedings – which include Samarco, LATAM, Renova, Americanas and companies in the agribusiness sector – have all resorted to raising funds via DIP financing. Although this number remains many times smaller than the increasing number of current judicial reorganisation procedures,[7] it is an indicator that building up positive case law may facilitate access to credit for distressed companies under judicial reorganisation.

Despite certain ongoing issues, the Reform and the inclusion of DIP financing in the Brazilian legal framework are more than welcome. The introduction of rules assuring creditor protections and privileges with regard to DIP financing represents a milestone for developing an important market in Brazil for granting credit to companies in distress. Certain positive effects of the Reform are already perceptible, for example in the recent judicial reorganisation proceedings of Oi and Brazilian retailer Americanas,[8] and we expect the market to continue benefiting from it in the future.

7 According to Serasa. the number of Judicial reorganisation proceedings in February 2023 increased by 87.3 per cent when compared with February 2022.

8 Americanas S.A. filed its judicial reorganisation in January 2023, with over 40 billion reais in debt. In February 2023 the court authorised the DIP financing by the issuance of up to 2 billion reais in debentures.