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Brazilian telecom's reorganization effort was stymied by a conflicted board, but collaborative bondholders and state-owned banks ensured the company unlocked value and set itself on a path to growth By Ted S. Lodge

Op-Ed: Oi restructuring heightens the need for stronger governance

Brazilian telecom Oi's court-supervised corporate restructuring was the largest of its type in the country's history.

The restructuring also set a precedent for Brazil that could spark fundamental change in the country's insolvency law and practice, while being instructive for US and European-based distressed investors.

Key stakeholders in Oi's restructuring included the shareholders and the company's general creditors.

Shareholders included "activist" stakeholder Nelson Tanure, who just before the judicial reorganization was filed, acquired about 6% of Oi's shares. In doing so, Tanure, through affiliates, could exert influence on Pharol, which held a 25% stake in Oi by virtue of Portugal Telecom's merger into Oi.

Tanure, his affiliates, along with Pharol and its affiliates are referred to as shareholders in this article.

Oi's general creditors comprised the company's unsecured creditors, which made up about BRL60bn ($16.2bn) of Oi's BRL66.5bn in debt, pre-petition.

Unsecured creditors included:

- State- and privately-owned banks with BRL8.2bn
- Export credit agencies with BRL5.3bn
- Bondholders with BRL32.2bn and
- Brazil's telecom regulator Anatel with BRL14.2bn

Under Brazilian insolvency law, adopted in 2005, the debtor is the only party that can propose a reorganization plan during a judicial reorganization proceeding.

There was no opportunity for creditors to promote a rival offer. Creditors can submit objections and changes to the plan proposed by the debtor, but these changes can only be implemented if agreed by the debtor.

Therefore, shareholders' undue influence on Oi's board conflicted with its consideration of proposed changes to the debtor's reorganization plan and alternative plans submitted by creditors.

The conflict among the board during the judicial reorganization saw two CEOs, two CFOs and 10 board members all resign and be replaced.

The board also refused to allow Oi's management to negotiate a consensual plan with creditors and adopted proposed plans without creditor input.

Shareholders, along with the board, pursued a plan support agreement with a limited number of bondholders who were also shareholders, which legally prohibited them from voting on a reorganization plan under Brazilian insolvency law. This served as an apparent attempt to "cram down" a majority of the general creditors, notably the bondholders, to impose a plan without bondholders' consent.

When independent management refused to support the board's plan, the board then threatened to dismiss the management, and appointed two new managers, who were also directors associated with the shareholders.

The board risked intervention by the regulator Anatel because of the instability that ensued. The regulator, however, did not take affirmative action to intervene.

The key for Oi's bondholders was the governance.

First, general creditors needed to align to break conflicted control of the company and use Brazil's judicial system to solve the impasse.

Brazil's state and privately-owned banks, the ECAs and Anatel were as concerned as the bondholders.

As both regulator and a general creditor, Anatel had been taking measures to help facilitate a resolution. This included placing observers in the board room, rejecting the plan support agreement with a minority group of bondholders/shareholders and requiring that the proposed reorganization be submitted to Anatel.

Ultimately, bondholders worked closely with state-owned banks and ECAs. And as the abuses of the shareholders and the conflicted board became more extreme, key bondholder groups filed novel motions with Brazil's bankruptcy court in Rio de Janeiro to ensure independent management could negotiate with creditors, unburdened by the conflicts of the board and shareholders.

While court decisions in Brazil have determined creditors' voting rights may be disregarded for abusive behavior in a restructuring, no comparable legal precedent existed for shareholders' abuse. The motions filed by the bondholders sought to disable the shareholders and conflicted board members from interfering with management's ability to negotiate a consensual plan with the creditors.

The state-owned banks and ECAs were supportive and advocated on behalf of the requested relief. With the broad support of creditors, the court appointed the CEO Eurico Teles as the person responsible for conducting and concluding negotiations with creditors, "regardless of the approval of the Board of Directors."

Teles and Oi's CFO Carlos Brandão could then negotiate with the creditors unburdened by the conflicts of the shareholders and board. Ultimately, they reached an agreement with creditors, adopting the mantra: "do right and fear no man."

Within a month of the court's decision, the creditors and independent management were able to negotiate a plan that was approved by the majority of creditors and confirmed by the court in record time.

The plan included provisions establishing an interim independent board as well as a process for appointing a post implementation independent board.

Essentially, the previous board was replaced with an interim board of three members designated by the creditors, three independent members from the existing board and three conflicted members of the existing board.

The court eventually removed the conflicted members from the interim board after continuing abuses, and the plan provided that the interim board would select a slate of independent board members identified from candidates sourced by an executive search firm.

Dysfunctional governance caused by conflicted shareholders stymied Oi's ability to present a plan that would be approved by the creditors.

Collective action by the general creditors enabled the court to see the failures of governance and to break the stalemate between creditors and shareholders, by ensuring the independence of management.

Moreover, the creditors' insistence on incorporating a governance regime in the reorganization plan ensured management would be accountable to an independent board while it implemented the wider plan, which is conducive to the long-term viability of Oi. LF

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