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CREDIT BIDDING IN BRAZILIAN JUDICIAL REORGANISATION PROCEEDINGS: LEGAL BASIS, COMPARATIVE INSIGHTS AND GUIDELINES FOR UTILISATION

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INSOL International is pleased to present this new technical paper, "Credit Bidding in Brazilian Judicial Reorganisation Proceedings: Legal Basis, Comparative Insights and Guidelines for Utilisation", written by Rodrigo Saraiva Porto Garcia (INSOL Fellow and Partner at Galdino Advogados)* and Bruna Vilanova Machado (Associate at Galdino Advogados)**.

The paper aims to analyse the role and legal treatment of credit bidding in Brazil, comparing it to the well-established practice under the United States Bankruptcy Code and also examining its application in the United Kingdom and Canada. Through this comparative perspective, the paper underscores how credit bidding can foster competition, maximise asset value, and enhance creditor engagement in restructuring scenarios.

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1. Introduction

Insolvency frameworks across jurisdictions increasingly rely on asset sales as a mechanism for preserving and maximising value in corporate rescue proceedings. A well-designed competitive sale process promotes efficiency by ensuring distressed assets are acquired by parties that are best able to utilise them productively.

Within this context, credit bidding – the practice of allowing creditors to use their claims as a form of "currency" in an auction – has emerged as a crucial tool for enhancing participation and competitiveness in distressed asset sales. This mechanism reduces entry barriers, particularly benefiting creditors who possess detailed insights into the debtor's operations, thus potentially generating higher sale proceeds or more significant debt reduction.

It has already been observed that "the standard turnout at auctions of insolvent companies is normally very low – uninformed bidders tend not to submit high bids and often demand break-up fees as a condition to their bid".[1] When there are few competitors in the acquisition of distressed assets, there is a movement contrary to the maximisation of asset values, the primary objective of the sale procedures in restructuring and bankruptcy proceedings.

Allowing creditors to bid with their claims may enhance the value obtained from the asset sale, as it expands the pool of potential bidders by providing them with a currency equivalent – namely, their claims – to compete effectively.[2] Generally, the greater the number of bidders participating, the higher the auction price is likely to be.[3] Therefore, to maximise asset value, competitive procedures for the sale of distressed assets should be designed to attract the broadest possible spectrum of interested bidders, an objective more readily achievable when credit bidding is authorised.

The relevance of credit bidding has increased significantly in Brazil, particularly following the reform introduced by Federal Law No. 14,112/2020, which amended the Brazilian Bankruptcy Law (Federal Law No. 11,101/2005), providing greater flexibility for asset sales during judicial reorganisation proceedings. Although the Brazilian Bankruptcy Law does not explicitly regulate credit bidding in asset sales, recent practice demonstrates a growing trend towards the practical adoption of this mechanism.

This technical paper aims to analyse the role and legal treatment of credit bidding in Brazil, comparing it to the well-established practice under the United States Bankruptcy Code and also exploring its application in the United Kingdom and Canada. Through this comparative perspective, the paper underscores how credit bidding can foster competition, maximise asset value, and enhance creditor engagement in restructuring scenarios.

2. Asset sales in rescue proceedings: objectives and economic rationale

The sale of assets during insolvency or rescue proceedings serves a dual function: to generate liquidity for the distressed debtor and to promote the productive reallocation of assets. From an economic standpoint, competitive sales are designed to maximise the value of the assets by encouraging participation from the broadest possible pool of potential buyers, ideally resulting in a price that reflects the asset's market value.

Transparency, publicity and equal access to information are essential to a well-functioning sale process. Asymmetric information between sellers and buyers tends to suppress bids, as potential purchasers hedge against unknown risks. Mechanisms such as public notices, data rooms and structured due diligence reduce this asymmetry and help ensure more accurate asset pricing.

Competitive pressure is another critical element. Auctions or tender procedures incentivise higher bids when participants know they must outbid others. However, in markets with limited access to capital – especially emerging markets – credit bidding offers an alternative that allows creditors to participate without needing additional financing. This potentially increases recoveries through either cash proceeds or debt set-off.

The legal design of asset sales, therefore, must strike a balance between flexibility and fairness. Sale mechanisms should be tailored to the restructuring objectives of each case, while protecting the integrity of the process and the rights of stakeholders. In many jurisdictions, this includes the express or implicit recognition of credit bidding as a legitimate and sometimes necessary mechanism to achieve value maximisation in distressed asset sales.

1 *HOFFMAN, Michael J. RadLAX Gateway Hotel, LLC v. Amalgamated Bank:* examining the importance of credit bidding at Chapter 11 asset sales. In: *Houston Law Review,* [*s. l.*], v. 50, n. 4, p. 1223-1254, 2013, p. 1252.

2 According to Paul R. Hage, Brian M. Resnick and Brent Weisenberg, "[i]n addition to protecting secured creditors, credit bidding can provide meaningful benefits to the bankruptcy estate. By hypothesis, the estate is seeking to maximise the value of the collateral (and to reduce unsecured deficiency claims against the estate when the proceeds of a sale are applied to the secured obligations). Credit bidding both enlarges the frequently small pool of bidders capable of submitting meaningful bids on the often-compressed timetable for a bankruptcy sale (theoretically leading to higher and more competitive bids), and discourages favouring 'white knight' or insider bidders, who may have perverse incentives and may not offer the 'highest and best' bids" (HAGE, Paul R.; RESNICK, Brian M.; WEISENBERG, Brent. *Credit-bidding in bankruptcy sales*: a guide for lenders, creditors, and distressed-debt investors. Alexandria, VA: American Bankruptcy Institute, 2015, p. 8). See also BUCCOLA, Vincent S. J.; KELLER, Ashley C. Credit bidding and the design of bankruptcy auctions. In: *George Mason Law Review*, [*s. l.*], v. 18, p. 99-124, 2010, p. 106.

3 See MCAFEE, R. Preston; MCMILLAN, John. Auctions and bidding. In: *Department of Economic Research Reports*, 8601. London, ON: Department of Economics, University of Western Ontario, 1986, p. 21-22. See also *HOFFMAN, Michael J. RadLAX Gateway Hotel, LLC v. Amalgamated Bank:* examining the importance of credit bidding at Chapter 11 asset sales. In: *Houston Law Review,* [*s. l.*], v. 50, n. 4, p. 1223-1254, 2013, p. 1252.

3. Credit bidding in the United States, the United Kingdom and Canada

Credit bidding is a mechanism that allows creditors to use the face value of their claims as consideration when acquiring assets in insolvency sales. Rather than paying in cash, the creditor offsets the bid amount against the outstanding debt owed by the debtor. Originally rooted in secured transactions, the tool evolved as a means of protecting creditor interests and encouraging more robust bidding in distressed asset auctions.

The use of claims as bidding currency reduces transaction costs and broadens the pool of potential participants, especially in scenarios in which liquidity is scarce. Creditors, who often have detailed knowledge of the debtor's business and assets, may be better positioned to value and operate the assets effectively. This contributes to higher bids and a more efficient reallocation of the asset.

While credit bidding is firmly embedded in the United States legal framework, other jurisdictions have developed the concept through case law or contract-based solutions.

The following sections explore the legal treatment and practical implementation of credit bidding in the United States, the United Kingdom and Canada, before analysing how the mechanism has been outlined and applied in Brazil.

3.1 United States

In the United States, credit bidding is expressly provided for in the Bankruptcy Code and plays a central role in protecting the interests of secured creditors in the sale of encumbered assets. Two key provisions govern this mechanism: section 363, which addresses sales outside the reorganisation plan, and section 1129, which deals with sales under a confirmed Chapter 11 plan. Therefore, the legal basis for credit bidding is present and guaranteed to holders of secured credits, subject only to case law interpretation. This means that there is no need to provide for credit bidding in contractual instruments or in the reorganisation plan, although this is possible.

Section 363 of the Bankruptcy Code governs sales that occur during the reorganisation process but outside the formal plan of reorganisation. Under section 363(b), the debtor-in-possession (or trustee) may sell assets outside the ordinary course of business, subject to court approval. If the sale involves assets that are encumbered by liens, section 363(f) permits the sale to be made "free and clear" of such interests. Section 363(k) provides the secured creditor with the right to credit bid at the sale, unless ordered otherwise by the court.

Section 1129 governs the confirmation of reorganisation plans. When the reorganisation plan proposes the sale of an encumbered asset, section 1129(b)(2)(A) sets out specific rules to protect secured creditors. In this context, one of the permissible options for the plan is to allow the asset to be sold free and clear of liens, provided that the secured creditor is given the right to credit bid for the asset as part of the sale process. This ensures the creditor is not forced to accept cash or other consideration in place of its collateral, unless the substitution reflects the true market value of the asset.

Thus, while section 363(k) applies to sales conducted independently of a reorganisation plan, section 1129(b)(2)(A) ensures similar protection when the sale is contemplated within the plan itself. In both cases, the principle underlying credit bidding is the same: to prevent the under-valuation of collateral and to protect secured creditors from being displaced by below-market sales. Courts may limit this right only upon a finding of "cause," such as bad faith, collusion, or the chilling of competitive bidding. As a result, credit bidding has become a cornerstone of distressed asset sales in United States bankruptcy practice.

3.2 United Kingdom

Unlike the United States, the United Kingdom does not have a statutory framework for credit bidding. However, in practice, secured creditors may acquire assets by offsetting their claims, particularly in administration proceedings and pre-packaged sales. These procedures are guided by overarching principles of fairness and value maximisation, rather than codified entitlements.[4]

Corporate insolvency in the United Kingdom may proceed through administration or via a pre-packaged sale. In administration, the appointed insolvency practitioner (the administrator) may sell the company's business or assets to repay creditors. When the sale is structured as a pre-pack, negotiations and sale agreements are finalised prior to the administrator's appointment, and the transaction is executed immediately thereafter.

While United Kingdom law contains no statutory equivalent to section 363(k) of the United States Bankruptcy Code, credit bidding by secured creditors is generally permissible in practice. Its acceptability depends on the administrator's duty to obtain the best result for creditors as a whole and on the transparency and independence of the sale process.

4 Practical experience in the United Kingdom has shown a more frequent use of credit bidding there, even without a legal provision authorising it. According to Amy Jacks and Trevor Borthwick: "Whilst there is no statutory equivalent in the UK, the process has evolved here into an accepted practice. Hedge funds, private equity firms and other distressed investors have used this device to affect their 'loan-to-own' strategies by buying into the debt of a distressed company at less than par and then using their secured position to take ownership, normally via an insolvency process, of the assets" (JACKS, Amy; BORTHWICK, Trevor. Credit bidding: US import turned UK lender tool. In: *Business Credit*, [s. l.], v. 123, n. 1, p. 34–35, 2021, p. 34).

Credit bidding of secured claims has generally been accepted because, economically, the effect is neutral: if a first-ranking secured creditor were to pay cash for an asset over which it holds security, the proceeds would immediately revert to the same creditor as repayment of its secured debt. Thus, whether the transaction is structured as a sale or a distribution is immaterial in these cases.[5]

The permissibility of credit bidding by unsecured creditors, however, raises more complex legal questions, particularly in light of the *pari passu* principle, which requires equal treatment among creditors of the same class. This issue was addressed in the special administration of *Sova Capital*, where the High Court approved a transaction in which illiquid Russian securities were transferred to an unsecured creditor in exchange for a waiver of its claim. The central legal question in Sova was whether the transaction constituted a distribution (subject to the *pari passu* rule) or a sale (which would not trigger that constraint). The High Court found that the transfer was a *bona fide* sale and emphasised that the administrators had acted reasonably, used a defensible valuation methodology, and ensured procedural fairness throughout the process.[6]

Looking forward, while credit bidding remains an exception-based practice in the United Kingdom, *Sova Capital* opens the door to its broader application, provided the structure aligns with the administrator's statutory obligations and does not violate creditor equality. Judicial scrutiny will remain central to ensuring fairness and legitimacy in such transactions.

3.3 Canada

The Canadian insolvency framework, including the Companies' Creditors Arrangement Act (CCAA) and the Bankruptcy and Insolvency Act (BIA), is silent on credit bidding. Nevertheless, courts and practitioners have recognised the practice, particularly under the CCAA, as an accepted feature of restructuring sales.

Under the CCAA, secured creditors often act as stalking horse bidders – a party that agrees in advance to purchase the assets of the debtor, setting an initial bid that establishes a price floor for the sale process.[7] In exchange, the stalking horse typically receives certain protections, such as break-up fees or matching rights, to compensate for the risk of being outbid. This structure preserves the creditor's ability to credit bid by allowing them to offset their claims against the proposed purchase price. Importantly, the stalking horse mechanism encourages competitive bidding by signaling a credible baseline value, while also ensuring the sale process reflects genuine market interest rather than simply serving as a means for secured creditors to recover collateral.

Creditors typically consider making a credit bid for one of three strategic reasons. First, as part of a long-term "loan-to-own" strategy, in which the ultimate goal is to acquire control of the debtor's business through the enforcement of credit rights. Second, to take temporary ownership and operate the business during a transitional phase, with the intent of preserving value and reselling the assets or the business once market conditions improve. Third, to act as a stalking horse bidder, setting a price floor to stimulate higher offers in an auction process, while retaining the option to acquire the business if no superior bid emerges.[8]

A leading example is *White Birch Paper Company*, in which a creditor group holding first-lien debt was pre-approved by the court as stalking horse bidders and permitted to credit bid CAD 78 million as part of a CAD 236 million purchase. A competing bidder objected that credit bids should not be treated equally, but the court confirmed the validity of comparing total consideration, including credit bids, to determine the highest offer.

Nevertheless, credit bidding in Canada remains a matter of practice, not a statutory right. Courts have endorsed it based on economic logic: since secured creditors would receive cash proceeds anyway, allowing them to bid with claims does not disadvantage other creditors; rather, it fosters transparency, protects asset value, and promotes competitive sales.[9]

4. Credit bidding in Brazil

There are significant differences between the treatment of credit bidding under Chapter 11 of the United States Bankruptcy Code and in Brazilian judicial reorganisation proceedings.

First, in a context of judicial reorganisation, creditors with real guarantees (mortgages, pledges and antichresis) are not entitled to receive the full amount of their credits up to the limit of the appraisal value of the object of the guarantee in Brazil. This is because the credits with real guarantees can be restructured by the reorganisation plan, with the imposition of discounts that will reduce the credits to amounts lower than the values of the assets that serve as collateral.[10] There is no notion similar to the absolute priority rule in Brazilian judicial reorganisation, and any change in this logic would require legislative change.

5 See BORTHWICK, Trevor; WOOD, Alexandra. "Credit bidding" unsecured debt in an administration. In: *Butterworths Journal of International Banking and Financial Law*, March 2024, available at https://bit.ly/3H099qR.

6 See *Sova Capital Ltd (in Special Administration)* [2023] EWHC 452 (Ch), [191]).

7 See ROGERS, Linc. Credit Bidding: the basics. In: *Mondaq*, available at https://bit.ly/46XbrSb.

8 *Ibid*.

9 See LATHAM, Joseph; O'Neill, Brendan. Credit bidding in Canada: recent developments. In: *Lexpert*, available at: https://bit.ly/45gPBb2.

10 It is important to emphasize that credits with fiduciary guarantees (*alienação fiduciária*, in Portuguese) are not subject to the judicial reorganization proceeding and are considered non-subject to bankruptcy proceedings (*extraconcursal,* in Portuguese). This means that, at least in theory, these creditors can seek their satisfaction by consolidating ownership of the asset and promoting its subsequent disposal, without participating in collective restructuring or insolvency proceedings.

As a result of the above, there is no specific provision in the Brazilian Bankruptcy Law allowing credit bidding as a mechanism to protect the interests of secured creditors. Article 50, paragraph 1, of the Brazilian Bankruptcy Law provides the only protection for creditors with a real guarantee in judicial reorganisation proceedings: the removal or replacement of the asset given as collateral, in the event of a sale, depends on the express approval of the creditor holding the collateral.

Although there is no express rule to deal with credit bidding in the Brazilian Bankruptcy Law, bidding with claims is not something new or unknown in Brazil.

Since the 19th century, the Brazilian legal system has allowed creditors to bid at public auction for sale of the underlying asset, using their claim, if authorised by the judge. Traditionally, this has meant that the creditor could participate in the auction, submit bids and buy the asset, but they were only required to deposit the price if there was any embargo or protest of preference and apportionment by another creditor. There being no questioning of the enforceable title by the debtor, nor other creditors and preference of another creditor, the bidding creditor was not obliged to deposit the winning bid – so that the asset was sold for their credit.

If there is another creditor with a material or procedural preference, the creditor can still use their credit to buy the asset, so long as they deposit the amount necessary to satisfy the creditors with preference. This reasoning can be seen in a ruling by the São Paulo Court of Appeals (TJSP in the Portuguese acronym), according to which in the case of "purchase of the asset by the creditor, ... using the credit being executed, it is necessary to order, in case that happens, she deposit the amount of the credit claimed by the other creditor, in order to avoid the frustration of the contest of creditors."[11]

If the creditor can participate in the public auction and buy the good with their credit, why not cut corners and consolidate the property of the asset right away? In this specific case, procedural legislation requires that the good be awarded to the creditor at its appraised value, while in the competitive sales procedure the asset can be sold for less than the appraised value, as long as it does not qualify as an unacceptably low price (below 50% of appraisal value). This is what commentators[12] argue and what the Brazilian Superior Court of Justice (ST in the Portuguese acronym) has decided, when it stated that, "[not] characterised the vile price or excessive burden for the debtor, it is possible for the creditor to buy the property, in a second auction, in a bid lower than the valuation and amount of the debt".[13] Therefore, the creditor may buy the asset for an amount lower than the valuation and continue to execute the remaining difference, obtaining a higher gain than they would have in the adjudication of property. In this case, it will be necessary to display the auction price.

In the context of judicial reorganisation, however, there is no specific rule to allow credit bidding in the sale of assets, either early in the proceeding or through a reorganisation plan.

The absence of express legal authorisation for credit bidding in Brazil does not, by itself, prevent its use in judicial reorganisation proceedings. Given the contractual nature of the reorganisation plan – formed through an agreement between the debtor and its creditors and approved under judicial oversight – it is possible to structure sales that allow the use of claims as consideration, provided this is clearly set out in the plan or in the applicable sale notice. Thus, in light of the original wording of Brazilian Bankruptcy Law, it was already possible for the reorganisation plan to provide for the participation of creditors in the competitive procedure for the sale of assets, with the submission of bids with their credits.

In the case of the *Varig Airlines Group*,[14] the reorganisation plan authorised a portion of the acquisition price of the operational production unit to be paid with credits, with different conversion factors depending on the class in which the creditor is situated:

(i) labour creditors and non-subject creditors could convert their claims from BRL 1.00 to BRL 1.00 in the acquisition currency for the asset, without any discount;

(ii) secured creditors could convert their claims at a 40% discount; and

(iii) unsecured creditors could convert their claims at a 60% discount.

In the case of the *Daslu Group*,[15] the plan also provided for the possibility of acquiring a production unit with the "Daslu" brand through credit bidding, with a conversion factor of BRL 1.00 to BRL 1.00. Any creditor could bid with their claims, even jointly, but the plan did not admit the offer made up of credits that had been assigned to third parties.

11 São Paulo Court of Appeals, AI No. 2241850-55.2019.8.26.0000, Judge Castro Figliolia, 12th Chamber of Private Law, 10 January 2020.
12 See ASSIS, Araken de. *Manual da execução* [e-book]. 4. ed. São Paulo: Revista dos Tribunais, 2018.
13 Brazilian Superior Court of Justice, REsp No. 332.108/SP, Justice Humberto Gomes de Barros, 3rd Chamber, 16 March 2006.
14 State Court of Rio de Janeiro, Proceeding No. 0071323-87.2005.8.19.0001, 1st Corporate Court of the Capital of Rio de Janeiro.
15 State Court of São Paulo, Proceeding No. 024498-11.2010.8.26.0100, 1st Court of Bankruptcy and Judicial Reorganization of the Capital of São Paulo.

In the case of the *Heber Group*,[16] the plan allowed the acquisition of assets with claims, provided that:

(i) a cash payment of 10% of the bid was made, with a minimum amount of BRL 200 million;

(ii) the entirety of the credit was included in the proposal made by the creditor, with the possibility of creditors submitting a joint offer; and

(iii) the credits had not been assigned to third parties – as in the case of the *Daslu Group*.

In the case of the *Renova Group*,[17] to the creditor that offered a bridge loan to the debtors (i.e. DIP financing), the plan authorised the submission of bids with the outstanding balance of the loan for the auction of an asset, with a factor of conversion of BRL 1.00 of credit to BRL 1.00 of currency in the auction. In such a case, the bid submitted by the creditor would be considered on equal terms with bids made entirely in cash.

A relevant case involving credit bidding was the *Abril Group*. The plan provided for the sale of production units as a means of financing the company and paying creditors, with the possibility of unsecured creditors choosing to convert a portion of their credits into payment currency at the auction of certain production units, in the proportion of BRL 1.00 of credit to BRL 1.00 of currency in the auction. The *Abril Group* plan provided that:

(i) the credit bid must compete on equal terms with other payment proposals, including in cash, with the bidder offering the highest bid being considered the winner;

(ii) the credit bid must correspond to at least 100% of the appraisal value of the production unit;

(iii) any remaining balance of the bidder's credit must be paid according to the specific payment condition provided for in the plan; and

(iv) the sale notice must set the maximum percentage of the auction price that can be paid with credits.

After the reorganisation plan was approved, the Abril Group requested the auction be carried out, with a minimum acquisition price of BRL 72.374 million. After court authorisation, a creditor confirmed their interest in converting the portion of their unsecured claims corresponding to BRL 500 million into credits for the acquisition of asset, and later won the auction with a credit bid in the minimum amount provided for in the public notice.

Therefore, even before the significant reform of the Brazilian Bankruptcy Law, it was already possible to see the adoption of credit bidding in competitive procedures for the sale of distressed assets. Despite the rigidity of the old modalities of sale provided by article 142 of the Brazilian Bankruptcy Law, there was no provision that required payment of the price in cash (and there still is not). In addition, in recent years there has been a process of making the legal framework more flexible, with the modification of sales procedures to accommodate stalking horse bids, for example. Considering the contractual nature of the reorganisation plan and the Brazilian experience in light of the procedural legislation, credit bidding could be stipulated for in common agreement between debtor and creditors.

The changes promoted by Federal Law No. 14,112/2020 to the asset sale regime in the Brazilian Bankruptcy Law only reinforced this possibility.

When the new wording of the Brazilian Bankruptcy Law came into force, *Estre Group* negotiated a provision in its judicial reorganisation plan for the sale of an asset with the possibility of credit bidding and the participation of a stalking horse bid of BRL 600 million, with payment of at least BRL 75 million in cash, making it possible for unsecured creditors and non-subject financial creditors to submit bids partially composed of their claims, with a conversion factor of BRL 1.00 to BRL 1.00. The sale through the submission of closed proposals was conducted by the judicial administrator (an insolvency practitioner that serves a supervisory role in judicial reorganisation proceedings, similar to a trustee in a Chapter 11 in the United States) and, in a virtual hearing for the opening of the bids, a proposal in cash was presented by a third party in the amount of BRL 800.88 million, already considering the payment of BRL 48.88 million as a break-up fee in favor of the stalking horse. After the opening of the third party's bid, the judicial administrator granted the stalking horse bidder the possibility of exercising their right to match, which culminated in a superior bid of BRL 840 million, with the payment of BRL 75 million in cash and the remaining BRL 765 million via credit bid. Faced with the superior offer from the stalking horse, the judicial administrator declared them the winner.

In light of the result of the competitive process, the third-party bidder questioned the legality of the procedure, especially considering the exercise of the right to match by the stalking horse bidder. In the order to approving the sale, the judge pointed out that the plan "established an objective criterion for verifying the winning proposal: the offer of highest value",[18] even though the bid was carried out partially with credits from the bidder. In the absence of any preference afforded by the plan in benefit of proposals made entirely in cash (as was the third-

16 State Court of São Paulo, Proceeding No. 1080871-98.2017.8.26.0100, 1st Court of Bankruptcy and Judicial Reorganization of the Capital of São Paulo.

17 State Court of São Paulo, Proceeding No. 1103257-54.2019.8.26.0100, 2nd Court of Bankruptcy and Judicial Reorganization of the Capital of São Paulo.

18 State Court of São Paulo, Proceeding No. 1078438-82.2021.8.26.0100, Judge João de Oliveira Rodrigues Filho, 1st Court of Bankruptcy and Judicial Reorganization of the Capital of São Paulo, 18 February 2022.

party bidder's proposal), there would be no way to escape the criterion of the highest value to declare the winner of the bidding process.

In parallel with the sale, one of *Estre Group*'s creditors challenged the reorganisation plan's provisions involving the sale of the asset. When judging the appeal, the 1st Reserved Chamber of Corporate Law of the TJSP acknowledged that there was no irregularity in the sale process, and that the use of credits as part of the bid would be possible, especially considering the drastic reduction in the company's indebtedness in that case.[19]

5. Guidelines for the use of credit bidding in judicial reorganisation proceedings in Brazil

The participation of the largest number of bidders in the competitive sale process is extremely important to achieve the primary objective of the sale of assets in judicial reorganisation proceedings: the highest possible auction price.[20] It is with this view that one should think about the structuring of the bidding process with respect to credit bidding in Brazil, based on the broad authorisation offered by items IV and V of article 142 of the Brazilian Bankruptcy Law.

In this context, one can outline the contours for credit bidding in judicial reorganisation proceedings in Brazil based on the following questions:

- Who is able to credit bid?
- How much can the credit bid be?
- What will be the conversion factor for the credit bid?

In response to the first question, as noted earlier, the United States Bankruptcy Code expressly provides secured creditors with the right to credit bid in certain situations (although the term itself is not used), but there is no such provision in Brazil. So what should be the guideposts in Brazil?

In the judicial reorganisation of the *Abril Group*, only unsecured creditors were permitted to acquire the relevant assets using their claims. In the *Renuka do Brasil Group* case, both secured and unsecured creditors could bid with their claims. In the *Varig Airlines Group*, all creditors – whether subject to the proceeding or not – were eligible to credit bid. In contrast, in the *UTC Group*, only DIP financing providers were allowed to use their claims to acquire assets. Notably, English case law has permitted an unsecured creditor to credit bid, provided the transaction is structured as a genuine sale rather than a distribution, as seen in the *Sova Capital* case. Which of these models would best promote competition and maximise asset value in Brazil?

One must remember that credit bidding in Brazil is a choice of the debtor and creditors when structuring the sale of assets in a judicial reorganisation proceeding, instrumentalised through the plan and the sale notice, and based on items IV and V of article 142. Thus, considering the maxim from auction theory that the more interested parties that participate in the competitive sale process, the higher the auction price tends to be, the authorisation for all creditors to participate in the auction with their credits may serve to increase competition and bring a potentially superior return to the debtor.

When referring to a return to the debtor, it is important to keep in mind that the asset may be sold entirely with cash (as with any other judicial sale), or with a portion in credits. In this second situation, the debtor benefits from the cancellation of the debt through the offsetting of debts and credits with the bidder, in addition to the payment of an eventual portion in cash.

Unlike in the United States, in which credit bidding is authorised only for secured creditors holding the real guarantee on the asset being sold, in Brazil there is no rule similar to the absolute priority rule in judicial reorganisation proceedings, in such a way that secured creditors may be paid separately from the sale of their collateral, including the imposition of a discount on the value of their claims. In the absence of a rule in this sense, in light of the Brazilian legal system, it would be possible to design the sale with credit bidding to authorise the participation of other creditors, in addition to those holders of a real guarantee on the asset put up for sale.

The cost of participating in the auction may be significantly reduced for these creditors, as they will not need to resort to financial institutions and the market to raise at least a portion of the funds necessary for the acquisition of the asset. This can be an incentive to participate in the competitive sale process. In addition, the participation of creditors who have more information about the debtor's activity and the asset being sold may reduce information asymmetries and lead to a pricing of the asset closer to its real value.

19 São Paulo Court of Appeals, AI No. 2230472-34.2021.8.26.0000, Judge J. B. Franco de Godoi, 1st Reserved Chamber of Corporate Law, 30 March 2022.

20 According to R. Preston McAfee and John McMillan, "[t]he more bidders there are, the higher on average is the valuation of the second-highest-valuation bidder. Hence: increasing the number of bidders increases the revenue on average of the seller". The authors go on to state that "[a]s the number of bidders approaches infinity, the price tends to be the highest valuation" (MCAFEE, R. Preston; MCMILLAN, John. Auctions and bidding. In: *Department of Economic Research Reports*, 8601, London, ON: Department of Economics, University of Western Ontario, 1986, p. 21-22).

But the authorisation for credit bidding provided for in the reorganisation plan or the sale notice should not be unrestricted and unconditional for all creditors. On some occasions, there may be doubts about the creditor's situation, such as when:

(i) there is a dispute over the very existence of the claim, which would have led the debtor, or even the judicial administrator, to omit the claim from their list of creditors, putting the creditor in a situation of uncertainty;

(ii) the debtor and creditor disagree as to the amount of the claim that should actually be listed, with a challenge in progress to judge the amount to be included in the list of creditors; or

(iii) the claim is still the subject of discussion in a lawsuit that demands an illiquid amount and was listed as an illiquid claim in the list of creditors.

In these cases, it is recommended that the credit bids by these creditors be conditioned to offering some type of security in the amount of the bid (e.g. a bank guarantee or surety bond), at least in the disputed portion of the credit. This is what happened in the *Octagon Roofing* case,[21] in which the United States court required the arrangement of a letter of credit to ensure payment in cash, in the event the bidder was unable to credit bid, due to a subsequent decision on the validity of their collateral.

Another issue regarding who will be able to participate in the sale process and credit bid concerns the assignees of credits, which were acquired at a discount in relation to their face value. In the case of the *Heber Group*, the reorganisation plan did not allow credit bids with credits that had been sold and traded to third parties. On the other hand, in the case of the *Renuka do Brasil Group*, the plan expressly provided for the possibility for assignees to submit bids for the acquisition of the production unit. Which path can be considered the best, in view of the maximisation of the value of assets?

The participation of assignees in the sale process, with the right to credit bid, may be an important selling point for investors interested in distressed assets. In addition to potentially increasing the number of bidders, such transferees may be willing to bid higher, as the credits were purchased at a discount to their face value. This leads to the following question: how much can the credit bid be?

In response to the second question raised at the beginning of this topic, it is possible for the reorganisation plan or the sale notice to establish certain limitations on the credit bids, with the objective of fostering competition and protecting the interests of creditors.

As Brazilian law does not require secured creditors to fully receive the balance of their claims within the limit of the value of the collateral, if credit bidding is accepted, a solution must be found for all other credits that were not used to buy the asset.

That is, it is necessary to:

(i) provide for a minimum payment in cash by the bidder; or

(ii) provide for the payment of other creditors, both subject to and not subject to, the effects of the judicial reorganisation proceeding, based on the debtor's remaining activity or the sale of other assets.

Due to item (ii), it will not be possible to carry out credit bidding for the acquisition of the entire company, pursuant to item XVIII of article 50 of the Brazilian Bankruptcy Law, if the payment in cash mentioned in item (i) is not guaranteed, equivalent to the credits that will not be paid any other way.

This is what happened in the cases of the *Estre Group*, the *Renuka do Brasil Group* and the *Heber Group*. The plans provided for a minimum payment in cash, which would be directed to the satisfaction of creditors, and in the cases of the *Estre Group* and the *Renuka do Brasil Group*, the plan established that the purchaser of the production unit should provide a solution for creditors holding guarantees on the assets sold.

In addition, if there is a stalking horse with a contractual provision for break-up fees and/or expense reimbursements, a part of the bid must be in cash to satisfy such obligations, without withdrawing funds from the seller, as the United States court ruled in the *Charles Street* case.[22]

By requiring a minimum cash payment, creditors holding relevant claims and eventual investors who have acquired credits to participate in the competitive sale procedure must have sufficient resources to pay this part of the auction price, but it is still possible for such bidders to have a chilling effect on competition and discourage the participation of other potential bidders.

21 U.S. Bankruptcy Court for the Northern District of Illinois, *In re Octagon Roofing*, 123 B.R. 583 (Bankr. N.D. Ill. 1991).

22 U.S. Bankruptcy Court for the District of Massachusetts, *In re Charles St. African Methodist Episcopal Church*, 510 B.R. 453, 455 (Bankr. D. Mass. 2014).

For this reason, when authorising credit bidding, the reorganization plan or the sale notice may set a threshold amount for bidding with credits alongside a minimum cash payment. In this way, the creditor will be able to structure their bid with a portion in credit and the remainder in cash. This limit may be a fixed amount or a percentage of the total bid. In the latter case, the effect will be the same as the provision of a minimum payment in cash fixed at a certain percentage of the auction value.

In response to the third question, it is important to identify what should be the conversion factor for the credit to currency in the competitive sale process. BRL 1.00 of credit does not necessarily have to be equivalent to BRL 1.00 of currency in the auction, up to the limit of the amount of the claim. In the case of *Estre Group*, unsecured creditors and non-subject creditors could use their claims to purchase the asset at a conversion factor of BRL 1.00 to BRL 1.00. The same was admitted in the case of *Abril Group* for unsecured creditors. In the case of the *UTC Group*, the conversion of credits for the purchase of an asset observed a factor of BRL 1.00 in credit to BRL 2.00 in currency at the auction. In the judicial reorganisation of *Renuka do Brasil Group*, the conversion was carried out with a discount of 50% - that is, for each BRL 1.00 of credit, creditors could use BRL 0.50 in their credit bids. In the case of the *Varig Airlines Group*, the plan provided for different discount factors depending on the classification of the claims.

Considering the freedom of creditors and debtor to negotiate the reorganisation plan, the plan may:

(i) elect a conversion factor that follows the percentage of discount applied in the respective class or subclass of creditors;

(ii) provide for a conversion factor at a lower discount when compared to the discount applied to the respective class or subclass; and / or

(iii) allow the participation of non-subject creditors, holders of credits with fiduciary collateral, holders of post-petition credits or of DIP financing providers, for example, with a conversion factor of BRL 1.00 for BRL 1.00.

The first and second alternatives seem to fulfil the objective of encouraging the participation of creditors in the competitive sale process and increasing competition, allowing a better return to those creditors who adopt a more active posture and participate in the auction. The third alternative may also stimulate competition, if carried out in combination with the first or second alternatives, expanding the potential participants in the bid by reaching creditors who are formally excluded from the reorganisation process.

As the result of credit bidding may mean that the debtor will receive a portion of the auction price in cash and the other portion will result in the cancellation of the credit owed by them (albeit partially) through offsetting, it may be interesting for the debtor to negotiate a conversion factor that includes a discount to the face value of the claims, providing a superior return to the debtor.

That said, the following guidelines should be observed when allowing credit bidding in the sale of assets in judicial reorganisation proceedings, in order to achieve the primary objective of maximising the value of assets:

(i) authorisation for all creditors, both subject to and not subject to, the reorganisation process, to bid with their credits;

(ii) the requirement of a security or bond to allow the submission of bids with credits that are in dispute;

(iii) permission for assignees to bid with their credits;

(iv) the provision of payment in cash of a portion of the winning bid, in a fixed amount previously established or in a percentage of the auction price, to be directed in whole or in part to the payment of creditors;

(v) the provision of a limit for the credit bid, in a fixed amount or in a percentage of the auction price; and

(vi) the provision of a factor for converting the credit into the currency in the auction, with a discount in relation to the face value for the subject claims, but still lower than the haircut applied to the cash payment option provided for in the plan for the class or subclass of said subject claims.

6. Conclusion

The primary objective of the sale of assets in judicial reorganisation and bankruptcy proceedings is to maximise their value. That is, one should always seek a greater return for the debtor and creditors. There are several ways to achieve this objective, with an emphasis on the instruments that allow a better pricing of the asset by potential buyers and that stimulate greater competition in the sale process.

To achieve the highest auction price in the sale process, there must be an incentive to offer higher bids – otherwise the price bidders are willing to pay will not be reached, the asset will be auctioned at an amount close to its reserve price and the debtor will not get the highest possible auction price.

That incentive is competition. The greater the number of participants in the sale process, the greater the chances of the asset being sold at a price closer to its real value, earning superior sale proceeds when compared to an auction with only one participant.

Credit bidding can be used to encourage competitive distressed asset sales in Brazil. The possibility for creditors to bid with their claims, upon authorisation in the reorganisation plan or the sale notice, may help reduce information asymmetries by putting the seller's creditors, who potentially have a more in-depth knowledge of the asset and the business, in the competition. And this may lead to better pricing of the asset put up for sale.

Credit bidding can also broaden the universe of participants in the sale process by allowing creditors to use their claims as part of their bids. As a result, there is a possible reduction in the costs of entering the auction and in the transaction costs related to the acquisition of the asset. In addition, an alternative is presented to creditors: receiving their credits in the form of the reorganisation plan or using the credits to purchase the asset. Thus, credit bidding may help to achieve the primary objective of selling assets in rescue proceedings, which is to sell the asset for the highest possible value.

This technical paper presents guidelines for the use of credit bidding in Brazil with the goal of maximising asset value in judicial reorganisations, as well as incentivising investors interested in acquiring distressed assets in Brazil (especially when trading of claims is involved).

Other jurisdictions that also lack express statutory provisions – such as the United Kingdom and Canada – have nonetheless benefited from credit bidding through case law and market practice, demonstrating that the tool can be effectively incorporated even in the absence of codified rules. It is hoped that continued practical experience in Brazil will help consolidate the role of credit bidding in distressed asset sales and demonstrate its positive impact for all stakeholders involved in the restructuring process.



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