

GLOBAL REFERENCE GUIDE

The top half of the cover features a composite image. On the left, the American flag waves against a sky with golden, dramatic clouds. On the right, a US dollar bill is partially visible, showing the portrait of George Washington and the text 'THE UNITED STATES OF AMERICA'. A lightning bolt strikes the right side of the bill.

americas restructuring

with global advisor directory

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Americas Restructuring 2011”**

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GLOBAL REFERENCE GUIDE

**americas restructuring
2011**

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Global Reference Guide
Americas Restructuring 2011

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UNITED STATES

Pre-packs: trending and enduring

by Tinamarie Feil | BMC Group (US)

PRE-PACKAGED RESTRUCTURING PLANS (pre-packs) continue to rise in popularity as a mechanism for US companies to solve their financial and debt woes. According to filing statistics reported in the Bankruptcy Yearbook and Almanac, 20 percent of the companies that had publicly traded debt and filed for Chapter 11 protection in 2010 utilised pre-packs. A June 2011 Alix Partners survey of bankruptcy lawyers, investment bankers, and fund managers indicates nearly half of respondents expect pre-arranged and pre-packaged filings to account for between half and three-quarters of all major corporate bankruptcies in the coming year.

Historically, there have been three classic solutions employed to effect a company's reorganisation: (i) out-of-court restructuring; (ii) the ordinary, 'traditional', Chapter 11 bankruptcy; and (iii) the pre-arranged or pre-packaged Chapter 11.

A company looking to reorganise might initially believe they would prefer to do so entirely out of court. However, out-of-court restructurings can be hampered by industry practice or non-bankruptcy law. A typical difficulty involves requirements of unanimous consent of creditors. Unanimous consent may be complicated due to party identification or simply party hold-outs, thus jeopardising the oft desired outcome of modifying debt structures and contracts, and/or selling assets.

A company engaging in the traditional Chapter 11 process – filing for protection with the bankruptcy court, engaging with its creditor constituencies, obtaining approval of its disclosure statement, soliciting votes, and then seeking to have its plan confirmed – often perceives the process as disruptive to business operations, costly, and overly time consuming. A majority of traditional Chapter 11s are filed in response to specific liquidity events. Some companies require only a balance-sheet restructuring, and the traditional Chapter 11 process seems onerous. Others require attention and repair of operational problems, and probably need to take advantage of the rights engendered by the phases of a traditional bankruptcy. But when a company files without first seeking the advice of a restructuring professional who is given adequate time to structure the protections afforded by the Bankruptcy Code, it is placed at a disadvantage. This type of case is generally referred to as a 'free fall'. In a free fall case, the company follows the traditional sequence of Chapter 11 case events.



Pre-packs, which have been around since the 1980s, boast both plan negotiation and vote solicitation prior to the case even being filed. Filing occurs with a potentially confirmable plan at the ready, mostly just waiting on the court's approval. The company can typically expect confirmation of a plan and emergence from bankruptcy within a few months or less. Thus, a good candidate for a pre-pack may suffer unnecessarily by going into a free fall. Even if votes cannot be solicited prior to filing, there are similar advantages available in the so-called 'pre-arranged' bankruptcy in which the terms of a restructuring are negotiated and plan support agreements put in place pre-filing. Since solicitation is performed post-filing, the pre-arranged bankruptcy typically exceeds a pre-pack in the time required to emerge by a couple of months.

The perceived certainty of outcome, reduced time in court, and lower cost makes pre-packs attractive. This pre-pack advantage is particularly relevant for companies whose primary goal is a balance-sheet restructuring. In such instances, the company can focus on negotiations with a limited and typically sophisticated creditor group – for example, secured lenders and unsecured bondholders – because the company's miscellaneous other creditors – trade vendors, landlords, and so on – may be left unimpaired by the plan and arguably irrelevant to the likelihood of a successful restructuring. Recent remarkable pre-packs include CIT, purported to be the largest pre-packaged bankruptcy ever, and Metro-Goldwyn-Mayer, which was completed in the lightning speed time frame of less than 30 days. The record for the shortest pre-pack bankruptcy to date appears still held by the Chapter 11 proceeding of Blue Bird Body Company in January 2006, which reportedly lasted just over 32 hours.

Certain pre-packs and pre-arranged cases are intended to effect a pre-arranged asset sale. Examples of US pre-arranged sales include Chrysler, General Motors and Lehman Brothers. The pre-planned approach offers advantages to a potential buyer of a company, such as eluding an auction process and obtaining injunctions and exculpation provisions not necessarily available in a sale under section 363 of the Bankruptcy Code.

Advisers have, as indicated by the cases mentioned above, learned to navigate the current law to use pre-packs to company as well as creditor advantage. The impending 'wall of debt' scheduled to mature between 2012 and 2015 is anticipated to push companies to focus on fixing their capital structures. While companies and their creditors strategise toward predictable outcomes with speed, cost-effectiveness, and minimal disruption to business, the pre-pack is – now more than ever – an attractive option, and is certainly here to stay. ■

UNITED STATES

Are retailers at the leading edge of a downturn?

by Van C. Durrer, II | Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

AS BORDERS BEGINS the final chapter of closing its remaining stores and liquidating the last of its assets, the restructuring landscape remains uncomfortably quiet for restructuring professionals and distressed players. Companies have access to the capital markets, and lenders have shown a willingness to restructure maturing obligations out of court. However, the sluggish economic recovery, hampered by gas and commodity price volatility, and politics among other things, is causing consumers to retreat, and retailers are feeling the effects. This writer predicts that there will be an uptick in restructuring assignments in the near future, and it will start in the retail sector.

In the first two quarters of 2008, US consumers were spending in the range of \$100 per day in stores, restaurants, online and at gas stations. Since the recession, during the first two quarters of 2009, 2010 and 2011, the average has hovered around \$65 per day. Even spending among upper-income individuals – those making \$90,000 or more per year – showed a similar shift in consumer spending behaviour to a lower level of spending post-recession. The Institute for Supply Management recently reported that its index of national factory activity fell to 50 for the month of June, showing no growth as manufacturers experience stagnant consumer spending.

Of course, the ‘new normal’ of retail bankruptcies will make the next 12 to 15 months very challenging for struggling retailers. As we enter the end-of-summer vacation period, retailers are already beginning to book inventory orders for the crucial year-end holiday selling season. Although revenues from sales will continue to gradually improve for retailers over the balance of the year, the inventory spend leading up to the fourth quarter will still strain overall liquidity. This year, several macro-economic factors will continue to cast a shadow over holiday spending by consumers. These include, among others, continued conflict in the Middle East, commodity and gas prices, and the fiscal strength – or lack thereof – of government at the national and municipal and local levels. If the holidays do not produce sufficiently positive results, retailers will be forced to examine a possible in-court process to restructure their financial obligations.

This exercise typically occurs for a retailer in January, when retailers are ‘cash-rich’ from the recent holiday selling season. Under the new Chapter 11 regime for retailers, however, retailers only have nine months within which to determine which stores to maintain and which to shutter.

In other words, retailers cannot develop and test operational innovations through a holiday selling period without landlord consent. In addition, a retailer's exit from bankruptcy is burdened by the new requirement to satisfy all vendor claims arising in the 20 days before bankruptcy in full, and in cash. Large and small retailers alike have failed to survive this intense and short 'breathing spell' within which to restructure. For example, Circuit City and Borders liquidated shortly after commencing their Chapter 11 cases, just as smaller retailers such as Rock & Republic and No Fear did very recently.

Interestingly, both the Rock & Republic and No Fear Chapter 11's ended in successful sales of those retailers' underlying brands. More and more buyers of such brands are emerging and pursuing licensing models, where the owner of the brand licences the brand to existing, stable retailers. In this scenario, the licensor continues to develop and market the brand, but the licensee often takes on the manufacturing and distribution costs while paying the licensor a royalty stream. Smaller retailers with strong, identifiable brands would be well-served to consider this strategy as they move into the inventory build period. At a minimum, a lucrative licensing transaction would generate much-needed liquidity to purchase inventory. Alternatively, such a transaction may suggest that the retailer consider a different direction altogether, such as a licensing model. In addition, consideration of this approach often helps support the retailer's valuation of its existing enterprise. ■

UNITED STATES

The changing role of the chief restructuring officer

by Stephen L. Kunkel | GlassRatner Advisory & Capital Group LLC

WITH THE LINGERING impacts of the most recent recession – particularly the restraint, if not outright reluctance, within capital markets – the nature of the chief restructuring officer (CRO) role has changed, as the ability to successfully restructure an enterprise becomes increasingly more difficult. No longer simply a matter of ‘right sizing’ and matching cost structures to balance sheets, CROs are now charged with creating long-term viability in stubbornly adverse environments and with deriving working capital options from a company’s internal operations. Successfully manoeuvring in such restrictive atmospheres requires honed skills in leading people and operating businesses, not just in understanding financial instruments or running a process.

Trusted advocate for all constituencies. Restructuring has evolved from an adversarial process to a collaborative one, and the CRO’s role has evolved to one of transparent consensus building, both with and between all constituencies. The CRO must be a trusted advocate of a consensual resolution to a company’s difficulties. For there to be an amicable solution to a company’s issues, a CRO needs to communicate effectively an answer to the basic business question of “from where does a company make money, and how best can we all get there?” Constituents are better partners when they understand the possible circumstances for resolution and that patience may be needed in order to effect the solution, wherein generated cash is utilised for continued operations, and not for pay downs.

In some circumstances, for example, it may be far more advantageous to negotiate with vendors individually and openly, as opposed to rejecting and accepting contracts in a court proceeding as a way of increasing viability. More and more, companies are establishing viable long-term business options by, among other actions, asking vendors for liberal terms on past due amounts, including steep discounts, in exchange for continued, long-term, contracted business. More lucrative going concern outcomes are often achieved when a CRO takes on the responsibility for seeking and maintaining transparency with and building consensus between all the various stakeholders. The success of such a stance is predicated on the CRO establishing and leading transparent dialogue and being a trusted advocate for a long-term viability plan that includes at least some resolution and benefit to all constituents.

Working internally to generate working capital and business options from within operations. As each constituent becomes comfortable with the process, even in light of some obscurity from an uncertain outcome, some working capital concessions might be achieved. In the current environment, however, CROs are charged with generating cash from within the operations of a company, often without assistance from ordinary sources.

When a CRO is entrusted with the stewardship of a company's future, no longer can that executive simply execute a one-time cost reduction 'right-sizing' event, adjust the business platform, or alter the capital stack. Charged with securing long-term viability predicated on reduced cash burn, a CRO needs to understand and communicate – both internally and externally – how a company actually makes money and establish a plan that preserves that ability while conserving working capital. To do this, CROs must instill a culture of critical thought, transforming a company's entire workforce into one utilising a mindful continuous critical evaluation of every aspect of the business. Essentially, CROs need to instill a culture change that sets a company down an unadventurous business path characterised by cash conservation, restructuring continuously. Longevity, in adverse circumstances, can really only be achieved through business tactics that generate and preserve cash and that carefully manoeuvre towards successful business options with both immediate and long-term benefits.

The skills of the new CRO. Historically, a CRO has been a financial professional, with an unbiased view of a business, and a sound understanding of the restructuring process. These skills, and an ability to see issues clearly, remain requirements today. Given the existing challenging financial and business environments, however, a CRO must also understand a business's circumstances and operations, so as to instill a cultural change, a shift to continuous critical evaluation, and to be able to lead negotiations openly for consensus. Today's difficult environment requires true business leadership on these and many fronts, not simply knowledge of finance and process. The resolution of a company's financial difficulties is found in that company's business operations, not necessarily in the capital stack, and a CRO leads that search.

The business arena is filled with companies that have exited 'restructurings', either formal court proceedings or otherwise, with still broken business models, destined for another restructuring or, worse yet, liquidation. At least some of these are due to either a lack of consensus or an unrepaired business operation, both certainly leading to excessive cash burn and continued difficulties. Today, more than ever, the characteristics of the CRO must include not only financial and process understanding, but also business operations and business culture expertise and leadership, both internally and externally. Both to a company's people and to company's external constituents, today's CRO leads the search to establish and communicate where the company makes money and how best to get there. ■

UNITED STATES

Midwest word from the street: times still are disconcerting

by Barry A. Chatz and George P. Apostolides | Arnstein & Lehr LLP

THE AMERICAN MIDWEST has always been the section of the United States where American middle market firms and manufacturers have thrived. With the transition to a more service-oriented economy in the US and mass consolidation in virtually all sectors of the economy, the Midwest has been suffering for some time. Events of the last few years, notably the stresses in the banking sector, have made matters even worse.

The humble Midwest continues to feel the impact of the double whammy of bank failures and a dearth of middle-market lending. As a result, businesses are suffering a severe liquidity crunch that does not appear to be noticeably improving. The impact of the lack of liquidity in the banking sector continues to plague businesses throughout this part of the country.

Banks, particularly middle-market or community banks, are facing government scrutiny of their lending practices as all parties involved in regulating the economy try to avoid another catastrophic market collapse. Banks are thus identifying non-monetary defaults and punishing small businesses by acting on those defaults, even if the business is paying its loans on time. Secured lenders with performing payment history loans continue to seek to force the borrowers out of their institutions often due to technical non-monetary defaults such as debt service coverage ratio violations. This has diverted the attention of business owners from operational issues to their lender priorities. As a result, operational growth and expansion are very difficult goals to attain. Further, opportunities to re-finance assets through existing traditional lenders are few and far between. Forbearance agreements continue to be the rage, facilitating fee income for the lenders as well as additional interest charges as borrowers have no other credit sources. But once the secured lender has a business on its radar, times will inevitably get tougher for the business. Not only does management have to devote time and energy to calming the squeamish lender and identify additional capital, but the legal fees attendant to such negotiations are yet another drag on the business.

As a result of all this, one would think that bankruptcy professionals would be busier than ever. But that is not the case. The bankruptcy option in a structured Chapter 11 is not generally an option as the costs attendant thereto, including legal fees, accounting fees, and potential debtor-in-possession financing charges, are too much to be absorbed by most companies. As a result,



many businesses are continuing to deliver the keys for their operations to their secured lenders as they lack equity to support their money hemorrhaging operations or enter into assignments for the benefit of creditors or Chapter 7 liquidations. The bankruptcy courts continue to see fewer Chapter 11 reorganisations, as the financing necessary to restructure has become virtually impossible to find. As a result, many restructuring professionals have plenty of time to work on their golf games.

Beyond the stresses caused by the banking industry, the Midwest's economy continues to struggle in general. Sales of goods, excepting absolute essentials, continue to be tepid. The real estate markets continue to lag, excepting sales and construction of apartment properties located in desirable areas. New construction, other than for apartment buildings – whose demand is created by the foreclosure crisis – is virtually non-existent on the residential real estate front. Commercial building construction is also at a lull. Even more worrisome is the prospect that growth will be stunted in both the short and medium term due to the banking industry's issues and the exploding debt on all levels of government.

The challenges in the business environment have caused issues in this region's employment. Unemployment persists and those who continue to lose jobs, and are lucky enough to find new positions are often finding positions at a significantly reduced rate. The effect of a decrease in incomes impacts all sectors of business and continues to cause defaults within the residential real estate marketplace, let alone the untold damage it is doing to families who are struggling to live the American dream.

Is there a bright side? Of course. Interest rates remain low. Employers have their pick of skilled workers seeking employment. The housing market seems to be close to bottoming out. And we in the Midwest know that when the economy cleans itself up, small and mid-size companies – the backbone of American business and our economy here – will be better able to grow and add value to the economy than the behemoths which dominate the coasts. The normal process of business success and failure will start again. And the restructuring professionals will have lowered their handicaps significantly. ■

CANADA

Canadian court clarifies approach to centre of main interest in context of corporate groups

by Kenneth D. Kraft | Heenan Blaikie LLP

INTERNATIONAL CO-OPERATION IN the insolvency arena has moved forward by leaps and bounds. In Europe there is the European Insolvency Regulation; UNCITRAL has its model law on international co-operation which was adopted in the US as Chapter 15 of the Bankruptcy Code; and this is largely replicated in Canada in the Companies' Creditors Arrangement Act (CCAA). However, despite the undoubted advances in international co-operation, one acknowledged gap is that while the international developments work at an individual company level, it breaks down at the group level.

Central to current insolvency legislation, both national and supranational is the concept of 'centre of main interest' (COMI). COMI is typically determined by the location of the debtor's registered office. However, in the typical multinational enterprise, there will be multiple debtor companies with registered offices in virtually every country where the debtor operates. Insolvency legislation typically provides that, absent proof to the contrary, the debtor's registered office is deemed to be the COMI. In the case of a corporate group, particularly small to medium sized enterprises, it would be extremely wasteful to have to file plenary proceedings in multiple jurisdictions. The cost of such action might actually prevent a restructuring from ever occurring and result in a liquidation for all, or parts, of the business that might have otherwise been salvaged.

Very recently, a court in Canada had the chance to look at the issue of COMI in the context of a corporate group. Elephant & Castle (E&C) operates pub style restaurants in Canada and the US. There are 14 companies in the group, including three Canadian entities, one of which was the parent company. The registered offices of the Canadian companies are in Canada (the "Canadian Debtors"). In addition, nearly one-half of E&C's operating locations are in Canada, approximately 43 percent of the employees work in Canada and GE Canada Equipment Financing G.P. is the primary secured creditor of E&C. As such, E&C sought to rebut the COMI presumption prescribed by the CCAA for the Canadian debtors. The remaining companies in the E&C group were all incorporated in various American jurisdictions. The head office for the group is in Boston.

E&C filed for Chapter 11 protection in the US. The issue before the Canadian court was whether the Chapter 11 Proceedings should be recognised as a foreign proceeding and, if so,

whether they were a ‘foreign main proceeding’ or a ‘foreign non-main proceeding’ under section 47 of the CCAA – there are comparable provisions in Chapter 15 of the Bankruptcy Code and the European Insolvency Regulation. If the court recognises the Chapter 11 proceedings as a foreign main proceeding the relief to be granted the applicants includes an automatic stay of proceedings – if the court determines the proceeding is foreign non-main proceeding then the decision to grant a stay of proceedings is discretionary, not automatic. A foreign main proceeding is defined in the CCAA, consistent with international protocols, as a foreign proceeding in a jurisdiction where the debtor has its COMI.

The court was satisfied that E&C had met the threshold to rebut the presumption that each debtors’ COMI is their registered office, in the circumstances, and the Canadian debtors’ COMI was found to be the US. In arriving at this finding, the court noted the international jurisprudence on the issue of a debtor’s COMI and commented that, in interpreting COMI, the following factors are usually significant: (i) the location of the debtor’s headquarters or head office functions or nerve centre; (ii) the location of the debtor’s management; and (iii) the location which significant creditors recognise as being the centre of the company’s operations.

Considerable emphasis was placed on the fact that E&C’s head office functions or nerve centre, and the location of the debtor’s management, were in Boston, Massachusetts. Further, GE, the primary secured creditor, did not oppose the relief sought.

E&C had also submitted, consistent with international jurisprudence, that additional factors the courts, both in Canada and internationally have considered in determining the COMI include: (i) where corporate decisions are made; (ii) the location of employee administration, including human resource functions; (iii) the location of the debtor’s marketing and communication functions; (iv) is the enterprise managed on a consolidated basis; (v) the extent of integration of an enterprise’s international operations; (vi) the centre of an enterprise’s corporate, banking, strategic and management functions; (vii) the existence of shared management within entities; (viii) the location where cash management and accounting functions are overseen; (ix) the location where pricing decisions and new business development initiatives are created; and (x) the seat of an enterprise’s treasury management functions.

Ultimately, the court in Canada narrowed the key factors down to the three in the preceding paragraph. In so doing, the court seemed to be signalling that the courts in Canada will take a pragmatic approach when dealing with insolvent groups. ■

CENTRAL & SOUTH AMERICA

Pre-packaged and pre-negotiated bankruptcies in Latin America

by Paul J. Keenan, Jr. and Nancy A. Mitchell | Greenberg Traurig, LLP

PRE-PACKAGED AND PRE-NEGOTIATED bankruptcies have been available in the US for many years, and many believe that their use is now on the rise due to the success of several recent large cases. In Latin America, pre-packaged and pre-negotiated bankruptcies were virtually unknown just a decade ago because most countries in that region only had antiquated bankruptcy laws that were geared more toward liquidation than corporate reorganisation. Beginning in 2000, however, several of the larger Latin American countries began enacting modern bankruptcy statutes designed for complex corporate restructurings. In some cases, the new statutes allow a company to pursue a form of pre-arranged plan of reorganisation.

In the US, a ‘true’ pre-packaged plan of reorganisation is one where the creditors’ votes are solicited and obtained before the bankruptcy case is even filed. Depending on the circumstances of the case, the bankruptcy case itself can last anywhere from just a few days or weeks or up to a couple of months, but typically lasts 30 days. In a pre-negotiated case, the company negotiates the terms of its restructuring plan before the commencement of the case, but the votes are not solicited until after the case begins. Such cases typically last at least two months.

Pre-packaged and pre-negotiated bankruptcies carry many benefits. The primary benefit of implementing a plan of reorganisation through an in-court process is that it allows a company to use the full weight of the bankruptcy statutes in order to restructure its debt and return the enterprise to profitability. Of course, the primary drawback is the stigma often associated with filing a bankruptcy petition and the lack of certainty about the outcome at the beginning of the case. The pre-packaged option is much more palatable because the time spent in bankruptcy and under court supervision is much shorter. Furthermore, the risk of an unsuccessful case is greatly reduced because the case is not even filed until the company’s creditors have approved the plan. In a pre-negotiated case, the time spent in bankruptcy and the uncertainty are perhaps more than in a pre-packaged case, but still much less than in most standard cases.

In the aftermath of its currency crisis in the mid-1990s, Mexico passed the *Ley de Concurso Mercantil* in 2000, which now governs business bankruptcy cases in Mexico. In Mexico, the law does not provide for a ‘true’ pre-packaged plan of reorganisation, but the new statute does provide for a form of pre-arranged plan.

In Mexico, a company can pursue an expedited bankruptcy case if it obtains approval from at least 40 percent in face value of the claims affected under the plan before commencing the bankruptcy case. In order for the plan to be approved, however, the requisite majority of creditors must still vote to approve the plan and the court must also approve the plan. While the process is much more like a pre-negotiated than a pre-packaged plan, there is still more certainty and expediency than in a standard bankruptcy case in Mexico.

As evidence that the relatively new system can work well in the right circumstances, Controladora Comercial Mexicana, one of the largest supermarket retailers in Mexico, recently completed its pre-arranged bankruptcy in a case that had nearly unanimous creditor consent and lasted only three and a half months. On the other hand, Vitro, a glass manufacturer, has had trouble obtaining court approval for its pre-arranged plan filed in December 2010 because its plan relied on intercompany claims to obtain the requisite number of approvals. Bondholders objected and the Mexican court rejected the plan, but an appeals court overruled that decision a few months later. The case is still making its way through the courts.

Relatively recently, Brazil and Argentina both adopted procedures that more closely resemble a 'true' pre-packaged bankruptcy option. Brazil revamped its corporate reorganisation law in 2005 and created the *recuperação extrajudicial*. Under this procedure, a corporate debtor can negotiate with its creditors out of court, and then request that a court ratify an agreement approved by three-fifths of each class of claimants. In 2002, Argentina adopted a similar procedure called an *acuerdo preventivo extrajudicial*.

There is yet another path for Latin American companies to move smoothly and swiftly through a bankruptcy process. Under the right circumstances, a Latin American company with assets and debt in the US can use the more predictable pre-packaged bankruptcy process in the US. One example of such a cross-border restructuring is Satélites Mexicanos (Satmex), a satellite owner and operator based in Mexico. Satmex had over \$400m in US bond debt to restructure, but was current with its local creditors. That scenario allowed the company to cruise through a US 'true' pre-packaged bankruptcy case in 35 days, without even filing a *concurso mercantil* in Mexico. While it may seem unusual for a Latin American company to use the US bankruptcy process, there are several examples of this approach, and in the right circumstances, the approach has had considerable success. ■

CENTRAL & SOUTH AMERICA

Restructuring in Mexico: how the courts are reshaping business

by Thomas S. Heather | Heather & Heather, S.C.

TODAY, MOST REPORTS on Mexico focus mainly on corruption, the violence resulting from what is truly a war on organised crime, and the condition of undocumented workers. These issues are very real but they are not what Mexico is all about. Mexico has moved forward in many areas and is a solid example of sound macroeconomic policies. Certainly there has been improvement in the much criticised judiciary and in its insolvency legislation: the *Ley de Concursos Mercantiles* of 2000 (the *Concurso* Law).

It is interesting to note that very few companies resort to bankruptcy protection. In 11 years of the 'new' *Concurso* Law, there have been less than 50 cases involving corporations with sales of over \$25m a year. In total, during 2009-2010, 88 petitions were filed, overwhelmingly on a voluntary basis; consequently even under the impact of a global crisis and a recessionary oriented economy in the US, only a handful of Mexican corporations of any significant size, have resorted to a *Concurso* filing.

Perhaps this fact explains why specialised bankruptcy courts have not been created. Federal courts have exclusive jurisdiction over insolvency proceedings and the selection process, supervision and preparation of judges has substantially improved. Nevertheless, it is also a fact that district judges are overloaded with an average 2500 cases mainly consisting of constitutional challenges (*amparos*), and that most have limited experience with regard to commercial matters or cross-border commerce.

There is also another peculiarity in Mexican insolvency practice; the *Concurso Law* provides for the development and continued training of specialists: trustee-administrators (*conciliadores*) and liquidators (*sindicis*). A supervisory body, the Federal Institute of Insolvency Specialists (IFECOM), plays a significant role in *Concursos* and in many ways oversees processes of special interest or material importance with the objective of ensuring, to the extent possible, compliance with the terms of the law. There are numerous restrictions prohibiting conflicts of interest relationships. The appointment procedure is to be based on random, electronic selection from the classes and ranges of experience pertaining to the experts registered. However, there has been recent criticism of appointments which seem to be less than random.

The *Concurso Law* provides for one sole proceeding (*Concurso mercantil*), encompassing two suc-

cessive phases: (i) a conciliatory phase of mediation; and (ii) bankruptcy. The objective of the conciliatory phase is to reach a restructuring agreement culminating in the *Concurso* plan proposed by the conciliator and approved by the court on a mandatory basis. The *Concurso* Law clearly provides that in no event may the conciliatory stage be extended beyond 365 days, whereupon bankruptcy and liquidation of assets immediately begin, although courts have had mixed performances with compliance therewith.

The *Concurso* Law was amended in December 2007 to create the possibility of a pre-packaged restructuring plan. The formal requirements to be included in a restructuring plan are simplified. It also includes precise rules as to its contents, while specifically allowing for restructured loans to be maintained in the original currency contracted under. To become effective, a restructuring plan must be subscribed to by the debtor and recognised creditors representing more than 50 percent of the sum of the total recognised amount corresponding to unsecured creditors and the total recognised amount corresponding to secured or privileged creditors subscribing the plan. Any such plan, with the validation of the court, will become binding on all creditors.

The real problem with the statute is that there are no provisions allowing qualified majorities to impose a plan on any recalcitrant participant, in regard to secured creditors; in addition, despite cases where more than 90 percent of creditors have supported a plan under the pre-packaged rules, the IFECOM must still be approached for the bureaucratic process leading to an appointment of a conciliator. The few Mexican pre-packs to date have required very substantial majorities to actually become an effective tool.

Recent experiences in the delays by Mexican courts in accepting *Concurso* filings, the uncertainties associated with the appointment of the significant role of a conciliator by the IFECOM, and the lack of immediate protective measures, among other factors, have led Mexican companies to turn north, for the protection of US bankruptcy courts under Chapter 11 filings. The recently concluded second insolvency case of SATMEX proved to be efficient and predictable, and a success story culminating in a six week pre-pack in the Southern District of New York. In contrast, the Mexican pre-pack alternative has been only modestly successful.

In conclusion, The *Concurso* Law is now due for a much needed revision. Nevertheless, it may be a few years before Congress will actually be persuaded to support the relevant changes which are necessary to make Mexican procedures and practices reliable and competitive. Consequently, consensual negotiations and out of court settlements and restructuring continue to be the preferred alternative with regard to Mexican financially impaired corporations. ■

CENTRAL & SOUTH AMERICA

Judicial approach and treatment of intercompany credits in bankruptcy procedures in Mexico

by Luis A. Cervantes M. | Cervantes Sainz, S.C.

A HOLDING COMPANY, in addition to having within its main assets shares from its subsidiaries and affiliates, often maintains several real and on-going operations with such entities, and such entities may be considered as debtors or creditors of its own holding. Notwithstanding such intercompany transactions, holdings, in most cases, exercise economic, financial and corporate control over their subsidiaries. Flows from subsidiaries may represent a relevant income for holdings for covering the latter's liabilities. If subsidiaries are prevented from paying capital and interest to their shareholders – including their holding companies – holdings may face liquidity problems that may drive them to seek bankruptcy protection before Mexican courts (*concurso mercantil*).

One of the purposes of Mexico's Bankruptcy Law, as a public interest regulation in Mexico, is to keep debtor companies from avoiding widespread failure of payment on their obligations, and thus preventing them from jeopardising and threatening their viability; and to protect third party interests in lieu of having such debtors continuing with their businesses, though sometimes such third parties may mingle the role of debtors and/or creditors of their own holdings by benefiting their holding and harming creditors.

Protection afforded by the bankruptcy procedures may be conveniently used by holding companies by playing with intercompany credits in their favour. The subject matter becomes of great interest when a holding company is about to enter into a bankruptcy proceeding and its subsidiaries and/or affiliates appear in the proceeding as debtors, or personified as creditors, which may or may not place a company within the hypothesis of a *concurso mercantil*.

It has become a current trend to have holding companies seek protection and participate hand-in-hand with their subsidiaries with a relevant and transcendental role in such proceedings – for example having intercompany creditors authorising business reorganisation and restructuring plans – benefiting from the status quo granted by the *concurso mercantil* and the provisional measures that a bankruptcy court may grant to such debtors.

According to our Bankruptcy Law, intercompany creditors may be considered as creditors in fraudulent transactions, but it does not provide a special treatment for such credits. In this regard, a *concurso mercantil* may not be filed by a business entity seeking protection for all its subsidiaries/affiliates, thus it must file a separate and individual petition for each entity, regardless of the

fact that upon request, such procedures may be accumulated before the same court but will not be processed as a whole and single economic unit. This has a great relevance when intercompany creditors achieve the ‘alleged’ bankruptcy protection of their holdings as a shield against other creditors.

Placing subsidiaries as creditors of their own holding could have the effect that the holding company itself, through its subsidiaries or through affiliates, may have full control over the *concurso mercantil*, since such companies may be considered as a majority, and may take their holding companies into a greater reduction or forgiveness of their debt by their own subsidiaries. In simple words, intercompany creditors may have control of the bankruptcy proceeding, and appoint auditors *ad hoc*, approve restructuring plans, and so on.

While some companies in business reorganisation procedures have sought to play with these intercompany credits, the current judicial trend in Mexico leads us to deduce that future bankruptcy proceedings will be more flexible in considering intercompany creditors as creditors in the *concurso mercantil*.

The Bankruptcy Law is silent regarding treatment of intercompany credits, but courts and the Federal Institute of Specialists in Concurso Procedures (*Instituto Federal de Especialistas de Concursos Mercantiles*), an entity that acts as supervisor in the *concurso mercantil*, currently tend to consider such loans as credits with the same rights from any other non-related creditor. This interpretation may lead to a reform of the Bankruptcy Law, allowing holdings and subsidiaries to file for bankruptcy petition as single businesses or economic entities or units, hence granting protection to a corporate unit as a whole, instead of segregating its members and considering each entity individually. ■

CENTRAL & SOUTH AMERICA

Amendment to Argentine bankruptcy law

by *Martín Campbell and Ricardo Walter Beller | Marval, O'Farrell & Mairal*

THE ARGENTINE BANKRUPTCY Law 24,522 was recently amended with the main purpose of increasing the rights of the workers of a debtor company which is undergoing a *concurso* (similar to a US Chapter 11) or a bankruptcy proceeding. The amendment was enacted by Law No. 26,684, published in the Official Gazette on 30 June 2011 (the 'Amendment'). We highlight below the main impact that the Amendment will have on creditors' rights, without attempting to cover all the new issues that the Amendment may potentially raise.

After the crisis of 2001/2, it became increasingly common that the workers of bankrupt companies took over the premises of the debtor and continued operating them through labour cooperatives. According to government data, as of 2011 approximately 280 bankrupt enterprises (mainly in the manufacturing business) had been taken over and were providing work to approximately 20,000 workers.

The Amendment recognises labour cooperatives as a subject with new rights in the *concurso* and bankruptcy proceedings. Through the labour cooperatives the workers of bankrupt companies have been granted several rights, including, among others, the following.

First, the right to request the judge presiding over the bankruptcy to order the continuation of the company's business in the event of bankruptcy; provided two-thirds of the workers of the bankrupt company support such request. In the event the court rules against this request, the workers have the right to appeal, a preferential right that no third parties are entitled to under similar circumstances.

Second, the right to bid for the acquisition of the debtor in the events of a cramdown or bankruptcy. The cramdown is a bidding process that is undergone if the restructuring plan presented by the debtor during a *concurso* proceeding is not approved by the required majority of creditors. The Amendment grants the labour creditors the right to bid in the cramdown, as well as in the acquisition of the company as a going concern in the event of bankruptcy, using their labour claims as payment of the purchase price.

Third, the right to purchase the assets of the bankrupt entity during the bankruptcy proceeding and set-off the labour claims of the members of the labour cooperative with the purchase price of the assets, and to use the labour claims as security/guarantee of performance of contracts.

Fourth, the right to purchase the business as a going concern in the event of bankruptcy with preference respect to other creditors, as the judge will give preference to the proposal which ensures the continuance of the greatest amount of workers possible.

Fifth, the right to request that the judge issue a two-year suspension of the enforcement of claims filed by secured creditors.

Sixth, the right to have the labour cooperative appointed as successor to all managerial powers of the debtor.

Seventh, the right to request that the government provide technical assistance.

Eighth, the right to appoint a labour representative to the creditors committees, which will also be integrated by three representatives of the major creditors.

The Amendment additionally provides that: (i) in the event of a *concurso* or bankruptcy, labour credits will continue to accrue interest, which is suspended for other classes of claims; (ii) the rights of labour creditors under the applicable collective bargaining agreements or special workers statutes also continue to be effective, whereas prior to the Amendment those agreements were suspended; and (iii) in the event of a *concurso*, 3 percent of the gross monthly income of the debtor company must be allocated to a reserve account that will be destined to pay labour creditors.

The Amendment undoubtedly favours labour creditors and affects the rights of third parties and other creditors – in particular in the event of a cramdown process or a bankruptcy proceeding. It is also being severely criticised by scholars as it includes some ambiguities and technical uncertainties. Therefore, judges applying the new provisions will have to ensure that the Amendment does not lead to abuses that may be committed in prejudice of legitimate creditors or third parties, without affecting the rights of workers granted under the Amendment. ■

OFFSHORE

Recovering trust assets in the Cayman Islands

by *Lindsay Luttermann | Walkers*

DATING BACK OVER 1000 years, the concept of the trust is as recognisable to practitioners in common law countries as it is unfamiliar to those in civil law jurisdictions. Separating the legal and beneficial ownership of property, such that a trustee is the legal owner but manages the property in the interests of the beneficial owners, makes the trust a popular tool for structuring personal and commercial transactions.

The Cayman Islands, whose legal system is based on English common law, is a successful trust domicile, reinforced by the regulation of service providers under the Banks and Trusts Companies Law (2007 Revision) and extensive anti-money laundering legislation. In a complex and interconnected investment world, trusts provide a means to wealth preservation and the flexibility to provide rights for beneficiaries to assets which cannot be achieved through contract law alone.

In the years that have followed the global financial crisis, the potential insolvency of settlors of trusts has grown in prominence as an issue, with creditors looking at their options in order to attempt to recover assets settled in trust. Two primary routes to recovering trust assets in the Cayman Islands are considered below.

Bankruptcy

One route is to petition for the settlor's bankruptcy under the Bankruptcy Law (1997 Revision) (the Bankruptcy law). Under the Bankruptcy law, any creditor owed at least C\$40 – approximately US\$49 – by an individual can petition the Cayman Islands court for the bankruptcy of that individual, where one of various 'acts of bankruptcy' has taken place. These include service of a summons and a bankruptcy notice on the individual, with no receipt of payment within seven days. On a successful petition, the court will make a provisional or absolute order in bankruptcy appointing an official trustee in bankruptcy to administer the individual's estate.

The trustee in bankruptcy can apply to the court to 'undo' certain dispositions, including avoiding a settlement if both: (i) it was not made in good faith and for valuable consideration; and (ii) the provisional/final order in bankruptcy is either within two years after the date of the settlement or within 10 years after the date of the settlement and the claiming parties are unable to demonstrate that the settlor, at the time of making the settlement, was able to pay all his debts without



the aid of the property settled and that the settlor's interest has passed to the transferee.

The Bankruptcy law provides that for an individual to be made bankrupt in the Cayman Islands, he must be personally present, ordinarily reside, carry on business or be a member of a firm or partnership carrying on business in the Cayman Islands. As these conditions will not generally apply to most settlors of Cayman Islands trusts, creditors will, in those circumstances, instead need to petition for bankruptcy in the settlor's home jurisdiction and apply for recognition in Cayman.

Fraudulent dispositions

Where creditors seek protection from the deliberate transfer of funds out of their reach, they can attempt to recover such assets in Cayman by making an application under the Fraudulent Dispositions Law (1996 revision) (the FD law). Under the FD law, the court can avoid dispositions of property made with an intent to defraud and at an undervalue, which means with no consideration or with consideration far less than the value of the property. The latter requirement means that many commercial trusts will be outside the scope of the FD law because in commercial contexts the transfer of property is often made for valuable consideration. The creditors must prove that the settlor had an intent to defraud at the time of the disposition, which can be a difficult hurdle to overcome. In addition, the creditor in question must have been prejudiced by the disposition.

Certain limitations apply, including that the disposition is only set aside to the extent necessary to satisfy the amounts owed to prejudiced creditors. Additionally, provided a transferee has not acted in bad faith in receiving property, assets may be retained to cover the proper legal fees to defend the proceedings. Further, transferees are entitled to retain their costs arising from administering the property until the point at which it is set aside under the FD law.

In summary, here assets are settled into trust, there are some methods by which creditors (or trustees in bankruptcy) can claim them back for the benefit of his estate, but there are safeguards that protect both the settlement of assets into trust by solvent settlors for legitimate reasons and the rights of innocent transferees. ■

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