

Lenders' Panel: Caribbean/South American Cross-Border Issues

Luis Salazar – Moderator
Greenberg Traurig, LLP; Miami

Rodolfo Pittaluga
Deloitte Financial Advisory Services LLP; Miami

Luis de Lucio
Alvarez & Marsal; São Paulo, Brazil

Reforming Latin American Insolvency Law: Big Strides for the Largest Economies, but Traps Remain for the Unwary¹

By: **Luis Salazar, Esq.**
Paul Keenan, Esq.²

I. Internal and External Pressures to Reform Latin American Insolvency Laws

Until recently, the insolvency laws of almost all Latin American countries were still heavily based on codes devised in the nineteenth century. These antiquated insolvency laws frustrated both domestic and foreign creditors and were considered a significant impediment to economic growth. Toward the end of the twentieth century, internal and external pressures caused the largest Latin American countries to reform their insolvency laws and develop modern corporate restructuring laws. The internal pressures arose largely from the demand for economic stability and growth, and the external pressures stemmed from the demands made by foreign investors and their governments.

A. Internal Pressures

The domestic capital markets of countries such as Brazil, Mexico and Argentina lack the depth to fulfill the enormous internal demands for working and investment capital. With increasing frequency, Latin American borrowers have been tapping the United States and European capital markets to fill the void. Such “financial globalization,” a term used by the International Monetary Fund to refer to the integration of domestic financial systems with international financial markets, has enabled Latin American corporations to avail themselves of foreign capital markets where the domestic market is unable to meet their hunger for capital. In some countries, financial globalization is so strong that cross-border capital flows have increased from less than five percent of GDP to twenty percent in the last two decades alone.

¹ This article is based in part on an article by Paul Keenan entitled “Reforming Latin American Insolvency Law,” published in the Practical Law Company’s (PLC) Restructuring and Insolvency Cross-Border Handbook, for 2006/07. Copies of the PLC article are available upon request.

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Inevitably, some of these businesses with cross-border financing will fail, resulting in an insolvency with a debtor in a Latin American country and creditors in another country. In fact, some economists believe that financial globalization itself may be the cause of some liquidity crises because cross-border financing more often comes in the form of short-term debt maturity from nervous lenders that historically has a higher rate of default.

In many Latin American countries there is great internal pressure from the populace to create economic growth and stability, and of course, jobs. The government response to these internal demands is multifaceted, but one of the key components of any plan for economic growth in a developing country is the introduction of measures designed to attract foreign capital. Historically such measures focused on reforms to macroeconomic policies. More recently, however, Latin American countries have begun to reform their corporate governance, banking and transparency laws, and now, their insolvency laws.

B. External Pressures

In addition to the internal pressure to attract foreign investment to stimulate growth, the rapid proliferation of trade agreements in the Americas creates an external pressure for insolvency reform. Multilateral and bilateral trade agreements often require their member nations to enact or reform certain legislation as a prerequisite for full implementation of the agreement, and the list of such “enabling legislation” often includes reform of the country’s insolvency system. This external demand for insolvency reform is driven by the goal of every trade agreement to encourage international investment and the creation of joint enterprises and jobs among the member nations. Enabling legislation such as modern reorganization and liquidation statutes are needed to create a more hospitable atmosphere for the foreign investment expected from the passage of a trade agreement.

For example, multilateral trade agreements such as the North American Free Trade Agreement (NAFTA) strive to increase the flow of trade among their member nations. By that measure, NAFTA has already achieved considerable success. Since the enactment of NAFTA in 1994, Mexico has dramatically increased its exports to the United States by doubling its share of the United States import market. The free trade phenomenon will grow even further with the implementation of the many bilateral and multilateral free trade agreements currently being negotiated or already implemented, such as the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA), whose full implementation is expected this year.

NAFTA and its progeny are expected to create a new wave of joint ventures and other multinational businesses, especially in industries targeted by a free trade agreement. For example, the United States is currently a large exporter of textile fabric and yarns and already exports a significant amount of that material to the Dominican Republic for use in manufacturing. Under DR-CAFTA, if a Dominican manufacturer makes garments from

material made in the United States, the importation of those garments to the United States will be duty-free. It is expected that such incentives will lead to growth in the creation of multinational businesses. Not surprisingly, among the legislative reforms required by DR-CAFTA is insolvency reform, and the Dominican Republic is presently crafting a modern insolvency statute.

C. Insolvency Reform

The globalization of national and regional economies has spawned a large increase in the cross-border flow of not only capital, but also goods, services and technology. These cross-border currents of tangibles and intangibles can result in an insolvency in a Latin American country that has a significant impact on businesses and persons far outside the borders of the debtor's home country. Therefore, foreign banks, investors and providers of goods and services increasingly became embroiled in Latin American insolvencies and all too familiar with the shortcomings of the region's antiquated insolvency laws. Recently, however, the landscape of insolvency law in Latin America has undergone dramatic change.

The internal and external demands for insolvency reform have been recently answered by the Latin American countries with the largest economies: Brazil, Mexico and Argentina. While the insolvency reform in these countries represents a significant step forward, the new laws are in some respects profoundly different from each other and from their European and North American counterparts. To further complicate matters, many Latin American countries still adhere to antiquated insolvency laws inherited from their colonial past. Before delving into the details of a particular country's insolvency laws, a foreign creditor that finds itself involved in a Latin American insolvency proceeding should take a few moments to understand the relevant historical and cultural idiosyncrasies that put the recent developments in Latin American insolvency law in perspective, which is crucial to understanding how a particular country's insolvency laws benefit debtors or creditors in different circumstances.

II. Latin American Insolvency Laws: Either 19th or 21st Century

In Latin America, the insolvency law of a particular country is either one of the few modern statutes passed in the last decade, or one of the many that is still based on an adaptation of the French Napoleonic Code.

A. The Napoleonic Code: *Suspensión de Pagos* or *Quiebra*

Almost all Latin American countries have a European style civil law system, as opposed to a common law system, that provides a comprehensive set of rules applied and interpreted by judges. These civil law systems have their origins in Roman law, which was eventually codified into the Napoleonic Code and subsequently adopted by the Spaniards, who then imported the code to Latin America. Even today, in most Latin American countries, a debtor has the same choice faced by a debtor under the Napoleonic

Code: to enter into either a liquidation (*quiebra*) or suspension of payments (*suspensión de pagos*) proceeding.

Of course, the substantive and procedural details of *quiebra* and *suspensión de pagos* proceedings have evolved over time and vary from one country to another, but there are still many common elements between them. First, generally speaking, a *suspensión de pagos* proceeding may only be commenced by a debtor, not by dissatisfied creditors. A debtor can only qualify for the proceeding if the value of its assets exceed its liabilities, otherwise, a *quiebra* is the only option. After filing basic financials with the appropriate court, the court will declare the *suspensión de pagos*, which stops the accrual of interest, operates as authorization for the debtor to suspend payments to its creditors, and sometimes converts the denomination of the debt to local currency. While the judicial declaration generally stays proceedings against the debtor, in many cases secured creditors can continue with their foreclosure actions, which can significantly impede a debtor's efforts to reorganize.

After declaring the *suspensión de pagos*, the court will then appoint a fiduciary (*síndico*), who is often member of the debtor's local chamber of commerce. The *síndico* will examine the debtor's asset list and monitor debtor's management during the course of the proceedings.

The claims process in a *suspensión de pagos* proceeding is almost always lengthy and contentious. Each creditor is responsible for affirmatively proving up its claims to the court, and each claim is examined and treated independently. This process can take years, even in the case of a debtor with a moderate number of claims. Creditors can object to one another's claims on almost any basis, and even the smallest and most obscure creditor can grind the process to a halt. Only after the claims process is completed can the creditors and debtor begin to formally propose a plan to restructure the company's debt within the judicial proceeding. The debtor or a creditor can submit a proposal, but a majority of the creditors must approve the plan, and there is often no ability for the court to "cram down" a plan over dissenting creditors.

As for the *quiebra* proceeding, dissatisfied creditors can commence the liquidation proceeding, in addition to the debtor itself. In the event the debtor and creditors are unable to reach an agreement in a *suspensión de pagos*, the proceeding will convert to a *quiebra*. A *quiebra* is a straight liquidation proceeding where the *síndico* supplants management, marshals and liquidates the assets of the debtor, and makes pro rata distributions to creditors in accordance with the country's classification and priority of claims.

In practice, the *suspensión de pagos* is a proceeding that heavily favors the debtor. To have any chance of making a recovery, creditors would have to pursue a multitude of remedies and navigate through a byzantine claims process in the hope that some day, many years down the road, there might be a meaningful recovery. In the meantime, the debtor could blissfully suspend payment on its debts entirely, or elect to pay only certain creditors. The prospect of such a lengthy and costly recovery process obviously gives a

lender pause before entering into a sizable transaction with a Latin American borrower, and at the very least, is a significant factor in determining the cost of capital.

Even now, the insolvency law outlined above is still the template followed by many Latin American countries. Many of those countries have moderately reformed their insolvency laws handed down from the colonial era. For example, in 1982, Chile enacted moderate reforms that strived to reduce the length, cost and bureaucratic hurdles endemic to its insolvency proceedings. Likewise, in 1999, Colombia also enacted measures to reform its *concordato*, a version of the *suspensión de pagos*, with the same objectives as the Chilean reform. However, it was not until the twilight of the twentieth century and the dawn of the twenty-first that the countries with the largest economies in Latin America radically reformed and modernized their colonial-era insolvency laws and established a working corporate restructuring statute. The result is a panorama of insolvency laws far less hegemonic than before.

B. Major Reform in Argentina, Mexico and Brazil

- **Argentina – *La Ley de Concursos y Quiebra*, and the APE**

The new insolvency and restructuring laws of Argentina provide for both judicial (in-court) and extrajudicial (out-of-court) proceedings. Prior to the reform, Argentine insolvency laws were similar to the colonial-era laws described above, although the laws more closely resembled those of the Italian civil code, in keeping with Argentina's cultural and historical heritage. The country experienced extraordinary hyperinflation in the late eighties and early nineties, driving many businesses into insolvency proceedings and exposing the weaknesses of the country's antiquated insolvency laws.

Internal and external pressures for reform resulted in the *Ley de Concursos y Quiebra* of 1995, which established a judicial reorganization proceeding (*concurso preventivo*) and a liquidation proceeding (*quiebra*). In a *concurso preventivo*, the reorganization process is an in-court proceeding where the debtor remains in possession and operational control of its assets, but is under the supervision of a court-appointed *síndico*. The *síndico* verifies the amount, validity and priority of claims, and issues a schedule of claims. Creditors then have the opportunity to object to the *síndico's* report before it is made final. Once the landscape of claims is fixed, the debtor proposes a payment arrangement for each class of creditors, who can accept or reject the proposed arrangement. If the requisite number of creditors accept, the *concurso preventivo* is approved by the court. Otherwise, the proceeding will convert to a *quiebra*.

The Argentine law takes an interesting turn where the parties cannot agree to payment arrangement under the *concurso preventivo*. In such a case, creditors, shareholders, employees and third parties are all welcome to purchase the debtor's assets and businesses. The drafters of the law believed that by allowing one last attempt to salvage the enterprise value and avert a *quiebra* would save jobs and redeploy valuable resources.

Economic troubles revisited Argentina at the beginning of the new millennium, eventually leading to a catastrophic devaluation of the peso. In response, Argentina tweaked many provisions of the *Ley de Concursos y Quiebra*, but more significant was the creation of an entirely new extrajudicial insolvency proceeding – the *Acuerdo Preventivo Extrajudicial*, known as the *APE*. An *APE* allows troubled Argentine businesses to privately restructure their debts with the consent of creditors. Under the *APE*, a debtor may attempt to restructure the principal, maturity, interest rate and other terms of its debts with some or all of its creditors. Court approval is required for the agreement to become effective. If a court approves a restructuring agreement for an entire class of creditors, the agreement is binding on non-consenting creditors and shareholders.

Some observers have hailed the *APE* as an efficient mechanism for private debt restructurings because the procedure is largely unregulated and is guided by the parties themselves. An *APE* is often much less expensive and time consuming than a *concurso preventivo*, which aids the goal of maximizing the salvage value of the enterprise. In addition, the absence of the *síndico* and formalistic challenges to creditors claims, and the avoidance of the stigma of bankruptcy all make the *APE* an attractive option for debtors and creditors alike.

However, nonconsenting creditors in some recent *APEs* have complained about perceived procedural and substantive unfairness in the proceedings. For example, in the cases of *Multicanal, S.A.* and *Cablevisión, S.A.*, foreign bondholders complained that the *APE's* lack of formal structure provided too much leverage for the debtor and allowed certain creditors to engage in concerted action against other creditors, both of which are reminiscent of insolvency proceedings under the old laws. Specifically, creditors have complained that in the absence of a obligations for the debtor to provide a liquidation analysis and projection of income and expenses, it is difficult for creditors to gauge the relative value and probability of success of the debtor's proposed plan.

Before Argentina modernized its insolvency laws, a debtor often used the cumbersome procedures to prolong its reorganization or liquidation almost indefinitely. With the advent of the in-court *concurso preventivo* and out-of-court *APE*, there is a more level playing field and an avenue for a quick turnaround where there is cooperation among the debtor and its creditors. However, recent cases demonstrate that debtors still can and will use the new laws to the disadvantage of some creditors.

- **Mexico – *Ley de Concurso Mercantil***

In 1943, Mexico enacted moderate reforms of the insolvency laws it inherited from Spain. However, in response to the currency crisis in the mid-nineties and the subsequent demand for foreign capital, Mexico radically reformed its insolvency laws in 2000 with the enactment of the *Ley de Concurso Mercantil* to govern corporate reorganizations. The Mexican *concurso mercantil* is similar to the Argentine insolvency system in that it provides an option for an in-court or out-of-court restructuring.

However, the practice and procedure of Mexico's *concurso mercantil* is quite different from the Argentine *concurso preventivo* and *APE*.

The debtor or two creditors can commence a *concurso mercantil*, which results in the appointment of an auditor who will then examine the books and records of the debtor to determine whether the debtor is insolvent, as defined by the statute. If the court finds the debtor is insolvent after hearing the auditor's report, then all proceedings against the debtor are stayed, the debtor suspends making payments on its debts, and the court appoints a *conciliador* (mediator), who will negotiate the restructuring among the debtor, shareholders and creditors. Once the creditors file proofs of claims, the *conciliador* files a schedule of claims and creditors have the opportunity to object. During the pendency of the *concurso mercantil*, interest does not accrue on unsecured debt (interest accrues on secured debt up to the value of the collateral), and unsecured debt denominated in a foreign currency converts to the peso. In a *concurso mercantil*, management remains in place, unless ten percent of the creditors petition for the appointment of an *interventor*, who will oversee management and the *conciliador*.

According to the statute, a *concurso mercantil* should only last one year, but Mexican practitioners have already found ways to prolong the proceedings. Even so, the effect of the deadline is to encourage the parties to reach an out-of-court agreement to prevent a showdown at the end of the one-year period. In many cases, the parties bring an out-of-court agreement to the court for approval, much like in an *APE*. If the parties do not reach an out-of-court agreement, then a plan must be approved by the debtor and a majority of the creditors. Once the court approves the plan, it is binding on nonconsenting creditors. Similar to the Argentine *concurso preventivo*, there is an opportunity for the existing shareholders to retain control of the debtor by infusing new capital.

One of the unique aspects of the *Ley de Concurso Mercantil* is the creation of a branch of bankruptcy specialists within the judiciary called the *Instituto Federal de Especialistas de Concursos Mercantiles*, or *IFECOM*. *IFECOM* bears some resemblance to the United States Trustee system. The duties of *IFECOM* include the promulgation of rules to govern insolvency proceedings and the conduct of parties involved in the proceedings, and also to provide for the training, monitoring and appointment of specialists involved in the *concurso mercantil* process, such as the auditor, *conciliador* and *interventor*.

Another innovation of the *Ley de Concurso Mercantil* is the adoption of the Model Law on Cross-Border Insolvency drafted by United Nations Commission on International Trade Law (UNCITRAL). UNCITRAL's model law provides a detailed procedural framework for the governance of cross-border insolvencies where a debtor has an insolvency proceeding pending in two or more countries. The model law seeks to coordinate the concurrent proceedings to avoid inconsistent orders and judgments. The United States recently enacted the model law as Chapter 15 of the United States Bankruptcy Code, and most European nations have enacted a similar cross-border insolvency statute.

In some respects, Mexico's *Ley de Concurso Mercantil* is more progressive than the reforms of its neighbors. Neither Argentina nor Brazil have enacted UNCITRAL's model law, and neither country has created a strong insolvency specialty within the judiciary, such as Mexico's *IFECOM*. However, the out-of-court restructuring process in the Mexican system does not appear to be as well defined as the Argentine *APE*, and it appears that Brazil may also have outpaced Mexico in establishing a constructive framework for out-of-court restructurings.

- **Brazil – Nova Lei de Falências e Recuperação de Empresas**

Until 2005, Brazil's insolvency laws had a reputation for discouraging corporate reorganizations. Under reforms made to Brazil's insolvency law in 1945, a debtor in distress could commence a *concordata*, a proceeding to reorganize its debt, or a debtor or its creditors could commence a *falência*, a liquidation proceeding. In a *falência*, the court would appoint a *síndico*, who would marshal and sell the debtor's assets, and then make distributions to creditors. Until Brazil reformed its insolvency laws in 2005, it was very difficult for a debtor to reorganize, even if it could reach an agreement with its creditors.

The *concordata* under Brazil's 1945 law was a court-supervised proceeding for the reorganization of debt. Unfortunately, statutory limitations on the *concordata* greatly reduced its utility for corporate debtors. For example, in many *concordata* proceedings secured claimants, let alone unsecured creditors, had very little hope of collecting any distributions because labor and tax claims, which can be significant in Brazil, had priority over secured claims.

Another limitation was that the old Brazilian insolvency law required the debtor to make specified minimum payments to unsecured creditors within twenty-four months. The statute provided a sliding scale where the earlier the debtor paid its unsecured creditors, the lower the percentage of unsecured claims the debtor could pay. For example, if the debtor paid its unsecured creditors immediately after approval of the plan, the debtor would only have to pay fifty percent of the amount of the claims. On the other hand, if the debtor took the entire two year period to pay its unsecured creditors, then the debtor would have to pay the claims in full. Failure to meet any of these conditions during the course of the *concordata* would result in conversion of the case to a *falência*. Furthermore, there were no provisions establishing creditor committees, or allowing for the sale of assets without certain encumbrances or liens, which diminished the means to provide a meaningful recovery for creditors.

The extraordinary constraints on debtors and creditors in the *concordata* created an environment where it was very difficult, and in many cases impossible, to successfully reorganize a corporate debtor even if the creditors agreed with the debtor on a proposed plan of reorganization. Coupled with arcane procedural rules that a debtor could use to its advantage, the result was often the slow demise of many going concerns that perhaps could have been salvaged with a better restructuring law.

In 2005, internal and external pressures caused Brazil to enact the *Nova Lei de Falências e Recuperação de Empresas*, the New Law of Corporate Bankruptcy and Restructuring, which is a significant step forward for the rehabilitation of troubled businesses in Brazil. Similar to the Argentine and Mexican statutes, the new Brazilian law provides a framework for out-of-court (*recuperação extrajudicial*) and in-court restructurings (*recuperação judicial*).

In stark contrast to its predecessor, the new law provides debtors and their creditors with wide latitude to reorganize debt. The law allows a debtor to attempt an out-of-court restructuring with all of its creditors, certain classes of creditors, or only select creditors. Remarkably, the new law allows a debtor to strike a deal with one group of creditors, without necessarily providing the same treatment to similarly situated creditors.

In a judicial restructuring, there is a general moratorium on the payment of debts for the first six months of the case and the debtor is provided an opportunity to submit a plan within the first two months of the case. If the plan is opposed by any single creditor, then the court will hold a meeting of creditors for the negotiation and approval of an alternate plan. Even if one of the classes rejects the plan, the court can still approve the plan if a majority of the aggregate amount of claims in each of the remaining classes votes in favor of the plan, and at least one-third of the opposing class approves the plan. Once a plan is approved, the debtor remains under the jurisdiction of the court for two years to ensure the terms of the plan are fulfilled. Failure to live up to the terms of the plan will result in conversion of the case to a liquidation.

In addition to improving the plan process, the new law made other reforms that are likely to heighten the prospect for a successful judicial reorganization, such as requiring the appointment of a creditors committee and judicial administrator to oversee the debtor's restructuring efforts. The court can also grant a superpriority lien to banks willing to lend to the debtor and to trade creditors willing to continue doing business with the debtor during the course of its restructuring.

As for the liquidation process, the 2005 Brazilian insolvency law provides much needed protection for secured creditors. Under the new law, secured claims are elevated in priority over tax claims, but still come behind labor claims. However, the new law caps labor claims at one hundred and fifty times the monthly federal minimum wage, per employee. By limiting each employee's labor claims to a more manageable sum and lowering the priority of tax claims, the 2005 law greatly enhances the probability that secured creditors will see a meaningful recovery, thereby encouraging their participation in the plan process.

In the event that an asset sale is the more logical course, the new law enables the court to authorize the sale of assets free and clear of encumbrances and protects asset purchasers from successor liability. In addition to asset sales, the new law allows a debtor to satisfy creditors in a myriad of other ways, including merging with another business, leasing its assets or raising new capital by issuing new debt or equity securities.

III. The Reforms by Argentina, Brazil and Mexico Significantly Enhanced the Prospects for Debtor Rehabilitation and Creditor Recovery

Most Latin American countries still adhere to a variation of the *suspensión de pagos* and *quiebra* proceedings held over from the Napoleonic Code. The nations with the three largest economies in Latin America – Brazil, Mexico and Argentina – have radically reformed their corporate reorganization laws in the last decade, setting them far apart from the rest of the region. However, the reforms in these countries are hardly uniform.

In Argentina and Brazil, the reforms created a formal process and requirements for judicial approval of out-of-court restructurings. In Mexico, out-of-court restructurings are just as prevalent, but appear less regulated. In each country, the reform provides an avenue for cram down on nonconsenting creditors, which prevents a lone class of dissenting creditors from single-handedly forcing the liquidation of an otherwise salvageable enterprise. However, the requirements for cram down vary from one country to another. Mexico has made additional strides by making bankruptcy a formal specialty within the judicial branch, and enacting UNCITRAL's model law on cross-border insolvencies.

When faced with the prospect of becoming involved in a Latin American restructuring or liquidation, it is important to understand where that nation is in terms of insolvency reform. An understanding of the status of the country's insolvency reform, if any, and how that reform is put into practice is essential for any party to protect its interests in an overseas insolvency proceeding.

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I. Internal and External Pressures to Reform Latin American Insolvency Laws

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In addition to the internal pressure to attract foreign investment to stimulate growth, the rapid proliferation of trade agreements in the Americas creates an external pressure for insolvency reform. Multilateral and bilateral trade agreements often require their member nations to enact or reform certain legislation as a prerequisite for full implementation of the agreement, and the list of such “enabling legislation” often includes reform of the country’s insolvency system. This external demand for insolvency reform is driven by the goal of every trade agreement to encourage international investment and the creation of joint enterprises and jobs among the member nations. Enabling legislation such as modern reorganization and liquidation statutes are needed to create a more hospitable atmosphere for the foreign investment expected from the passage of a trade agreement.

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Of course, the substantive and procedural details of *quiebra* and *suspensión de pagos* proceedings have evolved over time and vary from one country to another, but there are still many common elements between them. First, generally speaking, a *suspensión de pagos* proceeding may only be commenced by a debtor, not by dissatisfied creditors. A debtor can only qualify for the proceeding if the value of its assets exceed its liabilities, otherwise, a *quiebra* is the only option. After filing basic financials with the appropriate court, the court will declare the *suspensión de pagos*, which stops the accrual of interest, operates as authorization for the debtor to suspend payments to its creditors, and sometimes converts the denomination of the debt to local currency. While the judicial declaration generally stays proceedings against the debtor, in many cases secured creditors can continue with their foreclosure actions, which can significantly impede a debtor's efforts to reorganize.

After declaring the *suspensión de pagos*, the court will then appoint a fiduciary (*síndico*), who is often member of the debtor's local chamber of commerce. The *síndico* will examine the debtor's asset list and monitor debtor's management during the course of the proceedings.

The claims process in a *suspensión de pagos* proceeding is almost always lengthy and contentious. Each creditor is responsible for affirmatively proving up its claims to the court, and each claim is examined and treated independently. This process can take years, even in the case of a debtor with a moderate number of claims. Creditors can object to one another's claims on almost any basis, and even the smallest and most obscure creditor can grind the process to a halt. Only after the claims process is completed can the creditors and debtor begin to formally propose a plan to restructure the company's debt within the judicial proceeding. The debtor or a creditor can submit a proposal, but a majority of the creditors must approve the plan, and there is often no ability for the court to "cram down" a plan over dissenting creditors.

As for the *quiebra* proceeding, dissatisfied creditors can commence the liquidation proceeding, in addition to the debtor itself. In the event the debtor and creditors are unable to reach an agreement in a *suspensión de pagos*, the proceeding will convert to a *quiebra*. A *quiebra* is a straight liquidation proceeding where the *síndico* supplants management, marshals and liquidates the assets of the debtor, and makes pro rata distributions to creditors in accordance with the country's classification and priority of claims.

In practice, the *suspensión de pagos* is a proceeding that heavily favors the debtor. To have any chance of making a recovery, creditors would have to pursue a multitude of remedies and navigate through a byzantine claims process in the hope that some day, many years down the road, there might be a meaningful recovery. In the meantime, the debtor could blissfully suspend payment on its debts entirely, or elect to pay only certain creditors. The prospect of such a lengthy and costly recovery process obviously gives a

lender pause before entering into a sizable transaction with a Latin American borrower, and at the very least, is a significant factor in determining the cost of capital.

Even now, the insolvency law outlined above is still the template followed by many Latin American countries. Many of those countries have moderately reformed their insolvency laws handed down from the colonial era. For example, in 1982, Chile enacted moderate reforms that strived to reduce the length, cost and bureaucratic hurdles endemic to its insolvency proceedings. Likewise, in 1999, Colombia also enacted measures to reform its *concordato*, a version of the *suspensión de pagos*, with the same objectives as the Chilean reform. However, it was not until the twilight of the twentieth century and the dawn of the twenty-first that the countries with the largest economies in Latin America radically reformed and modernized their colonial-era insolvency laws and established a working corporate restructuring statute. The result is a panorama of insolvency laws far less hegemonic than before.

B. Major Reform in Argentina, Mexico and Brazil

- **Argentina – *La Ley de Concursos y Quiebra*, and the APE**

The new insolvency and restructuring laws of Argentina provide for both judicial (in-court) and extrajudicial (out-of-court) proceedings. Prior to the reform, Argentine insolvency laws were similar to the colonial-era laws described above, although the laws more closely resembled those of the Italian civil code, in keeping with Argentina's cultural and historical heritage. The country experienced extraordinary hyperinflation in the late eighties and early nineties, driving many businesses into insolvency proceedings and exposing the weaknesses of the country's antiquated insolvency laws.

Internal and external pressures for reform resulted in the *Ley de Concursos y Quiebra* of 1995, which established a judicial reorganization proceeding (*concurso preventivo*) and a liquidation proceeding (*quiebra*). In a *concurso preventivo*, the reorganization process is an in-court proceeding where the debtor remains in possession and operational control of its assets, but is under the supervision of a court-appointed *síndico*. The *síndico* verifies the amount, validity and priority of claims, and issues a schedule of claims. Creditors then have the opportunity to object to the *síndico's* report before it is made final. Once the landscape of claims is fixed, the debtor proposes a payment arrangement for each class of creditors, who can accept or reject the proposed arrangement. If the requisite number of creditors accept, the *concurso preventivo* is approved by the court. Otherwise, the proceeding will convert to a *quiebra*.

The Argentine law takes an interesting turn where the parties cannot agree to payment arrangement under the *concurso preventivo*. In such a case, creditors, shareholders, employees and third parties are all welcome to purchase the debtor's assets and businesses. The drafters of the law believed that by allowing one last attempt to salvage the enterprise value and avert a *quiebra* would save jobs and redeploy valuable resources.

Economic troubles revisited Argentina at the beginning of the new millennium, eventually leading to a catastrophic devaluation of the peso. In response, Argentina tweaked many provisions of the *Ley de Concursos y Quiebra*, but more significant was the creation of an entirely new extrajudicial insolvency proceeding – the *Acuerdo Preventivo Extrajudicial*, known as the *APE*. An *APE* allows troubled Argentine businesses to privately restructure their debts with the consent of creditors. Under the *APE*, a debtor may attempt to restructure the principal, maturity, interest rate and other terms of its debts with some or all of its creditors. Court approval is required for the agreement to become effective. If a court approves a restructuring agreement for an entire class of creditors, the agreement is binding on non-consenting creditors and shareholders.

Some observers have hailed the *APE* as an efficient mechanism for private debt restructurings because the procedure is largely unregulated and is guided by the parties themselves. An *APE* is often much less expensive and time consuming than a *concurso preventivo*, which aids the goal of maximizing the salvage value of the enterprise. In addition, the absence of the *síndico* and formalistic challenges to creditors claims, and the avoidance of the stigma of bankruptcy all make the *APE* an attractive option for debtors and creditors alike.

However, nonconsenting creditors in some recent *APEs* have complained about perceived procedural and substantive unfairness in the proceedings. For example, in the cases of *Multicanal, S.A.* and *Cablevisión, S.A.*, foreign bondholders complained that the *APE's* lack of formal structure provided too much leverage for the debtor and allowed certain creditors to engage in concerted action against other creditors, both of which are reminiscent of insolvency proceedings under the old laws. Specifically, creditors have complained that in the absence of a obligations for the debtor to provide a liquidation analysis and projection of income and expenses, it is difficult for creditors to gauge the relative value and probability of success of the debtor's proposed plan.

Before Argentina modernized its insolvency laws, a debtor often used the cumbersome procedures to prolong its reorganization or liquidation almost indefinitely. With the advent of the in-court *concurso preventivo* and out-of-court *APE*, there is a more level playing field and an avenue for a quick turnaround where there is cooperation among the debtor and its creditors. However, recent cases demonstrate that debtors still can and will use the new laws to the disadvantage of some creditors.

- **Mexico – *Ley de Concurso Mercantil***

In 1943, Mexico enacted moderate reforms of the insolvency laws it inherited from Spain. However, in response to the currency crisis in the mid-nineties and the subsequent demand for foreign capital, Mexico radically reformed its insolvency laws in 2000 with the enactment of the *Ley de Concurso Mercantil* to govern corporate reorganizations. The Mexican *concurso mercantil* is similar to the Argentine insolvency system in that it provides an option for an in-court or out-of-court restructuring.

However, the practice and procedure of Mexico's *concurso mercantil* is quite different from the Argentine *concurso preventivo* and *APE*.

The debtor or two creditors can commence a *concurso mercantil*, which results in the appointment of an auditor who will then examine the books and records of the debtor to determine whether the debtor is insolvent, as defined by the statute. If the court finds the debtor is insolvent after hearing the auditor's report, then all proceedings against the debtor are stayed, the debtor suspends making payments on its debts, and the court appoints a *conciliador* (mediator), who will negotiate the restructuring among the debtor, shareholders and creditors. Once the creditors file proofs of claims, the *conciliador* files a schedule of claims and creditors have the opportunity to object. During the pendency of the *concurso mercantil*, interest does not accrue on unsecured debt (interest accrues on secured debt up to the value of the collateral), and unsecured debt denominated in a foreign currency converts to the peso. In a *concurso mercantil*, management remains in place, unless ten percent of the creditors petition for the appointment of an *interventor*, who will oversee management and the *conciliador*.

According to the statute, a *concurso mercantil* should only last one year, but Mexican practitioners have already found ways to prolong the proceedings. Even so, the effect of the deadline is to encourage the parties to reach an out-of-court agreement to prevent a showdown at the end of the one-year period. In many cases, the parties bring an out-of-court agreement to the court for approval, much like in an *APE*. If the parties do not reach an out-of-court agreement, then a plan must be approved by the debtor and a majority of the creditors. Once the court approves the plan, it is binding on nonconsenting creditors. Similar to the Argentine *concurso preventivo*, there is an opportunity for the existing shareholders to retain control of the debtor by infusing new capital.

One of the unique aspects of the *Ley de Concurso Mercantil* is the creation of a branch of bankruptcy specialists within the judiciary called the *Instituto Federal de Especialistas de Concursos Mercantiles*, or *IFECOM*. *IFECOM* bears some resemblance to the United States Trustee system. The duties of *IFECOM* include the promulgation of rules to govern insolvency proceedings and the conduct of parties involved in the proceedings, and also to provide for the training, monitoring and appointment of specialists involved in the *concurso mercantil* process, such as the auditor, *conciliador* and *interventor*.

Another innovation of the *Ley de Concurso Mercantil* is the adoption of the Model Law on Cross-Border Insolvency drafted by United Nations Commission on International Trade Law (UNCITRAL). UNCITRAL's model law provides a detailed procedural framework for the governance of cross-border insolvencies where a debtor has an insolvency proceeding pending in two or more countries. The model law seeks to coordinate the concurrent proceedings to avoid inconsistent orders and judgments. The United States recently enacted the model law as Chapter 15 of the United States Bankruptcy Code, and most European nations have enacted a similar cross-border insolvency statute.

In some respects, Mexico's *Ley de Concurso Mercantil* is more progressive than the reforms of its neighbors. Neither Argentina nor Brazil have enacted UNCITRAL's model law, and neither country has created a strong insolvency specialty within the judiciary, such as Mexico's *IFECOM*. However, the out-of-court restructuring process in the Mexican system does not appear to be as well defined as the Argentine *APE*, and it appears that Brazil may also have outpaced Mexico in establishing a constructive framework for out-of-court restructurings.

- **Brazil – Nova Lei de Falências e Recuperação de Empresas**

Until 2005, Brazil's insolvency laws had a reputation for discouraging corporate reorganizations. Under reforms made to Brazil's insolvency law in 1945, a debtor in distress could commence a *concordata*, a proceeding to reorganize its debt, or a debtor or its creditors could commence a *falência*, a liquidation proceeding. In a *falência*, the court would appoint a *síndico*, who would marshal and sell the debtor's assets, and then make distributions to creditors. Until Brazil reformed its insolvency laws in 2005, it was very difficult for a debtor to reorganize, even if it could reach an agreement with its creditors.

The *concordata* under Brazil's 1945 law was a court-supervised proceeding for the reorganization of debt. Unfortunately, statutory limitations on the *concordata* greatly reduced its utility for corporate debtors. For example, in many *concordata* proceedings secured claimants, let alone unsecured creditors, had very little hope of collecting any distributions because labor and tax claims, which can be significant in Brazil, had priority over secured claims.

Another limitation was that the old Brazilian insolvency law required the debtor to make specified minimum payments to unsecured creditors within twenty-four months. The statute provided a sliding scale where the earlier the debtor paid its unsecured creditors, the lower the percentage of unsecured claims the debtor could pay. For example, if the debtor paid its unsecured creditors immediately after approval of the plan, the debtor would only have to pay fifty percent of the amount of the claims. On the other hand, if the debtor took the entire two year period to pay its unsecured creditors, then the debtor would have to pay the claims in full. Failure to meet any of these conditions during the course of the *concordata* would result in conversion of the case to a *falência*. Furthermore, there were no provisions establishing creditor committees, or allowing for the sale of assets without certain encumbrances or liens, which diminished the means to provide a meaningful recovery for creditors.

The extraordinary constraints on debtors and creditors in the *concordata* created an environment where it was very difficult, and in many cases impossible, to successfully reorganize a corporate debtor even if the creditors agreed with the debtor on a proposed plan of reorganization. Coupled with arcane procedural rules that a debtor could use to its advantage, the result was often the slow demise of many going concerns that perhaps could have been salvaged with a better restructuring law.

In 2005, internal and external pressures caused Brazil to enact the *Nova Lei de Falências e Recuperação de Empresas*, the New Law of Corporate Bankruptcy and Restructuring, which is a significant step forward for the rehabilitation of troubled businesses in Brazil. Similar to the Argentine and Mexican statutes, the new Brazilian law provides a framework for out-of-court (*recuperação extrajudicial*) and in-court restructurings (*recuperação judicial*).

In stark contrast to its predecessor, the new law provides debtors and their creditors with wide latitude to reorganize debt. The law allows a debtor to attempt an out-of-court restructuring with all of its creditors, certain classes of creditors, or only select creditors. Remarkably, the new law allows a debtor to strike a deal with one group of creditors, without necessarily providing the same treatment to similarly situated creditors.

In a judicial restructuring, there is a general moratorium on the payment of debts for the first six months of the case and the debtor is provided an opportunity to submit a plan within the first two months of the case. If the plan is opposed by any single creditor, then the court will hold a meeting of creditors for the negotiation and approval of an alternate plan. Even if one of the classes rejects the plan, the court can still approve the plan if a majority of the aggregate amount of claims in each of the remaining classes votes in favor of the plan, and at least one-third of the opposing class approves the plan. Once a plan is approved, the debtor remains under the jurisdiction of the court for two years to ensure the terms of the plan are fulfilled. Failure to live up to the terms of the plan will result in conversion of the case to a liquidation.

In addition to improving the plan process, the new law made other reforms that are likely to heighten the prospect for a successful judicial reorganization, such as requiring the appointment of a creditors committee and judicial administrator to oversee the debtor's restructuring efforts. The court can also grant a superpriority lien to banks willing to lend to the debtor and to trade creditors willing to continue doing business with the debtor during the course of its restructuring.

As for the liquidation process, the 2005 Brazilian insolvency law provides much needed protection for secured creditors. Under the new law, secured claims are elevated in priority over tax claims, but still come behind labor claims. However, the new law caps labor claims at one hundred and fifty times the monthly federal minimum wage, per employee. By limiting each employee's labor claims to a more manageable sum and lowering the priority of tax claims, the 2005 law greatly enhances the probability that secured creditors will see a meaningful recovery, thereby encouraging their participation in the plan process.

In the event that an asset sale is the more logical course, the new law enables the court to authorize the sale of assets free and clear of encumbrances and protects asset purchasers from successor liability. In addition to asset sales, the new law allows a debtor to satisfy creditors in a myriad of other ways, including merging with another business, leasing its assets or raising new capital by issuing new debt or equity securities.

III. The Reforms by Argentina, Brazil and Mexico Significantly Enhanced the Prospects for Debtor Rehabilitation and Creditor Recovery

Most Latin American countries still adhere to a variation of the *suspensión de pagos* and *quiebra* proceedings held over from the Napoleonic Code. The nations with the three largest economies in Latin America – Brazil, Mexico and Argentina – have radically reformed their corporate reorganization laws in the last decade, setting them far apart from the rest of the region. However, the reforms in these countries are hardly uniform.

In Argentina and Brazil, the reforms created a formal process and requirements for judicial approval of out-of-court restructurings. In Mexico, out-of-court restructurings are just as prevalent, but appear less regulated. In each country, the reform provides an avenue for cram down on nonconsenting creditors, which prevents a lone class of dissenting creditors from single-handedly forcing the liquidation of an otherwise salvageable enterprise. However, the requirements for cram down vary from one country to another. Mexico has made additional strides by making bankruptcy a formal specialty within the judicial branch, and enacting UNCITRAL's model law on cross-border insolvencies.

When faced with the prospect of becoming involved in a Latin American restructuring or liquidation, it is important to understand where that nation is in terms of insolvency reform. An understanding of the status of the country's insolvency reform, if any, and how that reform is put into practice is essential for any party to protect its interests in an overseas insolvency proceeding.