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# US CORNER

## Advance Planning for US-Mexican Cross-Border Reorganisations

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### 1. Introduction

When firms expand across national borders, they anticipate that the benefits of operations, assets, or relationships in multiple jurisdictions are superior to those available at home. When those same firms encounter difficulties, however, their restructuring efforts can yield unexpected results: dramatically differing legal schemes, varying levels of expertise and sophistication with respect to insolvency, and even differing cultural attitudes regarding debtor-creditor relationships can create unanticipated challenges for the international firm attempting to restructure, and for its creditors seeking to maximize their recovery.

In North America, Mexico and the US share a growing level of cross-border trade and business development. Partly in response to this growth, each country's national legislature has reformed or extensively revised its own insolvency law. Moreover, each jurisdiction now strongly upholds the recognition of insolvency proceedings commenced outside their borders. These changes raise an important question: how should the troubled firm – or its creditors – anticipate and plan for a cross-border reorganisation proceeding between Mexico and the US? This article offers some very general considerations for such planning.[2]

### 2. The ties that bind: Cross-border recognition provisions and their impact on cross-border reorganisation planning in Mexico and the US

Historically, cross-border bankruptcy planning has been hindered by a lack of uniform law and concerns over predictability. Though the need to recognize and coordinate multi-national restructuring efforts has been long understood, such relief was *ad hoc* and case-specific.[3] Indeed, it was the general lack of uniformity and predictability in this area that led, ultimately, to the UNCITRAL's draft of a proposed model law of cross-border recognition.[4] The UNCITRAL law has been adopted, either in large part or substantially *in toto*, by the legislatures of both Mexico and the US. As such, it now forms the framework for cross-border insolvency work between these jurisdictions.

The UNCITRAL law's strong emphasis on recognition of cross-border proceedings is critically important for strategic international insolvency planning: troubled

**Notes**

1 The author wishes to thank Lic. Eduardo Martinez Rodriguez of Martínez y Narváez Abogados S.C., Mexico, D.F., a member of the International Insolvency Institute, for his very helpful comments in preparing this article. The views and opinions expressed here (and any errors or omissions) are the author's own. For questions or comments regarding this article, contact mgood@southbaylawfirm.com or eaemartinez@mnabogados.com.

2 This article's discussion is limited to reorganisations, and does not discuss liquidations.

3 *See, e.g.*, *In re Maxwell Communication Corporation plc*, 93 F.3d 1036, 1041-42 (2d Cir. 1996) (describing arrangements specifically formulated for harmonising two primary, concurrent proceedings in England and the US) ('Simultaneous proceedings in different countries, especially in multi-party cases like bankruptcies, can naturally lead to inconsistencies and conflicts. To minimize such problems, Judge Brozman appointed Richard A. Gitlin, Esq. as examiner, pursuant to 11 U.S.C. § 1104(c), in the Chapter 11 proceedings. The order of appointment required the examiner, inter alia, to investigate the debtor's financial condition, to function as a mediator among the various parties, and to "act to harmonize, for the benefit of all of [Maxwell's] creditors and stockholders and other parties in interest, [Maxwell's] United States chapter 11 case and [Maxwell's] United Kingdom administration case so as to maximize [the] prospects for rehabilitation and reorganization." Judge Brozman and Justice Hoffman subsequently authorized the examiner and the administrators to coordinate their efforts pursuant to a so-called Protocol, an agreement between the examiner and the administrators').

4 The legislative history to the US BAPCPA amendments likewise reflect Congress' desire for greater certainty in cross-border insolvency. *See, e.g.*, H.R. REP. 109-31(I), 105 (April 14, 2005) ('Title VIII of the Act adds a new chapter to the Bankruptcy Code for transnational bankruptcy cases. It incorporates the Model Law on Cross-Border Insolvency to encourage cooperation between the United States and foreign countries with respect to transnational insolvency cases. *Title VIII is intended to provide greater legal certainty for trade and investment as well as to provide for the fair and efficient administration of cross-border insolvencies*, which protects the interests of creditors and other interested parties, including the debtor. In addition, it serves to protect and maximize the value of the debtor's assets') (emphasis supplied).

firms and creditors who are weighing their cross-border options may do so in the knowledge that, at least in theory, the insolvency proceedings of one jurisdiction should be recognized and upheld in the courts of another. Recent developments in both Mexico[5] and in the US[6] have made this theory a practical reality. Consequently, practitioners evaluating cross-border insolvency issues that involve these jurisdictions must consider the differences and relative advantages inherent in the substantive law of both countries.

Within the general context of cross-border recognition, the balance of this article explores just a few of the substantive differences between US and Mexican insolvency law and their potential impact on cross-border reorganisation planning.

## 3. Reorganisation planning: A brief cross-border comparison of US and Mexican bankruptcy law

### *3.1 Where to file? Relative location of creditors and cost-efficiency*

Because corporate reorganisation proceedings in any jurisdiction can be expensive, considerations related more to location and cost-efficiency than to substantive law may drive the selection of venue. Thus, creditors pursuing recovery against a debtor may weigh the effectiveness and cost-efficiency of an involuntary proceeding commenced in their home jurisdiction. Conversely, a debtor's management may be motivated by concerns over cost-efficiency in selecting a forum most likely to deter large or difficult creditors.

### *3.2 Continuation of management*

Management's ability to remain in control of operations while in insolvency is obviously one of the debtor's primary concerns. In the US, the 'debtor-in-possession' concept has been a cornerstone of Chapter 11 practise for more than 30 years. Built into the structure of the United States Bankruptcy Code (US Code) is the presumption that management may remain in place and may conduct all 'ordinary course' operations without interference. US Courts are also familiar with issues such as key employee retention programs (KERPs), often viewed as critical to the retention of senior management and the preservation of enterprise value.

In Mexico, the debtor operating in a *concurso* commenced under the Mexican *Ley de Concursos Mercantiles* (LCM) must do so under the supervision of a conciliator appointed by *IFECOM*.[7] Typically, the conciliator is an experienced insolvency practitioner who understands not only Mexican legal issues, but also the financial pressures that a struggling business must confront.[8]

The conciliator's role is a unique one, for it encompasses much more than the supervisory and monitoring duties commonly associated with court-appointed administrators and trustees. Instead, as discussed below, the conciliator is effectively responsible for 'brokering' a feasible reorganisation plan that will be acceptable, both to management and to the requisite majority of creditors.[9] In this sense, a conciliator appears to act more as a 'private referee' for the debtor's management and creditors, performing functions somewhat similar to those in practise in reorganisation proceedings under the US Bankruptcy Act of 1898.

**Notes**

5 In 2005, the Mexican Supreme Court upheld as Constitutional the cross-border recognition provisions of the *Ley de Concurso Mercantile* as they pertained to the involuntary Chapter 7 cases of Felipe, Jacobo, and José Maria Xacur. The *Xacur* cases, and their procedural history before the Mexican courts, are summarised in materials prepared by Mexican counsel for the Chapter 7 Trustee appointed in these cases. *See* D.U. Oscos Coria, 'THE XACUR CASE: The Mexican Experience', available at <www.insol.org/emailer/january2006_downloads/the_xacur_case.doc> (last accessed 31 March 2008). An English-language copy of the Mexico City District Court's original 2002 recognition order is available online at <www.iiiglobal.org/country/mexico/Xacur_Banamex_Ruling_English.pdf> (last accessed 31 March 2008). The LCM's cross-border provisions are set forth at Title XII (Art's. 278 – 312).

6 The recognition provisions of 11 U.S.C. § 1509 prescribe the streamlined procedures necessary to obtain recognition of a foreign 'main' or 'non-main' proceeding. Upon recognition, certain relief automatically applies under US law for foreign 'main proceedings.' See 11 U.S.C. §§ 1520. Still more is available upon request by the foreign representative, either in a 'main' or 'non-main' proceeding. 11 U.S.C. §§ 1507, 1521. To date, there appears to be no reported decision upholding the law of a foreign jurisdiction in a US Court under the US Code's new Chapter 15. However, in the *Maxwell Communications* decision cited above, the 2d Circuit Court of Appeals affirmed the lower courts' application of comity principles under prior law to dismiss fraudulent transfer complaints brought under Section 547 of the US Bankruptcy Code, finding instead that the laws of England were implicated to a greater extent than those of the US. *See Maxwell Communications*, 93 F.3d at 1044. Where 11 U.S.C. 1509(c) contemplates the continued extension of comity to representatives who have obtained recognition for foreign proceedings in the US, a similar result under Chapter 15 is likely.

7 LCM Art. 43(II).

8 LCM Art. 326.

9 LCM Arts 148, 150, 161.


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### 3.3 'Ordinary course' provisions and post-petition financing

Chapter 11 is designed to keep the debtor operating – if for no other reason than to facilitate a sale or an orderly 'wind-down' of operations. Over the years, Congress and the courts have defined and modified the US Code in order to balance carefully the competing rights and interests of operating debtors and their creditors. Thus, issues such as the extent and permissibility of 'ordinary course' operations,[10] use of 'cash collateral'[11] and the provision of 'adequate protection,'[12] and appropriate 'first-day' orders designed to facilitate ongoing business operations[13] are matters within which most US courts and practitioners are familiar. Indeed, many courts have formalised local procedures and standards for approval of such requests.

More importantly, the US is home to a relatively large and sophisticated lending market specialising in so-called 'post-confirmation' or 'debtor-in-possession' (DIP) financing. Based primarily upon the provisions of Code section 364, this lending market is widely perceived as critical to servicing the operational liquidity required by Chapter 11 debtors, and is a unique feature of US practise.

In Mexico, a great deal of the debtor's post-petition operational success depends on management's relationship with the conciliator. As suggested above, the conciliator acts essentially as a 'private referee.' In this capacity, the conciliator must review and approve the performance of existing contracts, whether the debtor can or should incur any new debt, whether and to what extent security interests should be created or substituted, and whether assets not related to the ordinary course of business should be sold, with the participation of the intervenor or the intervenors appointed by the creditors.[14] Further, the conciliator may seek court approval for the removal of management and assumption of administrative control of the firm.[15]

Consistent with the more 'individualised' nature of a *concurso* proceeding, Mexican insolvency practise involves a less formal approach to 'debtor-in-possession' financing than that common in the US.[16] As with other *concurso* operations, negotiation of new financing depends greatly upon the relationship between the conciliator.

### 3.4 Automatic stay

Perhaps one of the best-known features of the US Code is its 'automatic stay.' Effective immediately upon the filing of a petition, Section 362 of the Code enjoins any entity's commencement or continuation of an action or proceeding against the debtor, the enforcement of any judgment against the debtor's property, or any collection activity regarding a claim against the debtor.[17] The stay is universal in scope, so that even assets located outside of the US are protected by the automatic stay. Parties who violate the stay do so under threat of contempt proceedings and sanctions in US Bankruptcy Courts.

In Mexico, similar provisions exist, once an order authorising the *concurso* proceeding is entered.[18] When relief is required prior to the entry of a *concurso* order, the LCM provides for provisional relief.[19] Like the US Code's automatic stay, this protection is intended to apply universally. Moreover, the recognition provisions of Chapter 15 suggest that such protections would be upheld in the US by US Courts.

### 3.5 Reorganisation deadlines, 'plan exclusivity,' and confirmation standards

A careful assessment of reorganisation dynamics is vital to cross-border reorganisation planning. Though by no means exhaustive, the following discussion provides some key differences between the reorganisation process and applicable standards for approval in the US and in Mexico.

**Notes**

10 11 U.S.C. § 363.
11 *Ibid.*
12 11 U.S.C. § 364.
13 11 U.S.C. § 105.
14 LCM Art. 75.
15 LCM Art. 81.
16 LCM Art. 75.
17 11 U.S.C. § 362(a). Exceptions to the automatic stay are set forth in 11 U.S.C. § 362(b).
18 LCM Art. 65 ('From the business reorganisation judgment issue date to the end of the conciliation stage, no seizure or enforcement order may be executed against the Merchant's properties and rights'). The same article provides exceptions for 'seizure[s] or enforcement[s]' related to (i) wages for the two years preceding the business reorganisation; and (ii) accruing tax liabilities with certain limitation in this latter case. *See* Art. 69.
19 LCM Arts 37, 38.


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### 3.5.1 Reorganisation deadlines and 'plan exclusivity'

Legal reform in both jurisdictions has seen dramatic shortening of the time in which a debtor has to propose and obtain approval for a reorganisation plan.

In the US, reforms implemented by the 2005 BAPCPA limit the debtor's 120-day 'exclusivity' period – i.e., the period during which *only the debtor* has the *exclusive* right to propose a plan. Prior to these reforms, the debtor's 'exclusivity' could be extended almost indefinitely, upon a showing of 'good cause' – and often provided debtor's management with important bargaining leverage for dealing with recalcitrant creditors. With the 2005 reforms, the original 120-day 'exclusivity' period may now be extended for up to 18 months beyond the entry of an order for relief – i.e., for approximately 14 months beyond the original 'exclusivity' period in a voluntary case.[20] After such extensions, exclusivity terminates altogether, and any 'party in interest' may file and seek approval of a plan.[21]

Under the LCM, a conciliation agreement must be reached within 185 days of publication of the *concurso* order in the *Official Gazette*.[22] This period may be extended for two successive, 90-day periods. In any event, the conciliation period may not exceed 365 days.[23] If, at the end of the period, no conciliation plan has been agreed upon, the debtor will automatically be declared a bankrupt and a *sindico* (i.e., a trustee or receiver) appointed.[24]

Like the US legal reforms just mentioned, this feature of the LCM is a dramatic departure from prior law, where insolvency proceedings of any nature took from two to five years to complete. Moreover, like US law, the change has had a significant impact on the dynamics of plan negotiation and formation in Mexican proceedings: depending on the parties' positions, either creditors or debtors may use the threat of a 'short-fused' *concurso* proceeding and the threat of ultimate liquidation to extract concessions – or, at the very least, to temper extreme bargaining positions while a plan is being negotiated.

### 3.5.2 Voting and classification of claims

In the US, reorganisation plans are approved through a creditor voting process. In essence, eligible, 'impaired' creditors are separated into various classes, each of which may approve the plan by a vote of two-thirds in amount and a simple majority in number.[25] All such classes must approve the plan in order to effect a 'consensual' reorganisation.[26] Provided that at least one such class accepts the plan, the plan is eligible for non-consensual confirmation (i.e., 'cram-down') even where one class (or more) disapproves.[27] Thus, within the constraints imposed by the US Code and applicable case law, it is possible for the debtor to fashion an 'accepting class' of a few only creditors – and, therefore, to seek a 'cram-down' of the remaining majority of creditors.

Under the LCM, *all* creditors – including affiliates and 'insiders' holding claims[28] – vote as a single class, and approve the plan by a simple majority of the amount of 'recognised' debt.[29] Here, the plan negotiation dynamic depends on factors such as (i) whether or not a majority of debt is concentrated in the hands of a few creditors; (ii) the anticipated impact of 'related-party' debt; and (iii) whether the uniform treatment which must be afforded all such debt is truly feasible for the debtor.

### 3.5.3 Treatment of secured creditors

In the US, secured creditors remain subject to, and may be treated under, the provisions of a confirmed plan.[30] In essence, a plan may be confirmed over the objection of a secured creditor provided that such creditor is afforded either the present value, or the 'indubitable equivalent,' of its secured claim under the plan.[31] By contrast, secured creditors may not be affected by a *concurso* plan under the LCM unless they consent or receive full payment for their secured claims.[32] Thus, the debtor's ability to deal with secured creditors – and the proportion of secured debt on the distressed firm's

**Notes**

20 11 U.S.C. § 1121(d)(2)(A).
21 11 U.S.C. § 1121(c)(2).
22 LCM Art. 145.
23 *Ibid.*
24 LCM Art. 167(II).
25 *See* 11 U.S.C. § 1126(c). Certain creditors (i.e., those with 'administrative' or 'priority' status) are not eligible to vote, because their treatment is prescribed by statute. Classes of creditors whose claims are not 'impaired' are deemed to have accepted the plan, and are also not eligible to vote. 11 U.S.C. § 1126(f). Finally, classes of creditors whose claims will receive no distribution are deemed to have rejected the plan – and, likewise, are not eligible to vote. 11 U.S.C. § 1126(g).
26 11 U.S.C. § 1129(a)(8).
27 11 U.S.C. § 1129(b).
28 A narrow exception is made for the disallowance of claims asserted by the 'spouse, female or male concubine' of the [individual] Merchant, where the claims are 'payable by the Merchant under onerous contracts or for having paid the Merchant's debts.' LCM Art. 126.
29 LCM Art. 157.
30 11 U.S.C. §§ 1129, 1141(a).
31 11 U.S.C. § 1129(b)(2)(A).
32 LCM Arts 160, 165.


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balance sheet – will be an important consideration in gauging the ultimate relie f available to a firm weighing reorganisation under the US Code or the LCM.

### 3.5.4 'Absolute priority'

Finally, the US Code's 'classification mechanism' for plan formation and voting is constrained by an 'absolute priority rule' – i.e., a requirement that no class receive plan distributions until creditors with a higher priority receive payment in full regarding their claims.[33] This means that, in cases where unsecured creditors receive less than 100%, equity receives *nothing* under a plan, and equity holders' interests are wiped out.[34]

Not so under the LCM. Instead, equity *may* retain its interest in the firm provided that the requisite 50.1% of unsecured debt (including 'related party' debt) votes in favor of the plan. This feature of the *concurso*, though perhaps unusual to US creditors, is consistent with the business environment of many Latin American countries where the firm is commonly a closely-held concern, and where many of the largest firms are family-controlled.

A tabular summary of this comparison is provided below.

Despite these differences, US Courts have recognized and enforced *concurso* proceedings under former US cross-border law.[35] The 'streamlined' recognition provisions now applicable under Chapter 15 of the US Code now suggest that such results are now just as likely, if not more so, under BAPCPA. Likewise, the LCM's cross-border provisions have recently withstood critical judicial tests[36] and may be used to obtain recognition for US-based proceedings.

## 4. Conclusion

As the foregoing suggests, recent insolvency amendments and reforms in the US and Mexico highlight the need for careful planning when a Mexican-US cross-border reorganisation is contemplated. These changes – as well as new cross-border recognition provisions in each jurisdiction – offer new challenges, and fresh opportunities, for firms operating in Mexico and the US.

| | *US* | *Mexico* |
|---|---|---|
| Exclusivity | New limits on 'plan exclusivity' under BAPCPA. See 11 U.S.C. §1121. | LCM dramatically shortens time frame for a *concurso* – now only 365 days. |
| Voting and Claims Classification | Classification scheme affords some flexibility for treatment, and therefore obtaining 'one consenting class.' | All creditors vote as single class; simple majority of recognised debt is sufficient for approval. |
| Secured Creditors | Secured creditors can be 'crammed down.' | Secured creditors cannot be affected unless they consent to treatment or receive full payment. |
| 'Absolute Priority' | 'Absolute priority' rule acts to 'wipe out' equity where creditors receive less than 100%. | No 'absolute priority' rule – equity can retain its interests even where creditors receive less than 100% payment. |

Notes

33 11 U.S.C. § 1129(b)(2)(B).

34 This general rule is subject to a very narrowly interpreted 'new value' exception – i.e., equity may retain its interest provided it supplies market-tested, demonstrable 'new value' for the benefit of senior creditors. *See In re 203 N. LaSalle Street Partnership*, 524 U.S. 975, 141 L.Ed. 2d 785, 119 S.Ct. 24 (1999) (applying a 'market test' for 'new value' that may require either a right in parties other than the debtor to offer plans or at least a right of such other parties to bid for the right to reorganize the debtor).

35 *See, e.g., In re Garcia Avila*, 296 B.R. 95 (Bankr. S.D.N.Y. 2003).

36 *See* n. 5 above.




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