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ARTICLE

Pre-packaged Reorganisations under Mexico's *Ley de Concurso Mercantiles*: New Amendments Offer New Possibilities for Cross-Border Insolvencies

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1 Introduction

As Mexico's reformed *Ley de Concurso Mercantiles* (LCM) approaches its ninth year of effectiveness, the country's legislature and judiciary continue to search for procedures that further the law's stated objectives of corporate rescue.[2] That search has led, most recently, to amendments[3] to the LCM designed to implement and facilitate 'pre-packaged' reorganisations.

How will such reorganisations be treated in cross-border proceedings requiring recognition and other relief in US Bankruptcy Courts? The following article discusses very briefly the LCM's amendments and, based on existing precedent involving other Latin American cross-border restructurings, offers some initial thoughts as to how US Courts might treat 'pre-packaged' reorganisations commenced in Mexico.

2 Pre-packaged reorganisation plans under the *Ley de Concursos Mercantiles*

Among the LCM's 2007 amendments are a new 'Title XIV', captioned *Concurso Mercantil con Plan de Reestructura Previo* ('Reorganisation with Prior Plan of Restructuring'). These amendments – consisting of four new articles – are rooted in the policy objectives of encouraging commercial debtors to negotiate proactively with their creditors for an effective 'exit strategy' in advance of liquidity problems:

> 'The reform's most important addition is the implementation of the "Reorganisation with Prior Plan of Restructuring", designed to permit companies with anticipated liquidity problems to pre-negotiate with their creditors a reorganisation and exit.'[4]

The LCM's 'pre-pack' amendments are quite straightforward:

- A petition must comply with all requirements of Article 20 otherwise applicable to the commencement of *concurso* proceedings.[5]
- The petition must be submitted with sworn testimony evidencing the support of creditors representing at least 40% of the face value of the debt.[6]
- The petition must be submitted with the debtor's further sworn testimony that the debtor either (a) presently satisfies the liquidity requirements of Arts 10 and 11; or (b) satisfaction of such requirements is 'imminent'.[7]

Notes

1 The author wishes to thank Ernesto A. Linares, a registered *conciliador*, a principal with DKL CONSULTORES, S.C., Mexico, D.F. and a member of INSOL International and Lic. Eduardo Martinez Rodriguez of MARTINEZ Y NARVAEZ ABOGADOS, S.C., Mexico, D.F. and a member of the International Insolvency Institute, for their 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 elinares@dkl.com.mx.

2 LCM Art. 1 ('It is in the public interest to preserve companies and prevent the generalized default of payment obligations that jeopardise the continuation of the companies themselves and the companies with which they have dealings.').

3 The *Reformas a La Ley de Concursos Mercantiles* (*Reformas*), effective 27 December 2007, were provided to the author by Dr Luis Manuel C. Méjan, Director General of Mexico's *Instituto Federal de Especialistas de Concursos Mercantiles* (IFECOM) and a member of the International Insolvency Institute. Spanish and English-language copies of the *Reformas* are on file with the author. The author wishes to further thank Dr Méjan and Sr Jesús Enriquéz of IFECOM for the generous and gracious assistance.

4 *Reformas*, at p.37 ('La más importante adición de la reforma consiste en la creación de la figura del Concurso Mercantil con Plan de Reestructura Previo, inspirada por la idea de permitir a empresas que tienen dificultades de liquidez pactar privadamente con sus acreedores un camino de solución y salida.').

5 LCM Art. 339(I).

6 LCM Art. 339(II).

7 LCM Art. 339(III).

– The petition must be submitted with a proposed *concurso* plan, executed by the supporting creditors.[8]
– The *concurso* plan remains subject to (a) review and approval by an appointed *conciliador*; and (b) confirmation under the LCM's remaining *concurso* provisions.[9]

The LCM's 'pre-pack' amendments also appear extremely flexible and drafted to incentivise commercial debtors to bargain proactively with creditors for the rescue of the troubled enterprise. Specifically:

– As noted, to be admitted as a *concurso* proceeding, pre-packaged plans need only receive the approval of 40% of the face value of the debt.[10] These provisions offer a creditor approval threshold slightly lower than the simple majority (50.1%) required to secure final confirmation for a *concurso* plan,[11] but one nevertheless sufficiently close so as to provide the debtor and petitioning creditors with a high probability of success. With such a *quorum* of affirmative votes upon entry to the process, the likelihood of 'hold-out' creditors exerting leverage within the *concurso* period decreases dramatically.
– The ordinary requirement of a *Visitador* (Examiner) is waived, upon the sworn testimony of the merchant as to the present existence, or the imminence (i.e., the anticipated occurrence within 30 days), of liquidity conditions otherwise necessary to satisfy admission to a conventional *concurso* proceeding.[12] Because the primary purpose of a *Visitador* is to verify the status of the debtor's financial condition, and because – as a practical matter – the state of the debtor's books is often such as to require considerable forensic work before a *Visitador*'s report is issued, this simplified 'verification' requirement should be relatively easy to satisfy.
– The petitioning parties may seek the interim relief available under Article 37 and the Commercial Code,[13] and usually reserved for the appointed *Visitador*.[14] In so doing, the debtor and its creditors are able to negotiate between themselves those judicial measures best suited to preserve the debtor's enterprise value and assets, and to seek appropriate relief upon filing the petition.
– By obtaining the pre-consent of a significant *quorum* of votes necessary to confirm a *concurso* plan, the debtor mitigates significantly the threat of the LCM's 'automatic bankruptcy' provisions. Indeed, this is the specifically articulated policy of the amendment: 'This variant of *concurso* proceeding (i.e., the Reorganisation with Prior Plan of Restructuring) is a tool intended to help many commercial debtors prepare for and commence a *concurso* proceeding with a reasonable expectation of successful reorganisation, while eliminating the former law's risk that if a voluntary *concurso* proceeding were not successful, bankruptcy would inevitably result – a risk that previously deterred many commercial debtors from employing the *concurso* proceeding.'[15]

Notes

8 LCM Art. 339(IV).
9 LCM Arts 145-166.
10 LCM Art. 339(II) ('The Reorganisation with Prior Plan of Restructuring will be admitted to *concurso* proceedings when … [t]he request is submitted by the merchant and the holders of at least forty percent of the total of the merchant's debits.'); LCM Art. 337 ('If the petition for Reorganisation with Prior Plan of Restructuring meets all the previous requirements, the Judge will declare a *concurso* proceeding without the need to designate visitador.').
11 LCM Art. 157.
12 LCM Art. 339(II) ('For purposes of the Reorganisation with Prior Plan of Restructuring it will be sufficient that the petitioning debtor affirms under oath that the co-petitioning creditors represent at least forty percent of the debtor's total debts. The petitioning creditor must further affirm under oath that: (a) the debtor demonstrably meets the liquidity requirements of Articles 10 and 11; or (b) the petitioning debtor's satisfaction of the liquidity requirements of Articles 10 and 11 is demonstrably imminent. "Imminence" for purposes of this Aritcle is understood to mean such conditions are inevitable within thirty days.'). LCM Arts 10 and 11, in turn, impose a liquidity requirement on voluntary and involuntary 'Merchant' insolvencies. Specifically, a petition for business reorganisation requires a determination of 'generalised default', itself determined by: (I) a showing that at least 35% of the debtor's 'past due' obligations are at least 30 days delinquent as of the date of the petition; and (II) the debtor's 'liquid assets' (as defined in Article 10) are insufficient to 'cover' at least 80% of these 'past due' obligations.
13 LCM Art. 340 ('The debtor and the creditors who petition for a Reorganisation with Prior Plan of Restructuring will be able to seek from the court the protective provisions of Article 37 of this Law and of the Code of Commerce.').
14 LCM Art. 37 incorporates by reference and for the benefit of the *Visitador* the interim relief available to creditors under Art. 25, and provides further that in addition to such relief, 'the *Visitador* may ask the judge, throughout the inspection visit, to order, change or cancel the preventive remedies to which this Article refers, in order to protect the Estate and the creditors' rights, and must provide the reasons in all events of his request.' The same Article provides further that '[t]he judge may order such preventive remedies as he may deem necessary either by operation of law or upon the inspector's request.' These remedies include (i) prohibition of the payment of pre-petition obligations; (ii) suspension of enforcement proceedings against the debtor's property and rights; (iii) prohibition of the disposition or encumbrance of the debtor's property, and/or of the transfer of cash or securities to any third party; (iv) the seizure of the debtor's property; (v) appointment of a conservator for the debtor's cash; (vi) a restraining order requiring the debtor to appoint an agent for the business in the debtor's absence; and (vii) any other analogous relief.
15 *Reformas* at p. 37 ('Esta variante del Concurso con plan de reestructura previo es una herramienta que ayudará a muchos comerciantes el preparar el concurso y llegar a él con una razonable base de seguridad en el logro de un convenio, eliminando el riesgo existente en la ley original de que si no se lograba éste tendría que irremisiblemente llegar a la quiebra, lo cual alejó a muchos comerciantes del uso de la figura concursal.').

3 Integration with cross-border insolvency law: are 'pre-packaged' Mexican *concurso* proceedings recognisable in the United States?

The policy underlying the LCM's 'pre-pack' amendments adds a potentially new dimension to US-Mexican cross-border insolvency practice. Chapter 15 of the US Bankruptcy Code, added as part of the 2005 BAPCPA amendments, generally tracks the UNCITRAL Model Law's provisions[16] and replaces former Section 304 – itself the first codified procedure in the US by which a foreign bankruptcy representative could obtain recognition or facilitation for a foreign proceeding.[17] Chapter 15 builds on Section 304's precedent, fomalising and streamlining 'recognition' in the US for 'foreign proceedings' commenced off-shore, and codifying certain types of relief for appointed 'foreign representatives'.

Will 'pre-packaged' *concurso* proceedings commenced under the LCM's new Article 335 be recognised under Chapter 15 of the US Code? Though US courts have provided ancillary relief under Section 304 in support of conventional Mexican *concurso* proceedings under the LCM,[18] the novelty both of the LCM's amendments and of Chapter 15 means such recognition has yet to be tested. However, a pre-BAPCPA decision involving another Latin American 'pre-packaged' case is instructive, and may provide guidance as to type of analysis US courts are likely to apply whenever the question arises.

In *In re Board of Directors of Multicanal S.A.*,[19] the debtor – an Argentine cable company – sought recognition for its pre-packaged *Acuerdo Preventivo Extrajudicial* (APE) in US Bankruptcy Court. *Multicanal*'s ancillary proceeding was commenced to seek recognition of the APE over the objections of certain US creditors (holders of *Multicanal*'s Notes), two separate lawsuits commenced in the state of New York with respect to certain obligations, and an involuntary Chapter 11 commenced under Section 303 of the US Bankruptcy Code.

At issue regarding *Multicanal*'s petition for recognition were:

- Whether the APE was, itself, a legitimate Argentine legal proceeding worthy of recognition in the US;
- Whether the voting solicited in connection with the APE was legitimate; and
- Whether *Multicanal*'s APE discriminated against certain of the company's US creditors.

The US Bankruptcy Court's extensive, 37-page decision held that:

- The APE was, indeed, an Argentine legal proceeding worthy of recognition. The Bankruptcy Court based its ruling on the APE's comparable voting[20] and filing[21] requirements; the similarity of the APE's statutory framework to other foreign reorganisation statutes;[22] a judicial review process similar to that applicable to US 'pre-packaged' bankruptcies;[23] the availability of an 'automatic stay' upon commencement of the APE;[24] and the continued involvement of management in the debtor's day-to-day operations.[25] In recognising the APE, the Bankruptcy Court was not troubled by the absence of a direct analogue to the US Code's 'absolute priority rule'[26] or the 'best interests' test'.[27] As to the US Code's requirement of 'good faith' in confirming the plan,[28] the Bankruptcy Court looked to Section 304's comparable 'just treatment' requirement[29]

Notes

16 Some modifications are designed to conform the Model Law with existing US law. *See In re Iida* 377 B.R. 243, 256 (Bankr. 9th Cir. 2007) (hereinafter, '*Iida*').

17 *Iida* 377 B.R. at 254 (citations omitted) ('Congress enacted former § 304 as part of the Bankruptcy Reform Act of 1978… . It was an innovation. Prior to the enactment of § 304, United States bankruptcy law did not provide specific procedures by which a foreign bankruptcy trustee could obtain relief in the United States to facilitate the foreign bankruptcy proceeding.').

18 *See In re Petition of Garcia Avila*, 296 B.R. 95 (Bkrtcy S.D.N.Y., 2003) (enjoining creditors' efforts in the US to reach bond proceeds deemed critical to debtors' reorganisation efforts in *concurso* proceedings commenced shortly after passage of the LCM).

19 314 B.R. 486 (Bankr. S.D.N.Y. 2004), affirmed in part and reversed in part, *sub nom. Argentinian Recovery Co. LLC v Board of Directors of Multicanal S.A.*, 331 B.R. 537 (S.D.N.Y. 2005).

20 314 B.R. at 505.

21 314 B.R. at 503, 504.

22 314 B.R. at 504.

23 314 B.R.at 505.

24 314 B.R. at 505.

25 314 B.R. at 505.

26 314 B.R. at 506-07 (discussing *In re Garcia Avila*, 296 B.R. 95 (Bankr. S.D.N.Y. 2003), a similar recognition case under former Mexican law, and noting that 'the [bankruptcy] [c]ourt granted … recognition to a Mexican reorganization even though Mexican law does not explicitly require the proponent of a plan to satisfy either the best interests test or the absolute priority rule').

27 314 B.R. at 507.

28 11 U.S.C. § 1129(a)(3).

29 314 B.R. at 507 ('[T]he requirement of good faith, mandated for Chapter 11 confirmation … is incorporated into § 304 through the concept of comity and the requirement of § 304(c)(1) of "just treatment" of all holders of claims or interests'). Section 304's successor, Chapter 15, omits this specific 'just treatment' requirement, but maintains the former law's emphasis on comity. The prior statute continues to inform bankruptcy courts' determinations under the new law. *See Iida* 377 B.R. 243, 256 (Bankr. 9th Cir. 2007) (citing *In re SPhinX, Ltd.*, 351 B.R.

finding that '[i]n sum, *Multicanal*'s APE … is the type of reorganization proceeding that, in principle, is subject to recognition under § 304.'[30]

– The APE's voting procedures justified recognition. Over the strenuous objection of a large US holder of *Multicanal*'s Notes, the Bankruptcy Court distilled the analysis to a single question: 'whether due process [in the APE voting] was denied'.[31] The Bankruptcy Court found that, on the basis of an extensive evidentiary record before it, 'fundamental issues of due process [were] not implicated'.[32]
– The APE treated the holders of *Multicanal*'s Notes differently, depending on their status under US securities laws either as 'qualified institutional buyers' (QIBs) or 'retail investors'. Though, as recognised by the Bankruptcy Court, 'there are circumstances in which different treatment of creditors in the same class can be justified under U.S. bankruptcy laws',[33] the APE's proposed separate treatment of Noteholders based on their status under US securities laws nevertheless ran counter to the fundamental 'principle of equality between identically situated creditors' inherent in US insolvency law.[34]

On these bases, the Bankruptcy Court conditionally granted[35] recognition to *Multicanal*'s APE, enjoined the New York lawsuits, and dismissed the competing, involuntary Chapter 11. On appeal, the US District Court affirmed the Bankruptcy Court's decision in all respects except those concerning proposed remedies for the discrimination that would run afoul of US securities laws.[36]

In sum, this precedent suggests that 'pre-packaged' Mexican *concurso* proceedings will enjoy similar recognition in US Courts; however, the same precedent also suggests that in order for such recognition to remain effective, US securities laws or other, applicable US laws should be effectively anticipated and addressed.[37]

4 Conclusion

The recent addition of 'pre-packaged' insolvency proceedings to Mexico's reformed and maturing insolvency legislation – and the precedent underlying cross-border provisions of US insolvency law – are harbingers of a growing level of flexibility in planning and implementing cross-border insolvencies between the US and Mexico. The LCM's new amendments offer new possibilities for such cross-border work.

Notes

103, 112 (Bankr. S.D.N.Y. 2006)) ('Although case law developed under § 304 no longer directly controls chapter 15 cases, it continues to inform our determinations to some extent').

30 314 B.R. at 509.
31 314 B.R. at 509.
32 314 B.R. at 512, 515.
33 314 B.R. at 518.
34 314 B.R. at 518-519 ('The principle of equality between identically situated creditors is fundamental under U.S. insolvency law … . *Multicanal* has not adequately explained why it did not take appropriate steps to eliminate the disadvantageous aspects of the discrimination').
35 The Bankruptcy Court's recognition was conditional upon *Multicanal*'s ability to rectify the discrimination issue in a manner consistent with section 304.
36 *See Argentinian Recovery Co. LLC v Board of Directors of Multicanal S.A.*, 331 B.R. 537 (S.D.N.Y., 2005) (holding, among other things, that recognition could not be granted unless the debtor satisfied the registration requirements of the Securities Act or proved the availability of an exemption from registration, and remanding the matter for the Bankruptcy Court to decide the applicability of another registration exemption and other issues in connection with the proposed cure of discriminatory treatment).
37 *See also In re Cablevision S.A.*, 315 B.R. 818 (S.D.N.Y., 2004) (in ancillary proceeding to recognise Argentinean APE under Section 304, withdrawal of the reference from US Bankruptcy Court to US District Court required in order to consider application of US Trust Indenture Act to APE's provisions).

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