# Corporate Debt Restructuring in Latin America: New Developments—New Opportunities?

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During the last 10 years, Latin America has suffered various financial crises.[1] The most well-known are the Mexican Peso Crisis in 1995[2]; Ecuador's financial crisis and default on its external debt in 1999[3]; the devaluation of the Brazilian real in 1999[4]; Argentina's external debt default in 2001 and its banking crisis in 2002[5]; and, Uruguay's banking crisis and debt re-profiling in 2003.[6] Likewise, other financial crises such as the Asian crisis of 1997[7] or the Russian crisis of 1998[8] directly impacted on the region either

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1. Actually, the crises in Latin America occurred throughout its history but become recurrent since the beginning of the 1980s due to the high levels of sovereign debt being refinanced by new issuances of debt. Due to the number of crises, the 1980s in Latin America is known as the "lost decade". These recurrent crises gave origin to the Baker Plan and its successful successor, the Brady Plan. Since the conception of the Brady Plan in 1989, Argentina, Brazil, Costa Rica, the Dominican Republic, Ecuador, Mexico, Panama, Peru, Uruguay and Venezuela were the Latin American countries able to restructure their unsustainable debt—mostly in syndicated loans—by the issuance of Brady bonds. For an enlargement on the Baker and Brady Plans, see Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad-hoc Machinery* (Brookings Institution Press, Washington D.C., 2003).

Moreover, in 1989, the economist John Williamson coined the term "Washington Consensus", as a guideline of 10 market-oriented reforms to be adopted in state-directed economies of Latin America that were trying to recover from the debt crisis of the 1980s. The 10 points of the original Washington Consensus were: (i) fiscal discipline; (ii) reordering public expenditure priorities; (iii) tax reform; (iv) liberalisation of interest rates; (v) a competitive exchange rate; (vi) trade liberalisation; (vii) liberalisation of inward foreign direct investment; (viii) privatisation; (ix) deregulation; and (x) property rights. As stated by J. Clift, although this 10-point policy package was originally designed as a reform agenda for Latin America, it quickly became seen as a model for the wider developing world.

Since the aim of this paper is not to analyse the different financial crises in Latin America, *brevatis causæ*, we will only refer to the most recent ones. For an enlargement on the "Washington Consensus", see J. Williamson, *A Short History of the Washington Consensus*, paper commissioned by Fundación CIDOB for a conference: "From the Washington Consensus towards a new Global Governance", Barcelona, September 24–25, 2004, available at *www.iie.com/publications/papers/williamson0904-2.pdf* (last visited October 24, 2004); and *What Washington Means by Policy Reform, Latin American Adjustment: How Much Has Happened?* (Institute of International Economics, 1990). See also J. Clift, *Beyond the Washington Consensus*, Finance & Development, International Monetary Fund, September 2003, at p.9, available at *www.imf.org/external/pubs/ft/fandd/2003/09/pdf/clift.pdf* (last visited October 24, 2004); and, International Monetary Fund, *From Reform Agenda to Damaged Brand Name*, Finance & Development, International Monetary Fund, September 2003, at pp.10–13, available at *www.imf.org/external/pubs/ft/fandd/2003/09/pdf/williams.pdf* (last visited October 24, 2004).

2. For a detailed description of the Mexican Crisis, see D. Arner and T. Slover, "The Mexican Currency Crisis of 1995" in *Financial Crises in the 1990s: A Global Perspective* (British Institute of International & Comparative Law, London, 2002).

3. See L. Jacome H., *The Late 1990s Financial Crisis in Ecuador: Institutional Weaknesses, Fiscal Rigidities, and Financial Dollarization at Work*, International Monetary Fund Working Paper WP/04/12, available at *www.imf.org/external/pubs/ft/wp/2004/wp0412.pdf*, (last visited October 24, 2004); or, M. Patiño L., *Lessons of the Financial Crisis in Ecuador 1999*, 7 NAFTA L & Bus. Rev. Am. 589.

4. See Independent Evaluation Office (IEO), *The IMF and the Recent Capital Account Crises*, Evaluation Report, International Monetary Fund, 2003, available at *www.imf.org/external/np/ieo/2003/cac/pdf/all.pdf* (last visited January 17, 2005).

5. For an enlargement on this issue, see US Congress Joint Economic Committee Report titled "Argentina's Economic Crisis: Causes and Cures", June 2003, available at *www.house.gov/jec* (last visited January 17, 2004).

6. One of the main reasons for Uruguay's crisis was the Argentine crisis. As stated by the Bureau of Western Hemisphere Affairs of the US Department of State on August 2004, "[s]tarting in late 2001, an economic crisis in Argentina undermined Uruguay's economy ... [i]n mid-2002 Argentine withdrawals from Uruguayan banks started a bank run that was overcome only by massive borrowing from international financial institutions. This, in turn, led to serious debt sustainability problems" (see *www.state.gov/r/pa/ei/bgn/2091.htm*, last visited August 7, 2004). In the same line of thinking, see The Economist Global Agenda, "Playing Dominoes", *The Economist*, June 27, 2002, available at *www.economist.com/research/backgrounders/displaystory.cfm?story_id=1200071*, last visited September 27, 2004.

7. The countries affected by the 1997–1998 economic, currency and financial Asian crises were Indonesia, Hong Kong, Malaysia, Philippines, South Korea and Thailand. For an enlargement on the Asian Crisis, see G. Corsetti, P. Pesenti and N. Roubini, "What Caused the Asian Currency and Financial Crises? Part I: A Macroeconomic View", available at *www.stern.nyu.edu/globalmacro/AsianCrisis.pdf* (last visited October 2, 2004) and "What Caused the Asian Currency and Financial Crises? Part II: The Policy Debate", available at *www.stern.nyu.edu/globalmacro/asiacri2.pdf* (last visited October 24, 2004). For a comprehensive list of papers on the topic available electronically, see *www.stern.nyu.edu/globalmacro/asian_crisis/basic_readings.html* (last visited October 2, 2004).

8. See B. Pinto, E. Gurvich, and S. Ulatov, *Lessons from the Russian Crisis of 1998 and Recovery*, draft chapter for, *Managing Volatility and Crises: A Practitioner's*

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by deepening recessive periods or originating these crises.[9] Given this framework, it can be said that Latin America has been under continuous economic distress during the last 10 years. The recent external debt episode in Argentina that resulted in an acute financial and economic crisis, championing the biggest default in history, is a clear indicator of the Latin American reality.

Corporations doing business in these countries are not exempt from the turmoil. As stated by Stone, corporate restructuring on a large scale is usually made necessary by a systemic financial crisis, which is defined as a severe disruption of financial markets that by impairing their ability to function, has large and adverse effects on the economy.[10]

During the economic stability periods, corporations invest and try to expand. During recessive periods, corporations try to maintain their market share and develop new lines of business. In both cases, corporations have recourse to different financing techniques to raise the required capital to achieve their objectives. Subject to their debt-to-equity ratio, corporations have to decide if they are going to finance themselves with debt or equity.[11] Debts grant their holders a right to collect monies. Therefore, the corporation is obliged to repay the agreed sums of money and the fulfilment of this obligation can be enforced by courts, eventually leading to a bankruptcy. In the case of equity, technically there is no liability. Holders of equity have a residual right over the assets of the company.

Since corporations usually have an international presence in different markets either inside or outside the region, they are able to take advantage of financing from other financial markets in a foreign currency with better terms, resulting in lower costs. On the other hand, if a corporation does not have international presence and it tries to obtain financing abroad, the debt will be denominated in a strong foreign currency in order to avoid any currency risk. In both cases, corporations will end up being indebted in a foreign currency while its income is normally denominated in the local currency of the country.

Latin American corporations usually raise funds in the US market. If it is debt, by means of loans or bonds; if it is equity, by means of American Depositary Receipts (ADRs). Both ADRs and bonds or notes are normally issued through Rule 144-A and Regulation S to target the US market.[12]

As a result of the financing practices described above, when Latin American corporations issue debt they are usually indebted in foreign currencies. When the economies of the countries of these indebted corporations are going through a recessive period, they are faced with low rates of return. Upon a crisis, Latin American currencies—unless they are pegged to the US dollar, as occurred in Argentina between 1991 and early 2002, or if the US dollar is the legal tender as in Ecuador since 2000—are usually devalued resulting in even lower rates of return (in US$ values). While their income is reduced, the burden to pay principal and/or interest on the corporation's debt in a foreign and "strong" currency increases. This mismatch, in many cases has ended in restructuring episodes. As Rieffel stated, a sharp depreciation of the domestic currency in the course of a crisis causes companies to default on their loans from domestic banks as well as from foreign creditors, rendering a large segment of the corporate sector insolvent.[13]

According to Norton,[14] if a corporation is financially troubled and decides to restructure its debt to find its way to recovery, it will be faced with three alternatives that, for the most part, are negotiated and implemented out-of-court, *i.e.* (i) out-of-court reorganisation or non-bankruptcy workouts; (ii) prepackaged reorganisation plans; and (iii) pre-arranged or pre-negotiated reorganisation plans. These three alternatives can be defined and characterised as follows[15]:

- An "out-of-court reorganisation" or "non-bankruptcy workout" is a financial restructuring of a company by means of an understanding between the debtor and its creditors

*Guide,* February 2004, available at *www1.worldbank.org/economic policy/documents/mv/pgchapter10.pdf*, (last visited January 22, 2005); and H. Huang, D. Mark and C. Xu, *Financial Crisis, Economic Recovery, and Banking Development in Russia, Ukraine, and Other FSU Countries,* International Monetary Fund, Working Paper WP/04/105, June 2004.

9. An example of this is the following quotation from one of Argentina's leading economic newspapers that stated that: "The Russian Crisis of 1998 originated the declining process in Argentina that finished at the end of 2001 with the default and the subsequent devaluation". (*Infobae*, "Rusia ensaya una crisis Argentina", July 8, 2004, available at *www.radio10.com.ar*).

10. M. Stone, *Corporate Sector Restructuring: The Role of Government in Times of Crisis*, International Monetary Fund, Economic Issues No.31, June 2002, available at *www.imf.org/External/Pubs/FT/issues/issues31/index.htm* (last visited January 27, 2005).

11. See J.S. Levin, *Structuring Venture Capital, Private Equity and Entrepreneurial Transaction* (Aspen Publishers, New York, 2000).

12. Rule 144-A is a safe harbour for private re-sales of securities issued outside the United States to holders within the US territory (QIBs) during the seasoning period without the need of registration with the US Securities and Exchange Commission. After a two-year holding period, restricted securities can be freely resold to non-qualified investors in the United States. Regulation S contains the rules governing offers and sales made outside the United States without registration under the Securities Act of 1933. For an in-depth analysis of the interaction of Rule 144-A and Regulation S, see M.I. Steinberg and D. Lansdale, "Regulation S and Rule 144A: Creating a Workable Fiction in an Expanding Global Securities Market" 29 INTLLAW 43.

13. L. Rieffel, *Restructuring Sovereign Debt: The Case for Ad-hoc Machinery* (Brookings Institution Press, Washington D.C., 2003), at pp.43–44.

14. See W.L. Norton Jr., *Norton Bankruptcy Law and Practice*, (2nd ed.), § 86:1, also available online at *www.westlaw.co.uk*.

15. n.14 above.

without the intervention of any court or regulatory authority. It is a contractual voluntary agreement where the terms and conditions are agreed between the parties.

- A "pre-packaged reorganisation plan", or simply "pre-pack", is the procedure that a company can have recourse to if it is either in default or has general economic or financial difficulties to design and negotiate a settlement with its creditors without having the need to file a full court-supervised reorganisation procedure. The aim of these plans or procedures is to enhance the efficiency of the insolvency procedures by permitting a fast recovery from a situation that might lead to a bankruptcy. Upon the filing of the agreement reached by the parties, the court or regulatory authority reviews the agreement to ensure that it fulfils the minimum requirements set forth by law and proceeds to homologate it. If the agreement is approved by the court, it becomes binding on all creditors affected by said agreement even though they have rejected or abstained to vote.
- A "pre-arranged" or "pre-negotiated" plan is similar to the pre-packaged reorganisation plan since it is also negotiated between the debtor and its creditors on an out-of-court basis and then is filed with a court to obtain the benefits of its approval. Although the parties have conducted substantial negotiations prior to the filing, there is no formal solicitation of votes. As stated by Jacoby,[16] the difference between the "pre-packaged reorganisation plan" and the "pre-arranged" or "pre-negotiated plan" is if it is "pre-voted" or "post-voted".

The aim of this article is do a comparative analysis of these out-of-court alternatives in Latin America, focusing on the so-called "pre-packs" in view of an important precedent that has been developed by a US Bankruptcy Court which had to determine if recognition should be granted to an Argentine pre-packaged reorganisation plan under US law. In summary, the idea is to provide the reader with an up-to-date description of the situation in the Latin American region regarding corporate debt restructuring by means of out-of-court reorganisation alternatives, mentioning some possible business opportunities in the distress debt market.

## "Pre-packaged reorganisation plans" in Latin America

Recently, many Latin American countries amended their bankruptcies laws and a new push has been given to the use of pre-packs (*e.g.* Argentina) or the inclusion of this alternative in their insolvency legislation (*e.g.* Brazil). In this part of the article, a brief reference to the out-of-court restructuring alternatives of each Latin American country will be made.[17]

### Brazil (pre-pack deals)

The most recent case is Brazil. This country passed a new bankruptcy law (*Lei de Falências*) on December 15, 2004—after having been in Congress for more than 10 years—which replaced the previous insolvency law of 1945 (Decree Law 7,661). The main features of the new Law No.11,101/05[18] are: (i) the inclusion of an "extra-judicial restructuring" procedure to restructure debts—excluding labour and tax debts[19]—on an out-of-court basis (*i.e.* pre-packs); and, (ii) the reorganisation of the priority ranking, enhancing banks' lending on real security basis.

The recently enacted law states that in order to proceed satisfactorily with a pre-pack and request its judicial ratification, at least 60 per cent of each category of creditor should have accepted the proposed agreement in order to make it enforceable *vis-à-vis* all creditors.[20]

### Bolivia (pre-negotiated plans)

In 2003, it was the turn of Bolivia, who passed Law 2,495 titled "Corporate Voluntary Restructuring Law"[21] which specifically rules pre-negotiated reorganisation plans. In February 2004, Decree No.27,384[22] was enacted to regulate Law 2,495.[23]

Pre-negotiated reorganisation plans are referred in the law as "transactional agreements".[24] Once the debtor has negotiated a "transactional agreement", he requests the approval of said agreement by the corporation's supervisory authority (Superintendencia de Empresas). A trustee appointed by the corporation's supervisory authority to oversee the whole proceeding summons a general meeting to decide on the "transactional agreement". If the

16. M.B. Jacoby, "Prepacks and the Deal-litigation Tension" (2004) 23(2) A.B.I.J. 34.

17. The analysis in this article neither includes the Latin American countries of Central America nor the Caribbean.

18. A Portuguese version of this law is available at *www.dji.com.br/leis_ordinarias/2005-011101/2005-011101.htm*.

19. See Art.161 §1, Law 11,101/05, where other two specific situations are also excluded.

20. See Art.163, Law 11,101/05.

21. A Spanish version of this law is available at *www.bolsa-valores-bolivia.com/leyes/Ley_2495_Restructuraci%C3%B3n_Voluntaria.pdf* (last visited January 26, 2005).

22. A Spanish version of this Decree is available at *http://servdmzw.sbef.gov.bo/circular/leyes/DS27384.pdf* (last visited January 26, 2005).

23. It is common in certain Latin American countries that after passing a law, the Executive enacts a regulatory decree to clarify or enlarge the scope of certain aspects of the law to make it operative. These decrees are supposed not to affect or modify the essence of the law.

24. See Art.1, Law 2,495.

agreement is approved by the required majority, it is mandatory on all the creditors and produces the novation of the original obligation.

## Peru (pre-negotiated plans)

The insolvency framework in Peru was amended in October 2002 by Law No.27,809 (*Ley General del Sistema Concursal*).[25] The insolvency proceedings are lead and supervised by an administrative authority known by its acronym INDECOPI (National Institute of Competition and Protection of Intellectual Property). Since pre-packs are not an alternative in Peru, the law contemplates pre-negotiated arrangements. Peru is a curious case because in pre-negotiated agreements the role of the court is performed by an administrative authority, the role of the courts being limited to certain exceptional circumstances once the administrative instance has been exhausted.

Under Peruvian law, there are two reorganisation procedures (*concurso*): preventive or ordinary. Being the preventive reorganisation procedure a previous instance in the concurso. If a debtor requires a preventive reorganisation procedure and a "global restructuring agreement" with the creditors is not obtained, INDECOPI would start an ordinary reorganisation procedure. In order to obtain the approval of the so-called "global restructuring agreement", a general meeting of creditors is summoned.[26] The resolution would be adopted by a creditors' general meeting with the vote of more than 66.6 per cent of the total liabilities at the first call; and, with the vote of more than 66.6 per cent of the liabilities present at the meeting at the second call.[27]

## Chile (non-bankruptcy workouts)

The provisions regarding reorganisation agreements in Chile are included in the Bankruptcy law No.18,175 (as amended and restated on May 31, 2002).[28]

Under Chilean law, there are three types of agreements, two of which are under the supervision of the court; if it is before the declaration of bankruptcy, it is a "preventive agreement" and if it is after, it is a "judicial agreement".[29] The third type of agreement is a non-bankruptcy agreement that can only be obtained if it is unanimous (*i.e.* involving all the creditors).[30] If unanimous agreement is not obtained, the agreement would only be binding on those that took part, it is a private arrangement between the parties. This notwithstanding, a creditor who did not take part in the agreement can demand to be subject to same.[31]

## Argentina (pre-pack deals)

On May 15, 2002, as a result of the financial and economic crisis, Law No.25,589 was passed to amend the Argentine Bankruptcy Law No.24,522, as amended and restated by Law No.25,563. Among other things, the provisions of the pre-packaged reorganisation plans (*Acuerdo Preventivo Extrajudicial* or "APE") were amended to boost the use of this tool as a mechanism to solve the debt imbalance that many Argentine companies were facing.

A debtor who suspends his payments or has economic or financial difficulties may reach an agreement with his creditors and submit it for judicial homologation. In order to request the judicial homologation of the agreement, the Argentine Bankruptcy law states that it is necessary to obtain a double threshold: (i) an absolute majority (more than 50 per cent) of unsecured creditors on a head-count basis; and, (ii) at least two thirds (66.66 per cent) of the aggregate amount of unsecured liabilities.[32]

The main effects of the homologation of the agreement are: (i) the novation of all the obligations having an origin or cause prior to the agreement; and (ii) the homologated agreement produces effects with respect to all general creditors whose claims had been included in the agreement, even if they have not participated in the restructuring or if they have opposed it.[33]

## Uruguay (pre-pack deals)

The Bankruptcy Law is included in the Commercial Code.[34] In January 2001, some articles of the Bankruptcy Law were amended by Law No.17,292.[35]

25. A Spanish version of this law can be obtained from *www.indecopi.gob.pe/legislacionyjurisprudencia/crp/leyconcursal1.asp* (last visited January 27, 2004).
26. Art.51.1, Law 27,809.
27. Art.53.1, Law 27,809.
28. A Spanish version of this law can be obtained at *www.bcn.cl/pags/home_page/ver_articulo_en_profundidad.php?id_subarticulo=80&id_destaca=71* (last visited January 27, 2005).
29. Art.173, Law 18,175.
30. Art.169, Law 18,175.
31. Art.172, Law 18,175.
32. See Law 24,522, Art.73. Moreover, according to the general reorganisation rules under Argentine law, in the event of securities issued in series, the voting system is as follows (i) a meeting summoned by the trustee or when, pertinent, by the Court shall be held; (ii) at the meeting, the creditors who attended will approve or reject the proposed agreement (in the event there are options and the proposal is approved, and shall state which alternative they support); and, (iii) the consent shall be calculated by the capital representing all those who have accepted the proposal and as though granted by one single person; rejections shall also be calculated as one single person.
33. See Art.56, Law 24,522.
34. A Spanish version of the Commercial Code is available at *www.parlamento.gub.uy/htmlstat/pl/codigos/codigocomercio/1997/cod_comercio.htm* (last visited January 26, 2005).
35. A Spanish version of this law is available at *www.todoelderecho.com/Uruguay/LEGISLACION_NUEVA_7.htm* (last visited January 26, 2005).

According to the provisions in the Commercial Code, the debtor can execute an out-of-court "preventive agreement" (concordato preventivo extrajudicial).[36]

Besides certain documents required by law, the debtor has to obtain the affirmative vote of: (i) at least 75 per cent of the of the aggregate amount of unsecured liabilities; and (ii) at least 75 per cent of the liabilities resulting from the going concern of the company, these liabilities being registered on the Company's books and included within the 75 per cent referred in (i) above.[37] Under certain circumstances, a person to oversee the business of the debtor and the fulfilment of the agreement can be appointed. The homologation of the agreement by the court is binding on all general creditors.[38]

## Mexico (non-bankruptcy workouts)

On May 12, 2000, Mexico passed the so-called "Law of Commercial Insolvency", amending its 1943 insolvency law. According to the law itself, the preservation of businesses and the avoidance of default due to its risks to the company itself as well as other companies is of public interest.[39] The main features of this law are that it modernises the old insolvency law, incorporates virtually all the provisions of the United Nations Commission on International Trade ("UNCITRAL") Model Law on Cross Border Insolvency, and in its aim of providing transparency creates a quasi-judicial agency (*Instituto Federal de Especialistas de Concursos Mercantiles* or "INFECOM") to oversee the administration of insolvency cases.[40]

Although Mexico's amendment is relatively recent, it neither includes pre-packaged arrangements nor pre-negotiated agreements. This notwithstanding, it is worth mentioning that a financially distressed company can resort to a body of conciliators of INFECOM to reconcile the creditors' interests and the debtor's situation.[41] Creditors can also request the help of INFECOM to collect their credits.[42]

## Colombia (pre-pack deals)

The main framework is established in Law No.550 passed in December 1999.[43] Colombia is another curious case, since all corporate reorganisation procedures are performed on an out-of-court basis, as in the case of Peru. The rationale behind this peculiar situation can be found in the backlog in the judicial proceedings prior to the enactment of the law.

The agreement between the debtor and its creditors is referred in Law No.550 as "restructuring agreement".[44] A restructuring agreement is binding on all creditors (including those who voted against the agreement or those who were absent) if the required majorities are achieved. The majority required by law is the affirmative vote of a simple majority (more than 50 per cent) of a plural number of internal or external creditors of the company which also should represent the simple majority of the admissible votes. Moreover, these votes should also correspond to at least three of the creditor categories provided for by Law 550 (*i.e.* (i) internal creditors; (ii) labour creditors and pensioners; (iii) public entities and social security institutions; (iv) financial institutions and other entities subject to the supervision of the Financial Authority; and (v) other external creditors).[45]

## Ecuador, Paraguay and Venezuela (non-bankruptcy workouts)

Under Ecuadorian law, insolvency procedures are regulated by the "Insolvency Law" (*Ley de Concurso Preventivo*) dated August 1997, and the "Law for the Economic Transformation of Ecuador", Law No.4 RO/Sup 34 dated March 13, 2000.[46] In Paraguay, the law ruling insolvency procedures is Law 154 of 1969. Finally, in Venezuela, the norms regarding insolvency are included in the Commercial Code (as amended and restated in 1955).[47]

The possibility of resorting to pre-pack deals does not exist in Ecuador, Paraguay, or Venezuela. This notwithstanding, private contractual arrangements can be achieved with creditors. Unfortunately, a super-majority would not be able to bind a dissenting minority as is the case of other countries that have pre-packs or pre-negotiated plans. These countries' insolvency regimes are old and out-of-touch with today's business practices (in the case of Ecuador's 2000 law, some issues were specifically addressed due to the economic crisis but no general amendments to the Insolvency Law were passed).

36. Art.1523, Commercial Code.
37. Art.1524, Commercial Code and Art.79, Law 2,230.
38. Arts 1701 and 1702, Commercial Code.
39. See Art.1, Mexican Law of Commercial Insolvency.
40. See J. Fernandez-McEvoy, "Mexico's New Insolvency Act: Increasing Fairness and Efficiency in the Administration of Domestic and Cross-Border Cases (Part I)" *ABI Journal*, July/August 2000, p.16.
41. See Art.312, Mexican Law of Commercial Insolvency.
42. n.41 above.
43. A Spanish version of this law is available at *www.supersociedades.gov.co/ss/drvisapi.dll?MIval=sec&dir=96* (last visited January 26, 2005). Other relevant provisions are included in Law 222, in the Civil Code and in the Commercial Code.
44. Art.5, Law 550.
45. If only three categories are part of the agreement, the requirement is reduced to two categories. But, if only two categories are applicable, the votes should be from both categories. See Art.29, Law 550.
46. A Spanish version of this law is available at *www.cig.org.ec/pancho/pdf/leytransformacioneconomica.pdf* (last visited January 27, 2005).
47. Art.898 *et seq.* A Spanish text of the Commercial Code is available at *http://comunidad.vlex.com/pantin/ccom.html* (last visited January 27, 2005).

## A regional overview

Argentina, Brazil, Colombia and Uruguay have pre-packaged reorganisation deals. In Colombia the trend is that all the reorganisation procedures (court and out-of-court based) are performed on an out-of-court basis although it produces the same effects as a pre-pack filed with a court for homologation.

In general terms, it can be said that in those Latin American countries where pre-packs are available—exempting certain differences between each jurisdiction—the procedure is similar. Usually, after a negotiation between the debtor and its creditors the agreement is filed with the pertinent court (or administrative authority) for homologation. The debtor has to fulfil the requirements set forth in each jurisdiction (documentation) and demonstrate that the required majorities are achieved. The majorities vary between each jurisdiction, sometimes being a twofold or threefold requirement. Once the agreement is homologated by the court, it is binding on all the general creditors. Privileged creditors or secured creditors are usually excluded.

In Bolivia and Peru, a pre-negotiated plan can be reached. The whole reorganisation procedure is performed out-of-court since it is an administrative authority that will summon and oversee the creditors' meeting. Courts have very limited intervention (only in the event that the different instances of the administrative procedure have been exhausted).

Regrettably, in Chile, Ecuador, Mexico, Paraguay, and Venezuela, there are no pre-packs or pre-negotiated plans. Therefore, an out-of-court agreement requires unanimity: otherwise it would not be binding on all creditors. The following chart summarises the different out-of-court or minimum court involvement alternatives available in the different Latin American countries.

Finally, it is worth mentioning that Argentina is a particular case to analyse due to its magnitude as a result of the recent crisis. During the last two years, more than 50 corporations, three banks and three Argentine provinces or municipalities restructured their outstanding debt,[51] and many corporations are still undergoing the restructuring of their debts. A 2003 report on Argentine corporations stated that over US$31.5 billion is being restructured including 95 per cent of the stock of corporate bonds.[52] Due to the magnitude and the development of an interesting judicial precedent in a New York Bankruptcy Court applicable to other pre-packaged reorganisation plans in the Latin American region, the *Multicanal* case, involving an Argentine corporation, will follow in the analysis.

*Out-of-Court or Minimum Court Involvement Restructuring Alternatives in Latin America*

| *Restructuring Alternatives* | *Countries* |
|---|---|
| Pre-Packs Plans | Argentina<br>Brazil<br>Colombia[48]<br>Uruguay |
| Pre-Negotiated Agreements[49] | Bolivia<br>Peru |
| Non-Bankruptcy Restructurings | Chile<br>Ecuador<br>Mexico[50]<br>Paraguay<br>Venezuela |

## The *Multicanal* case: an important precedent under US law for Latin American pre-packs[52a]

A recent case in a New York Bankruptcy Court granted more legitimacy to debt reorganisation procedures in Latin America. In this section, reference will be made to the case of *Multicanal*, an Argentine corporation that filed a pre-pack (APE, according to its acronym in Spanish) under Argentine law and since its reorganisation was challenged by a US creditor in US courts, decided to file recognition of the Argentine procedure in the United States under s.304 of the US Bankruptcy Code.[53] The case under study includes the following files or documents:

1. *In re: Board of Directors of Multicanal SA, Debtor in Foreign Proceeding. In a Proceeding Under § 304 of the U.S. bankruptcy Code*, Case No.04-10280 (ALG), 307 B.R. 384 (Bankr. S.D.N.Y., March 12, 2004)[54];

48. All insolvency proceedings in Colombia are out-of-court driven.
49. Pre-negotiated agreements in Bolivia and Peru are filed with the regulatory authority (not a court) to summon the creditors to vote and obtain the benefits of its approval.
50. Although it is a non-bankruptcy workout, the Mexican Law of Commercial Insolvency (§312) contemplates the possibility to recourse to the conciliators of the overseeing authority (INFECOM) to reconcile debtor and creditors' interests.
51. Some of these, among others, are: Telecom Argentina SA (US$2.7 billion); Banco Galicia (US$1.4 billion); Petrobras Energía S.A. (US$1.9 billion); Province of Buenos Aires (US$3.2 billion); Banco Hipotecario S.A. (US$1.2 billion).
52. See A. Milne, A. Panton and B. Saez, "Argentina Corporates 2003–2004: From Ashes to APEs" Deutsche Bank, November 10, 2003.
52a. The analysis in this section is based on an article by the same author, R. Olivares-Caminal, "Recognition of Corporate Debt Restructuring Procedures in Latin America under US Law: Lessons from the Multicanal Case" (2005) 2 (3) *International Corporate Rescue*.
53. 11 U.S.C. §101 *et seq.*
54. 2004 Bankr. LEXIS 308.

2. *In re: Board of Directors of Multicanal SA, Debtor in Foreign Proceeding. In re Multicanal S.A., Alleged Debtor (in a proceeding under § 304 of the Bankruptcy Code*, Case No.04-10280 (ALG), Involuntary Ch.11, Case No.04-10523 (ALG)), 314 B.R. 486 (Bankr. S.D.N.Y., August 27, 2004)[55]; and
3. Order dated January 6, 2005 in Cases No.04-10280 (ALG) and 04-10523 (ALG).[56]

Multicanal SA ("Multicanal"), an Argentine cable company, issued, between 1997 and 2001, five series of unsecured notes governed by New York law. The aggregate principal amount corresponding to the notes was US$509 million which together with the bank's debt represented 97 per cent of Multicanal's total outstanding debt. Due to the Argentine crisis, servicing Multicanal's debt became more difficult and the acquisition of programming from the United States became much more expensive. Upon default,[57] Multicanal formed an informal negotiating group with creditors to find a work-able solution. After consultations and negotiations, Multicanal's final restructuring proposal can be summarised as follows:

- Cash Option: a cash tender offer to purchase approximately a 20 per cent of the outstanding debt at 30 per cent of its face value plus two per cent interest per annum from the date on which the pre-pack was approved to the date on which note-holders effectively receive payment. Non-qualified investors were only able to accept this offer.
- Par Option: an exchange offer of US$1,050 principal amount of Multicanal's 10-year notes bearing interest at rates that would increase over time from 2.5 per cent to 4.5 per cent for each US$ 1,000 of existing debt tendered; and
- Combined Option: a combination of $440 principal amount of Multicanal's seven-year notes bearing interest at a fixed seven per cent annual rate or an economically equivalent floating rate, as elected by the holder, and 641 of Multicanal's Class C shares of common stock for each US$1,000 of existing debt tendered. This option has a 35 per cent cap out of the total outstanding shares of Multicanal.

Over a year after defaulting, Multicanal filed an APE with the Argentine Commercial Court for homologation in order to make it binding on all creditors. Multicanal also requested the court to summon a note-holders' meeting which was held in December 2003. The outcome of the meeting was that 68 per cent of the creditors voted in favour of Multicanal's proposal while 32 per cent voted against it. As previously explained, Argentine law requires a double threshold: at least two thirds (66.66 per cent) of the aggregate amount of unsecured liabilities—which was obtained—and also, an absolute majority (more than 50 per cent) of the number of unsecured creditors. According to the mechanism set forth in the Argentine bankruptcy law to count the number of note-holders,[58] the second threshold was also obtained. Therefore, the double threshold was achieved, and the court issued a preliminary resolution stating that prima facie the requirements were fulfilled and that a 10-day period to file observations should be opened. After the period to file observations had expired, the judge resolved that creditors who rejected or abstained from voting at the note-holder's meeting should be given a 30-day term to opt among one of the three options proposed by Multicanal.

Simultaneously, on December 2003, WRH Partners Global Securities LP (WRH Partners) and Argentinian Recovery Company LLC (Argentinian Recovery), commenced two lawsuits in the Supreme Court of the State of New York to obtain a judgment on the overdue amount on the notes and an injunctive relief that Multicanal could not restructure its debt in the Argentine pre-pack based on provisions of the Trust Indenture Act of 1939 (TIA).[59] Additionally, by the end of January 2004, Argentinian Recovery and other two creditors filed an involuntary Ch.11 petition against Multicanal under s.303 of the US Bankruptcy Code.[60]

In response to the law suits, Multicanal filed a petition under s.304 of the US Bankruptcy Code[61]

55. 2004 Bankr. LEXIS 1356.
56. See *www.nysb.uscourts.gov*.
57. On February 1, 2002, Multicanal defaulted on certain notes, defaulting on payments due on all the series on April 2002.

58. See n.32 above.
59. 15 U.S.C. § 77aaa *et al.*
60. According to § 303, an involuntary case may be commenced only under Ch.7 (liquidation) or 11 (reorganisation) of the Bankruptcy Code by three or more entities, and only against a person that may be a debtor under the chapter under which such case is commenced.
61. 11 U.S.C. §304 reads as follows: "Cases ancillary to foreign proceedings.
(a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.
(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may:
(1) enjoin the commencement or continuation of:
(A) any action against:
(i) a debtor with respect to property involved in such foreign proceeding; or
(ii) such property; or
(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
(3) order other appropriate relief.

seeking recognition in the United States of the APE which was proceeding in Argentina; and moved to enjoin Argentinian Recovery from continuing to pursue two law suits in a New York State Court to obtain a judgment on the overdue amount on the notes. On the same date, the court granted a temporary restraining order enjoining Argentinian Recovery and WRH Partners:

> "from prosecuting or taking action in furtherance of the State court lawsuits, taking action in the U.S. interfering with the administration of the Argentine restructuring proceedings, or commencing or continuing any other action against Multicanal or its property outside the Bankruptcy Court relating to any bond, note or bank debt owed by Multicanal."[62]

According to s.304(b) of the US Bankruptcy Code, an eligible foreign debtor can obtain relief by means of the court enjoining the commencement or continuation of an action against itself or its property. Moreover, s.304(c) of the US Bankruptcy Code provides that in order to grant relief, "the court should be guided by what will best assure an economical and expeditious administration of [the] state".

As stated by the US Bankruptcy Court, Argentinian Recovery and WRH Partners's main arguments to consider Multicanal's pre-pack under s.304 as prejudicial and unfair to US creditors were: (i) that the APE is a form of private insolvency regime not subject to adequate judicial control and not entitled to recognition under the general standards of s.304(c); (ii) that the vote taken in favour of the APE was coerced and unfair, and that a lack of judicial oversight (among other things) led Multicanal to engage in abusive practices that created a climate of coercion and intimidation; (iii) that Multicanal discriminated against US retail investors in its restructuring.[63]

The first two issues were straightforwardly resolved by the court. In regard to the first issue under consideration, after a detailed comparison between the APE and the US pre-packaged Ch.11 proceeding, the Court stated that the APE "is the type of reorganisation proceeding that, in principle, is subject to recognition under s.304".[64] As regards the vote issue, the Court considered that the way in which the votes were calculated was in accordance with Argentine law. Also, it referred to the fact that the method for "calculation of majorities is exactly the same in a U.S. Chapter 11 case, where those who do not vote are not included in the numerator or denominator".[65] As regards the method for calculation of numbers, the Court stated that although it is not the same as in the United States, "there is no basis for rejecting the entire APE because the courts in Argentina applied Argentine law in accordance with determinable standards".[66]

Finally, in connection to the third issue, *i.e.* the allegations of discrimination against US note-holders, the Court found that the APE discriminated against the US non-qualified investor note-holders because they were only able to accept the "Cash Option" and that such discrimination must be remedied if it were receive recognition under s.304.

In August 2004, in the Memorandum of Decision, the Court stated that the APE may be recognised and enforced in the United States pursuant to s.304 of the Bankruptcy Law subject to the elimination of the discrimination. Finally, in January 2005, the Court ordered the granting of the s.304 petition and issued a permanent injunction upon Multicanal's elimination of the discrimination.[67] Additionally, the involuntary petition was dismissed. The March, August and January decisions have been appealed to the US District Court for the Southern District of New York.[68]

The key issue behind the *Multicanal* case was to establish if relief under s.304 of the US Bankruptcy Code could be granted in favour of Multicanal. If so, Multicanal could continue with its APE under Argentine law—its outcome applicable *vis-à-vis* to all creditors (*i.e.* including those in the United States that were grounding their claims under the protection of the TIA). The rationale in resolving the granting of the relief and dismissing the involuntary petition was that allowing parallel plenary insolvency proceedings to go forward under the circumstances in the *Multicanal* case would hinder, rather than advance, equitable distribution to creditors.[69]

## Concluding remarks

Many insolvency laws have recently been amended in Latin America. Those that have not been

(c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with:
(1) just treatment of all holders of claims against or interests in such estate;
(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
(3) prevention of preferential or fraudulent dispositions of property of such estate;
(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
(5) comity; and
(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns."

62. 2004 Bankr. LEXIS 1356.
63. 2004 Bankr. LEXIS 1356.
64. 2004 Bankr. LEXIS 1356.
65. 11 U.S.C. §1126(c).
66. 2004 Bankr. LEXIS 1356.
67. A copy of this resolution is available at *www.multicanal.com.ar/inversores/eng/Multicanal103.pdf* (last visited January 27, 2004).
68. At the time of writing, these appeals are still to be ruled.
69. See S.A. Melnik, "US Bankruptcy Cases Concerning Foreign Debtors: Evolving Paramaters and Pitfalls" (2005) 2(1) *International Corporate Rescue* 39, at p.43.

amended are currently under review. This trend of amending or reviewing the regional insolvency laws, is a reaction to the financial and economic condition of Latin America's economies as well as an ever-increasing number of corporations under distress. It is also a response to a global impetus of trying to save troubled companies rather than see them in liquidation.

The use of pre-packs—a debtor-driven approach —allows debtor and creditors to negotiate the terms of an agreement in a shorter period of time than traditional reorganisation procedures avoiding the problem of hold-out creditors.

As the Argentine case has proven—not only with Multicanal but with many other Argentine corporations that recently had restructured their debts[70]—pre-packs are essential in facilitating reorganisation procedures. Highly indebted corporations have been able to "wash" their balances over a short period of time with the collaboration of their creditors gaining a solid credit ratio. Therefore, it seems that there might be a possibility of enhanced business activity in the distressed Latin American markets. Although one would expect, as it is common, increased business activity in the debt market, that may not be the case, since trying to block a restructuring to obtain better terms might be too risky.[71] In lieu, buying shares of a distressed company upon default (when non-qualified investors usually try to get rid of their shareholding or qualified investors sell their shareholdings due to a liquidity problem as result from the crisis) might provide the possibility to buy shares of a highly indebted company at low cost.

Thus—over a short period of time—by means of a pre-pack, the default would be cured and a big portion of the company's liabilities would have disappeared from the balance sheet. Consequently, a pre-pack contributes to the viability of the company and could increase the value of the shares that were bought at a steep discount after the default. Since Multicanal is not a listed company, it cannot be used to prove the decrease experienced in the price of shares of a highly indebted company with the onset of financial distress, and its increase upon achieving a successful restructuring. Therefore, Telecom Argentina SA, an Argentine listed company that went through the restructuring of its debt by means of an APE will be used to demonstrate these fluctuations.

*Fluctuation of the Price of Shares of a Restructuring Company undergoing an APE (Telecom Argentina S.A.)*

| *Date* | *Status of the Restructuring* | *Value of the Share (AR$)*[72] |
|---|---|---|
| October 2, 2001 | Six months prior to default. | 1.60 |
| April 2, 2002 | Announcement of moratorium on principal. | 1.40 |
| June 24, 2002 | Announcement of moratorium on interest. | 0.61 |
| October 21, 2004 | Filing of the APE with the court for homologation. | 6.18 |
| February 4, 2005 | Note-holders' meeting endorsing the APE. | 7.05 |
| March 4, 2005 | One month after achieving the restructuring. | 8.42 |

Finally, the US case studied in this article is a preliminary confirmation that pre-packs initiated in a Latin American country can be recognised under US law. So far, it seems that holdouts trying to interfere with the local process by parallel proceedings in the United States should not constitute an issue. This notwithstanding, a confirmation from the Court of Appeals is still pending. Such lack of interference is quite essential since many (in some cases, most) of the creditors are from the United States.

Historically, the application of s.304 of the US Bankruptcy Code has been continuously contested and resolved on a case-by-case basis.[73] This notwithstanding, a confirmation would be important in setting a path for future restructurings in Latin America.

70. Among others, Acindar SA, Autopistas del Sol SA, CTI Holdings SA, Metrogas SA, Química Estrella S.A.C.I, Sideco S.A., and, Telecom Argentina S.A.

71. Moreover, it should also be borne in mind that most of the companies undergoing reorganisations—at least from the Argentine experience—are utilities companies or service providers, which in the case of a liquidation do not have many assets to liquidate.

72. There are other factors besides the APE that might also impact on the price of the shares (*i.e.* country risk, company's performance, etc.). The analysis of these factors exceed the purpose of this article. This notwithstanding, a study on these factors should be done to discover precisely how default and debt restructuring really affects the price of the shares of a company irrespective of other factors. Besides the previously mentioned observations, the fluctuation of the value of the shares shown in this table is very illustrative.

73. See S.A. Melnik, n.69 above, at p.40.