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Restructuring Strategies for Mexican Eurobond Debt

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Restructuring Strategies for Mexican Eurobond Debt

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PART 1
INTRODUCTION

A. The Bondholder Constituency

Since December 20, 1994, the Mexican Peso has fallen dramatically in value. As a result, Mexican companies that incurred a substantial amount of debt denominated in foreign currencies have experienced an enormous increase in their liabilities, giving rise to liquidity and/or leverage problems. The response of the Mexican government to the inflation sparked by the devaluation—a tight money policy leading to high real interest rates—has given rise to Mexico's most severe recession since the 1930s. The recession has led to a sharp drop in demand among Mexican consumers, and has created significant business problems for a number of Mexican companies that target the Mexican market rather than the export market.

The liquidity and leverage problems and, to a lesser extent, the business problems are common to many of Mexico's largest companies, a large number of which carry substantial amounts of external debt. Since 1988, more than sixty Mexican companies have sold to emerging markets investors dollar-denominated bonds, primarily in the form of unsecured Eurobonds (including Eurobonds issued under medium term note programs) that are not registered under U.S. securities laws. Investors in these debt securities are very diverse, and include U.S. insurance companies, pension funds, and public mutual funds, as well as off-shore funds, foreign financial institutions and off-shore retail investors.¹ Most of these Eurobond issues have been in the range of \$50 to \$200 million,² although a few have been in amounts of \$300 million or more.³

At the beginning of 1995, outstanding Mexican Eurobonds totaled, collectively, approximately \$20 billion, of which approximately \$13 billion had been issued by private sector Mexican companies.⁴ As the Mexican devaluation crisis commenced, the Mexican corporate sector also had substantial foreign currency-denominated bank debt

¹ See generally World Bank, *World Bank Debt Tables 1993-94*, Part I.1. External finance for developing countries; Financial flows to developing countries: developments and issues, pp. 9-29; *Id.*, Part II.3. Appendixes — Portfolio investment in developing countries, Mexico, pp. 126-127, 130, 131. In addition to Eurobonds, several Mexican companies also sold "Yankee" bonds — debt securities registered with the Securities and Exchange Commission — in 1993 and 1994.

² All references hereinafter to amounts are to U.S. Dollars.

³ See *supra* Annex II — Selective List of Maturing Eurobonds of Private Sector Mexican Issuers.

⁴ Cecile Gutscher, *Banks, Construction Firms are Mexico's Most Vulnerable*, LDC Debt Report, Jan. 23, 1995, at 1.

and short-term debt in the form of Euro-commercial paper and Euro-certificates of deposit, which, collectively, accounted for approximately \$33 billion of additional debt.⁵ In addition, the Mexican Government had approximately \$90 billion of its own external debt.⁶

Most of the outstanding Eurobond issues will mature, with bullet payments,⁷ during the next three years. In 1995, for example, at least fourteen major private sector issues matured, totaling close to \$900 million.⁸ In 1996 and 1997, another twenty-five private sector issues will mature, which together represent approximately \$2.75 billion of Mexican Eurobond indebtedness. In 1998, more than twenty Mexican private sector issues will come due, aggregating another \$3.7 billion of indebtedness.⁹

Barring a substantial improvement in the Mexican economy or the perceived creditworthiness of Mexican companies, many Mexican issuers will find it difficult to redeem or refinance their Eurobonds as they mature in 1995, 1996 and beyond. In addition, many of the Mexican issuers of Eurobonds face substantial amortization and interest payments on their bank debt. A number of these issuers are in default currently under financial covenants in their Eurobonds or their bank debt, which would give debt holders a legal right to accelerate the debt.¹⁰ The inability of Mexican issuers to make these payments and to comply with the terms of their debt obligations may trigger a wave of debt restructuring and workouts long before many of the Eurobond maturity payments are due.

Unless the international capital markets become widely receptive to refinancing Mexican Eurobonds, by early to mid 1996, the holders of these Eurobonds — Mexico's new "bondholder constituency" — may find themselves at the center of a restructuring process encompassing a significant portion of the \$13 billion of Eurobond debt outstanding, as well as a sizable amount of the other \$33 billion of foreign

⁵ Estimate for private sector holdings under Euro-CD and Euro-commercial paper programs obtained from First National Bank of Chicago's Emerging Markets Research Report on Mexico, Jan. 13, 1995, at 1; estimate for bank debt obtained by subtracting outstanding private sector Eurobonds, Euro-commercial paper and Euro-CD's from total private sector foreign debt as estimated by the Mexican Finance Ministry (*Secretaría de Hacienda y Crédito Público*).

⁶ *Business Week* (cover story), Mar. 20, 1995, drawing on data provided by the Mexican Finance Ministry.

⁷ There are also a limited number of amortizing Eurobond issues.

⁸ See *infra* Annex II — Selective List of Maturing Eurobonds of Private Sector Mexican Issuers.

⁹ See *infra* Annex II — Selective List of Maturing Eurobonds of Private Sector Mexican Issuers.

¹⁰ See *infra* Part 6.

currency-denominated debt owed by the Mexican corporate sector. Indeed, as this article goes to press, Eurobond holders are engaged in restructuring negotiations for hosiery maker Grupo Synkro, which defaulted on its \$70 million Eurobond in October 1995. (In addition, 1995 saw defaults by conglomerate Grupo Sidek and flagship air carrier Aeromexico.)

Both bondholders and Mexican issuers are beginning to ask how their restructuring negotiations will unfold and whether they will be similar to past workout experiences, including:

- the restructurings in the United States of high yield bond debt in the early 1990s, and
- the restructuring of billions of dollars of bank debt owed by Mexican corporations in the mid-1980s.

B. Mexican Debt Restructuring During the 1980s

From the standpoint of U.S. bondholders, who wonder about the likely Mexican approach to debt restructuring and workouts, there are lessons to be learned from Mexico's experience with private sector workouts in the mid-1980s, when approximately \$14 billion of Mexican corporate debt was restructured.¹¹

Creditor Constituency. Most of the private sector debt restructured in the 1980s was owed to U.S. and Mexican banks. The banks generally functioned through advisory committees consisting of bank representatives that had both Mexican and U.S. counsel.

Magnitude of the Restructurings. During the period 1982-1988, Mexico's private sector borrowers participated in a handful of very large debt restructurings, each involving over \$300 million of debt.¹² In addition, Mexican private sector companies participated in over sixty workouts of substantial size, each involving the restructuring of, on average, \$50 to \$100 million of debt. Finally, Mexican companies

¹¹ For a very general discussion of Mexican private-sector debt restructuring agreements, see *Mexican Central Bank's Debt Program For Firms Gets Support*, Dow Jones News Service — Edited Wall Street Journal Stories, Nov. 11, 1983, at Section 1, 31; and Karene Witcher, *Banks Give Ground on Mexico Debt Terms in Exchange for Close Watch on Economy*, WALL ST. J., Aug. 30, 1984, at Section 1, 23.

¹² Among the largest private sector restructurings were those for Grupo Industrial Alfa, S.A. (Grupo Alfa), a Monterrey-based conglomerate, and a number of its operating subsidiaries (including steel producer Hylsa S.A. de C.V.), and for Valores Industriales, S.A. (Grupo Visa), a Monterrey-based beverage company, and a number of its operating companies, including Fomento Economico Mexicano, S.A. de C.V., the beer and soft drink bottler. In the mid-1980's, Grupo Alfa restructured approximately \$2.4 billion of debt and Grupo Visa restructured over \$1 billion of debt, in each case involving debt contracted at both the holding company level and the operating company level.

engaged in well over 100 smaller restructurings, where creditor claims ranged, on average, from \$15 to \$20 million.

Deal Structure. In the vast majority of the restructurings, the central feature was some type of "rollover" of corporate debt, with maturities being extended while concessions were made in terms of interest rate and amortization schedules. In addition, a number of companies successfully negotiated a repurchase of their debt at a steep discount from its face amount. In some cases, another central feature was the sale of assets with the proceeds used for a partial paydown of debt. Although there were only a handful of workouts involving an exchange of debt-for-equity, these workouts included some of the largest and most visible corporate restructurings of the period.¹³

Bankruptcy Avoidance. In the Mexican workouts of the 1980s, it was extremely rare to see negotiations collapse and a company enter suspension of payments proceedings. Both debtors and creditors viewed such proceedings as something to be avoided if at all possible.

Government Involvement. During the Mexican workouts of the 1980s, the Mexican Government introduced the Trust for Coverage of Exchange Risk (*Fideicomiso para la Cobertura de Riesgos Cambiarios*), or *Ficorca*, a trust fund through which the Government encouraged private sector restructurings by providing foreign exchange coverage to Mexican debtors on restructured loans, so long as the restructured loans included certain specified concessions related to amortization, interest rates and extended maturities.¹⁴

¹³ The Grupo Visa restructuring, completed in 1988, exemplifies these different restructuring options. Grupo Visa and its various external creditors divided the global restructuring into several distinct and more manageable restructurings, of which the largest were for the holding company — Valores Industriales S.A. (Visa) — and its largest operating subsidiary — Fomento Economico Mexicano, S.A. de C.V. (FEMSA). In the Visa restructuring, creditors could exchange their overdue principal and interest of approximately \$400 million for either cash at 46% of face value or Mexican government securities at a similar discount. The cash payment was funded in large part from asset sales. In the FEMSA restructuring, creditors could exchange their overdue principal and interest of approximately \$700 million for either cash at 42% of face value, Mexican government securities at a similar discount, or new FEMSA notes. The FEMSA cash payment was funded by new loans from the International Finance Corporation and NAFINSA (a Mexican government development bank), existing cash and an equity infusion by an affiliate of Citibank. See Visa Group Debt Package (summary of restructuring offer distributed to Grupo Visa creditors), Aug. 1, 1988.

¹⁴ Introduced by the Mexican Government in 1983, Ficorca offered Mexican private sector debtors several options for covering the foreign exchange risk of restructured external debt. By 1982, private sector borrowings had soared to \$19 billion and many companies began to default on their debt-service payments. Mexican debtors were permitted to make peso deposits with the Ficorca trust in respect of restructured external debt in exchange for the equivalent dollar amount of such deposits at preferential exchange rates to be paid out over the term of the restructured debt. Although participating debtors were free to select among a number of payment

C. Refinancing and Restructuring of Mexican Eurobonds

Despite very high local interest rates, most Mexican issuers hope to be able to refinance through the Mexican banking community a significant portion of their external debt. In addition, Mexican companies hope that, prior to the maturity of their Eurobond debt, investors in the international capital markets will become receptive to the issuance of new bonds to refinance their current debt. However, Mexican banks themselves are currently confronting serious liquidity problems, making questionable their availability as a refinancing source in any significant fashion in the near term,¹⁵ and there is no certainty as to when, and to what extent, the international capital markets will be willing to refinance outstanding Mexican Eurobond debt for any but the most credit worthy borrowers with regular Dollar-doc-

terms (Ficorca mandated that all debtors negotiate with their external creditor as a condition for participating in the program), the Mexican government required a minimum term of six years with three years grace for principal payments. Approximately 1200 Mexican companies participated in Ficorca, covering almost \$12 billion in external debt or about two-thirds of the total external debt of Mexico's private sector. The payout schedule, however, proved to be unsustainable and in early 1987, Mexico and several foreign banks renegotiated the remaining \$10.3 billion in Ficorca debt. For additional information, see *Repayment of Principal, Guaranties Against Inconvertibility*, Business Int'l Investing Licensing of Trading, Aug. 1, 1989; Sergio A. Leiseca and Thomas W. Studwell, *Latin American Accounts Receivable: To Sue for Collection or to Refinance?*, 39 Bus. Law. 495 (Feb. 1984); *External Payments and Debt*, Country Profile, Economist Intelligence Unit, Nov. 1, 1993.

¹⁵ In April 1995, the Bank of Mexico implemented the *Unidades de Inversion (UDI)* program, designed to assist overburdened Mexican corporate debtors and Mexican banks facing liquidity problems in restructuring their loan portfolios. Under the program, non-performing loans are refinanced with new loans denominated in UDIs, an accounting unit linked to the Peso, to be funded by UDI-denominated deposits. UDI loans and UDI deposits are indexed to the consumer price index, and carry a fixed real interest rate plus a margin. Restructured loans are placed in a trust fund, which issues a UDI deposit instrument to the Bank of Mexico. The UDI program allows loan repayments to be extended, and to be weighted more heavily toward the end of the loan maturity. As of the end of August 1995, the UDI program had been unsuccessful in relieving the debt servicing burden of Mexican companies and the overdue loan problems of Mexican banks, and was widely considered an inadequate governmental response to the crisis affecting Mexican corporate debtors and their Mexican bank creditors.

Responding in part to the ineffectiveness of the UDI program, in late August 1995, the Mexican government introduced a new program designed to help overburdened Mexican debtors. Under this program, the government and Mexican banks subsidize interest payments on all outstanding loans for small and medium-size borrowers, by offering borrowers fixed-rate below-market interest rates on credit card loans, consumer loans, mortgage loans and small business loans, for the period September 1, 1995 through September 30, 1996. (For example, the interest rate under qualifying credit card and consumer loans is 34%, and the rate under qualifying commercial loans is 25%.) The cost of the program of almost \$3 billion is split between the government and Mexican banks. See *International Financial Review 1097* (Sept. 2, 1995) at 74; *Emerging Markets Debt* (Sept. 4, 1995) at 1.

umented cash flows.¹⁶ As a consequence, Mexican companies with significant Eurobond and/or bank debt should not indefinitely postpone consideration of some restructuring strategy. Mexican debtors likely would find the damages to their regulations to be less, and their long-term access to the capital markets to be greater, if they were to negotiate a settlement with bondholders and other creditors prior to default.

PART 2 LEGAL AND INFORMATIONAL ELEMENTS

A. The Courts

Until the late 1980s, Mexican insolvency proceedings could be instituted in both Mexican federal and state courts.¹⁷ However, due to the volume and complexity of insolvency proceedings in the Federal District of Mexico (which encompasses Mexico City), special bankruptcy courts (*Juzgados de lo Concursal*) were created in the Federal District of Mexico in 1987, with jurisdiction over all suspension of payment and bankruptcy proceedings within the Federal District of Mexico. Special bankruptcy judges are appointed by the Higher Court of the Federal District (*Tribunal Superior de Justicia del Distrito Federal*) for a six-year term.

B. Mexican Bankruptcy Law

In Mexico, insolvency proceedings are regulated by the Bankruptcy and Suspension of Payments Law (the *Ley de Quiebras y Suspensión de Pagos*, or "Bankruptcy Law").¹⁸ Enacted in 1942 and most recently amended in 1982, this statute contemplates two distinct types

¹⁶ Even if investors in the international capital markets are willing to purchase new refinancing bonds, the terms of such bonds, including interest rate, covenants and collateral, are almost certain to be considerably less attractive than the terms of the outstanding bonds. During 1995, the only Mexican companies generally able to access the international capital markets were exporters that secured their borrowings with export trade receivables or banks that secured their borrowings with Dollar-denominated credit and receipts or workers' remittances receipts. Such financing is considerably more complex and expensive than the Eurobond debt incurred in the early 1990s.

¹⁷ Each state in Mexico has its own courts, while the federal court system is organized by geographical regions. Each federal judicial circuit includes a court with jurisdiction over bankruptcy proceedings.

¹⁸ *Ley de Quiebras y de Suspensión de Pagos* [Law of Bankruptcy and Suspension of Payments in Mexico], *Diario Oficial de la Federación* (April 20, 1943) [hereinafter L.Q.S.P.], translated in 2 *Doing Business in Mexico*, pt VIII Documents, app. 8 (Andrea Bonime-Blanc & William E. Mooz Jr., eds., Transnational Juris Publications, Inc. 1995); see also *id.*, vol. 1, pt IX, ch. 2 (general survey of the L.Q.S.P.).

of proceedings, both of which are more fully discussed in Parts 7 and 8 of this article:

- Suspension of Payments proceedings (*Suspension de Pagos*),¹⁹ which aim to rehabilitate the debtor and are roughly equivalent to a Chapter 11 reorganization under the U.S. Bankruptcy Code.²⁰
- Bankruptcy proceedings (*Quiebra*),²¹ which contemplate a total liquidation of the debtor's business, and resemble a Chapter 7 liquidation under the U.S. Bankruptcy Code.²²

Some observers have suggested that Mexican companies with Eurobond debt, so long as they have some meaningful business presence in the United States, may be able to reorganize under Chapter 11 of the U.S. Bankruptcy Code, thus entirely avoiding a reorganization process under Mexico's Suspension of Payments proceedings. However, under Mexican law, any such reorganization would, to the extent the subject company is domiciled in Mexico and has its principal place of business in Mexico, only apply to such company's business presence in the United States, and would have no "legal" reorganizational effects with regard to the company's Mexican businesses.²³

A new Mexican insolvency law, which would repeal and replace the existing Bankruptcy Law, was prepared and circulated in 1995. The Proposed New Insolvency Law does not contemplate a relief mechanism such as the suspension of payments mechanism provided by the Bankruptcy Law. As of the beginning of 1996, this proposed new law did not appear likely to be considered soon by the Mexican Congress.

C. U.S. Securities Laws

United States securities laws affect bondholders' rights to trade Eurobonds issued by Mexican companies, to receive information about the companies and to participate in certain restructurings, such as debt exchanges, that might involve the bondholders' receipt of new securities.

¹⁹ See L.Q.S.P., *supra* note 18, tits. VI, VII, VIII.

²⁰ See 11 U.S.C. § 1101 *et seq.*

²¹ See L.Q.S.P., tits. I-V, VII, VIII.

²² See 11 U.S.C. § 701 *et seq.*

²³ See L.Q.S.P., *supra* note 18, arts. 13 and 14 (for U.S. judgment to be enforced, U.S. court must have been competent under Mexican law; for U.S. court to be competent under Mexican law, Mexican domicile of subject company must be deemed a sham and actual principal place of business must be the United States); *see also* Código Civil para el Distrito Federal en Materia Común y para todo la República en Materia Federal, Diario Oficial de la Federación (September 1, 1932), arts. 12, 15 (II) and 28; Código de Comercio, Diario Oficial de la Federación (October 7-13, 1989), art. 1347-A (particularly III and VII).

Although several Mexican companies have issued "Yankee" bonds registered with the U.S. Securities and Exchange Commission (SEC) under the U.S. Securities Act of 1933²⁴ (the Securities Act), most debt securities issued by Mexican companies have been in the form of unregistered Eurobonds. Almost all of the Eurobonds were sold to either (a) offshore investors under an exemption from the registration requirements of the Securities Act offered by Regulation S²⁵ under the Securities Act or (b) U.S. "qualified institutional buyers" (essentially institutional investors having assets of \$100 million or more) under the resale exemption offered by Rule 144A under the Securities Act.²⁶ Most Eurobonds are traded in the secondary market among large institutions that qualify as "qualified institutional buyers" under Rule 144A, and accordingly such resales qualify for the Rule 144A exemption from the registration requirements of the Securities Act.²⁷

Even though Mexican Eurobonds are not registered under the Securities Act, they remain "securities" for purposes of the anti-fraud provisions of the U.S. Securities Exchange Act of 1934²⁸ (the Exchange Act).²⁹ Rule 10b-5 under the Exchange Act prohibits a bondholder from trading in Eurobonds while the bondholder possesses material "inside" information about the issuer of the Eurobonds.³⁰ As a result, bondholders who become members of a Bondholders' Committee for a Mexican issuer, just like bondholders who are members of a bondholders' committee for a U.S. issuer of high yield bonds, normally will become restricted from trading in the Eurobonds. Safeguards designed to permit trading are discussed in Part 3 below.

The trading restrictions of Rule 10b-5 apply only to the extent that a bondholder has received material nonpublic information concerning the issuer. However, bondholders may freely trade on publicly available information. Most Mexican Eurobond issuers have shares that are publicly traded in Mexico or, in many cases, in the

²⁴ See 15 U.S.C. § 77a *et seq.* (1988).

²⁵ 17 C.F.R. § 230.901-904 (1994).

²⁶ 17 C.F.R. § 230.144A.

²⁷ See generally Luis F. Moreno Trevino, *Access to U.S. Capital Markets For Foreign Issuers: Rule 144A Private Placements*, 16 Hous. J. INT'L L. 159 (1993).

²⁸ 15 U.S.C. § 78a *et seq.* (1988).

²⁹ With respect to Euro-securities sold in reliance on Regulation S under the Securities Act, Preliminary Note 1 to Regulation S states that "[t]he following rules relate solely to the application of Section 5 of [the Securities Act] and not to antifraud or other provisions of the federal securities laws." Preliminary Notes preceding 17 C.F.R. § 230.901 (1994). Preliminary Note 1 to Rule 144A is substantially identical. Preliminary Notes preceding 17 C.F.R. § 230.144A (1994).

³⁰ 17 C.F.R. § 240.10b-5 (1994).

United States (in the form of American Depositary Receipts), and are required to comply with periodic reporting requirements of the Mexican and/or U.S. securities authorities. In addition, some Eurobonds contain contractual provisions obligating the Mexican issuer to provide quarterly and annual information as to its financial status. A more detailed description of Mexican reporting requirements applicable to Mexican companies is set forth in Section D, Part 2.

U.S. securities laws may also affect the restructuring options available to a Mexican issuer in a workout, to the extent that the workout contemplates issuing new debt or equity securities to bondholders. Any securities issued to bondholders in an exchange offer must either be registered with the SEC under the Securities Act or, preferably, qualified for an exemption from registration requirements of the Securities Act.³¹ Eurobonds issued to bondholders in an exchange should qualify for the Regulation S and, depending on structure, 144A exemptions on which the original issuance of the restructured Eurobonds relied. Registered equity and debt securities issued to bondholders in an exchange may qualify for the exemption afforded to certain exchange offers under Section 3(a)(9)³² of the Securities Act, which provides issuers with an exemption for securities issued to their existing security-holders.³³ Exchanges for new debt or equity securities are described in more detail in Part 4 below.

D. Reporting Requirements for Mexican Issuers

The *Comisión Nacional Bancaria y de Valores (CNBV)*, the principal securities regulator in Mexico, and the *Bolsa Mexicana de Valores*, the Mexican stock exchange (the *Bolsa*), require most Mexican public companies to file annual audited financial statements (within 120 days after the end of the calendar year), quarterly unaudited financial statements (within twenty business days after the end of the first, second and third quarters and within forty-five business days after the end of the fourth quarter), and announcements regarding material corporate events and other material events which

³¹ New securities issued to bondholders as part of an exchange offer, whether registered with the SEC or exempt from the registration requirements of the Securities Act, may have to be registered with the *Comisión Nacional Bancaria y de Valores (CNBV)*, Mexico's securities regulatory agency.

³² 15 U.S.C. § 77c(a)(9) (1988).

³³ See James E. Spiotto, *The Applicability of the Exemption under Section 3(A)(10) of the Securities Act to Debt Restructurings, Section 316(B) of the Trust Indenture Act, and Section 3(A)(9) Exchanges*, in REAL ESTATE LAW & PRACTICE COURSE HANDBOOK SERIES No. 376 (Prac. L. Inst. Nov. 7-8, 1991).

may affect the market value of the publicly traded securities they shall have issued.³⁴ The annual filing includes a current list of shareholders, directors and officers and a list of holders of powers of attorney. These filings are publicly available through the *Bolsa*.

Companies in industries such as banking, securities brokerage and insurance are exempt from a number of such *CNBV* and *Bolsa* filing requirements, because these industries are separately regulated by other government agencies. The principal regulators of such companies are in most cases required to provide such information to the *Bolsa*, where it will be publicly available.

Mexican companies are often late in providing the required information to the *Bolsa*. Historically, Mexican companies perceived little risk in these delays, although the *CNBV* has recently begun to impose more severe penalties. In addition, Mexican companies often fail to provide the information in a useful format with comparisons to prior periods, sometimes providing what resembles a computer tape "dump" of information.

Mexican companies without public securities traded in Mexico are not required to provide public information to the *CNBV*, and creditors find it extremely difficult to obtain any useful information about such private companies. Holders of Eurobonds issued by private companies have virtually no legal access to financial or other information if the Eurobonds do not provide information-reporting covenants.

PART 3 USE OF BONDHOLDER COMMITTEES

A. The Committee's Role in Restructurings

Because few Mexican companies, until relatively recently, had relied on Eurobonds for external financing, Mexican issuers have had few opportunities to negotiate anything of substance directly with their bondholder constituency. The terms and conditions of most Eurobonds of Mexican issuers have been negotiated between the issuers and the lead underwriters for the Eurobonds; rarely, if ever, did issuers discuss these issues directly with the investors purchasing the bonds from the underwriters. Therefore, the issuers have no relevant past experience to guide them on issues such as how to initiate discus-

³⁴ See *Ley del Mercado de Valores*, Diario Oficial de la Federación (January 2, 1975), arts. 14 (VI) and 16; *Circulares* 11-11, 11-11 Bis 2, 11-11 Bis 3, 11-23, 11-24 and 11-25 issued by the *CNBV*.

sions with bondholders, who precisely to talk to and what types of protocols should govern the dialogue.

If Mexican Eurobond issuers and holders of Mexican Eurobond debt are going to have successful restructuring negotiations, they must devise a vehicle through which useful discussions can take place. In many cases, that vehicle may be an ad hoc "Bondholders Committee," which will be composed of the largest holders of the issuer's Eurobond debt (with Committee members, ideally, owning at least a majority of all bonds outstanding). This vehicle is likely to be similar to the Bondholder Committees utilized in the U.S. junk bond restructurings over the past few years.³⁵ Such Committees offer several advantages:

- *Credibility.* Bondholders are skeptical of a restructuring proposal made by the issuer on a unilateral basis. The proposal is far more credible if it is based on prior discussions with the largest bondholders, functioning through a Bondholders Committee.
- *Creditor Consensus.* It is counter-productive for various individual bondholders to each tell the issuer what they want to see in a restructuring deal, because their opinions may be conflicting. Instead, the bondholders can use the Committee as a forum to compare opinions and forge a consensus view with respect to the essential economic terms of an acceptable restructuring proposal.
- *Identifying Other Holders.* The numerous smaller holders of Eurobond debt also must be identified since their support for any restructuring proposal will be important. Bondholder Committees have a proven track record of being able to network within the bondholder community, identify smaller holders and gain their confidence.
- *Deal Endorsement.* Finally, if a restructuring agreement is reached with a Committee of the largest holders, the agreement tends to be viewed as an important endorsement of the deal, and smaller holders are far more inclined to be supportive.

B. Organizational Issues

Within the U.S. context, Bondholder Committees usually have been formed in response to an initiative by the issuer of the bonds (the Company), often because it faces an imminent coupon payment default. Typically, the Company convenes an informal meeting of its

³⁵ For a general overview of creditors' committees, see Marta G. Andrews, *The Chapter 11 Creditors' Committee: Statutory Watchdog?*, 2 BANK. DEV. J. 247 (1985). For a description of how Bondholder Committees have operated in the context of U.S. junk bond restructurings, see James E. Spiotto, *Analysis of Defaults and Remedies for Indenture Trustees and Bondholders*, REAL ESTATE LAW & PRACTICE COURSE HANDBOOK SERIES No. 399 (Prac. L. Inst. Feb. - March 1994); and Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232 (1987).

largest bondholders, provides them with an operational and financial update and then urges the group to meet among themselves and select the membership of a Bondholders Committee.

As part of this process, the Company also is expected to "recognize" the Bondholders Committee. This means that the Company is committed to look to the Committee as the principal vehicle through which it will negotiate and communicate with the bondholder constituency. The Company also is expected to provide the Committee with all information necessary to evaluate restructuring alternatives.

Because Mexican issuers of Eurobonds have little or no experience with Bondholder Committees, it is unlikely that they will take the initiative in the process of Committee formation. A far more likely scenario is for the issuer's largest bondholders to network among themselves and gradually build a coalition of concerned holders who can function as an ad hoc Committee. At that point, advisors to the Committee also can be selected and should include both U.S. and Mexican legal counsel, and possibly financial or accounting advisors.

Once the Committee is formed and has advisors, there are several steps it should take before speaking with the Company:

- *Identify Holdings.* The Eurobond positions of each Committee member should be clearly established and, if possible, other large holders identified and incorporated into the Committee's membership. Ideally, the Committee members together should own at least 51% of all bonds outstanding.
- *Gather/Compare Information.* The Company's available financial reports should be gathered and Committee members should share whatever additional information they may have learned. Advisors also can compile and analyze information about the Company's industry and competitors.
- *Analysis of Legal Documents.* The advisors should analyze the rights of the bondholders as set forth in the applicable fiscal agency agreement or indenture. If there is other significant debt, such as bank debt, the Company's operative loan agreements should be obtained and reviewed. In addition, creditors' rights issues under Mexican law should be studied.
- *Restructuring Alternatives.* While restructuring alternatives may be explored on a preliminary basis, it will be premature to reach many conclusions until additional information from the Company is obtained.

C. Interaction with the Company

Once the Committee is formed, and has completed its preliminary analysis, it has several tactical options. First, it can simply take a

“wait and see” attitude, knowing that bondholders are now better prepared to deal with future developments. Second, if there are other major creditor groups, such as banks, the Committee can initiate discussions with them to explore issues of common concern.

Finally, the Committee can open up talks directly with the Company. In that event the bondholders’ objectives could include the following:

- Send a message that the Committee is not seeking immediate confrontation, but rather seeks cooperation from the Company in providing additional information.
- Indicate that the Committee has no definitive views on the elements of a possible restructuring—or whether one is even necessary—and merely wants to explore alternatives.
- Seek payment of the Committee’s advisors by the Company, which has been customary in U.S. restructurings of public debt where a Bondholders Committee has been involved.
- If in-depth restructuring negotiations are likely, define a working group of Committee members and Company representatives who will serve as the focal point for these talks.

D. Handling Non-Public Information

As already noted, Mexican Eurobonds remain subject to the anti-fraud provisions of the U.S. federal securities law (*e.g.*, Rule 10b-5 under the Exchange Act). Therefore, it would be a violation of U.S. law for select bondholders to obtain non-public information from a Mexican issuer or from parties (such as directors or advisors) deemed to have non-public information and proceed to sell their bonds or otherwise trade in the issuer’s securities.³⁶ In addition, any party (whether or not a bondholder) who obtains non-public information from a Mexican issuer, or from parties (such as directors or advisors) deemed to have non-public information, and thereafter buys or sells in the issuer’s securities traded in Mexico before such information is deemed to be public, would be in violation of Mexican insider trading rules.³⁷

Once bondholders “become restricted,” they must refrain from further trading until the non-public information that they have received is publicly disclosed.³⁸ These regulations could present a

³⁶ For more information on the application of insider trading laws to members of Creditors’ Committees, see Mark J. Krudys, *Insider Trading By Members of Creditors’ Committees: Actionable!*, 44 DEPAUL L. REV. 69 (1994).

³⁷ Ley del Mercado de Valores, Diario Oficial de la Federación (Jan. 2, 1975), arts. 16 Bis, 16 Bis-1, 16 Bis-2 and 52 Bis-2.

³⁸ *Id.*

thorny problem for holders of Mexican Eurobonds who become part of a Bondholders Committee that seeks non-public information from a Mexican issuer.

Essentially the same problem has confronted members of Bondholder Committees functioning in the context of U.S. public debt restructurings.³⁹ They have successfully dealt with the issue in several ways, which may have application to Bondholder Committees functioning in the Mexican context:

- *Advisors and Subcommittees.* A Committee can agree that only its advisors and a few select Committee members will have access to non-public information. All that they will convey to the Committee at large is their recommended negotiating strategy, but not the detailed information on which it is based.
- *Postpone Restricted Status.* In the final phase of restructuring negotiations, often all Committee members agree to become restricted — but only for a period of a few days to conclude the restructuring agreement.
- *Mandated Disclosure.* On occasion, a Committee and an issuer in restructuring agree that when their negotiations are concluded the issuer will publicly disclose all non-public information furnished to the Committee.
- *Information-Blocking Devices.* Under the so-called “Chinese Wall” approach, the Committee member receiving non-public information is insulated by strict internal procedures from other colleagues who remain free to trade.⁴⁰ This approach has been approved for Bondholder Committee members in several of the larger U.S. Chapter 11 cases, including Allied/Federated.⁴¹

PART 4 RESTRUCTURING ALTERNATIVES

For Mexican companies contemplating a restructuring of their Eurobond debt, there are a number of restructuring alternatives.⁴²

³⁹ See Robert C. Pozen, *Creditors' Committees and Insider Trading*, in *CORPORATE LAW & PRACTICE COURSE HANDBOOK SERIES* No. 828 (Prac. L. Inst. Nov. 4-6, 1993) (distributed at the 25th Annual Institute on Securities Regulation).

⁴⁰ See Robert C. Pozen and Judy K. Mencher, *Chinese Walls For Creditors' Committees*, 48 *BUS. LAW.* 747 (Feb. 1993).

⁴¹ See *In re Federated Dep't Stores, Inc.*, No. 1-90-00130, 1992 Bankr. Lexis 392 (Bankr. S.D. Ohio Mar. 7, 1991).

⁴² For a more thorough description of the various alternatives for restructuring debt, as applied in the context of sovereign debt management, see Douglas A. Doetsch, *Developing Country Debt: A Summary of the Recent Impact on Commercial Banks*, 1 *THE FINANCIER: ACMT*, No. 3, Aug. 1994. See also Lee C. Buccheit, *Documentation Issues and Alternative Techniques of Debt Restructuring*, in *LATIN AMERICA SOVEREIGN DEBT MANAGEMENT* (Ralph Reisner, Emilio J. Cardenas and Antonio Mendes eds., InterAmerican Dev. Bank 1990); Robert Kenneth MacCallum, *Sovereign Debt Restructuring: The Rights and Duties of Commercial Banks Inter*

Many of these alternatives were successfully used in both the Mexican private sector restructurings of the 1980s, as well as the U.S. high yield bond restructurings of the early 1990s.

A. Covenant Relief

In order to achieve relief from temporary liquidity problems, one restructuring alternative for a Mexican issuer would be to seek amendments of, or waivers from compliance with, restrictive non-monetary covenants contained in the agreement which governs the terms of the issuer's Eurobonds.

The contractual rights of the holders of Mexican Eurobonds, as more fully discussed in Part 5, are governed either by a Fiscal Agency Agreement (which is customarily used with Eurobonds governed by New York law) or a Trust Agreement (which is customarily used with Eurobonds governed by English law), both of which can be viewed as somewhat shorter versions of the qualified trust indentures that govern bonds issued publicly in the United States.

Like bonds issued under a qualified trust indenture, Eurobonds issued under a Fiscal Agency Agreement or a Trust Agreement typically require the unanimous consent of each affected bondholder in order to amend any of the monetary terms of the Eurobonds. However, Eurobonds issued under Fiscal Agency Agreements and Trust Agreements also include a set of non-monetary covenants that restrict various activities of the issuer, and these covenants typically may be amended and liberalized by a vote of a simple majority of the bondholders.

While covenant relief may be one part of the restructuring process, it will not be sufficient to address the most serious financial problems of certain Mexican issuers.

B. New Money/Refinancing

A second restructuring alternative is the redemption or repurchase at a discount of the issuer's Eurobonds with funds provided through the issuance of new debt securities or new bank financing.

In the current environment, few Mexican companies are in a position to issue new debt securities, whether they are denominated in foreign currency or Mexican Pesos (Pesos).

Sese, 1987 COLUM. BUS. L. REV. 425; Michael Chamberlin et al., *Sovereign Debt Exchanges*, 1988 U. ILL. L. REV. 415 (1988); Ricki Rhodarmer Tigert, *Recent Regulatory Perspectives on Debt-For-Equity Swaps and Securitization of Third World Debt* 1988 U. ILL. L. REV. 481 (1988); Ralph Reisner, et al., *International Debt: Focus on Mexico*, 82 AM. SOC'Y INT'L L. PROC. 478.

In the near term, the market for dollar-denominated bank loans also appears to be inaccessible to all but the most creditworthy Mexican companies with liquid and readily available collateral. Very few banks (primarily large foreign banks with long-standing commitments to Latin America) have evidenced a willingness to extend significant credit to Mexican companies, and then only for their largest and most creditworthy customers.

The market for bank loans denominated in Pesos appears to be slightly more promising, although the loans have limited appeal to Mexican companies since they are characterized by high rates of interest (often in excess of 70% during the first six months of 1995), short maturities (often less than thirty days), and potentially onerous collateral requirements.

However, as more Mexican companies face the prospect of defaulting on their Eurobonds and other external debt at maturity, the Mexican Government may step up its involvement. Indeed, some observers expect that the Government will exert substantial pressure on the largest Mexican banks to provide the Mexican corporate sector with meaningful amounts of new financing, presumably Peso-denominated.

In theory, the other source of new money would be the controlling shareholders of Mexican issuers, many of whom are among the most wealthy families in Mexico. While some of these families may have the net worth to recapitalize the companies they control, some observers point out that such net worth may not be liquid, and the controlling shareholders may be hesitant to make large new money investments.

C. Sale of Assets/Additional Collateral

Most of the larger Mexican companies have been successful at borrowing on an unsecured basis. Consequently, substantially all Eurobond debt currently outstanding, and much of the Peso-denominated Mexican corporate bank debt, is unsecured.

With a potentially large base of valuable and unencumbered assets, several Mexican companies, including some that have issued Eurobonds, may be in a position to (i) sell non-essential assets and use proceeds to pay down Eurobond debt, or (ii) collateralize their Eurobond debt so that holders will have a new secured obligation.

It should be noted, however, that if a Mexican issuer was prepared to collateralize its Eurobonds, it almost certainly would seek

concessions on other terms of the indebtedness — such as a reduced interest rate and an extended maturity.

D. Exchange Offer for New Debt

A fourth restructuring alternative is a debt-for-debt exchange, pursuant to an exchange offer. During the course of the next year, this type of exchange offer may well become one of the more frequently utilized techniques for implementing restructuring agreements between Mexican issuers of Eurobonds and their bondholder constituency.⁴³ In many of these transactions, current holders of Eurobonds will swap into new debt securities that have an extended maturity. If they make such concessions, bondholders probably will demand that their new Eurobonds (i) become collateralized, (ii) have more restrictive covenants, and (iii) if possible, have a gradual amortization through a new sinking fund feature. In addition, the bondholders may seek a sizable amount of the post-restructuring equity, thus diluting the ownership position of existing shareholders.

As noted above, any securities issued to bondholders in an exchange offer must either be registered with the SEC or, preferably, qualify for an exemption from registration requirements.⁴⁴ If the new securities are Eurobonds issued to offshore bondholders, the exchange should qualify for the exemption provided by Regulation S on which the original issuance of the restructured Eurobonds relied. If the new securities are Eurobonds issued to U.S. institutional investors, the exchange might qualify for an exemption under Section 4(2) of the Securities Act⁴⁵ (if the number of investors was limited) or Rule

⁴³ Aeromexico's June 1995 debt exchange is the first significant example since the Peso devaluation of a Mexican debt for debt exchange offer. In the Aeromexico restructuring, holders of approximately \$138 million of Aeromexico's Eurobonds and Euro-commercial paper exchanged their existing securities, which matured in June 1995, for the same principal amount of new 5-year securities. Surprisingly, Aeromexico's Mexican bank creditors — whose debt was *pari passu* with the Euro-securities debt — converted their debt to equity, essentially subordinating their future claims to those of the holders of Euro-securities. (Some participants in the restructuring, including one of the authors of this article, believe that the primary reason that Mexican banks were willing to subordinate their claims was due to the difficulty of locating the holders of the Euro-securities in order to negotiate effectively.) Aeromexico had conditioned the exchange offer on receiving acceptances from Euro-securities holders owning 95% in principal amount of Euro-securities, and had threatened to file for Chapter 11 bankruptcy in a U.S. bankruptcy court if the 95% threshold was not obtained. *International Financial Review*, 1090 (July 15, 1995).

⁴⁴ For a brief overview of how some securities may qualify for an exemption from registration requirements, see Richard H. Rowe, *Certain Issues As to Securities Laws Exemptions in Restructuring and Reorganization Transactions*, Corporate Law & Practice Course Handbook Series (Prac. L. Inst.) March - April 1991.

⁴⁵ 15 U.S.C. § 77d(2) (1988).

144A⁴⁶ under the Securities Act (if an underwriter agreed to purchase and then resell the new securities only to “qualified institutional buyers”). Alternatively, equity and debt securities which are registered with the SEC and issued to bondholders in an exchange may qualify for the exchange offer exemption under Section 3(a)(9)⁴⁷ of the Securities Act, which provides issuers with an exemption for securities issued to their existing security-holders so long as no compensation is paid to a financial advisor or other agent for soliciting the exchange.⁴⁸

While exchange offers are a reasonably efficient transaction, they have one practical drawback, which relates to investors commonly known as “holdouts.” These investors refuse to tender their bonds into an exchange offer because they assume, often correctly, that if the transaction is completed, their “old bonds” will become more valuable because the issuer’s balance sheet will have been improved.

When the holdout group becomes sizable— representing 10% or more of the bonds outstanding— the holdouts tend to thwart the exchange offer because issuers are reluctant to complete the deal if a large block of old debt remains outstanding. Mexican issuers of Eurobond debt who are considering exchange offers may confront the holdout problem, which in their case will be exacerbated by the fact that many Eurobond issues include “bearer bonds” whose owners are difficult to identify and communicate with.

Within the context of the restructuring of U.S. public debt issues, the holdout problem eventually was addressed through the increased use of “prepackaged” Chapter 11 Plans. This solution, and the question of whether it could be adapted to Mexican transactions, is discussed below in Section G, Part 4.

E. Exchange Offer for New Equity and the Use of ADRs

A fifth restructuring alternative would involve the exchange of some portion of a Mexican issuer’s Eurobonds for new equity in the Mexican issuer.⁴⁹

If the U.S. experience with exchange offers is any guide, it is unlikely that U.S. holders of Mexican Eurobonds will be prepared to swap their position entirely for new equity in any Mexican issuer.

⁴⁶ 17 C.F.R. § 230.144A (1994).

⁴⁷ 15 U.S.C. § 77c(a)(9) (1988). See *supra* note 32.

⁴⁸ See generally Bradley Jay Gans, *The Mechanics of Rule 144A/Regulation S Underwriting*, in CORPORATE LAW & PRACTICE COURSE HANDBOOK SERIES No. 879 (Prac. L. Inst. Feb. 1995).

⁴⁹ For additional information regarding debt-for-equity programs, see Robert D. Sloan, *The Third World Debt Crisis: Where We Have Been and Where We Are Going*, 11 WASH. Q. 103 (1988).

Most observers agree that if the Mexican economy continues to deteriorate, the holders of Eurobonds are far more secure if they maintain their position as a creditor, as opposed to moving down the capital structure to become shareholders.

However, a look at the U.S. restructurings of public debt over the past few years reveals that bondholders of U.S. issuers often were willing to convert large blocks of bond debt into equity. To some extent this philosophy may prevail with the holders of Mexican Eurobonds, who may be influenced by the favorable results generally obtained by creditors accepting equity in several large Mexican restructurings of the 1980s.⁵⁰ This process may be facilitated by the recent liberalization of Mexican foreign investment laws, which permit majority foreign investment in approximately 80% of the Mexican economy, with only a few strategic areas still reserved to the Mexican Government and Mexican nationals.⁵¹

Mexican issuers could choose to use in an exchange either (i) common stock or "limited voting stock" in the form which it is traded in Mexico on the *Bolsa*, (ii) common stock in the form of American Depositary Receipts (ADRs), or (iii) "neutral stock," which is common stock with limited voting rights and which, under Mexico's 1993 Foreign Investment Law, is not computed as foreign investment in determining the percentage participation of foreign investment in a Mexican company.⁵² "Limited voting stock" may only be issued by public companies with the prior approval of the *CNBV*, which in most cases would not permit "limited voting stock" to exceed 25% of the outstanding capital stock of a Mexican company.⁵³ "Neutral stock" may be issued with the prior approval of the National Commission of Foreign Investments (NCFI).⁵⁴ The NCFI has not yet defined the percentage that "neutral stock" may represent in a Mexican company, nor the matters in which "neutral stock" may be permitted to vote. The lack of definition may allow a Mexican Eurobond issuer to tailor

⁵⁰ There are, however, significant dissimilarities between the debt crisis in Mexico in the 1980s, where debt-equity conversions were negotiated by small advisory committees consisting of banks, and the current situation in Mexico, where the ownership of Eurobonds is diverse and widespread, and may make negotiation of any conversion into equity more difficult.

⁵¹ See generally Augustin Berdeja-Prieto, *Mexico Streamlines Foreign Investment Law*, 8 INT'L FIN. L. REV. 31 (Feb. 1994); Michell Nader and Jorge Cervantes Trejo, *Mexico Liberalizes Foreign Investment Regime*, 4 MEXICO TRADE & L. REP., Mar. 1, 1994.

⁵² Ley de Inversion Extranjera [Foreign Investment Law], Diario Oficial de la Federación (Dec. 27, 1993), translated in FOREIGN INVESTMENT LAW OF MEXICO, 3-6, 8.17 (Carl Smith Ball García Cachoy Asociados, S.C. trans, 1993) [hereinafter FOREIGN INVESTMENT LAW].

⁵³ FOREIGN INVESTMENT LAW, *supra* note 52.

⁵⁴ FOREIGN INVESTMENT LAW, *supra* note 52, art. 20.

with the NCFI each proposed conversion of Eurobonds into "neutral stock." Where a public company is to issue "neutral stock," the prior approvals of the CNBV and the NCFI will be required.

Additionally, any conversion of Mexican Eurobonds into any type of Mexican equity securities (i) for an actual consideration of approximately \$25 million or more, or (ii) which would represent 35% or more of the equity of a Mexican company with annual sales of approximately \$25 million or more, or (iii) in which the Mexican company and the party or parties converting the Mexican Eurobonds into equity have combined assets or sales of more than \$100 million, would require clearance from the new Mexican Antitrust Commission.⁵⁵

Most Eurobond holders probably would prefer to receive ADRs rather than Mexican common stock, because the ADRs are denominated in dollars and (if registered with the SEC) can be easily traded in the United States. Presumably, bondholders would value ADRs more highly than Mexican capital stock due to the better liquidity of ADRs, leading bondholders to agree to a more favorable exchange ratio for ADRs as compared to Mexican equity securities. Mexican issuers presumably would weigh this exchange ratio against the costs of compliance with U.S.-style disclosure standards and, possibly, an SEC registration in determining the optimal equity "currency" in an exchange.

It is unclear whether Mexican issuers would be able to rely on Section 3(a)(9) under the Securities Act as an exemption permitting an unregistered exchange offer for new ADRs. Section 3(a)(9) requires that the issuer of the new securities issued in the exchange offer be identical to the issuer of the old securities, and the issuer of ADRs technically would be the bank depositary, not the Mexican company that had issued the Eurobonds. If the SEC determined that Section 3(a)(9) did not permit an unregistered exchange offer for new ADRs, the ADRs could only be issued pursuant to an effective registration statement approved by the SEC, which would substantially increase the cost of, and lengthen the time needed for, an exchange.⁵⁶ Alternatively, the ADRs could be issued in an exchange pursuant to an exemption from the registration requirements provided by Regulation S⁵⁷ or Regulation D/Rule 144A, either of which would limit secondary

⁵⁵ Ley Federal de Competencia Económica, Diario Oficial de la Federación (Dec. 24, 1992), arts 16, 20. (These threshold amounts are expressed in terms of a multiple of daily minimum wages in Mexico City, and assume a daily minimum wage in Mexico City of approximately \$2.)

⁵⁶ 15 U.S.C. § 77c(a)(9) (1988).

⁵⁷ 17 C.F.R. § 230.901-904 (1994).

market trading in the ADRs, since each exemption imposes certain restrictions upon transfers.⁵⁸

F. Equity Investment by a Strategic Investor

A sixth restructuring alternative contemplates an equity investment by a strategic investor. U.S. or other international companies operating in the same industry as a Mexican debtor may already be familiar with the Mexican debtor, and have a view as to the long-term viability of the debtor company. These companies may be willing to invest quickly in companies facing leverage problems like those now common in Mexico. A sale of equity to a strategic investor typically requires, at a minimum, three to six months from the beginning of the search for an investor until the closing of the acquisition.

Debtors contemplating a sale of equity to a possible strategic investor typically would engage an investment bank or other advisor to assist in the sale. The advisors would assist the debtor in determining the optimal size and structure of the required investment. Considerations would include the size of the investment, common vs. preferred stock, representation on the board of directors for the investor and other control issues.

In addition to preparing an information memorandum and contacting potential investors, the advisors would assist the debtor in negotiating final terms of a stock purchase agreement and, typically, a shareholders' agreement with the investor and other major shareholders. After closing of the sale, the proceeds of the sale presumably would be applied to repay debt.

Creditors of the Mexican debtor — including representatives of a bondholders' committee — generally would participate in these negotiations in order to assure themselves that the terms of the new investment are sufficient to restore the financial health of the debtor and to ensure that the investment package does not include terms that may be adverse to their senior position (*e.g.*, management fees or preferred dividends to be paid to the strategic investor). Equally as important, creditors must assure the strategic investor that they are comfortable with the debtor's proposed new capital structure and have waived and/or amended their credit agreement or indenture so that no default will occur upon or shortly after closing the equity investment.

⁵⁸ See generally Gans, *supra* note 48.

G. Variation of a "Prepackaged Plan"

A seventh restructuring alternative contemplates the possible use, in a suspension of payments proceeding, of a previously negotiated plan of reorganization similar to a Prepackaged Chapter 11 Plan of Reorganization.

Prepackaged Chapter 11 Plans — or "prepacks" — were one of the most innovative techniques to emerge from the wave of U.S. public debt restructurings in the early 1990s.⁵⁹ Simply stated, prepacks aimed to expedite the process of developing the Plan of Reorganization, which is the legal document that compromises and resolves creditor claims and leads to an exit from a Chapter 11 reorganization. Absent some negotiations with creditors before a Chapter 11 Petition is filed, it often takes years to formulate a consensual Plan and conclude a large Chapter 11 case.

In a prepack transaction, the Company — before entering bankruptcy — negotiates an acceptable Plan with its bondholders and sometimes other major creditor groups. In advance of the bankruptcy filing, the Company also drafts the proposed Plan, has creditors vote on it and obtains the necessary Plan acceptances.

Then, when the Company files its Chapter 11 Petition, it is able to advise the Bankruptcy Court that there already exists an acceptable Plan approved by creditors. This prepack procedure typically shortens the entire bankruptcy process to less than 90 days.

Prepacks also are an effective way to deal with the previously noted problem of "holdout" bondholders who do not want to accept the restructuring deal. In a prepack, the bondholders, as a class, are deemed to have accepted the Plan if only two thirds in dollar amount and a majority in number (of those voting) vote in favor of the Plan.⁶⁰ Hence, bondholder holdouts who control only a small percentage of the bonds will simply be outvoted and will be forced, in effect, to accept the same consideration that all bondholders are to receive under the Plan.

Given the many advantages of prepacks, some observers have asked whether a variation of a prepack could be adapted to implement restructuring agreements between Mexican issuers of Eurobonds and their bondholder constituencies. There are several el-

⁵⁹ See David M. Friedman, et al. *Pre-packaged Plans of Reorganization*, in *CORPORATE LAW & PRACTICE COURSE HANDBOOK SERIES* No. 733 (Prac. L. Inst. April, 1991).

⁶⁰ See 11 U.S.C. § 1126 (1988).

ements of the Mexican Bankruptcy Law which suggest that this may be possible:

- In its suspension of payments proceeding, Mexican law already provides for the rough equivalent of a Chapter 11 reorganization.⁶¹
- One of the central features of the Mexican proceeding is a "Preventative Agreement."⁶² Like a Plan of Reorganization, this aims to describe how creditors' claims are to be compromised and resolved.
- The Preventative Agreement is viewed as a proposal by the debtor, and it is supposed to be filed on the same day that the Suspension of Payments case is commenced.⁶³
- However, there is nothing to stop the debtor and its creditors from negotiating acceptable terms for the Preventative Agreement *before* the suspension of payments proceeding begins.

If an entirely consensual Preventative Agreement was presented to the Mexican bankruptcy court on the first day of the suspension of payments proceeding, the process of creditor voting on the Agreement, and its final approval by the court, should be expedited. Hence, a successful and "fast track" proceeding would become far more likely — producing results roughly analogous to a "prepackaged" Chapter 11 proceeding.

H. Judicial Reorganization

If some type of out-of-court restructuring agreement cannot be achieved between a Mexican issuer of Eurobonds and its bondholder constituency, the last alternative is to attempt to reorganize the company under Mexican Bankruptcy Law. Consistent with creditors' behavior in the 1980s in Mexico, bondholders probably will resort to Mexican bankruptcy court as a last resort.

A suspension of payments proceeding is obviously preferable in most instances since its objective is rehabilitation of the issuer, whereas a Bankruptcy Proceeding usually results in a total liquidation of the business. But any such proceeding should be avoided if at all possible, for the following reasons:

- Suspension of payments proceedings may be time-consuming, often taking at least two years to complete where a reorganization arrangement cannot be expediently reached.
- While a Chapter 11 filing in the U.S. no longer carries heavy negative connotations for the debtor and its business, a suspension of payments filing in Mexico stigmatizes the debtor and can be extremely harmful to its reputation in the Mexican business community.

⁶¹ See L.Q.S.P., *supra* note 18, tits. VI, VII, VIII.

⁶² See L.Q.S.P., *supra* note 18, arts. 398-402.

⁶³ L.Q.S.P., *supra* note 18, art. 398.

PART 5
THE RESTRUCTURING PROCESS

A. The Major Constituencies

During the course of an out-of-court restructuring of Mexican Eurobond debt, the bondholders must deal with several different constituencies, each of which has its own distinct agenda.

The Company. If the Company's debt is unmanageable, but its operations are reasonably sound, then the bondholders' priority will be to help develop a more appropriate capital structure. If they encounter delays, it probably means that (i) there are core operational problems, (ii) the Company is not providing quality information to creditors, or (iii) some constituency is adamantly resisting the restructuring. If any of these factors are present, the creditors will have to take greater control of the workout process.

Bank Debt. Many Mexican companies have both secured and unsecured bank debt. Generally, medium term bank debt of Mexican companies is dollar-denominated and is fully secured, while short term bank debt is Peso-denominated and is unsecured. All such unsecured bank debt is *pari passu* with the unsecured Eurobond debt of such companies, and, as a consequence, banks holding unsecured debt and bondholders should have many common interests and should be able to develop a close working relationship in any restructuring.

Trade Creditors. Mexican companies vary in the extent to which they have dollar-denominated trade debt. However, even where there is not a large amount of trade debt, most Mexican companies can be expected to have numerous individual trade creditors. It will be logistically difficult to obtain concessions from the entire group, on an out-of-court basis, and hence deep discounting of these creditor claims should not be expected.

Shareholders. If holders of Eurobonds are expected to accept new debt instruments with extended maturities, then they almost certainly will expect to receive a meaningful amount of new equity. This may lead to conflict with existing shareholders, who would be diluted. Mexico does not have a system that permits automatic conversion of debt into equity with only a Board of Directors' authorization. Thus, any proposed conversion would require the approval of the controlling shareholders of the Company.

The Government. At present there is no indication that the Government plans to institute anything comparable to its *Ficorca* program from the mid-1980s and set minimum acceptable terms for creditor

concessions. Nevertheless, some version of substantial Governmental “activism” or “oversight” may emerge, related either to financial inducements to Mexican banks (beyond those set forth in the UDI and ADE programs described in Part I, Section C of this article) to extend payment terms on existing debt to Mexican borrowers or to a restructuring of debt owed to Mexican development banks.

Labor. Struggling Mexican companies will probably have labor problems (*i.e.*, massive labor force reductions, delay of payment of salaries or benefits). Labor organizations have access to special labor tribunals where they have standing to protect workers’ contractual, statutory and traditional rights. Like tax claims of the Government, the claims of labor will often have priority over unsecured, and sometimes even secured, creditor claims.

Joint Venture Partners. Many Mexican companies participate in one or more joint ventures with U.S. or other foreign companies. Often, Mexican companies rely on their joint venture partners for financial and/or technological assistance that is critical to their long-term business health. These joint venture partners may be a source of new financing. In addition, joint venture partners may have to approve the broad terms of any financial restructuring, either due to the express terms of a joint venture or similar agreement or as a practical necessity based on the importance of the venture.

B. Evaluating the Business

If a restructuring involves a Mexican Company that is operationally sound, with solid management, then the evaluation of its business should not be a controversial or overly time-consuming process. What is presented, simply stated, is a “good company/bad balance sheet,” requiring the Company to re-engineer its capital structure.

On the other hand, in restructuring some Mexican companies the creditors may confront significant operational problems, which are likely to fall into one of three broad categories:

- the Company needs new management;
- the Company needs to redefine its core business, which probably will lead to disposition of non-core assets; or
- the Company needs to redefine its core markets and core customer base, which may lead to a downsizing of some part of the corporate infrastructure.

In order to intelligently address these types of problems, the Company probably will find itself in some type of strategic planning exercise, developing a “new business plan” with long-term financial projections. In that event, creditors should develop positions on (i)

how long they think the planning process should last, (ii) how much it should cost, (iii) which members of senior management should be involved, and (iv) whether the creditors want to offer their own independent recommendations. The Company and its creditors must strike a balance between detail and expeditiousness in developing any such business plan, in order to assure that the plan development exercise is not used as a stalling mechanism by the Company, which might then prompt certain creditors to institute legal action against the Company.

C. Developing the Restructuring Agreement

As previously noted, most Mexican issuers of Eurobond debt have other significant constituencies besides the bondholders. They may well have bank debt, they almost certainly will have trade creditors, and they all will have shareholders. The most useful restructuring agreements will address every one of those interests, so that the entire capital structure is fixed definitively.

If the terms of the Eurobond debt are to be restructured, the restructuring is likely to occur through negotiations between the Company and some type of Bondholders Committee. If an acceptable deal is reached, it is likely to be reflected in some sort of "term sheet." That document, in turn, will provide the basis for preparation of exchange offer materials, assuming that is the chosen means of deal implementation.

If the issuer also has bank debt, then there will be a separate set of negotiations over the terms of that indebtedness, conducted between the Company and bank representatives. It is unlikely that the bondholders would directly participate in these talks, but they should coordinate with the banks since both creditor groups will have many common interests. Assuming an agreement is reached with the banks, it will require an amended and restated loan agreement.

PART 6 BONDHOLDER RIGHTS

A. Covenant Protection

Mexican Eurobond holders' leverage in restructuring negotiations will be determined largely by their legal rights under the Eurobond documentation, as well as by the bondholders' relative rights upon a suspension of payments or bankruptcy filing. Like bonds issued under a qualified Trust Indenture governing registered

debt securities issued in the United States, Eurobonds issued under a Fiscal Agency Agreement or a Trust Agreement are subject to a package of operating and, in some cases, financial covenants designed to restrict activities of the issuer that could impair its creditworthiness and thus the credit quality of the bonds.

The covenant package of most Mexican Eurobond issues is comparatively limited in scope, but it should include most of the following provisions:

Merger and Asset Dispositions. Typically the Company is prevented from a merger or consolidation with another entity, or the sale of substantially all of its assets to another entity, unless that entity expressly assumes the Company's Eurobond indebtedness.

Ratable Security. Typically, Eurobonds are unsecured. Thus, there is a covenant providing that no lien may be created as security for other indebtedness unless the bondholders' debt also becomes equally and ratably secured.

Limits on Additional Debt. While the incurrence of additional debt is rarely prohibited, it often is conditioned on the satisfaction of specified financial ratios. There also can be limited "carve outs" that permit the Company, for example, to guarantee the indebtedness of its subsidiaries.

Financial Maintenance Tests. Sometimes there is a covenant that obliges the Company to comply with some financial test — such as a debt-to-equity ratio — which is considered indicative of a reasonably sound financial condition.

B. Events of Default and Acceleration

If a Company is in violation of its covenants — and shows no inclination to cure such violations — then the bondholders may wish to take advantage of the remedies provided in their bonds. Most Eurobonds issued under Fiscal Agency Agreements and Trust Agreements provide that the holders of a specified principal amount of the Eurobonds (generally varying, depending on the Eurobond issue, from 25%-51%), acting in concert for this purpose, can give the Company a Notice of Default, specifying the covenant violation and declaring the entire principal amount of the bonds to be due and payable. With Eurobonds issued under Trust Agreements, the Trustee usually may also give the default notice to the Company.

There are important differences in the rights of bondholders under a Fiscal Agency Agreement, as compared to qualified Trust Indentures, which govern public debt issued by U.S. companies, and Trust Agreements, which typically govern Eurobonds subject to English law.

First, a Fiscal Agent, unlike a Trustee, has no fiduciary duties to bondholders. Whereas the Trustee acts as a representative of bondholders, the Fiscal Agent acts as an agent of the issuer. Second, the Fiscal Agent has a more limited role in enforcement of remedies. For example, only a group of bondholders, and not the Fiscal Agent, can act to accelerate the bond indebtedness. Finally, the Fiscal Agency Agreement contains no "direct action clause" which, as a provision of most Indentures, prohibits bondholders from taking legal action on their own without first requesting the Indenture Trustee to act on their behalf. Indeed, under most Eurobonds, each holder of Eurobonds may pursue remedies individually with respect to its own Eurobonds in the event of a payment default on the Eurobonds.

C. An "Involuntary Filing"

When a U.S. issuer of public debt is in monetary default, it is possible for three or more of its unsecured bondholders to file an involuntary Chapter 11 petition.⁶⁴ If the petition is granted, it has the effect of putting the Company, against its will, into the bankruptcy process. This is one of the most potent weapons in the arsenal of bondholder rights.

Mexican law takes a somewhat similar approach by permitting one or more creditors of the Company to petition the court for a "declaration of bankruptcy, leading to a *quiebra* or liquidation proceeding."⁶⁵ The court will grant the relief, thus commencing bankruptcy proceedings, if one of several "presumptions of bankruptcy" are satisfied.⁶⁶ In established judicial practice, one of these tests is that the Company is in default with respect to the majority of its monetary obligations. Under Mexican practice, the determination as to whether such default has occurred is based on whether the majority of the debts payable by the Company are current, irrespective of the amount of such debts. (Note that Mexican law does not permit creditors of a Company to file an involuntary suspension of payments, or rehabilitation proceeding, against the Company.)⁶⁷

The danger with this type of involuntary bankruptcy declaration is that it places the Company into a *quiebra* proceeding, which leads to total liquidation of the business. Accordingly, creditors hold a highly

⁶⁴ See 11 U.S.C. § 303 (1988).

⁶⁵ See L.Q.S.P., *supra* note 18, art. 6.

⁶⁶ See L.Q.S.P., *supra* note 18, art. 2.

⁶⁷ See L.Q.S.P., *supra* note 18, arts. 394, 395.

potent weapon that can be so devastating to the Company that its use may be counter-productive.

D. Collection Actions

If a Company defaults in the payment of its Mexican Eurobonds, the holders of a specified amount thereof, acting through the Trustee or the Fiscal Agent as indicated in section B above, may institute, in a Mexican court with jurisdiction, a mercantile action against the Company, which may allow the bondholders to attach assets of the Company and take control of its cash flow at the commencement of the action.⁶⁸ To the extent the Company has no other major creditors, such a mercantile action could help in reaching a restructuring agreement. However, in cases where the Company has other major creditors, the institution of a mercantile action by the bondholders may be followed by other collection actions from other creditors, which may lead the Company to seek suspension of payments relief.

PART 7 SUSPENSION OF PAYMENTS PROCEEDINGS⁶⁹

A. Effects of Declaration of Suspension of Payment

A Mexican debtor's willingness to negotiate with its Eurobond holders will depend on the debtor's view of its alternatives, which include a voluntary suspension of payments proceeding (a rehabilitation proceeding) or a voluntary or involuntary bankruptcy proceeding (a liquidation proceeding). A suspension of payments proceeding is commenced by the insolvent bond issuer (the Debtor) filing a "petition" with the court in the Debtor's corporate domicile, which will have jurisdiction over the proceeding.⁷⁰ The petition contains basic financial information about the Debtor and is somewhat similar to the petition that commences a Chapter 11 case under the United States Bankruptcy Code.⁷¹

Numerous legal consequences flow from the court's declaration of suspension of payments, which alters the normal legal rights of the Debtor, its creditors and litigants. The most important of these conse-

⁶⁸ For a description of judicial collection actions and the enforcement of domestic judgments, see Agustin Berdeja-Prieto, *Debt Collateralization and Business Insolvency: A Review of the Mexican Legal System*, 25 U. MIAMI INTER-AM. L. REV. 227, 240 (Winter 1993/1994).

⁶⁹ For a thorough summary and analysis of suspension of payments proceedings, see *id.*

⁷⁰ See L.Q.S.P., *supra* note 18, art. 395.

⁷¹ See L.Q.S.P., *supra* note 18, art. 6 (applicable to suspension of payments by virtue of article 429); 11 U.S.C. §§ 301-304 (1988).

quences, many of which are roughly analogous to the effects of commencing a Chapter 11 reorganization under the United States Bankruptcy Code, are summarized below:

Business Operations. Under a suspension of payments proceeding, the Debtor and its management are permitted to remain in charge of the business, much like the “debtor-in-possession” in a Chapter 11 case.⁷² However, the Bankruptcy Court appoints a Trustee (the *Síndico*), who is authorized to closely supervise the Debtor’s affairs.⁷³

Debt and Interest Payments. Once a suspension of payments proceeding is declared, the Company is prohibited from paying any outstanding debts (which for purposes of the suspension of payments become due and payable), and, for practical purposes, interest on those debts (other than secured debt, to the extent of the value of collateral) ceases to accrue.⁷⁴

Property of the Estate. The Debtor is viewed as having an “Estate” composed of property in which it has legal and equitable interests.⁷⁵ The assets of the Estate are what become available for the payment of creditor claims. Parties may take legal action to separate and reclaim certain types of assets from the Estate — including property pledged as collateral for secured transactions.⁷⁶

Litigation. All pending collection litigation being prosecuted by or against the Debtor is transferred to the suspension of payments proceeding and comes under the jurisdiction of the Bankruptcy Court, with the exception of litigation brought with respect to security interests granted by the Debtor.⁷⁷ All future litigation against the Debtor, other than litigation brought with respect to security interests granted by the Debtor, also must be brought before that Court.⁷⁸

Sale of Assets. Once the suspension of payments case is commenced, the approval of the Bankruptcy Court is required for the Debtor’s sale of assets outside the ordinary course of its business and Court approval also is essential for other business transactions.⁷⁹

⁷² Compare L.Q.S.P., *supra* note 18, art. 410 with 11 U.S.C. § 1107 (1988).

⁷³ See L.Q.S.P., *supra* note 18, arts. 415, 416.

⁷⁴ See L.Q.S.P., *supra* note 18, arts. 408-13.

⁷⁵ See L.Q.S.P., *supra* note 18, arts. 15, 83, 115 (applicable to suspension of payments by virtue of art. 429).

⁷⁶ See L.Q.S.P., *supra* note 18, arts. 158-62 (applicable to suspension of payments by virtue of art. 429).

⁷⁷ See L.Q.S.P., *supra* note 18, arts. 122-27 (applicable to suspension of payments by virtue of art. 429).

⁷⁸ L.Q.S.P., *supra* note 18, arts. 122-27.

⁷⁹ See L.Q.S.P., *supra* note 18, arts. 410, 411.

Bar Date. After the declaration of suspension of payments has been published, the creditors have forty-five days within which they must make filings establishing the *bona fides* of their respective creditor claims.⁸⁰

Debt Converted To Pesos. Upon commencement of a suspension of payments proceeding, all debt denominated in foreign currency is converted by court order to Peso-denominated debt. Accordingly, Eurobond holders would become subject to the risk that the value of the Peso vis-à-vis the dollar would fall after commencement of a proceeding.⁸¹

B. Treatment of Creditor Claims

The Mexican Bankruptcy Law — like the U.S. Bankruptcy Code — has a set of provisions that relate to the treatment of creditor claims and cover issues ranging from the priority of various types of claims to the procedures for determining claims allowance:

Intervenors. Shortly after a suspension of payments proceeding is commenced, an informational meeting of creditors is convened. At that time the creditors may designate a panel of “Intervenors” (usually a three-member or five-member panel) who are to act as the creditors’ representatives in monitoring case developments.⁸² This panel of Intervenors is in some respects similar to a Creditors Committee in a U.S. Chapter 11 reorganization.⁸³

Priority of Claims. Pursuant to Mexican Bankruptcy Law, there are six categories of creditors — the categories being known as “degrees” — which are listed below in descending order of preference:⁸⁴

- 1st Exclusively privileged creditors, which include claims for one year’s back wages by the debtor’s employees.

⁸⁰ See L.Q.S.P., *supra* note 18, art. 15 (applicable to suspension of payments by virtue of art. 407).

⁸¹ See L.Q.S.P., *supra* note 18, art. 132 (applicable to suspension of payments by virtue of article 429). See also Berdeja-Prieto, *supra* note 68, at 253 n. 198 (citing Mexican judgment in which court interpreted Article 132 to mean that debts denominated in foreign currency are fixed in Mexican pesos at the rate of exchange applicable on the date of the declaration of bankruptcy).

⁸² See L.Q.S.P., *supra* note 18, art. 417. See also L.Q.S.P., *supra* note 18, arts. 58-72 (applicable to suspension of payments by virtue of art. 429).

⁸³ See 11 U.S.C. § 1102 (1988).

⁸⁴ See L.Q.S.P., *supra* note 18, art. 261 (applicable to suspension of payments by virtue of art. 429).

- 2nd Secured creditors, which are creditors with a lien on the assets of the debtor. This category includes real estate mortgagees, pledgees (i.e., creditors secured by personal property) and creditors under purchase finance agreements. These creditors enjoy a priority over other creditors to the extent of the proceeds available from the security. If a creditor is partially unsecured, however, the unsecured component of their claim falls into the 4th category.
- 3rd The Government, for payment of back taxes.
- 4th Creditors with a special privilege, which includes a select group of unsecured trade creditors such as building contractors and commission agents.
- 5th Common creditors arising out of business transactions, a group which would include the holders of unsecured Eurobond debt as well as unsecured bank debt.
- 6th Common creditors based on civil law transactions, which would include all other unsecured creditors.

All creditors within a given class must be paid *in full* before any distributions are made to the next most senior class of creditors.⁸⁵

Claims Allowance Proceedings. The suspension of payments proceeding provides for a creditors' meeting to be convened for the purpose of "recognition of claims," a determination that resembles the "allowance" of claims under the U.S. Bankruptcy Code.⁸⁶ The process of recognition involves each creditor claim being scrutinized by the *Síndico* and the Interveners, with the Bankruptcy Court reaching the final decision. If a creditor claim is not recognized, then it is not entitled to any recovery.⁸⁷

C. The Preventative Agreement and Case Conclusion

As noted in Part 4 of this article, the "Preventative Agreement" is similar to a Plan of Reorganization in a U.S. Chapter 11 case in that it sets forth the compromise and resolution of all creditor claims and leads to the Debtor's exit from suspension of payments proceedings.

The key provisions governing the formulation and approval of the Preventative Agreement are summarized below.

Negotiating Process. After the proposed Preventative Agreement is filed by the Debtor, which must occur at the beginning of the suspension of payments proceeding,⁸⁸ a period of judicial struggle and out-of-court negotiations with creditors typically follows. However, a

⁸⁵ See L.Q.S.P., *supra* note 18, art. 269 (applicable to suspension of payments by virtue of art. 429).

⁸⁶ Compare L.Q.S.P., *supra* note 18, arts. 220-259 (applicable to suspension of payments by virtue of art. 407); compare 11 U.S.C. § 502 (1988).

⁸⁷ See L.Q.S.P., *supra* note 18, arts. 220-259.

⁸⁸ See L.Q.S.P., *supra* note 18, arts. 398, 399.

creditor vote on the Agreement cannot take place until the process of creditor claim "recognition" is completed, since that determines which claims are allowed and thus entitled to vote.⁸⁹

Meeting to Approve Agreement. The Preventative Agreement is approved at a special meeting of creditors, which is convened for that purpose, and is administered by the bankruptcy judge. The only creditors who may vote are those who attend in person.⁹⁰

Competing Proposals. Mexican Bankruptcy Law recognizes that there can be competing proposals put before the creditors, such as one Preventative Agreement advanced by the Debtor and another proposed by a creditor group.⁹¹ In that event, both proposals will be voted on and the one with the greatest number of votes will be deemed accepted.⁹²

Voting Procedures. Except in those cases where the Bankruptcy Law requires special weighted voting, in calculating the necessary votes in favor of or against the Preventative Agreement, each creditor is entitled to one vote, with no special weighting of votes based on the amount of a creditor's claim, so long as the majority of the creditors are present at the meeting.⁹³ Secured creditors, at their option, may abstain from voting.⁹⁴

Votes Required for Approval. If the Preventative Agreement proposes to pay creditors at a discount from their face amount of their claims, whether in immediate cash or in installments, the Bankruptcy Law provides for a weighting mechanism designed to level creditors' influence in the voting.⁹⁵

Results of Voting. If the creditors' voting results in the approval of a Preventative Agreement, then the Bankruptcy Judge declares the proceedings concluded.⁹⁶ If a Preventative Agreement is not approved, then the suspension of payments proceedings are converted to

⁸⁹ See L.Q.S.P., *supra* note 18, arts. 233, 234 (applicable to suspension of payments by virtue of art. 429).

⁹⁰ See L.Q.S.P., *supra* note 18, arts. 296-379 (applicable to suspension of payments by virtue of art. 418).

⁹¹ See L.Q.S.P., *supra* note 18, arts. 296-303 (applicable to suspension of payments by virtue of art. 429).

⁹² See L.Q.S.P., *supra* note 18, art. 315 (applicable to suspension of payments by virtue of art. 418).

⁹³ See L.Q.S.P., *supra* note 18, art. 79 (applicable to suspension of payments by virtue of art. 418).

⁹⁴ See L.Q.S.P., *supra* note 18, art. 308 (applicable to suspension of payments by virtue of art. 418).

⁹⁵ See L.Q.S.P., *supra* note 18, arts. 317, 318 (applicable to suspension of payments by virtue of art. 418).

⁹⁶ See L.Q.S.P., *supra* note 18, arts. 420-423, 347.

bankruptcy (*quiebra*) proceedings, leading to total liquidation of the business.⁹⁷

Voluntary Exit. The Debtor may waive at any time the suspension of payments protection and enter into one or more restructuring agreements with its creditors outside the umbrella of the suspension of payments proceeding.⁹⁸

PART 8 BANKRUPTCY PROCEEDINGS (*QUIEBRA*)

A. The Effects of Case Commencement

A bankruptcy proceeding, under Mexican Law, is known as *quiebra* and, like a Chapter 7 proceeding under the U.S. Bankruptcy Code, it generally leads to the total liquidation of the Debtor's business.

Unlike a suspension of payments proceeding, which may only be commenced by the Debtor voluntarily, a bankruptcy proceeding may be commenced by the Debtor who voluntarily files a petition for a "declaration" of bankruptcy or by a creditor who files a petition for an involuntary "declaration" of bankruptcy.⁹⁹ The effects of bankruptcy commencement are similar to suspension of payments in that there is (i) defined property of the "estate,"¹⁰⁰ (ii) a bar date for filing of creditor claims and a process of claim "recognition,"¹⁰¹ and (iii) the designation of a panel of Intervenor to protect creditor interests.¹⁰²

Significant features of a bankruptcy proceeding include the classification of the bankruptcy as either "accidental," "culpable" or "fraudulent," which, despite the language of the statute, is not found in a suspension of payments proceeding in practice.¹⁰³ Moreover, those in control of the Debtor can be punished with a term of imprisonment of one to four years (for a culpable bankruptcy) and a term of five to ten years (for a fraudulent bankruptcy).¹⁰⁴ Additional unique features of a bankruptcy proceeding are the replacement of the Board of Directors by the *Síndico*¹⁰⁵ and the establishment of a "suspicious

⁹⁷ See L.Q.S.P., *supra* note 18, art. 419.

⁹⁸ See L.Q.S.P., *supra* note 18, art. 428.

⁹⁹ See L.Q.S.P., *supra* note 18, art. 5.

¹⁰⁰ See L.Q.S.P., *supra* note 18, arts. 15, 83, 115.

¹⁰¹ See L.Q.S.P., *supra* note 18, arts. 220-259.

¹⁰² See L.Q.S.P., *supra* note 18, arts. 58-92.

¹⁰³ See L.Q.S.P., *supra* note 18, art. 91.

¹⁰⁴ See L.Q.S.P., *supra* note 18, arts. 95, 99.

¹⁰⁵ See L.Q.S.P., *supra* note 18, arts. 46-57.

period” preceding the declaration of bankruptcy.¹⁰⁶ Any transaction carried out by the Company within the “suspicious period” may be subject to special scrutiny by the Bankruptcy Court and the *Síndico*, and may be voided if deemed to constitute a fraudulent conveyance.¹⁰⁷ The bankruptcy judge is given sole discretion to establish the length of the “suspicious period,”¹⁰⁸ unlike in the United States where the length of similar review periods is specifically stated in the Bankruptcy Code.¹⁰⁹

B. The Role of the *Síndico*

The role of the court-appointed *Síndico* in a bankruptcy proceeding is far more expansive than the *Síndico*'s role in a suspension of payments proceeding. In a bankruptcy proceeding, the Board of Directors and the existing management of the Debtor is displaced by the *Síndico*, who takes control of day-to-day operations.¹¹⁰

The *Síndico*'s mandate is to promptly marshal all assets of the Estate and develop a plan for their liquidation. The only way to avoid total liquidation is for the creditors to show that it would not be in their best interests.¹¹¹

C. Plan of Liquidation

The distribution of liquidation proceeds does not take place until after the bankruptcy court has conducted the special meeting of creditors at which creditor claims are “recognized.”¹¹² No later than four months after that meeting, the *Síndico* must presumably begin interim distributions of liquidation proceeds, and continue this process once every four months until all proceeds have been distributed to creditors.¹¹³ The distributions are made in accordance with the priority of creditor claims previously discussed in Part 7.

As the process of distributions nears completion, the Court convenes a final meeting of creditors at which the *Síndico* issues its final report, accounting for all liquidation distributions.¹¹⁴ Thereafter, the bankruptcy proceeding is concluded.

¹⁰⁶ See L.Q.S.P., *supra* note 18, arts. 118, 121.

¹⁰⁷ See L.Q.S.P., *supra* note 18, arts. 168-174.

¹⁰⁸ See L.Q.S.P., *supra* note 18, arts. 116-121.

¹⁰⁹ See 11 U.S.C. §§ 547, 548 (1988).

¹¹⁰ See L.Q.S.P., *supra* note 18, art. 46.

¹¹¹ See L.Q.S.P., *supra* note 18, art. 201.

¹¹² See L.Q.S.P., *supra* note 18, art. 220.

¹¹³ See L.Q.S.P., *supra* note 18, arts. 274-278.

¹¹⁴ See L.Q.S.P., *supra* note 18, arts. 274-278.

PART 9
CONCLUSION

Many Mexican companies face substantial Eurobond maturities in 1996 and 1997, in addition to the burdensome maturities that came due in 1995 after the Peso's devaluation. Unless the financial markets for new Mexican Eurobond debt strengthens considerably in 1996, a number of Mexican companies may face difficulties in refinancing their Eurobond debt and may be forced to consider consensual, out-of-court restructurings with their Eurobond holders or consider much less attractive options such as suspension of payments or bankruptcy proceedings in Mexico.

In these restructuring negotiations, holders of Mexican Eurobonds — who are new as a major creditor constituency in Mexican restructurings — may draw on their experiences in U.S. high yield, or “junk bond,” restructurings of the early 1990s. Mexican companies’ “bondholder constituency” may seek to form bondholder committees to lead negotiations with the companies, much like “advisory committees” of commercial banks which typically represented creditors in the Mexican restructurings of the 1980s. Mexican debtors and their bondholders are likely to consider restructuring alternatives ranging from the relatively minor — temporary covenant relief, partial repayments and/or the posting of collateral — to a comprehensive revamping of the debtors’ capital structure — involving debt-for-debt exchanges, debt-for-equity exchanges and new equity holders.

Eurobond holders’ leverage in restructuring negotiations will be determined largely by their legal rights under the agreements pursuant to which the Eurobonds were issued, which will vary depending on the Eurobonds’ covenant package, events of default, acceleration provisions and the ability of bondholders to initiate collection suits against a defaulting Eurobond issuer. Mexican debtors and bondholders are likely to view restructuring as preferable to a suspension of payments proceeding, which is long, expensive and uncertain. Almost all parties to a restructuring will wish to avoid a Mexican bankruptcy (*quiebra*) proceeding, which will be all but certain to result in the debtor’s liquidation.

ANNEX I
SELECTIVE COMPARISON OF U.S. AND MEXICAN
BANKRUPTCY LAWS

Those familiar with the U.S. Bankruptcy Code may have noticed from the summaries of suspension of payments and bankruptcy pro-

ceedings in Parts 7 and 8 of this article that they did not include several key features of the U.S. Bankruptcy Code's Chapter 11 reorganization process. Some of those significant features are noted below:

A. Exclusivity

In a suspension of payments proceeding, only the debtor has the ability, initially, to propose a Preventative Agreement, which is roughly analogous to a Chapter 11 Restructuring Plan.¹¹⁵ The Preventative Agreement, however, must be proposed and filed on the first day of suspension of payments proceedings.¹¹⁶ Typically this is followed by several months of negotiations with creditors over what they consider to be acceptable terms for the Agreement. Thus, creditors can attempt to influence the restructuring process almost immediately.

Under Chapter 11 of the U.S. Bankruptcy Code, the Debtor's exclusive right to file a Plan lasts for the first 120 days of the reorganization proceeding.¹¹⁷ This "exclusivity" often is extended. This can lead to extreme frustration among creditors who may have developed their own version of a Plan but cannot propose it, or bring it to a vote, so long as the Debtor's exclusive period remains in force.

B. Class Voting

While the general rule is that each creditor is entitled to one vote in the voting of the Preventative Agreement, the Bankruptcy Law requires qualified majorities of creditors and amounts of claims to approve certain Preventative Agreements where excessive debt forgiveness and/or repayment time is sought.¹¹⁸

In a Chapter 11 Plan of Reorganization, the various types of creditors — secured, subordinated and unsecured — must be divided into separate "classes" and must vote on the Plan by class.¹¹⁹

For a class to be deemed to have accepted the Plan, it requires the votes of two-thirds in dollar amount and a majority in number of those voting within a given class.¹²⁰ At least one "impaired" class (*i.e.*, a group of creditors receiving less than a full recovery) must vote to

¹¹⁵ See L.Q.S.P., *supra* note 18, art. 398.

¹¹⁶ See L.Q.S.P., *supra* note 18, arts. 398-492.

¹¹⁷ See 11 U.S.C. § 1121(b) (1988).

¹¹⁸ See L.Q.S.P., *supra* note 18, arts. 317-323.

¹¹⁹ See 11 U.S.C. § 1122 (1988).

¹²⁰ See *id.* § 1126.

accept the Plan,¹²¹ and creditors who receive a full recovery do not vote and instead are deemed to have accepted the Plan.¹²²

Because of the two-thirds dollar amount requirement for class acceptance of a Plan, a group of dissident creditors — who hold, for example, 35% of the claims in their class — are viewed as having a “blocking position.” Simply put, if all these creditors voted against the Plan, class acceptance could not possibly be obtained.

Creditors with the larger dollar amount of the claims also have greater influence in the voting. This is because acceptance of the Plan by a class requires a vote of two-thirds in dollar amount, as well as a majority in number, of the creditor claims voting within a given class.¹²³

C. Cram Down

If a Preventative Agreement receives a majority vote of the creditors in a suspension of payments proceeding, then the Agreement, and the creditor recoveries it offers, apply to all creditors.¹²⁴ Creditors who voted against the Agreement — even if they are a large minority block — are forced to accept the recoveries provided for in the Agreement.

Chapter 11 takes a somewhat different approach, providing that a Plan can be approved even if all creditors, in a given class, vote against it.¹²⁵ However, in order for the Plan to be “crammed down” on these dissident creditors, it must be shown that (i) no one junior to the dissident creditors is receiving any consideration,¹²⁶ and (ii) the dissident creditors would fare no worse in a liquidation of the Debtor.¹²⁷

D. Equitable Subordination

Under Chapter 11, the claims of a given creditor or creditor group can be “subordinated” by the Bankruptcy Court to a more junior ranking, thus diminishing their creditor recovery under the Plan.¹²⁸ Under Mexican Bankruptcy Law, there is no analogue to equitable subordination.

¹²¹ See *id.* § 1129(a)(10).

¹²² See *id.* § 1126(f).

¹²³ See *id.* § 1126(c).

¹²⁴ See L.Q.S.P., *supra* note 18, art. 316 (applicable to suspension of payments by virtue of art. 418).

¹²⁵ See 11 U.S.C. § 1129 (1988).

¹²⁶ See *id.* § 1129(b).

¹²⁷ See *id.* § 1129(a)(7).

¹²⁸ See *id.* § 510.

E. Disclosure and Plan Confirmation

Under Mexican suspension of payments proceedings, the entire process of approval of the Preventative Agreement is far less complicated than the analogous Chapter 11 process of Plan confirmation.

First, Mexican law completely eliminates the need for a Disclosure Statement, which is a lengthy document, similar to a prospectus, which must accompany a Plan of Reorganization and requires Bankruptcy Court approval before it can be distributed.¹²⁹

Second, if a Chapter 11 Plan obtains the requisite creditor acceptances, it still must be the subject of an elaborate confirmation hearing and will not be approved by the Bankruptcy Court unless numerous conditions to confirmation are satisfied.¹³⁰ In contrast, if a Preventative Agreement is approved by a vote of the creditors, it is accepted by the Court as long as certain minimal requirements are met. Among other things, the amount offered to creditors must not be below the repayment capacity of the debtor, and the enforcement of the agreement must be sufficiently guaranteed.¹³¹ There is, however, a mechanism by which the Court's approval or disapproval of the Agreement may be appealed.¹³²

¹²⁹ See *id.* § 1125.

¹³⁰ See *id.* § 1129.

¹³¹ See L.Q.S.P., *supra* note 18, art. 420.

¹³² See L.Q.S.P., *supra* note 18, arts. 422, 343-346.

ANNEX II
SELECTIVE LIST OF MATURING EUROBONDS OF
MEXICAN PRIVATE SECTOR ISSUERS*

Issuer	Industry	Coupon (in % p.a.)	Maturity	@ Issue (Millions of U.S. Dollars)
1995 Maturities				
TUBOS DE ACERO DE MEXICO (TAMSA)	STEEL PRODUCTS	N/A	1/30/95	50
AEROMEXICO	AIRLINE	N/A	6/10/95	100
BANCO INTERNACIONAL SNC	BANKING	N/A	6/25/95	50
BANCA CREMI	BANKING	N/A	6/29/95	150
SIDEK INTERNATIONAL FINANCE	CONGLOMERATE	N/A	7/5/95	50
BANPAIS	BANKING	8 1/4	8/18/95	100
GRUPO SYNKRO SA DE CV	APPAREL & OTHER TEXTILES	8	10/7/95	50
CEMEX SA	CEMENT PRODUCTS	10	10/10/95	50
CEMEX SA	CEMENT PRODUCTS	N/A	10/25/95	75
IUSACEL SA DE CV	COMMUNICATIONS	N/A	11/19/95	15
IUSACEL SA DE CV	COMMUNICATIONS	9	11/19/95	45
CYDSA	CHEMICAL PROD.	9	11/24/95	50
BANCA CREMI	BANKING	9	11/30/95	50
SIDEK INTERNATIONAL FINANCE	CONGLOMERATE	N/A	12/21/95	50
1996 Maturities				
BANCA SERFIN	BANKING	10 1/2	1/17/96	70
DYNAWORLD BANK	BANKING	N/A	1/17/96	70
GRUPO SITUR	REAL ESTATE	7 3/4	2/12/96	20
GRUPO TELEvisa	BROADCASTING	FRN	4/7/96	100
GRUPO TELEvisa	BROADCASTING	FRN	4/7/96	100
CEMEX SA & TOLMEX SA	CEMENT PRODUCTS	N/A	5/21/96	425
GRUPO CONDUMEX SA DE CV	CONGLOMERATE	6 1/4	7/27/96	65
EMPRESAS ICA SOC. CONTROLADORA SA	CONSTR. & ENGINEERING	FRN	8/2/96	72
FIRST MEXICAN ACCEPTANCE CORP. SA	CONGLOMERATE	8 3/4	9/15/96	19
FIRST MEXICAN ACCEPTANCE CORP. SA	CONGLOMERATE	10 3/4	9/15/96	10
EL PUERTO DE LIVERPOOL	RETAIL SALES	7 1/4	10/19/96	100
CEMEX SA	CEMENT PRODUCTS	10	11/15/96	100
GRUPO INDUSTRIAL DURANGO SA DE CV	PAPER & PULP	FRN	11/18/96	100
EMPAQUES PONDEROSA	PAPER & PULP	8 3/4	12/6/96	50
APASCO	CEMENT PRODUCTS	10 1/4	12/11/96	100
1997 Maturities				
BANPAIS	BANKING	7 1/4	1/28/97	100
APASCO SA DE CV	CEMENT PRODUCTS	N/A	5/15/97	50

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TUBOS DE ACERO DE MEXICO (TAMSA)	STEEL PRODUCTS	N/A	6/12/97	50
FOMENTO ECONOMICO MEXICO SA (FEMSA)	BEVERAGES	9 1/2	7/22/97	300
VVP HOLDINGS (VITRO)	GLASS	9	10/27/97	70
TMM FINANCIAL SERVICES	SHIPPING	9 3/4	10/28/97	75
CEMEX S.A.(CONV.)	CEMENT	4 1/4	11/1/97	403
GRUPO TELEVISIA	BROADCASTING	10	11/9/97	200
EMPRESAS LA MODERNA SA	TOBACCO	10 1/4	11/12/97	150
CONSORCIO G GRUPO DINA	AUTOMOTIVE	10 1/2	11/18/97	150
GEMEX-GRUPO EMBOTELLADORA DE MEXICO	FOOD/BEV.	0 3/4	11/19/97	110
DESC-SOCIEDAD DE FOMENTO INDUSTRIA	CONGLOMERATE	1	12/15/97	125
1998 Maturities				
EMPRESAS ICA SOC. CONTROLADORA SA	CONSTR. & ENGINEER	9 3/4	2/11/98	151
HYLSA	PRIMARY METAL INDUSTRIES	11	2/23/98	175
GRUMA SA DE CV (MASECA)	FOOD/BEV.	9 3/4	3/9/98	125
THIRD MEXICAN ACCEPTANCE CORP.	CONGLOMERATE	N/A	3/15/98	50
THIRD MEXICAN ACCEPTANCE CORP.	CONGLOMERATE	N/A	3/15/98	25
CYDSA	CHEMICAL PRODUCTS	9 1/4	4/8/98	50
APASCO	CEMENT PRODUCTS	9 1/4	4/20/98	80
CONTROLADORA COMERCIAL MEXICANA	RETAIL SALES	8 3/4	4/21/98	130
CEMEX SA	CEMENT PRODUCTS	8 7/8	6/10/98	1,000
INDUSTRIAS UNIDAS (IUSA)	PRIM. METAL IND.	10	6/21/98	75
GRUPO IMSA SA DE CV	CONGLOMERATE	8 3/4	7/7/98	90
BANCOMER	BANKING	8	7/7/98	750
GRUPO IRSA	CHEMICAL PRODUCTS	8 3/8	7/15/98	150
BANCO INTERNACIONAL SNC	BANKING	8 3/4	8/4/98	100
GRUPO SITUR	REAL ESTATE	8 3/4	9/14/98	100
INDUSTRIAS AXA	ELECTRONICS	8 1/2	10/1/98	75
DINE SA DE CV	REAL ESTATE	8 1/8	10/15/98	75
BANCO MEXICANO	BANKING	8	11/4/98	100
BANCO DEL ATLANTICO	BANKING	7 7/8	11/5/98	100
CORPORACION INDUSTRIAL SAN LUIS SA	MANUF. VAR.	9 1/8	11/16/98	75
FIFTH MEXICAN ACCEPTANCE CORP.	CONGLOMERATE	8	12/15/98	60
FIFTH MEXICAN ACCEPTANCE CORP.	CONGLOMERATE	9	12/15/98	15

GRUPO SIMEC SA	FABRICATED METAL PRODUCTS	8 7/8	12/15/98	65
1999 Maturities				
EMPRESAS LA MODERNA S.A.	TOBACCO	11 3/8	1/25/99	125
INDUSTRIAS UNIDAS (IUSA)	PRIM. METAL IND.	8 1/2	1/27/99	50
TUBOS DE ACERO DE MEXICO (TAMSA)	STEEL PRODUCTS	N/A	3/10/99	20
GRUPO TRIBASA SA DE CV	CONSTR. & ENGIN.	FRN	3/17/99	150
SEVENTH MEXICAN ACCEPTANCE CORP.	CONGLOMERATE	10	8/15/99	160
SEVENTH MEXICAN ACCEPTANCE CORP.	CONGLOMERATE	10	8/15/99	40
GRUPO IMSA SA DE CV	CONGLOMERATE	10	10/13/99	50
CEMEX SA	CEMENT PRODUCTS	10	11/5/99	280
2000 Maturities				
CEMEX SA	CEMENT PRODUCTS	8 1/2	8/31/00	120
TRANSPORTATION MARITIMA MEXICANA, S.A. DE C.V.	SHIPPING	8 1/2	10/14/00	150
GRUPO TRIBASA SA DE CV	CONSTR. & ENGIN.	7 3/4	12/22/00	100
2001 Maturities				
GRUPO MEXICANO DE DESARROLLO	CONSTR. & ENGIN.	8 1/4	2/17/01	250
ISPAT MEXICANA	PRIM. METAL INDU.	10 3/8	3/15/01	175
GRUPO INDUSTRIAL DURANGO SA DE CV	PAPER & PULP	12	7/15/01	150
MC-CUERNAVACA TRUST	TRANSPORTATION	9 1/4	7/25/01	265
CEMEX SA	CEMENT PRODUCTS	9 1/2	9/20/01	300

* Source: BDS Securities; *Latin Finance*