LATIN LAWYER

THE GUIDE TO RESTRUCTURING

Editors
Joy K Gallup and Michael L Fitzgerald

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Publisher's Note

Latin Lawyer is delighted to publish *The Guide to Restructuring*.

Edited by Joy K Gallup and Michael L Fitzgerald of Paul Hastings LLP and containing the knowledge and experience of 25 leading practitioners from throughout the region and across disciplines, it provides guidance that will benefit all practitioners advising on restructurings in Latin America.

Restructurings are by their nature both international and deeply domestic, and moves to standardise and draw together the legislative framework in the region demonstrate the benefits and challenges of this trend. Understanding the commonalities, but also the differences, in both black letter law and common practice around the region is critical. This guide draws on the expertise of highly sophisticated practitioners to draw out these trends and give practitioners the tools they need. Its aim is to be a valuable resource for insolvency and restructuring advisers of all stripes as they play their role in the complex economic situation facing the region today.

We are delighted to have worked with so many leading firms and individuals to produce *The Guide to Restructuring*. If you find it useful, you may also like the other books in the Latin Lawyer series, including *The Guide to Corporate Compliance* and *The Guide to Mergers and Acquisitions*.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

Clare Bolton
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The Interplay between Different Stakeholders in Mexican Restructurings: Equity versus Debt

Alejandro Sainz and Ana Gabriela Avendaño[1]

Since most restructurings in Mexico are debtor-in-possession proceedings, the company always plays a very important role. The approval of a reorganisation plan will always require the debtor's approval and in the equitisation of claims, certain corporate acts would need to be agreed by existing shareholders.

There is still a tendency in the courts to favour debtor protection. Courts constantly issue reliefs to protect the debtor, which allows a company to operate more easily during proceedings.

Court-appointed officials, such as examiners, conciliators and receivers, also have a key role as facilitators between the debtor, the creditors and the judge. They oversee the process, and are entitled to make proposals and authorise most of the company's relevant transactions.

The conciliator is important as a mediator between the creditors and debtor and has the capacity to make proposals and even authorise certain transactions.

Creditors are relevant, too, as the consent of a majority to the reorganisation plan is needed prior to its approval pursuant to the rules under the Insolvency Law (*Ley de Concursos Mercantiles*). If a company and its creditors reach a restructuring agreement during the conciliation stage, the company will pay its debts pursuant to the reorganisation plan and the insolvency proceeding (*concurso*) will be terminated.

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1 Alejandro Sainz is a partner and Ana Gabriela Avendaño is an associate at Sainz Abogados, SC.

Employees are given priority under the rules of insolvency proceedings. They are entitled to a salary and benefits as well as severance payments. These claims, as well the enforcement of other labour and employment claims, are not subject to a *concurso* stay. Employees may amicably assist in the process or frustrate any attempted restructuring. Labour laws in Mexico are very protective and conservative, and employees cannot waive any accrued and unpaid benefits (including salary), making it very difficult to amend any labour conditions such as economic conditions, suspensions or termination of relationships, without the consent of a labour court.

The interplay between the different stakeholders in the implementation of a financial and legal agreement is dependent on various factors: the situation of the debtor, the calibre and experience of the parties involved, the jurisdictions involved, among other things.

The process can be complex, owing to the number of possible variants and, thus, the diversity of alternatives that can be applied during a restructuring process, depending on the expectations of the parties and the sector involved. The interests of all stakeholders in a restructuring proceeding – which can include the shareholders, board, employees (including unions), authorities, regulators and creditors (government, suppliers, banks, etc.), must be taken into account.

The ability to reach consensual decisions among creditors is critical in a successful negotiation since restructurings in Mexico, as mentioned above, are mostly debtor-in-possession proceedings.

One of the main issues to be addressed in a Mexican restructuring is to restore trust among stakeholders to achieve an agreement. Whether this will be achieved will depend to a large extent on communication and the delivery of credible and regular information to creditors.

The control of most listed companies in Mexico is in the hands of a family. This can result in the administration of the company being manipulated, which can bring about failures in internal controls. In many family-owned businesses, family members are on the board or in high-level official positions.

In certain cases concerning public service providers, the industry regulator has a key role in appointing the conciliator or receiver and also has the power of veto over the reorganisation plan.

Creditors with higher priority will be paid in full, and those with lower priority will be recompensed only if there are sufficient remaining funds. The existing Insolvency Law classifies creditors in the following main categories or classes (and with the following rankings or preferences):

- first priority claims against the 'estate' (assets) of the debtor (*créditos contra la masa*), which include:

- special labour claims (severance payments and unpaid accrued wages) under Section XXIII, Chapter A of Article 123 of the Constitution, and applicable regulations, by increasing the wages during the corresponding two years prior to the *concurso* judgment (formal commencement of the *concurso* procedure of the debtor);
- debt incurred for management of the estate of the debtor with the authorisation of the conciliator or the receiver, as the case may be, or those contracted directly by the conciliator;
- debt (including debtor-in-possession financing) incurred to cover ordinary expenses for the safety and protection of the assets, their repairs, conservation and management; and
- debt incurred through judicial or extrajudicial acts for the benefit of the estate; provided, however, that under Article 225 of the Insolvency Law with respect to secured creditors, with mortgages or pledges, or creditors with special privileges,[2] the preference or privilege of the claims against the estate would not apply, except for the following claims:
  - the 'special labour claims' referred to above;
  - the litigation expenses incurred for the defence or recovery of goods or assets subject to the security interest of the secured claims or over those assets that are included as part of a 'special privilege'; and
  - the expenses necessary for the repair, conservation and sale of those assets;

- secured creditors (those with mortgages and pledges over assets of the debtor) and tax claims secured with a security *in rem* (up to the value of the guarantee), which are paid first with proceeds from the sale of mortgaged or pledged items. If the items have a value or a price in excess of the debt, any such excess or remaining value is directed to cover subsequent debt payments to other creditors. If the price does not cover the debt, mortgage or pledge, the corresponding creditor may participate, pro rata, as a common or unsecured creditor, to collect the remaining amount. In principle, assets transferred out of the estate in the form of true-sale vehicles (trust agreements) should

2 Special privilege creditors are those that are qualified as such by law or that have a withholding right. A withholding right provides the possibility to withhold something that you do not own and that should be delivered to a third party. The person with a withholding right has the possession of an asset of a debtor and is authorised to have possession until the debtor fulfils his or her obligation.

be excluded from the estate (although such vehicles might be challenged if they have been structured as simple guarantee trusts rather than as true-sale mechanisms);
- other tax claims and general labour claims;
- common or unsecured creditors (trade creditors would usually rank as unsecured creditors and there are no particular mechanisms to secure their unpaid debts by statute); and
- subordinated creditors (intercompany claims).

Once a judge declares the debtor's bankruptcy or liquidation, shareholders would be liquidated only if there is any balance remaining after all creditors have been paid (either through a liquidation of the assets through public bids or by agreeing a reorganisation plan at the liquidation stage).

It is important to note that *concurso* provisions allow the debtor to incur unsecured or secured indebtedness in the ordinary course of business. If such credit is approved by the court or conciliator, as the case may be, it provides a priority claim or a lien to a lender on the debtor's unencumbered assets or a second priority claim on encumbered assets.

Debtor-in-possession loans have a priority claim in the insolvency, except for certain labour, tax and secured claims.

Published by Latin Lawyer and edited by Joy K Gallup and Michael L Fitzgerald, partners at Paul Hastings LLP, *The Guide to Restructuring* is designed to assist restructuring advisers of all disciplines, and affected companies, as they negotiate complicated restructurings.

This guide delivers specialist insight to our readers across the region – advisers, practitioners, corporate decision makers and court officials – throughout the process.

In preparing this guide, we are grateful for the cooperation and insight of the broad range of participating advisers and practitioners, who have contributed a wealth of knowledge and experience.