Pratt's
Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT™ JUNE 2015

EDITOR'S NOTE: *PRATT'S* TRAVELS
Steven A. Meyerowitz

SUBNATIONAL INSOLVENCIES AND CHAPTER 9 OF THE UNITED STATES BANKRUPTCY CODE: HISTORY OF CHAPTER 9 AND ITS OPERATION IN THE CITY OF DETROIT'S DEBT ADJUSTMENT CASE—PART II
Patrick E. Mears

A NEW WORLD FOR LATAM CREDITORS: INSOLVENCY REFORM IN LATIN AMERICA
Richard J. Cooper, Adam Brenneman, and Jessica E. McBride

LIGHT AT THE END OF THE PRC PROPERTY MARKET TUNNEL, OR WAS IT THE SHADOW OF A FREIGHT TRAIN COMING THIS WAY?
Christopher W. McFadzean, David Richardson, and Alesya Tepikina

CASES INTERPRETING REJECTION OF STATUS QUO OBLIGATIONS UNDER SECTION 1113
Andrew Roth-Moore

LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D. at .... 1-800-424-0651 ext. 3207
Email: .... kent.hanson@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . (518) 487-3000
Fax Number . . . . (518) 487-3584
Customer Service Web site . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call

Your account manager or . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2015 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt™ Publication

Editorial Offices
630 Central Ave., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

(2015-Pub.4789)

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF
Steven A. Meyerowitz
President, Meyerowitz Communications Inc.

EDITOR
Victoria Prussen Spears
Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Scott L. Baena
Bilzin Sumberg Baena Price & Axelrod LLP

Leslie A. Berkoff
Moritt Hock & Hamroff LLP

Ted A. Berkowitz
Farrell Fritz, P.C.

Michael L. Bernstein
Arnold & Porter LLP

Andrew P. Brozman
Clifford Chance US LLP

Kevin H. Buraks
Portnoff Law Associates, Ltd.

Peter S. Clark II
Reed Smith LLP

Thomas W. Coffey
Tucker Ellis & West LLP

Michael L. Cook
Schulte Roth & Zabel LLP

Mark G. Douglas
Jones Day

Timothy P. Duggan
Stark & Stark

Gregg M. Ficks
Coblentz, Patch, Duffy & Bass LLP

Mark J. Friedman
DLA Piper

Robin E. Keller
Lovells

Matthew W. Levin
Alston & Bird LLP

Patrick E. Mears
Barnes & Thornburg LLP

Alec P. Ostrow
Stevens & Lee P.C.

Deryck A. Palmer
Pillsbury Winthrop Shaw Pittman LLP

N. Theodore Zink, Jr.
Chadbourne & Parke LLP

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company., Inc. Copyright 2015 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access

www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerowitz@meyerowitzcommunications.com, 631.331.3908. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 630 Central Avenue, New Providence, NJ 07974.

A New World for LatAm Creditors: Insolvency Reform in Latin America

Richard J. Cooper, Adam Brenneman, and Jessica E. McBride*

This article provides an overview of the consensual restructuring processes in each of five major Latin American jurisdictions—Argentina, Mexico, Brazil, Peru, and Chile—and provides some practical tips on how creditors can protect their interests.

For years, investors in emerging markets have routinely criticized the effectiveness of local legal regimes when it comes to dealing with financially stressed or insolvent issuers. Nowhere has this been more true than in Latin America, which, like other emerging economies, has experienced the financial high and lows that are endemic to such markets, and as a result has seen its fair share of corporate failures. Over the last several years, however, the legal landscape for dealing with such situations in Latin America has been changing. Five major Latin American jurisdictions—Argentina, Mexico, Brazil, Peru, and Chile—have undertaken reforms to their insolvency systems in the last 15 years. Several of these reformed bankruptcy laws have now been in place sufficiently long to begin to be tested by large insolvencies with international creditors; indeed, the current 2014 reform in Mexico is a direct response to the experiences of Mexican debtors and their creditors under the previously amended law, and Argentina and Brazil have both seen multiple waves of restructurings. Others, like the insolvency regime in Peru and the brand-new system in Chile, have yet to be tested in the throes of a major restructuring battle. However, in each system, the common theme has been a move away from liquidation-focused regimes to systems in which distressed companies can adjust their debts and seek to reorganize.

While each country's approach varies, there are some broader trends that can be seen in the reforms. Shareholders continue to maintain control of the process in most jurisdictions, although there is greater transparency in the process, and none of the regimes have implemented an absolute priority rule. Some of the defects or ambiguities in the laws that have favored debtors, such as the use of

* Richard J. Cooper is a partner at Cleary Gottlieb Steen & Hamilton LLP, focusing his practice on domestic and international restructurings, mergers and acquisitions, and leveraged finance (including project and acquisition finance). Adam Brenneman is a partner at the firm, where he concentrates on international corporate and financial transactions, with a primary focus on Latin America. Jessica E. McBride, an associate at the firm, focuses her practice on international corporate and financial transactions. The authors may be contacted at rcooper@cgsh.com, abrenneman@cgsh.com, and jmcbride@cgsh.com, respectively.

intercompany claims to cram down third-party creditors, have been mitigated. Concern with efficiency of reorganization processes has led to laws that set tight deadlines to reach a deal, although many restructurings continue to suffer from interminable delays. Automatic stays apply more widely, although a number of jurisdictions continue to exclude key creditors, and prepackaged restructurings have been expanded to bind minority dissenting creditors. And, despite the particularities of each country's laws, restructurings throughout the region continue to be set against the backdrop of government involvement—as constructive lender, such as the BNDES in Brazil, as shareholder, such as the Argentine pension fund in the Argentine utility cases, or as a transformative intervener, as the Mexican government did with Oceanografía. This article provides an overview of the consensual restructuring processes in each of the five major jurisdictions—and provides some practical tips on how creditors can protect their interests.

ARGENTINA

Although Argentina's sovereign debt restructuring has captured most of the headlines in the past 15 years, distressed corporates have made frequent use of Argentina's Bankruptcy and Liquidation Law (*Ley de Concursos y Quiebras*) to deal with overleveraged balance sheets, exchange rate devaluations, government interventions and a prolonged economic slowdown. Argentina has an in-court reorganization scheme (*concurso preventivo*), but in most international insolvencies creditors focus on the prepackaged *acuerdo preventivo extrajudicial* ("APE") proceeding, which was added in a series of reforms passed in the wake of Argentina's 2001–2002 financial crisis.

In-Court Reorganization

Only the unwary or the truly determined choose to restructure through a *concurso preventivo* in Argentina. *Concurso preventivo* bears a strong resemblance to a U.S. Chapter 11 on paper—the debtor has a 90-day exclusivity period to file a plan (which can be extended by up to 30 days), and the debtor must receive support from creditors both representing a majority in number and holding 2/3 in amount of the debt within each class of the debtor's outstanding liabilities. Following the expiration of the exclusivity period, creditors may propose their own plan, which can be approved by the same majorities but does not need the consent of the debtor. Management stays in place during a *concurso preventivo* while an automatic stay blocks enforcement action against the debtor in many, but not all, circumstances. However, a number of key differences and practical concerns make *concurso preventivo* vastly different than Chapter 11.

First, the Argentine *concurso preventivo* proceeding typically takes three years

or more to complete, not counting appeals—an eternity for a going concern that hopes to transform itself quickly. Despite the lengthy process, Argentine law does not provide for any sort of debtor-in-possession financing, which can severely hamper the operating prospects of debtors relying on working capital or other financing to fund operations. Although there is an automatic stay imposed on unsecured creditors, the stay does not apply to secured creditors, who are permitted to immediately foreclose on collateral and undertake other remedial actions. As a result, businesses that have significant amounts of their key assets pledged are at risk of being whittled away while they try to negotiate with creditors. In addition, secured creditors aren't truly at the table in restructurings—debtors are required to pay secured creditors the full value of their security unless they agree otherwise, giving secured creditors a significant amount of leverage.

Prepackaged Restructuring

The prepackaged restructuring offers a reorganization alternative that is typically much shorter and less costly than the *concurso preventivo* proceeding, but it is not without its pitfalls. In an APE transaction, a debtor negotiates directly with creditors to reach a prepackaged restructuring agreement outside of formal court proceedings. Once approved by the requisite creditors (the same numbers as are required to approve a *concurso preventivo* plan), the debtor files its APE with the court for its endorsement. However, unlike in a *concurso preventivo*, a default is not a prerequisite for commencing an APE proceeding—so a debtor can begin negotiations in advance of a default, and can carry out negotiations while it is lining up bridge financing. However, because the negotiation and solicitation of APE votes takes place *before* the agreement is filed with the court, the debtor is not subject to a stay and therefore remains vulnerable to claims by creditors.

On paper, there is a 10-day period following the filing for creditors to file objections to an APE based on limited grounds. However, in practice, objections can delay the court's approval by up to several months. For example, in the APEs of Multicanal and Sideco Americana, court approval was delayed as a result of objections filed by third parties, who were ultimately found to not have standing. Because of these delays, the APE's primary role in many recent transactions has been as a backstop to incentivize creditors to participate in a voluntary exchange offer with high minimum participation thresholds. However, threatening to restructure through an APE is not without its own pitfalls. In a recent restructuring involving the Argentine gas distributor Transportadora del Gas del Norte ("TGN"), the debtor filed for an APE; however, court approval was delayed by objections from holdout creditors and years of ensuing litigation. TGN eventually withdrew the APE as a result of changes in economic

circumstances that occurred during the period of almost three years in which the court's approval remained pending. When TGN tried to file for a *concurso preventivo* within the year following its abandonment of the APE, the Argentine courts rejected the filing, noting that TGN had already taken one bite at the restructuring apple and should not have expected a second.

MEXICO

The question that every prospective creditor of a Mexican company was asking in 2014 was: has the *concurso* been fixed? After international creditors began making noise about the perceived "friendliness" of *concurso* proceedings to shareholders, Mexico decided to reform its *Ley de Concursos Mercantiles* in 2014 in an attempt to further modernize its bankruptcy proceedings. Although the reforms are generally considered to be an improvement on the existing law, challenges remain in the practical implementation of a number of features, and concerns about political interference and a lack of transparency continue to raise concerns on the part of creditors and debtors alike.

In-Court Reorganization

Mexico's in-court reorganization proceeding, *concurso mercantil*, has a strong pedigree, having been tested in the Iusacell, Corporación Durango and SATMEX cases, among others. The proceeding may be started by a debtor *or* any of its creditors if an insolvency test is satisfied, and a debtor is also permitted to file a preemptive bankruptcy petition if it can demonstrate "imminent" insolvency, *i.e.*, that it will be insolvent within the next three months. Once the debtor is declared in *concurso* (a process that can take up to four months), an automatic stay is imposed, and the debtor has an initial 185-day mediation period to formulate and propose a plan of reorganization, which can be extended by up to an additional 180 days with creditor support. However, the extension is limited: after an aggregate 365-day period, the debtor is required to go directly into liquidation. The recent filings of Corporación GEO, Desarrolladora Homex, and Oceanografía have shown that the initial 185-day deadline to emerge from *concurso* is proving hard to meet and debtors have been struggling to gather sufficient creditor support to obtain extensions.

While a debtor is negotiating with creditors, it generally maintains its management and continues operations. Asset sales that are in the ordinary course of business may continue regularly, and the sale of unpledged assets deemed "non-essential" only requires approval of a court-appointed mediator (*conciliador*) who is not required to seek creditor approval. However, sales of "essential" assets must be conducted through a court-approved auction process and sales of pledged assets require the consent of the relevant secured creditor. Following the 2014 reforms, companies may enter into post-petition credit

facilities to maintain their operations. These debtor-in-possession ("DIP") facilities benefit from super-priority status, thus encouraging DIP lenders to extend credit to debtors subject to a *concurso* process. However, the reform does not allow DIP financing to "prime" existing secured debt or for proceeds to be used to "roll-over" prepetition debt. The recent homebuilder cases have demonstrated that DIP financing is still quite a challenge, and that Mexican banking laws, which require banks to create reserves for loans to companies in *concurso*, have not caught up with the new DIP financing regime.

As a general rule, a reorganization plan needs to be approved by creditors holding at least a majority of the voting claims. A plan may be imposed on dissenting unsecured creditors only if they receive equal treatment and at least 30 percent of the unsecured debt has agreed to the plan. Only a majority of unsecured creditors (excluding subordinated intercompany claims) may veto the plan, but any creditor may file a judicial appeal before the courts. In contrast, the *concurso* law does not allow creditors to impose a plan on the company in *concurso* without the company's consent. Despite its professed "pro-creditor" guiding principles, the 2014 reform did not implement any sort of absolute priority rule and therefore creditors cannot dilute equity holders without their consent.

One of the biggest challenges for Mexico's *concurso mercantil* has been the treatment of secured creditors, who generally opt out of the *concurso* process, which has impeded the ability of debtors to restructure secured debt. The 2014 reforms improved a number of aspects of *concurso* with a view to clarifying the status of secured creditors (and possibly increasing their participation in the process). For example, it is now clear that if a secured creditor chooses to participate in a plan, its collateral is not released. In addition, the reforms made a debtor's "non-essential" assets exempt from the automatic stay, thus allowing secured creditors to foreclose on those assets during a consensual restructuring process. However, the law continues to protect the interest of secured creditors that opt out of the plan by providing that they are entitled to keep their collateral unless the plan provides for the payment of their claim in full (or the return of their collateral). This creates an enormous challenge for debtors with widely held secured debt, as it means that every single secured creditor must consent to a plan that compromises secured debt.

Finally, there is the *bête noire* of *concurso*: intercompany debt. After the Vitro case attracted international attention (and a number of court cases in the United States), Mexico decided to address the issue of intercompany claims in the 2014 reforms. On one hand, the reforms did strengthen creditors' rights to challenge intercompany transactions by automatically extending the clawback period when the alleged fraud is connected to an intercompany loan. And the

2014 reforms explicitly recognized contractually subordinated claims. On the other hand, the law has left a wake of confusion as to how intercompany debt would actually be treated in a *concurso*. The reforms provided that if 25 percent or more of "voting debt" is represented by intercompany claims, intercompany claims would not count towards votes. However, questions remain as to what would happen if intercompany debt that votes represents less than 25 percent of the voting claims—as was the case in Vitro and many other restructurings. Until these issues are resolved, debtors can expect continued creditor insistence on intercompany voting trusts to ensure that equity does not unfairly engineer back-door control of a *concurso* proceeding.

Prepackaged Restructuring

Mexico is the only jurisdiction in Latin America that offers a prepackaged restructuring option that continues to enjoy widespread acceptance. Since pre-pack provisions were adopted in 2007, a number of debtors have opted to test their effectiveness in practice—Contraladora Comercial Mexicana ("CCM"), which exited *concurso* with nearly unanimous creditor support for its pre-pack after just 3.5 months in court, is one example of how well it can work (others include Sanluis Interco, Metrofinanciera, and Iusacell). With a prenegotiated process, or *concurso con plan de reestructura previo*, a debtor may submit a prepackaged plan to the court upon receiving the support of creditors representing a majority of the voting unsecured debt. This has the significant benefit of avoiding the often lengthy examiner process, which involves a determination of whether the debtor is eligible to file that can often take months and is somewhat duplicative of the equally lengthy claims recognition process. Flexibility to modify the plan post-filing is limited—encouraging fully baked deals as opposed to indicative plans, although a debtor may opt for a "menu option" approach, with alternative instruments and treatments offered to all creditors to maintain some flexibility. The threshold for filing a prepackaged plan is relatively low, since a debtor may file based solely on its representation that those creditors supporting the plan represent at least a majority of its obligations, without any court-appointed certification of the debtor's liabilities prior to a declaration of *concurso*. But getting into a pre-pack *concurso* process may be easier than getting out of it—a debtor may consider its intercompany creditors part of the requisite majority to submit the preliminary plan, only to see them excluded for purposes of approving the definitive plan.

BRAZIL

In 2005, Brazil adopted a new insolvency code that was designed to provide a flexible, modern framework for maximizing the value of a distressed business as a going concern. The decision was prescient—after years of the Brazil boom

(or, in the eyes of some creditors, bubble), Brazil has become one of the most active restructuring markets, including the largest Latin American restructuring to date (OGX) and a number of new restructurings arising out of the "Operation Car Wash" scandal. The Brazilian bankruptcy law provides for both in-court (*recuperação judicial*) and out-of-court (*recuperação extrajudicial*) restructurings and is unique among Latin American jurisdictions in that the out-of-court restructuring process is widely perceived to be less effective than the in-court process.

In-Court Reorganization

Brazil's in-court proceeding, called *recuperação judicial*, is only available to debtors—creditors generally cannot file any proceeding involuntarily except for a liquidation (*falência*) proceeding. Notably, the proceeding is unavailable to any debtor that has previously obtained relief through judicial recovery over the prior five years, thus deterring the serial restructurings that Argentina and, to a lesser extent, Mexico have seen in the past decade. Following commencement of the proceeding, a 180-day automatic stay is imposed on most secured and unsecured creditors. However, two important classes of creditors are expressly excluded from the automatic stay. First, holders of claims secured by "fiduciary liens" are not subject to *recuperação* proceedings and are permitted to foreclose on their collateral, which has made the restructuring of secured debt in Brazil a significant challenge. In addition, creditors that hold claims in respect of "foreign exchange advances" (*adiantamentos sobre contratos de câmbio*, or "ACCs") are exempt from *recuperação* proceedings and can continue exercising remedies against debtors. Given this exemption, creditors have sought to characterize a wide range of claims as "foreign exchange advances," further complicating the prospects for a restructuring in a complicated capital structure.

Once a proceeding is initiated, the debtor has a 60-day period during which to formulate a plan and obtain creditors' approval. While there is no outside date for confirmation, a general meeting of creditors typically occurs within the 180 days in which the debtor has the protection of the automatic stay. To be confirmed, a debtor's plan must be approved through a vote at a general meeting of creditors by both a majority in number of each of labor and small company creditors voting at the meeting, as well as a majority, in number and amount of debt held, of both classes of secured and unsecured creditors voting at the meeting. In the event that the debtor fails to gain approval of a plan by all four creditor classes, a judge may nonetheless "cram down" the plan on creditors—as happened in the Rede Energia proceeding—if

- a majority in amount, regardless of class, vote in favor of the plan;
- two out of three voting classes (or one out of two if three are not

present) vote in favor of the plan;

- at least 1/3 of creditors in the rejecting class voted in favor of the plan; and
- all creditors within the rejecting class are treated equally under the plan.[1]

If no plan is approved, the proceeding is converted into a liquidation—although in practice at least one debtor has received a second chance from the court before landing in liquidation. All creditors, secured or unsecured, that are dissatisfied with the terms of the plan of reorganization may appeal the confirmation order, but stays pending the appeals are unlikely to be granted except in the most extraordinary circumstance, and the appeals can take years to resolve. As such, since creditors may not propose an alternative plan of reorganization or propose amendments to the debtor's plan, creditors have little power to prevent confirmation outside of voting against the plan itself.

The question of who is entitled to vote on a plan in a *recuperação judicial* proceeding—and how they can cast their votes—has emerged as an important issue in restructurings. This issue is particularly acute with respect to bondholders who beneficially hold New York law-governed bonds. In contrast to a U.S. Chapter 11 proceeding, where a bondholder's right to vote on a plan of reorganization is fundamental to the proceedings, Brazil lacks well-established procedures, legislative or otherwise, for bondholder voting in a *recuperação judicial*. In the absence of formalized procedures, bondholders are left at the mercy of the debtor, who submits specific procedures for court approval—as in the OGX restructuring—by which bondholders may elect to individualize their claims and vote on the plan of reorganization. This, combined with conflicting case law in Brazil regarding a trustee's right to vote on behalf of individual bondholders, means that a bondholder that does not individualize its claims risks total disenfranchisement.

Management retains control of a debtor in a *recuperação judicial* proceeding, but it is subject to supervision by a court-appointed judicial administrator, and it is within the bankruptcy judge's power to remove management in the case of fraud, dishonesty or gross mismanagement of the debtors' assets. While under judicial supervision, a debtor may only sell or pledge non-fixed assets without court approval, and the sale or pledge of fixed assets must either be provided for

[1] Note that the ability to cram-down a plan on creditors with the support of two of the three classes was cast into doubt when the law was recently amended to provide for a fourth class of creditors (small companies), leaving it unclear whether two of four classes is sufficient, or if support from three out of four classes is needed to cram-down a plan.

in a confirmed plan or otherwise be approved by the court. However, in a nod to modernity, similar to Section 363 sales under the U.S. bankruptcy code, sales of assets in a *recuperação judicial* proceeding can be effected so they are free and clear of claims and encumbrances. A debtor is permitted to seek DIP financing, and creditors who provide DIP financing are accorded superpriority status in the *recuperação* proceeding—a feature that proved crucial in the OGX restructuring, where creditors provided over $250 million in DIP financing to ensure that OGX could continue operating while the restructuring was ongoing.

The fact that court approval is required for DIP financing that is secured by fixed assets highlights one of the most important issues that creditors and debtors face in *recuperação* proceedings: filing the case in a court with sophisticated and knowledgeable judges is crucial to getting key elements of a plan approved in a timely fashion. The lack of transparency and predictability of some Brazilian courts has been a significant hindrance in a number of prominent restructurings.

Prepackaged Restructuring

Given the success of Brazil's in-court *recuperação judicial* procedure, creditors might think that the out-of-court procedure—known as *recuperação extrajudicial*—would offer even more benefits. However, this has not been the experience of most debtors and creditors. In the *recuperação extrajudicial* process, a debtor negotiates with its creditors prior to filing and submits its creditor-approved plan to the court, which then analyzes the plan for legality and viability. However, certain limitations make *recuperação extrajudicial* processes unfeasible in many restructurings. First, the thresholds for plan approval are higher in a *recuperação extrajudicial*, requiring 60 percent approval by each class of creditors. Furthermore, labor claims are also excluded from *recuperação extrajudicial* proceedings, which severely curtails the use of the procedure by businesses looking to solve both operational and balance sheet concerns.

As with most prepackaged proceedings, the automatic stay does not apply during negotiation of a *recuperação extrajudicial*, and thus a business remains vulnerable to remedial actions by creditors. This is an important issue in Brazil, where vendor and financial creditors often file *protestos* and other suits against a defaulting debtor and push it prematurely into a judicial filing. In addition, DIP financing is not available in a *recuperação extrajudicial* process, making it difficult for debtors to secure financing and continue operating in the face of a liquidity crisis. Additionally, and notwithstanding the recent successful *recuperação extrajudicial* proceeding involving Lupatech, where the issue was not raised, there is some question as to whether creditors can be forced to take

equity as part of a *recuperação extrajudicial* proceeding—as opposed to the *recuperação judicial* context, where this issue has been litigated and resolved. And while negotiations of a *recuperação extrajudicial* may be completed prior to the court filing, the requirement of court review and approval of the plan, combined with the unpredictability and inexperience of many Brazilian courts in insolvency matters, means that *recuperação extrajudicial* offers few benefits when compared to *recuperação judicial* plans.

PERU

Peru's General Bankruptcy System Law (*Ley General de Sistema Concursal*) is the oldest of the major Latin American insolvency regimes, and given the economic boom that has benefitted Peru over the past 10 years, also the least tested of all of the older regimes. Adopted in response to the global financial crisis of the late 1990s and a perception that the prior law was overly friendly to creditors, the law provides for two types of reorganization procedures—an ordinary proceeding (*procedimiento concursal ordinario*) and a type of prepackaged insolvency proceeding called a preventive proceeding (*procedimiento concursal preventivo*). However, successful reorganizations remain very much the exception rather than the rule; only a small percentage of all recent insolvency cases have resulted in reorganizations, with the vast majority ending in liquidation proceedings. As Peru's economy, and with it, the rapid increase in foreign investment in Peruvian debt that has marked the past decade, begins to slow, the ability of the Peruvian insolvency regime to provide a platform for successful reorganization will be put to the test.

Ordinary Proceedings

In many ways, Peru's insolvency laws are some of the most creditor-friendly laws. Ordinary proceedings may be filed involuntarily by the debtor or the debtor's creditors (although secured creditors may not file involuntary ordinary proceedings unless they have been unsuccessful in foreclosing on their security). After a notice of an insolvency proceeding has been published, an automatic stay of all court and administrative court cases against the debtor becomes effective—although the publishing of the proceeding may take up to three to six months following filing, leaving the debtor dangerously exposed. Notably, the automatic stay applies to secured claims, which makes the restructuring of secured debt more feasible in Peru than in other Latin American jurisdictions. However, given the absence of an absolute priority rule, sophisticated creditors have tended to use bankruptcy-remote collateral trusts, which are not subject to the automatic stay, in order to hold their security interests.

Creditors are required to organize a meeting to decide whether to reorganize or liquidate the debtor but are only permitted to do so after claims against the

debtor have been verified, which is supposed to take just 30 business days but in practice can take the better part of a year to complete. The decision to reorganize requires a vote of 2/3 of the total amount of claims (or if a quorum is not met following the first meeting, 2/3 of the amount of claims participating in the creditors' meeting). A decision to reorganize must be made within 45 business days of the formation of the creditors' meeting; if a decision is not reached during that window, the debtor is irreversibly referred to a liquidation proceeding.

Within 60 business days of making the decision to reorganize the debtor, the creditors' meeting must propose and approve a reorganization plan. A majority of 2/3 of the amount of claims (or 2/3 of the amount of claims participating in the creditors' meeting in a second meeting) is required to approve a reorganization plan—and the plan may be approved without the consent of the debtor. Other than a requirement that at least 30 percent of the debtor's projected annual cash flow used to pay recognized claims must be used to pay labor claims, the creditors' meeting has broad latitude to amend the terms of recognized claims, including imposing haircuts and extending maturities. Notably, secured claims can also be adjusted as part of a plan approved by the relevant supermajorities without the consent of secured creditors, an important distinction from other Latin American insolvency regimes. There are no special provisions in the General Bankruptcy System Law that facilitate the provision of DIP financing and, hence, not much experience with DIP financing in Peru. While special treatment for suppliers who supply goods and services during reorganization proceedings is usually provided for in the reorganization plan, there are no provisions of law that explicitly protect these entities. Loans provided to the debtor and security interests granted by the debtor during ordinary proceedings are not afforded super-priority status; as a result, DIP financing remains relatively uncommon in Peruvian insolvency proceedings.

In contrast to most other LatAm jurisdictions where management stays in place during a restructuring process, in Peru the creditors' meeting has broad authority to replace the officers and directors of the debtor, and shareholders effectively lose all power over the debtor's business. The creditors' meeting may also approve a merger, change the debtor's constitutive documents and capitalize existing claims (excluding tax claims) into capital stock on a *pro rata* basis. Since Peruvian law imposes no restrictions on the transfer of claims among creditors or with third parties, many creditors have used these features to take control of distressed debtors by buying claims and capitalizing them without having to wait for an auction proceeding to be conducted.

Preventive Proceedings

A preventive proceeding (*procedimiento concursal preventivo*) can only be filed

by a debtor; the proceeding is intended to facilitate the approval of a prepackaged reorganization plan (*acuerdo global de refinanciación*) before a debtor or its creditors meet the prerequisites for initiating ordinary proceedings. While the law does not specifically provide for an automatic stay in a preventive proceeding, debtors typically request, and are granted, a discretionary stay that remains in effect until the creditors' meeting approves the prepackaged plan. A prepackaged plan is subject to the same voting requirements as ordinary proceedings. If the prepackaged plan is not approved, the creditors' meeting may file for an ordinary proceeding with a simple majority of all claims. Creditors' ability to manage the affairs of the debtor are much more limited in a preventive proceeding. They do not have a right to replace the debtor's management, and the shareholders of the debtor retain all of their rights. However, if a debtor does not honor any of the payment terms included in the prepackaged plan, the plan terminates automatically and all claims become due according to their original terms.

The preventive proceeding is one of several elements of the Peruvian insolvency regime that makes it somewhat of an odd duck among Latin American bankruptcy laws—in Peru, creditors sit in the driver's seat, but the law does not recognize basic tools like DIP financing that are gaining in acceptance across Latin America. And despite being in force for over a decade, the law has seen minimal use by international creditors. The most notable recent filing, Doe Run Perú, bounced back and forth between reorganization and liquidation before it assets were sold off. The test of how Peru's regime stacks up against the trend in other Latin American jurisdictions is yet to come.

CHILE

For many years, the primary means for a Chilean company to restructure its debt was through a Chapter 11 case filed in the United States, a route first taken by the Chilean electricity generator Edelnor. Until recently, a liquidation-focused bankruptcy regime and strong cultural prejudice against bankruptcy led to few, if any, successful restructurings in Chilean courts. However, as of October 2014, Chilean debtors and their creditors have been able to take advantage of a new insolvency law in Chile, which represents a major overhaul of the previous, liquidation-focused regime. Thus far, no Chilean company has tested the law—the last major restructuring, Alsacia and Express, was conducted in U.S. courts in a prepackaged Chapter 11 filing. However, the law offers a number of features that may make it attractive for future restructurings—along with a number of drawbacks that may make creditors and debtors more wary.

In-Court Reorganization

A judicial reorganization (*reorganización judicial*) can be commenced only by the debtor—there is no possibility of an involuntary proceeding filed by creditors. A 30-day stay on most creditor actions is automatically imposed once a case is filed and published, which can be extended for up to a total period of 90 days with creditor support. The automatic stay applies to both secured and unsecured creditors with limited exceptions, including actions brought by labor claimants. Unique among Latin American jurisdictions, Chile has adopted the U.S. prohibition on termination and acceleration of a debtor's contracts, including on the grounds of insolvency, during the automatic stay. Creditors who violate the stay will have their claims relegated to the lowest priority in recovery, behind intercompany and other related-party claims. However, unlike the U.S., Chile does not favor an active claims trading market—any creditor that has acquired its claim within 30 days of the commencement of proceedings is prohibited from participating.

Once the debtor has entered the judicial reorganization process, it then proposes a reorganization plan, which requires the approval of at least 2/3 in number of the creditors present at the creditors' meeting, which must also represent at least 2/3 of the debtor's liabilities. Control of a Chilean judicial reorganization proceeding still remains firmly in the hands of shareholders—only the debtor may propose a reorganization plan; the only option for dissatisfied creditors is to convert the proceeding into a liquidation. A judicial reorganization plan may include several alternatives for creditors' treatment and may opt to classify creditors among classes, and so long as creditors holding 2/3 of the affected liabilities agree, the plan may also treat members of each class differentially. However, there is no absolute priority rule, and therefore creditors may face the choice of accepting a debtor-proposed plan that benefits shareholders or having to recover through a potentially lengthy liquidation process.

Having taken note of Mexico's experience, the new law explicitly bars intercompany and related-party claims from voting on a reorganization plan, and debts owed to such parties that are not documented at least 90 days prior to the commencement of the reorganization proceeding will be paid at a lower priority. An approved plan binds both unsecured and secured creditors, with the exception of those holding assets declared by the court to be "non-essential" for the preservation of the debtor's business as a going concern. If an asset is declared by the court to be non-essential, a creditor with a pledge on that asset may exercise remedies and then participate in the reorganization plan to the extent its claim exceeds the value of its security.

The new law offers several new or improved features intended to preserve the

debtor as a going concern during the proceeding, as well as support creditors' involvement in the reorganization. These include DIP financing of up to 20 percent of the debtor's total debt without creditors' consent, which is accorded superpriority status. A debtor is also permitted to sell its assets—up to 20 percent of its total assets without creditors' consent.[2] In addition, the law affords preferential treatment to pre-petition debt from certain ordinary course suppliers and international trade financing counterparties that continue to provide services to the debtor during the bankruptcy proceedings, a feature not generally found in Latin American insolvency regimes, which underscores the challenges of restructuring operating companies (as opposed to holding companies in need of a balance sheet adjustment).

The new insolvency law also includes a number of enhancements to creditor protections. For example, creditors may bring clawback actions with respect to certain transactions—preferential prepayments, payments-in-kind, and the provision of additional security—made within one year prior to the debtor's reorganization filing. This one-year lookback period may be extended to two years if the beneficiary of the contract or payment was "aware" of the debtor's economic state and the contract or payment was not made on market terms. Other elements, such as measures for increased transparency and accessibility to information, as well as the incorporation of a cross-border insolvency proceeding similar to U.S. Chapter 15, make the new regime more navigable and useful to international debtors and their creditors.

Prepackaged Restructuring

Debtors may also take advantage of prepackaged plans (*acuerdos de reorganización extrajudicial*), which, once agreed by the debtor and its creditors, may be presented to the court for judicial recognition with the support of two or more creditors representing at least 75 percent of the total claims corresponding to their respective classes. Upon court approval, the plan is deemed binding on all creditors—a notable distinction from the previous bankruptcy regime, in which a prepackaged plan bound only those creditors that had approved it. In addition, similar to the judicial reorganization process, once the prepackaged plan is presented to the court, actions against the debtor are stayed and the debtor's ability to sell its assets is generally frozen pending court approval of the plan.

With the 2014 reform, Chile joined the rest of the major Latin American economies in shifting away from a liquidation-focused regime. Its legislators

[2] Note that the law does not specify whether these assets are sold free and clear of encumbrances.

crafted the statute with evident care, drawing on international model law and picking and choosing many of its elements from neighboring jurisdictions. With the ink still fresh in the official gazette, debtors and creditors alike are awaiting the result of the Chilean blend in practice.

2015 Restructuring Scorecard

	Argentina	Brazil	Mexico	Chile	Peru
Involuntary reorganization proceeding that can be initiated by creditors?	No	No	Yes	No	Yes
Secured creditors subject to automatic stay?	No	Yes, unless they hold instruments (e.g. fiduciary liens) exempt from stay	Yes, but can enforce on non-essential assets	Yes, but can enforce on non-essential assets	Yes
Other significant exclusions from automatic stay?	No	Yes (e.g., holders of "fiduciary liens" and "foreign exchange advances")	No	Yes (e.g., labor claimants)	No
Prevents voting by intercompany debt?	No	No	Yes, subject to "25 percent rule"	Yes	No
Can creditors propose a plan?	Yes, but only following expiration of exclusivity period	No	Yes	No	Yes
Absolute priority rule?	No	No	No	No	No
Grants superpriority status to DIP financing?	No	Yes	Yes	Yes	No
Strict time limits on completing procedure?	No	No, but maximum 180-day stay	Yes—365 days	Yes—90 days	No, but plan must be approved within 105 days of the creditors' meeting
Management remains in place during proceeding?	Yes	Yes, unless judge replaces them	Yes	Yes	Yes, unless creditors replace officers/directors
Management has ability to sell asset during proceeding?	Yes, subject to court approval	Yes, but only non-fixed assets without court approval	Yes, but essential assets are sold via court proceeding	Yes, up to 20 percent without creditor support	Yes, but only with creditor support
Viable prepackaged insolvency proceeding?	Yes, but with flaws	Yes, but challenging to implement	Yes	Time will tell	No