Protecting and Reorganizing Latin American Businesses with the Help of U.S. Courts

A Practical Overview for Latin American Lawyers and Executives

Agenda

Introduction

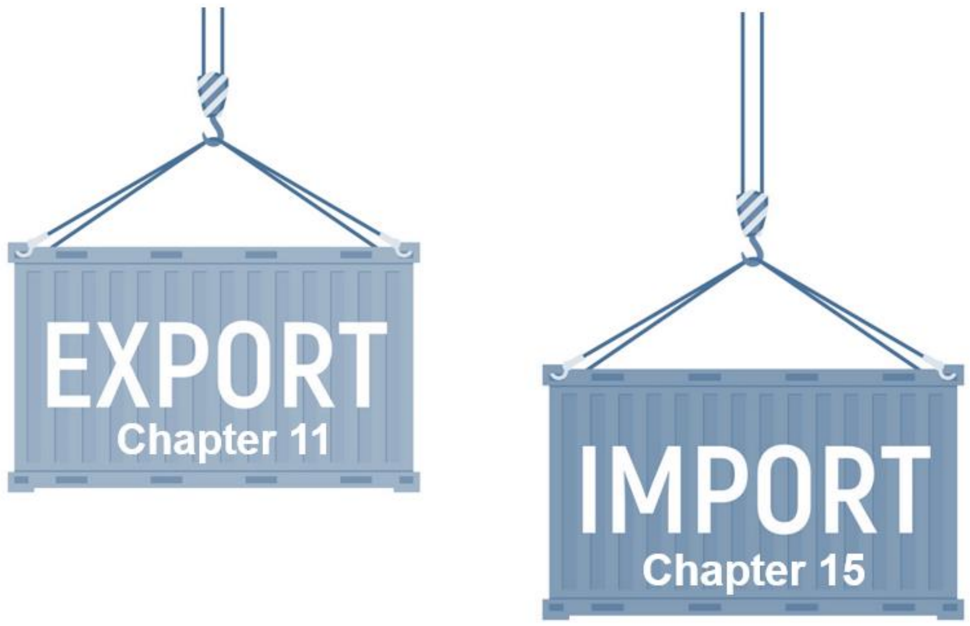
Chapter 15 (Import)

Chapter 11 (Export)

Lessons Learned

Cross-border insolvencies and the U.S. Bankruptcy Code

- The U.S. Bankruptcy Code offers powerful, pragmatic tools to prevent liquidations in cases of insolvency.
- The code is extraterritorial and can be used to implement restructurings of groups operating predominantly outside the United States.
- Chapter 11: Designed to preserve corporate value and assist businesses in reorganizing as going concerns.
- Chapter 15: Designed to harmonize cross-border restructurings by implementing the terms of a foreign restructuring in the United States.



Why are U.S. courts ready to help non-U.S. companies?

I WANT YOU,
TO RESTRUCTURE!

- It is in the interest of the U.S. to promote successful cross-border restructurings.
  - Many investors are U.S. persons.
  - Many non-U.S. business have direct or indirect U.S. suppliers, customers and partners.
- However, extraterrorialism is not about imposing U.S. law on non-U.S. companies.
  - Under both Chapter 11 and Chapter 15, U.S. courts are dedicated to the principal of comity: deference to non-U.S. law to determine the rights of stakeholders and the duties of directors.

So, can a Latin American group use Chapter 11 to protect and reorganize its business?

Yes. Chapter 11 is available to companies organized in, and predominantly operating in, Latin America.

- Eldenor
- Alsacia
- LATAM Airlines /
- Corp Group Banking
- Avianca
- Alpha Latam Management
- AeroMexico
- Maxcom Telecomunicaciones
- China Fishery Group Limited *

* Significant business presence

Agenda

Introduction

Chapter 15 (Import)

Chapter 11 (Export)

Lessons Leaned

Chapter 15: Overview

- In 2005, the United States added Chapter 15 to the Bankruptcy Code to adopt the UNCITRAL Model Law on Cross-Border Insolvency.
- The purpose of Chapter 15 is to provide an effective mechanism for dealing with cross-border insolvency cases where the 'center of main interest' of a debtor is outside of the United States *and* a plenary (or main) proceeding is initiated in that jurisdiction.
- Certain Latin American countries have also adopted the UNCITRAL Model Law and, as a result, have regimes analogous to Chapter 15:


Brazil


Chile


Colombia


Dominican Republic


Mexico

- Chapter 15 can be very useful to non-U.S. debtors because important creditors (hedge funds) and assets (bank accounts, contract rights) are often located in the U.S.

Latin American restructurings have shaped Chapter 15 law and practice

Argentina

- EDEA
- SuperCanal

Brazil

- Avianca (Oceanair)
- Constellation
- OAS
- Odebrecht
- Oi
- Rede Energia
- Samarco
- Usina Santa Terezinha

Chile

- Enjoy

Mexico

- Grupo Famsa
- Mexicana
- Oro Negro
- Vitro

Process Overview

1. Petition
2. Provisional Relief
3. Recognition
4. Discretionary Relief
5. Close

Foreign representative to provide notice of substantial developments in foreign proceeding

Provisional Relief

- The filing of a Chapter 15 petition does not result in immediate relief
- Foreign debtors typically request (and courts typically grant) provisional relief pending a hearing on recognition
- Common types of provisional relief:

Stay of action against the debtor’s U.S. assets (unlike in Ch. 11, there is no automatic stay)

Suspension of third party rights to transfer or encumber debtor property

Administration or realization of U.S. assets

Authorization to examine witnesses and conduct bankruptcy discovery

Recognition

- Courts very infrequently deny recognition to foreign insolvency proceedings.
- Foreign proceedings may be recognized either as main or non-main proceedings.

Main proceeding: jurisdiction where debtor has its center of main interest (COMI)

Non-main proceeding: jurisdiction where debtor has any establishment

- A key difference between a main and a non-main proceeding is that automatic relief follows the recognition of a main proceeding.
- In practice, very few foreign proceedings are recognized as "non-main proceedings," although this can be helpful if there is a dispute about where COMI is located.

Relief upon Recognition of a Main Proceeding

- Stay with respect to U.S. litigation and property within the United States
  - Contrast with Chapter 11 cases, where the automatic stay is global
  - Creditors frequently seek relief from the stay
- Authorization to operate business and use collateral, so long as secured creditors are adequately protected against diminution of value
- Potential authorization to sell U.S. property “free and clear” of liens
  - Section 363 review applies to sales of U.S. assets
  - Notice and hearing required prior to approval of sale
  - Can be coordinated with dispositions of non-U.S. property

Discretionary Relief

- Chapter 15 also provides courts with broad, flexible rules to fashion other relief to facilitate legitimate restructuring objectives
- Examples of discretionary relief include:
  - Granting full force and effect to reorganization plan within the U.S.
  - Third party releases (*see* In re Avanti, *but see also* In re Vitro)
  - Exemptions from U.S. securities laws
  - Authorization to sell U.S. assets “free and clear” of interests
  - Administration of U.S. property
  - Rule 2004 discovery
  - Turnover of U.S. assets

Typical Timeline: Uncontested Latin Am. Restructuring

Petition → **Provisional Relief** → **Recognition** → **Discretionary Relief** → **Close**

Petition

Jan. 15
Foreign Representative files petition for recognition and requests provisional relief

Provisional Relief

Jan. 15
Court grants provisional relief (*e.g.*, stays actions in the U.S. against the foreign debtor)

Recognition

Feb. 15
Court grants recognition of foreign main proceeding (automatic relief follows)

Discretionary Relief

Jul. 15
Debtor requests discretionary relief (*e.g.*, order granting full force and effect to non-U.S. plan)

Aug. 15
Court enters order granting the requested relief (*e.g.*, full force and effect order confirming plan)

Close

Sep. 15
Debtor files a final report and a motion seeking an order closing the Chapter 15 case

Oct. 15
Court enters order closing Chapter 15 case

Limitations of Chapter 15

- Chapter 15 does not provide debtors with access to the full set of tools that would be available in Chapter 11
  - No global, automatic stay
  - No avoidance powers under the U.S. bankruptcy code (state actions may be available)
  - Not possible to sell non-U.S. property free and clear of liens
  - No executory contract or other business optimization powers
  - No U.S. plan of reorganization powers (e.g., cross-class cramdown)
  - Limited access to U.S. DIP and exit financing markets
- One way large multinational groups address these concerns is to file combinations of Ch. 11 and Ch. 15 cases, together with local proceedings (e.g., Abengoa)

Chapter 15: Key Takeaways

- ✓ Considerable precedent: a “well-trodden path”
- ✓ Exceptions to recognition are rare
  - Creditors can generally be prevented from re-litigating issues decided in the home jurisdiction
  - Appeals are not frequent (~ 10% of cases)
- ✓ Chapter 15 has important limitations
  - Can help only within the U.S., not in other jurisdictions.
  - The liquidity, M&A and financing tools of chapter 11 are not available.
  - Viability depends on the viability of the judicial process in the jurisdiction where the debtor has COMI.

Agenda

- Introduction
- Chapter 15 (Import)
- **Chapter 11 (Export)**
- Lessons Leaned

In the United States there are two primary ways to implement a balance sheet restructuring

	Out of Court	Chapter 11
Changes to money terms	Under U.S. law, requires consent of each holder affected	$^{2}/_{3}$ in principal amount and $^{1}/_{2}$ in number of creditors voting can drag minority
Negative covenants that prohibit liens, debt and dispositions	Enforceable	Unenforceable
Currency for nonconsensual payment	Only cash	Anything of value, subject to Chapter 11 rules
Ability to issue new equity	Stockholder approval required	No stockholder approval required
Access to liquidity	Limited by covenants	Priming financing available under appropriate circumstances
Global stay	No	Yes
Ability to reject, assume or assign contracts	No	Yes
Broad discharge	No	Yes

Why should a Latin American corporate consider Chapter 11 as an option?

Chapter 11 can create an effective pathway for financial debt restructurings that would not otherwise occur on same terms, as quickly or at all.

Global Automatic Stay

Provides an opportunity to negotiate a debt restructuring with global creditors.

Implementation

Offers multiple (tested) tools to enhance liquidity and implement restructurings.

Why Ch. 11 can be a powerful option to LatAm corporates?

Insolvency proceedings governed by local laws may not be as effective or efficient as Ch. 11.

Relative to other regimes, there is significant legal certainty associated with Chapter 11 cases and a timetable that usually can be predicted and controlled.

International investors are very familiar with Chapter 11, which offers non-U.S. companies new opportunities for DIP loans, exit loans and reorganized equity investments.

Ch. 11 offers powerful tools to build liquidity and enhance the business, which may not be available domestically (see next slides).

Introduction

- It is relatively easy for foreign debtors to obtain Chapter 11 protection.
  - The primary jurisdictional requirement is that the company have some property in the United States (a bank account or a retainer with a U.S. law firm should suffice).
- U.S. court orders have global reach.
  - Violations are punishable as contempt of court.
  - Debtors may be able to recover punitive damages and attorney fees.
- However, U.S. court might not accept a Chapter 11 case where critical court orders cannot be enforced (*Yukos* case).

Home Country Lawyers Play a Critical Role in Chapter 11

- The viability of U.S. jurisdiction for foreign debtors rests on two principles of deference:

  1. **Deference to foreign law** with respect to non-bankruptcy matters (size and priority of claims, validity and priority of liens, corporate laws and fiduciary duties).

  2. **Respect for foreign creditors** and the pragmatic limits of a U.S. court's reach (*e.g.*, its common to allow payment of employees and local trade creditors outside the U.S. in the ordinary course upon debtor request).

- Home country lawyers also are key to address practical issues associated with the enforcement of U.S. court orders extraterritorially (*e.g.*, in connection with DIP financing).

- Sometimes Debtors may commence insolvency proceedings in the home country as well, simultaneously with or after filing for Chapter 11.

Types of Chapter 11 Cases

Prepackaged

Debtor and creditors agree to a plan prior to the bankruptcy filing. The plan is negotiated and voted on prior to filing.

- Higher operational and legal certainty; lower costs.
- Appropriate in the context of a balance sheet restructuring.
- Debtor can emerge very quickly (1-60 days).

Prenegotiated

Debtor negotiates with its largest creditors prior to filing a petition, but does not formally solicit creditor approval until after it has filed its case.

- Optimally, the debtor will file plan with the petition.
- Debtor then seeks court approval to solicit creditor approval for the plan.
- Debtor can emerge as early as 60-90 days after filing.

Conventional

Debtor does not have any prepetition agreement with its creditors with respect to its restructuring. The plan is negotiated during the case.

- Less operational and legal certainty; higher costs.
- A debtor will emerge as quickly as circumstances permit.
- Many cases are completed in 6 to 20 months.

Important Features of Chapter 11

Specialized courts. Judges have expertise and significant discretion.

No requirement of insolvency. Many debtors have had substantial equity value when they file.

Board and management remain in control (no receiver or administrator appointed).

Deal-friendly environment. Extraordinary transactions require court approval (after a notice and a hearing). Sale of substantially all the debtors do not necessarily require creditor approval.

Unsecured creditors are represented by a committee (in most cases). Other committees may be appointed.

Board has exclusive right to propose a reorganization plan during the first 120 days of the case (can be extended with court approval).

Key Stages of a Conventional Chapter 11

1	2	3
Stabilize	**Optimize**	**Exit**
Finance the case, establish the longest possible runway and marshal assets under the control of the company as trustee.	Operate the business, make prudent capital investment, dispose of non-strategic assets and assume, reject or renegotiate contracts.	Negotiate of a plan of reorganization with stakeholders, resolve any objections, discharge liabilities and raise exit capital.

- The three phases may be virtually simultaneous, or the optimization phase may last well over a year if the Debtor is well-funded and decides to wait.
- Typically, most activity, disputes and expense occur in phases 1 and 3.

1

Stabilization

Automatic Stay: Global stay arises automatically upon the filing. It prevents creditor enforcement, contract termination and other actions to assert control over debtor property.

- With the benefit of the automatic stay and the invalidity of ipso facto clauses, the debtor is able to continue to maintain normal business operations.
- Failure to abide by the stay could result in the imposition of significant sanctions by the bankruptcy court on the interfering party, including costs, damages and punitive damages.

DIP Financing: Filing Chapter 11 generally improves a distressed company's liquidity and access to credit. Subject to the satisfaction of certain statutory tests, a debtor can borrow money senior to all prepetition creditors, even if they are secured.

- The U.S. has a robust market for DIP financing, with commercial banks and institutional investors both actively participating.
- If the debtor has adequate collateral value, DIP terms can be substantially better than terms available before filing.

2 Optimization

Executory Contracts: Executory contracts (where material performance is due from both parties) can be assumed or rejected, or the debtor may renegotiate favorable amendments.

- Contracts often can be assumed and assigned to a buyer, even in violation of anti-assignment provisions.
- Rejection is akin to a court authorized breach, and it allows the debtor to cease performing under the contract. If the contract is rejected, the damages for breach of contract are treated as prepetition unsecured claims.

Asset Sales: Extraordinary asset dispositions can occur with Court approval after notice and a hearing, even if prohibited by prepetition credit agreements.

- Sales may involve substantially all the debtors’ assets as a going concern.
- Buyers will take assets “free and clear” and be fully protected from constructive fraudulent transfer and most other legal risks.
- Prices in a competitive Chapter 11 sale often exceed prices for a similar sale out of court because of the elimination of risks for the buyer.

3 Exit

Discharge and Channeling Injunction: At the end of a typical reorganization, debts are discharged and the board and management are exculpated from liabilities relating to the restructuring.

- Under special circumstances, plans of reorganization may include releases of non-debtors from claims and causes of action held by creditors and other stakeholders.
- Courts may grant injunctions channeling claims against the debtor and specified third parties to a trust funded for the benefit of claimants. Claimants are enjoined from asserting their claims against the parties protected by the injunction and must seek recovery from the trust.

Exit Financing: Most often, part of the reorganization involves the payment of certain claims in cash from the proceeds of new financing.

- New money financing may be provided by third parties, existing creditors or any combination.
- Existing equity can invest on fair terms subject to a market test.
- Chapter 11 provides an exemption from certain U.S. securities laws where securities are issued to prepetition stakeholders principally on account of their claims or interests.

Common Challenges for a Latin American Chapter 11 Debtor

Chapter 11 has limited power to impair claims of employees, trade creditors, governmental actors or other home country creditors without concurrent local insolvency proceedings.

Chapter 11 cannot override some local laws, such as stockholder approval requirements. Home country corporate processes must sometimes run in parallel.

Unfamiliarity with chapter 11 among local creditors, authorities, employees and even directors. Suspicions about loss of control or sovereignty.

Chapter 11 can be expensive, especially if a prepackaged case is not achieved.

Relative to most jurisdictions, chapter 11 means a higher level of transparency and scrutiny.

Chapter 11: Key Takeaways

Fully available to debtors with limited U.S. contacts, regardless of COMI

Deferential to non-U.S. law, director duties and creditors

Recognition outside of the U.S. may not be necessary for many cases (e.g., *Garrett Motion*)

- Global stay and confirmation orders, enforceable against those subject to U.S. jurisdiction or with assets reachable by U.S. court process
- Can be combined with other proceedings, whether at start or during the chapter 11 case

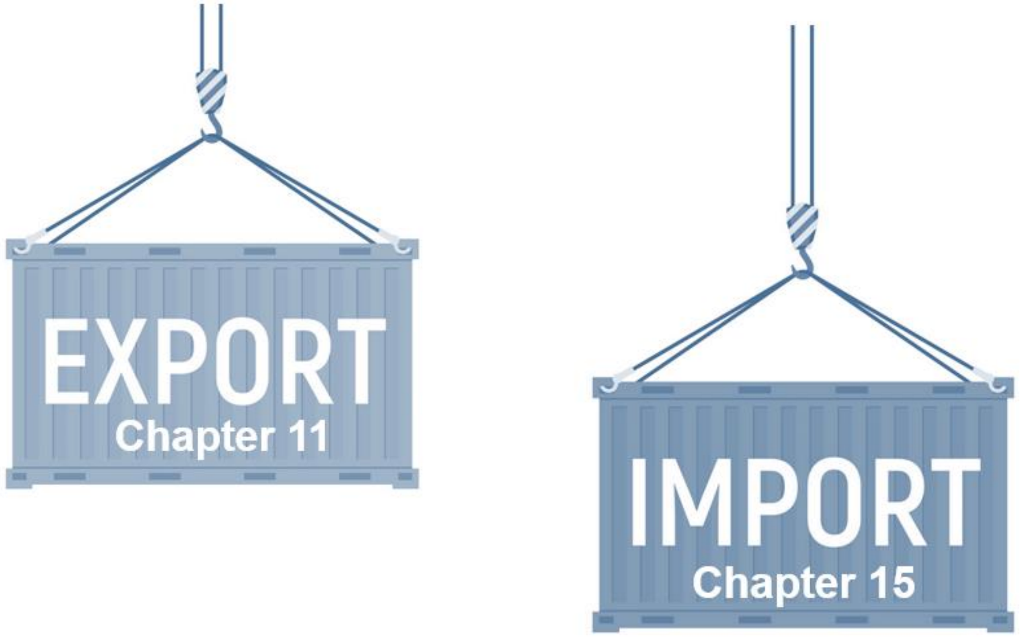
A balanced approach – not overly favorable to debtors or creditors

Agenda

- Introduction
- Chapter 15 (Import)
- Chapter 11 (Export)
- **Lessons Leaned**

What is the best option?

Well, that depends… Latin American debtors should consult with chapter 11 debtor's counsel and actively consider **both** options based on the facts of the case.



Making the right decision takes advance planning

There are **multiple** legal and commercial **alternatives** to consider but no cookie cutter solutions

Strategies are **fact dependent**. Optimal strategies involve a **combination** of **local** and **U.S. law**

Focus on **liquidity is paramount**. Early planning and action typically makes the difference

Some practical suggestions for team building

Good results start with good **process** and a good **team**

Multidisciplinary and holistic strategies make a difference

An effective **litigation** strategy and plan is often critical

Effective **coordination** between U.S. and local counsel is paramount