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Treatment of Bond Debt and Intercompany Claims Under Mexican Bankruptcy Law

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The authors discuss a variety of issues regarding publicly traded bond debt and intercompany claims that have been addressed recently by the Mexican judiciary.

With the enactment of the Ley de Concursos Mercantiles (the “LCM”) in 2000, Mexico took a dramatic step toward modernizing its bankruptcy and insolvency laws. Several years later, in 2007, Mexico took additional steps by enacting a number of reforms aimed to create or clarify the legal framework regarding various important topics that were novel in Mexico, including implementation of a process to obtain approval of pre-negotiated plans.

Despite these steps and the obvious advancements made, certain issues regarding publicly traded bond debt and intercompany claims which are not expressly regulated in the LCM, have recently come up in some well-known bankruptcy cases. As discussed in this article, these issues have been addressed by the Mexican judiciary with mixed results. Considering that legislative amendments to the LCM are not expected in the near future, federal judges responsible for applying the bankruptcy laws in Mexico are posed with the challenge of establishing a clear line of prec-

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edents to address the shortcomings in the law and, in doing so, providing the financial and business community with a higher level of certainty.

PUBLICLY TRADED BOND DEBT IN MEXICAN BANKRUPTCY CASES

A debtor that issues publicly traded bond debt typically is not aware of the identity of its beneficial holders, especially where the bond debt is held by investment funds. Given that the identity of the creditors may not be clear, a Mexican court may be presented with issues related to a creditor's standing:

- to participate in a Mexican bankruptcy case,
- to file a proof of claim,
- to negotiate and agree to the terms of a restructuring plan, or
- to challenge the rulings of the Mexican court.

At its heart, the issue is probably not the actual identity of the creditors, but rather who may assert the rights of creditors. Should it be the fund that purchased the bond with private investments, the beneficial holders, or the trustee?

In the bankruptcy case of *Metrofinanciera*, a Mexican home-finance company, the Mexican court allowed indenture trustees to file proofs of claim on behalf of bondholders for the face value of the issuances and precluded individual creditors from filing separate claims on account of their bonds. In the bankruptcy case of *Iusacell*, a Mexican mobile phone operator, the Mexican court allowed individual beneficial holders of bonds to file their own separate proofs of claim. By virtue of having filed their own proofs of claim, the bondholders had the requisite standing to object to the terms of a restructuring plan under Mexican law. Ultimately, the individual bondholders successfully persuaded the Mexican court not to approve the proposed restructuring plan notwithstanding that the indenture trustee had agreed to its terms.

The different outcomes in *Metrofinanciera* and *Iusacell* highlight a

significant flaw in the current framework — it is not clear as to who has the requisite authority or standing under Mexican law to assert the rights of bondholders. Indeed, this lack of clarity exists out of court as well. In the out of court restructuring of *Su Casita*, a real estate developer, the indenture trustee was not involved in the negotiations. In that instance, the debtor negotiated the terms of the restructuring with a common representative of the bondholders, who acted in accordance with the instructions of the majority of the bondholders.

Although this lack of consistency has been criticized by the Mexican legal community, there is no consensus on a solution. Some commentators have proposed amending Mexican law. Others, however, believe that this issue is better left for the Mexican courts to decide. In any event, the time has come for either the Mexican legislature or judiciary to implement a set of criteria based on the experience acquired by the *Instituto Federal de Especialistas en Concursos Mercantiles* (“IFECOM”) in Mexican bankruptcy cases and resolve the divergent outcome in cases, such as *Iusacell* and *Metrofinanciera*.

TREATMENT OF INTERCOMPANY CLAIMS IN MEXICAN REORGANIZATION PROCEEDINGS

There has been a great deal of debate in Mexico about the treatment of intercompany claims in reorganization proceedings, particularly because the LCM is silent on the topic. Not surprisingly, some have argued that intercompany claims should not be considered for purposes of determining eligibility to file a request for relief or for calculating the votes on a restructuring plan. Others, however, have argued that intercompany claims should not be treated differently than other claims. A similar debate has arisen in addressing debt held by a “friend” of the debtor (or a third party subject to de facto control by the debtor).

In the bankruptcy case of *Corporación Durango*, a large Mexican paper producer, the debtor proposed a plan that was approved by affiliates holding substantial intercompany claims and a minority of unsecured creditors. Absent the votes supporting the plan by the holders of intercompany claims, the restructuring plan would not have been approved. Ultimately, however,

the Mexican court concluded that intercompany claims could be counted, like other claims, in determining the outcome of the vote on a restructuring plan. Thus, the debtor was able to implement a restructuring plan that was not supported by the vast majority of non-affiliate unsecured creditors.

In the bankruptcy case of *Vitro*, a leading Mexican glass producer, the Mexican court initially rejected the debtor's voluntary petition for relief on the basis that most of its debt was intercompany debt and could not be taken into account for purposes of determining eligibility for an order for relief. On appeal, this decision was reversed and the debtor has been permitted to go forward with its voluntary petition. As of yet, however, an order for relief has not been entered. Moreover, this decision may be subject to further challenge, including on constitutional principles.

Intercompany claims have generally been treated like other claims under Mexican law and have been considered in determining a debtor's eligibility and the outcome of the vote on a restructuring plan. Nevertheless, an intercompany claim may be subject to attack under other theories under Mexican law, such as a fraudulent transfer.