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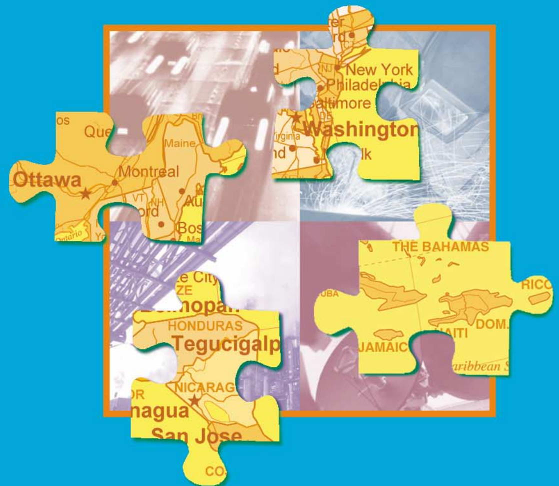

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As Latin American cross-border insolvencies increase, so do the questions of law

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In recent years, there has been a significant growth in the number of cross-border insolvencies involving Latin American-based companies with operations – or creditors – in the United States. For example, Chivor SA ESP, one of the largest hydroelectric power generators in the Republic of Colombia, sought help from the US bankruptcy court system to restructure its indebtedness with various lending institutions, including a number of US banks. North American companies with operations in Latin America, such as DirecTV Latin America LLC and MCI, owner of a majority interest in Brazil's Embratel, have also been involved in these types of cross-border financial restructurings.

If the debt of these companies cannot be restructured out of court, one of the key legal issues that has to be resolved at the very beginning of such a process, both by the debtor and, independently, by its creditors, is which jurisdiction and whose laws will control the restructuring.

In some instances, Latin American companies may file for relief under Chapter 11 of the United States Bankruptcy Code. In other cases, they may begin a primary proceeding under the laws of a Latin American country and may commence an ancillary proceeding in the US under Bankruptcy Code section 304. That section authorises US bankruptcy courts to assist in the administration of insolvency, bankruptcy, or debt restructuring proceedings pending in foreign courts. A third model would not involve any proceeding within the jurisdiction of US courts.

Complex legal questions can arise in each of these cross-border insolvency scenarios. Two of the most significant are the ability of a foreign company to obtain the protections of a US bankruptcy court and the extent to which foreign bankruptcy proceedings are entitled to deference under US law. Although the answers to many of the questions that arise in cross-border insolvencies are not yet completely resolved, debtors and creditors will find important guidance in decisions that have been rendered to date by US courts.

Latin American debtors in US bankruptcy courts

Chapter 11 of the US Bankruptcy Code provides for the reorganisation of troubled companies. Under Chapter 11, a debtor is authorised to reorganise its business for its own benefit and that of its creditors and shareholders. In addition to permitting the rehabilitation of a debtor, Chapter 11 promotes equality of treatment of creditors and equity security holders who hold

substantially similar claims against, or equity interests in, the debtor and its assets. In furtherance of these two goals, upon the filing of a petition for relief under Chapter 11, section 362 of the Bankruptcy Code provides for an automatic stay that bars most formal and informal actions for the collection of claims or enforcement of liens against the debtor or the property of the bankruptcy estate. The stay applies to all property in which the debtor has an interest regardless of possession or title. Generally speaking, the stay is intended to preserve the status quo.

The principal objective of a Chapter 11 case is to draw up a plan of reorganisation which sets out the means for satisfying claims against, and equity interests in, a debtor. Confirmation of a plan of reorganisation by the bankruptcy court makes the plan binding upon the debtor, any issuer of securities under the plan, any person or entity acquiring property under the plan, and any creditor of the debtor or equity security holder of the debtor's property, whether or not such creditor or equity security holder is impaired under, or has accepted, the plan, or receives or retains property under the plan.

When a Latin American corporation files for Chapter 11, the bankruptcy court must first consider whether it may hear the case or whether the debtor should be required to enter a bankruptcy proceeding in the country in which it is incorporated or its business is centred. The analysis of this issue begins with Bankruptcy Code section 109(a), which permits a Chapter 11 filing in a US bankruptcy court by a person (defined in section 101(41), which includes a corporation "that resides or has a domicile, a place of business, or property in the United States." Courts have concluded that companies with even a minimal amount of property located in the US meet the section 109(a) requirement. In *In re Global Ocean Carriers Ltd* (2000), a court decided that a few thousand dollars in a bank account and the unearned portions of retainers provided to local counsel was a sufficient amount of property so that a foreign shipping company and more than a dozen of its subsidiaries could reorganise in a Delaware bankruptcy court.

Even when a Latin American company has property in the United States, a US bankruptcy court still may dismiss the case or suspend all proceedings, under Bankruptcy Code section 305(a)(1), if it finds that the interests of both the debtor and its creditors would be better served by such dismissal. Dismissal under this section is recognised as "extraordinary relief".

Additionally, section 305(a)(2) of the Bankruptcy Code permits US bankruptcy courts to dismiss a case or suspend proceedings if a foreign proceeding is pending and the factors set out in Bankruptcy Code section 304(c) warrant such action. Several courts have relied on section 305(a)(2) to dismiss filings or suspend further proceedings in cases brought in the United States by foreign debtors. For example, *In re Xacur* (1998) involved an involuntary bankruptcy proceeding brought by three Mexican banks that held notes issued in Mexico against a Mexican citizen who owned property in the United States. The court found that:

- it did not have jurisdiction over the Mexican debtor generally, as opposed to jurisdiction over his minimal property in the US;
- a case had been brought in Mexico by these same creditors;
- it would be unfair to the debtor to open separate proceedings in the United States;
- separate proceedings would provide ineffective relief to the petitioning creditors; and
- the Mexican courts would not necessarily recognise the United States proceedings.

Therefore, the court dismissed the proceeding.

Recently, however, in *In re Aerovias Nacionales de Colombia SA Avianca* (2003), the US Bankruptcy Court for the Southern District of New York rejected contentions that a Chapter 11 petition filed by the leading airline of the Republic of Colombia should be dismissed. The court's analysis on the issue of whether a foreign debtor should be permitted to reorganise in a US bankruptcy court

may be persuasive to other courts that face this issue in the future.

The Chapter 11 filing

Aerovias Nacionales de Colombia SA Avianca ("Avianca") is a publicly-traded corporation organised under the laws of Colombia. It provides passenger and cargo service internationally and within Colombia. Avianca's administrative offices are located in Bogotá, Colombia and it also has offices in the United States. When Avianca entered into bankruptcy in New York, it had flights from two hubs located in Colombia to a number of locations in Colombia and in other countries (primarily in Central and Latin America), as well as to Miami and New York. Avianca had a fleet of 31 aircraft and more than a dozen spare engines that it leased from lessors located or doing business in the United States. It employed about 4,000 people in Colombia and about 200 outside of Colombia, including 28 in the United States. More than 50 per cent of Avianca's revenues came from the Colombian market and approximately one-quarter of its international air service was between Colombia and the United States.

According to its bankruptcy court filings, Avianca owed to its aircraft lessors (located primarily in the US) approximately US$290m. Avianca acknowledged that it owed US$27.7m to noteholders under a master trust agreement with the Bank of New York and that these notes were secured by Avianca's credit card receivables. Additionally, Avianca conceded that it owed US$15m to creditors in the United States, US$115m to creditors in Colombia, and US$12m to creditors outside of both Colombia and the United States.

The motion to dismiss

Certain creditors of Avianca asked the bankruptcy court to dismiss the Chapter 11 case under Bankruptcy Code section 305(a) and to require Avianca to seek protection in Colombia under Colombia's reorganisation law, Law 550 of 1999. These creditors argued that Avianca had engaged in improper forum shopping and that they had been prejudiced by its bankruptcy filing in New York.

The bankruptcy court first examined whether it should dismiss the petition under section 305(a)(1). It decided that Avianca would not be "better served" by dismissal and, presumably, the filing of a proceeding under Law 550. First, the court stated, the creditors did not show that Avianca could have obtained jurisdiction over its lessors and other major financial creditors in Colombia. The court also pointed out that, unlike the US Bankruptcy Code, Law 550 has no provision that permits a debtor to reject a burdensome lease, a power which Avianca used to reject a number of unfavourable aircraft leases.

The court next found that the "great bulk" of Avianca's creditors had been well served by the US bankruptcy proceedings. It noted that Avianca had been able to maintain its routes and continue its business and that it had entered into agreements – approved by the bankruptcy court after the creditors' committee's participation – with major suppliers, taxing authorities, employee representatives, and other entities in Colombia and the United States.

With respect to dismissal under section 305(a)(2), the court pointed out that there was no foreign proceeding pending and decided that it would be "unwarranted" to impose an obligation on Avianca to file a proceeding in its "home" court or to assume that if such a proceeding were filed it would justify suspension or dismissal of the US case. In the court's view, nothing in the Bankruptcy Code suggested that a foreign entity could not commence a full bankruptcy proceeding in a US bankruptcy court or that a Section 304 ancillary case was a preferred alternative for a foreign enterprise.

The court concluded its analysis by declaring that there were a number of factors that supported maintaining Avianca's case in the United States. These included the level of contacts between Avianca and the United States, the court's ability to exercise jurisdiction over non-consenting creditors, the fact that application of US bankruptcy principles would not cause unfair prejudice to

individual creditors, and the absence of complaints by Colombian creditors that they would be unfairly treated by the application of US bankruptcy law.

Traditionally, the presence of property in a jurisdiction has been the predicate for a bankruptcy filing. As the *Avianca* case suggested, today, so long as the standards of section 109 are met, courts may look to other factors – such as the presence of creditors in the jurisdiction, the power of the court to exert judicial power over them, and the willingness of other creditors to submit to the court's jurisdiction – so that a US bankruptcy court may exercise jurisdiction over a Latin American debtor notwithstanding that the majority of its assets or business is in Latin America. Although some may argue that it is "unseemly" for United States courts to take sole jurisdiction over the reorganisation of a business with its centre of main activities abroad, US courts may choose, when considering the various factors enunciated by the *Avianca* court, to exercise their power to the full extent of their jurisdiction in appropriate cases.

Section 304

Under section 304 of the Bankruptcy Code, a "foreign representative" appointed in a "foreign proceeding" may petition a US bankruptcy court for more limited relief than the commencement of a full bankruptcy case, such as an order restraining creditors from interfering with property in the United States involved in the foreign proceeding or an order to remit property of the foreign estate to the foreign court for administration there. In essence, section 304 permits a US bankruptcy court to enter orders that would assist in the economical and expeditious administration of the foreign debtor's estate.

There are a number of factors that a foreign representative must satisfy before commencing a Section 304 proceeding, but a key prerequisite is the existence of a foreign proceeding. 11 USC § 101(23) of the Bankruptcy Code defines a "foreign proceeding" as a "proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganisation." Courts have broadly interpreted this definition of foreign proceeding to mean "a foreign judicial or administrative process whose end it is to liquidate the foreign estate, adjust its debt or effectuate its reorganisation."

When a US court is asked to determine whether this definition is met in a particular case, it will examine the amount of judicial involvement and supervision or, conversely, the degree of access to the foreign court which is available at various stages to creditors so that they may voice any objections they may have. Accordingly, if the law of the foreign jurisdiction does not provide any court supervision or any access to the courts by creditors, it is highly unlikely that the restructuring would constitute a foreign proceeding as defined by the Bankruptcy Code. By contrast, if creditors have a right to request court intervention or if a foreign court is supervising the restructuring, it is likely that the restructuring would constitute a foreign proceeding.

US courts have granted relief under section 304 in connection with proceedings pending in a number of Latin American countries, including the liquidation of banks in Ecuador and Peru, the reorganisation of companies under Mexican and Argentine laws, and the bankruptcy of a Nicaraguan company. In *In re Board of Directors of Compania General de Combustibles SA* (2001), the US Bankruptcy Court for the Southern District of New York noted the similarity between a "*concurso preventivo*" under Argentine law and Chapter 11 reorganisations, and it thus continued a preliminary injunction issued in connection with the debtor's reorganisation.

The APE case

An issue that has not yet been definitively resolved, and that reflects the development of international bankruptcy law as well as the growth in cross-

border insolvencies, is whether section 304 can be applied where the debtor seeks to restructure its debt through an "*acuerdo preventivo extrajudicial*", or "APE", under a recently-enacted Argentine insolvency law. An APE has some similarity to a pre-packaged Chapter 11 US bankruptcy case (a "pre-pack"). In a pre-pack, the reorganisation plan is prepared and voted on prior to the actual commencement of a bankruptcy case. Where successful, the formal bankruptcy case proceeds rapidly and may be concluded within 45 to 60 days.

Recognition of an APE was at the heart of a dispute, involving Multicanal SA, an Argentine cable company that commenced a Section 304 proceeding in a New York bankruptcy court earlier this year, and was in connection with its APE proceedings pending in an Argentine court in Buenos Aires.

The Argentinian Recovery Company LLC and its related entities ("ARC") argued that the APE proceeding did not qualify for recognition under section 304 and thus could not affect the rights of US bondholders holding US$500m of notes issued by Multicanal. ARC asserted that an APE is a streamlined procedure under Argentine law that is consensual in nature and that does not contain the procedures and creditor protections of a formal bankruptcy process. It further contended that an APE is nothing like a US pre-pack and, indeed, is significantly different from a *concurso preventivo*. ARC argued that the role of the Argentine court is strictly limited to reviewing the APE for misstatements by the company of its assets or liabilities or for a failure to obtain a sufficient majority of votes in favour of the APE.

Needless to say, Multicanal objected to that characterisation. According to Multicanal, court supervision of APE proceedings is conducted under Argentine insolvency law to ensure just treatment of all the debtor's creditors. In particular, Multicanal asserted, to affect non-consenting creditors, the debtor must obtain the support of two-thirds of the holders of unsecured debt affected by the APE and more than half in number of the claims affected by the APE; affected creditors may object before the Argentine court to the debtor's statement of assets and liabilities and to other documents filed by the debtor; and affected creditors may file objections with the Argentine court as to whether or not the debtor obtained the required votes and whether the APE is abusive or fraudulent. Moreover, affected creditors have the right to appeal decisions of the Argentine court presiding over a debtor's APE and even have six months to seek to unwind a confirmed APE for fraud or because affected creditors received preferential distributions.

The courts in the United States have not finally settled the questions raised in the Multicanal case about APE proceedings. Even if that were to occur, changes to Latin American insolvency laws are likely to continue to require that similar questions be considered in future Section 304 proceedings.

Conclusion

Whether a troubled Latin American company or a US entity with Latin American operations will decide to file a Chapter 11 in the US, or will proceed with a restructuring under Latin America law – with or without a supportive Section 304 filing in the US – requires a detailed analysis of a broad range of tactical factors. The analysis must go well beyond whether the debtor may file a Chapter 11 petition in the US or whether an action in a Latin America country is a "foreign proceeding" sufficient to permit a US court to exercise jurisdiction over a Section 304 petition. Indeed, debtors must consider everything from the location of their financial creditors to their ability (and desire) to pay their trade creditors. For their own part, creditors also must examine a variety of issues to determine whether to accede to a US filing of a Chapter 11 petition or a Section 304 proceeding, or even whether to bring the debtor before a US bankruptcy court involuntarily. By their very nature, cross-border insolvencies are more complex than traditional corporate reorganisations of purely domestic entities. As the world's economies become more interconnected, the legal issues these transactions raise are likely to become even more difficult to resolve.

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Howard Seife chairs Chadbourne's global bankruptcy and financial restructuring practice. He has extensive experience in cross-border insolvency issues and was selected as counsel to the unsecured creditors' committee in the Parmalat USA Corp chapter 11 cases. He also represented the creditors' committee in Maxwell Newspapers, Inc, the bank group in the Lernout & Hauspie/Dictaphone cases, and some of the largest creditor banks and insurance companies in Enron Corporation's Chapter 11. A leader in innovative uses of section 304 of the US Bankruptcy Code, Mr Seife represented Sabena Airlines and Jazztel in their ancillary bankruptcy proceedings, the Australian and Bermudian liquidators in the insurance insolvency of New Cap Re, and the provisional liquidators for Independent Insurance Co. He regularly comments on bankruptcy issues on US television and in *The New York Times* and *The Wall Street Journal*, and is co-editor of *Cross-Frontier Insolvency of Insurance Companies* (Sweet & Maxwell). In 2003, he advised the Australian Government on a white paper on *Rehabilitating Large and Complex Enterprises in Financial Difficulties*. Mr Seife currently serves as Chairman of INSOL International's Technical Research Committee. He received his JD from Georgetown University Law School and his LLM from the London School of Economics.

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