

# CORPORATE DEBT RESTRUCTURINGS IN MEXICO: FOR FOREIGN CREDITORS, INSOLVENCY LAW IS ONLY HALF THE STORY

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Although Eduardo Martinez gave a thorough and insightful presentation on Mexican insolvency law at today's symposium, it is important to recognize that a proper understanding of a country's insolvency procedures can often be attained only by looking beyond the law to the informal methods and customs which have developed in that country for dealing with debtors in crisis. This is particularly true in Mexico today, as the worst recession in that nation's history has left many Mexican corporations on the brink of financial ruin. Because Mexico's legal system is often inadequate and ineffective at handling complex bankruptcy cases, many debtor crises are handled through out-of-court restructurings. Although out-of-court "workouts" such as these are common in many countries, including the United States, in Mexico this restructuring process is dominated by large and powerful Mexican bank lenders. These banks are often able to exploit the workout process to negotiate favorable terms for themselves, leaving the growing number of foreign investors with little or no recovery.

Mexico's devaluation of the peso on December 19, 1994, and the recession that followed led to significant business problems for many Mexican companies. Indeed, a number of Mexican corporations with substantial amounts of debt denominated in foreign currencies are now facing significant liquidity and leverage problems due to the fall in the peso's value.<sup>1</sup> Because many of these firms currently are, or will soon

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1. Duncan N. Darrow et al., *Symposium—The New Latin American Debt*

become, unable to make the interest payments due under the terms of their debt obligations, Mexico may be headed for a private sector debt crisis similar to the one it experienced during the 1980's.<sup>2</sup>

In Mexico, commercial insolvency is governed by federal law—the Law of Bankruptcy and Suspension of Payments (*Ley de Quiebras y de Suspensión de Pagos*, or “LQSP”)—which provides for two types of proceedings: Liquidation Bankruptcy (*Quiebra*) and Suspension of Payments (*Suspensión de Pagos*).<sup>3</sup> Liquidation Bankruptcy, which is similar to a Chapter 7 liquidation under United States bankruptcy law, contemplates a total liquidation of the debtor's business.<sup>4</sup> Suspension of Payments, like a Chapter 11 proceeding in the United States, is designed to allow the debtor to restructure its liabilities so that it may continue as an operating business.<sup>5</sup> Unlike a Chapter 11 proceeding, however, a Suspension of Payments proceeding merely creates a period of time during which the debtor is excused from paying its obligations and interest accrual on most debts is temporarily halted.<sup>6</sup> The debtor is not required to restructure its business operations as would be typical under Chapter 11.<sup>7</sup>

The LQSP is primarily a debtor-oriented statute which remains essentially unchanged since its passage in 1943.<sup>8</sup> In addition, the law's ambiguities and uncertainties have often led to inconsistent application by the courts.<sup>9</sup> For this reason, both debtors and creditors generally prefer an out-of-court restructuring to formal Liquidation Bankruptcy or Suspension

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*Regime—Restructuring Strategies for Mexican Eurobond Debt*, 16 NW. J. INT'L L. & BUS. 117, 119 (1995). The Mexican corporate sector owed approximately \$46 billion in non-peso denominated debt in late 1995. *Id.* at 120-21.

2. Anne Schwimmer, *U.S. Investors Gear Up for High-Profile Mexican Workouts; Vultures May Hop In, But Investment Banks Want Out*, INVESTMENT DEALERS' DIG., Mar. 11, 1996, at 10.

3. John A. Barrett Jr., *Mexican Insolvency Law*, 7 PACE INT'L L. REV. 431, 435 (1995); John E. Rogers & Adrian Z. Arriola, *Mexico, Banking Yearbook 1995*, INT'L FIN. L. REV. 161, 161-162 (Supp. Oct. 1995).

4. Darrow, *supra* note 1, at 125.

5. Barrett, *supra* note 3, at 453-54.

6. Thomas S. Heather, *Mexico's Bankruptcy and Suspension of Payments Law in DEALING WITH FOREIGN WORKOUTS AND INSOLVENCIES 1993: PRACTICAL STRATEGIES FOR LENDERS AND INVESTORS 135* (PLI Commercial Law and Practice Course Handbook Series No. 671, 1993).

7. Barrett, *supra* note 3, at 454. For this reason, perhaps, Suspension of Payments proceedings are not generally successful. It is believed that since 1975, only 30 companies have effectively restructured under the Suspension of Payments procedure. *Id.*

8. *Id.* at 436; Rogers & Arriola, *supra* note 3, at 161.

9. Barrett, *supra* note 3, at 436.

of Payments procedures.<sup>10</sup> During the debt crisis of the 1980's, for example, when nearly \$14 billion (US) of Mexican corporate debt was restructured,<sup>11</sup> nearly all corporate debt restructurings were accomplished out of court.<sup>12</sup> At that time, almost all the foreign debt of Mexican corporations was held by a relatively small number of large international banks.<sup>13</sup> During the restructuring negotiations, these international banks, through advisory committees consisting of both Mexican and US counsel, often acted in concert to secure favorable terms for themselves.<sup>14</sup>

Current restructurings, however, are radically different because a larger amount of debt is held as Eurobonds by foreign investors.<sup>15</sup> In fact, holders of internationally placed debt securities have now replaced international commercial banks as the principal foreign creditors of Mexican corporations.<sup>16</sup> Much of the outstanding Eurobond debt will mature during the next three years: from 1996 through 1998, forty-five issues are due to mature, totaling nearly \$6 billion (US).<sup>17</sup> Given the remote possibility of refinancing these bonds as they mature, massive restructurings are predictable.<sup>18</sup> In fact, investment bankers estimate that approximately twelve Mexican companies, holding nearly \$3 billion (US) in foreign bonds outstanding, will begin to restructure their outstanding debt by the end of this year.<sup>19</sup>

Unlike the large bank creditors of the 1980's, the foreign Eurobondholders are a diverse and geographically dispersed group that includes off-shore retail investors, insurance companies, pension funds,

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10. See generally Craig Torres, *Out of the Loop: Mexican Restructuring of Firms' Debt Often Hurts Foreign Holders*, WALL ST. J., May 13, 1996, at A1; Rogers & Arriola, *supra* note 3, at 163.

11. Darrow, *supra* note 1, at 121.

12. Rogers & Arriola *supra* note 3, at 162.

13. Torres, *supra* note 10; Darrow, *supra* note 1, at 121.

14. *Id.*

15. Rogers & Arriola, *supra* note 3, at 161. In early 1995, \$20 billion (U.S.) in Mexican Eurobonds was outstanding, of which approximately \$13 billion (U.S.) had been issued by the Mexican private sector. Darrow, *supra* note 1, at 119 & n.2.

16. Rogers & Arriola, *supra* note 3, at 161.

17. Darrow, *supra* note 1, at 120. According to the Weston Group, which recently published a report regarding pending Mexican corporate restructurings, twelve Mexican corporate Eurobonds, totaling \$1.2 billion (U.S.), are due to mature in 1996. Henry Tricks, *Wave of Restructurings Seen for Mexican Eurobonds*, THE REUTER EUR. BUS. REP., January 30, 1996, available in LEXIS, Nexis Library, News/Curnws File.

18. Tricks, *supra* note 17.

19. Torres, *supra* note 10.

mutual funds and financial institutions in the U.S. and abroad. These parties lack the bargaining power of their Mexican bank predecessors.<sup>20</sup>

As previously noted, the inefficiency and unpredictability of a formal bankruptcy proceeding in Mexico forces most debtors to negotiate an out-of-court restructuring. Such out-of-court restructurings are common in many countries, including the United States. However, out-of-court restructurings in the United States follow a relatively orderly procedure in which all creditor interests are represented.<sup>21</sup> The workout process in Mexico, by contrast, is uniquely ad hoc and dominated by Mexican bank lenders whose relationships with the borrower are often laden with conflicts of interest.<sup>22</sup> This lack of a sophisticated legal framework governing out-of-court restructurings allows some creditors, specifically the powerful Mexican banks, to gain an advantage not shared by the foreign bondholders.<sup>23</sup>

A good example is the recently announced restructuring by Grupo Sidek, S.A. de C.V. ("Grupo Sidek"). On April 2, 1996, Grupo Sidek announced the details of a restructuring plan reached with the seventeen member Mexican bank group which controls approximately seventy percent of the company's outstanding debt.<sup>24</sup> As has become typical in Mexico, the agreement was negotiated by a steering committee for the Mexican bank group, while the foreign debtholders, who own approximately \$570 million (U.S.) of Grupo Sidek bonds, were not represented in the negotiations.<sup>25</sup>

The situation is exacerbated by the potential conflicts of interest that arise because of the close relationship between Grupo Sidek and many of these banks. Grupo Sidek's Chief Executive, for instance, is a board member of Grupo Financiero Banamex-Accival ("Banacci"), the bank that led the restructuring negotiations.<sup>26</sup> Banacci also holds an equity stake in a Grupo Sidek tourism subsidiary and two Banacci co-chairmen have

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20. Darrow, *supra* note 1, at 119.

21. Torres, *supra* note 10.

22. *Id.*

23. *Id.* "An out-of-court restructuring in the U.S. usually incorporates the concerns of all creditors. The lack of a specific legal framework for out-of-court restructures in Mexico sometimes results in some creditors being treated more advantageously than others." *Id.* (quoting Agustin Berdeja, Managing Partner of Berdeja & Asociados, a Mexican law firm).

24. *Grupo Sidek Presents Major Elements of Debt Restructuring Proposal*, PR NEWSWIRE ASS'N, April 2, 1996, available in LEXIS, Nexis Library, News/Curnws File [hereinafter *Restructuring Proposal*].

25. *Id.*; Torres, *supra* note 10.

26. Torres, *supra* note 10.

served as Grupo Sidek directors.<sup>27</sup> Finally, Eduardo Robinson Bours, the mediator in charge of the Grupo Sidek refinancing, has several potential conflicts of interest: his family owns shares in Mexican banks that are Grupo Sidek creditors, his uncle is a Grupo Sidek board member and his family has invested in various real estate projects with Grupo Sidek subsidiaries.<sup>28</sup>

Grupo Sidek's restructuring plan divides existing creditors into four categories. Category I includes the aforementioned group of Mexican banks. Category II includes secured debt collateralized by assets currently generating significant cash flow. Category III includes all remaining secured debt up to the value of its underlying collateral and unsecured debt of subsidiaries which have no secured debt. Category IV includes the under-secured portion of the secured debt included in Category III and all other unsecured debt.<sup>29</sup> Holders of each category of debt will be offered new securities of Grupo Sidek in exchange for existing debt.<sup>30</sup>

Creditors in Category I will be offered four-year United States dollar-denominated secured notes with a floating rate of interest estimated to be equal to LIBOR<sup>31</sup> plus 700 basis points.<sup>32</sup> Creditors in Category IV, including foreign Eurobond holders, will be offered United States dollar-denominated unsecured mandatorily exchangeable notes. These notes accrue no interest during the eighteen months after the restructuring, bear interest at LIBOR plus 700 basis points during months eighteen through thirty following the restructuring and after month thirty are mandatorily exchanged for common stock of Grupo Sidek at prices to be agreed upon in the future.<sup>33</sup>

Foreign creditors are angered not only by the disparate treatment among debt categories, but also by their subordination to the Mexican banks with respect to assets held by a Grupo Sidek steel subsidiary, Grupo Simec.<sup>34</sup> Grupo Simec owns many valuable assets which Eurobondholders expected to be a part of the pool of assets available to repay their debt in the event of liquidation or restructuring. Instead, in 1995 Grupo Sidek

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27. *Id.*

28. *Id.*

29. *Restructuring Proposal*, *supra* note 24.

30. *Id.*

31. London Interbank Offered Rate. See THOMAS P. FITCH, *DICTIONARY OF BANKING TERMS* 365-66 (1990).

32. *Restructuring Proposal*, *supra* note 24.

33. *Id.*

34. Torres, *supra* note 10.

used its ownership interest in Grupo Simec to guarantee a \$170 million (U.S.) emergency loan from the bank group.<sup>35</sup> As part of the restructuring agreement, the banks will release the guarantee in exchange for a pledge of Grupo Sidek's sixty-two percent equity interest in Grupo Simec.<sup>36</sup>

This disparate treatment between foreign creditors and Mexican bank creditors is becoming a common problem in Mexico. In late 1995, for example, Grupo Synkro, S.A. de C.V. ("Grupo Synkro") defaulted on \$347 million (U.S.) of debt, including \$50 million (U.S.) of Eurobonds.<sup>37</sup> In the subsequent restructuring—organized by Eduardo Robinson Bours, who also mediated the Grupo Sidek restructuring—part of the bank loans were exchanged for new loans indexed to Mexico's inflation rate and guaranteed by various Grupo Synkro assets.<sup>38</sup> Although the foreign creditors shared ratably in the guarantees, the Eurobond debt was not indexed.<sup>39</sup> Thus, the principal on the bank loans rises with inflation (estimated to be approximately thirty percent in 1996), using a larger part of the guarantees, while the principal amount due on the Eurobonds remains fixed.<sup>40</sup>

Foreign bondholders are attempting to protect their interests: ING Barings Securities Inc., a Grupo Sidek Eurobondholder, is seeking to form a committee of bondholders to demand better terms in the proposed restructuring and several Grupo Sidek bondholders have filed suit in federal district court in New York for alleged breaches of the debt contract.<sup>41</sup> Nonetheless, foreign creditors of Mexican corporations can expect large losses to continue until more efficient and modern bankruptcy laws are developed in Mexico.

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35. *Id.*

36. *Restructuring Proposal, supra* note 24.

37. Torres, *supra* note 10.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*