

**LATEST EVENTS ON CROSS-BORDER INSOLVENCY IN LATIN AMERICA**BY TOMÁS M. ARAYA AND JACQUELINE DONALDSON<sup>1</sup>**I. Introduction**

Recent closures in the aviation and telecommunication industries have indicated that surviving in new international markets is beyond the capabilities of not only small, but multinational companies too. And as the world is developing, we can only expect the struggle for market survival to reach epic proportions, with the number of companies leaving the market space exceeding those attempting to enter it.

This new scenario has lead companies that withstood decades of competition and adverse economic environments, to redefine their structures in order to adapt them to the current markets, accepting globalization as a fact<sup>2</sup>. In their struggle for survival, some businesses fall under the arms of foreign multinationals seeking to expand; others directly go bankrupt, whilst others defend themselves by growing (i.e. acquiring small local businesses and integrating them to their operations), for which they require heavy financing.

The latter trend has been particularly common in Latin American companies. Indeed, in the past decade, many Latin American businesses

---

<sup>1</sup> Tomás M. Araya is a lawyer graduated from the National University of Rosario, Argentina (1994), with a Master on Business Law (with honors) from Austral University of Buenos Aires, Argentina (1996). He also has an LL.M. on General Studies from New York University (2001) and is a Fulbright Scholar. Jacqueline Donaldson is a lawyer graduated with honors from the School of Law of Austral University of Buenos Aires, Argentina (2004), and was an exchange student at Duke University in 2003. Both authors are members of the Financial Services Department of M. & M. Bomchil Abogados and can be reached at [tomas.araya@bomchil.com](mailto:tomas.araya@bomchil.com) and [jacqueline.donaldson@bomchil.com](mailto:jacqueline.donaldson@bomchil.com).

<sup>2</sup> "Whether we accept globalization, whether we like it, whether we are indifferent to it, or whether we think it is a bad idea, globalization is here to stay. It is a reality of the new world in which we do business. We must adapt ourselves to be able to compete effectively within that new world market. For those that can achieve reforms and compete effectively, there are rewards to be gained. But for those that lag behind and for countries that are unwilling to adapt and reform, the price and the cost of this market can be quite harsh and exacting. Countries that don't adapt and reform, but which choose to play in the game, will suffer more so than they do now" (Gordon W. Johnson -Lead Counsel of the Insolvency & Creditor Rights Systems of The World Bank- opening remarks in the Forum of Insolvency in Latin America – FILA-, Río de Janeiro, Brazil, June 8-9, 2004) (available at <http://www4.worldbank.org/legal/fila/index.html>).

were able to access the international markets in search of significant amounts of foreign finance, mostly in the form of debt<sup>3</sup> (particularly, through the issuance of bonds or notes governed by U.S. law).

Thereon, unforeseeable social, economical and political crises, recessions, and governmental breakdowns resulted in a wave of restructurings in Latin America as most of these companies found themselves in unthought situations, without funds to attend the outstanding foreign debt. Despite its inherent tragedy, this shared situation provided a remarkable scenario for the analysis of the new challenges regarding multinational default and the need for Latin American legislations to adapt to globalizing markets.

One of the issues that have been proved to be of major difficulty –and importance– is that of the ambiguity as to which jurisdiction’s laws should govern the default of “international” debtors when they face financial difficulties and where creditors should seek redress for their claims. Several questions arise in this new scenario for a “local” issuer in default seeking to restructure its obligations: should it file a reorganization proceeding in its home country pursuant to its home bankruptcy law, even though its creditors are mostly “foreigners”?; or, instead, would it be more convenient –given the large amount of outstanding foreign debt- a filing in the “foreign” country where its main creditors are located or where it has financial interests, regardless its domicile? Are these apparently opposite alternatives available for the debtor to decide?; or bankruptcy law is a matter of “public order” with non disposable rules by the interested parties?

Focusing on two landmark Latin American restructurings cases, this article attempts to describe the different ways that a Latin American company with assets and creditors dispersed in different countries may have to pursue a

---

<sup>3</sup> A corporate study, developed by Deutsche Bank in 2003 showed that for instance in Argentina, 95% of the corporate bond market is represented by U.S. Dollar denominated bonds, issued by 35 Argentine businesses which total an amount of US\$31.5 billion. (See Deutsche Bank report, “*Argentina Corporates 2003 – 2004, From Ashes to APEs*”, November 10, 2003, page 6).

successful restructuring procedure, either by filing locally or in a foreign country.

The First Part of this article briefly describes the outdated Latin America cross-border insolvency legal framework (Montevideo Treaties). The Second Part analyzes the “traditional” approach to pursue a successful restructuring of an international Latin American company, which requires a local filing and the opening of ancillary proceeding in a foreign country. Here we describe the case of an Argentine cable company (Multicanal S.A) and a relevant United States court decision on the jurisdiction matter mentioned above. The Third Part refers to an alternative way for Latin American companies to restructure international obligations by filing in the United States, an unconventional path successfully followed by a renowned Colombian airline (Avianca).

In Fourth Part we set forth our conclusions. We anticipate that as different as they may appear, the decisions in “Multicanal” and “Avianca” denote a common underlying lesson: insolvency law is converging and international debt restructuring shall be inevitable considered by different courts located in different countries, with the aim of guaranteeing a non-discriminatory proceeding. This trend – coupled with the efforts made by international organizations as The World Bank and UNCITRAL – will eventually result on internationally accepted principles on insolvency law upon which national bankruptcies laws should be based. Harmonization seems inevitable; Latin America should be ready to take advantage of this new reality, otherwise it would jeopardize its ability to provide major companies a friendly local forum to restructure their obligations.

## **II. First Part**

**Latin American legal framework on cross-border insolvency: the need to adapt to globalized markets**

Cross-border insolvency is not an unknown subject in Latin America. The Montevideo Treaties of 1889 and 1940, as well as the Bustamante Code of 1928 both set forth special provisions regarding this subject. However, this set of rules has proved to be insufficient to solve cross border insolvencies in an efficient way.

Of the two traditional tendencies (i.e., the "territoriality" approach pursuant to which insolvency proceedings in a country affects, in principle, only assets located in the country, and the "universalism" approach whereby there should be just one proceeding involving all of the assets of the debtor, despite location), these Treaties pretended to follow the universalism approach. However, in fact the Treaties included numerous exceptions to the universalism rule enabling the opening of two or more bankruptcy proceedings in different countries, therefore resulting in the adoption of the territorial approach.

Notwithstanding that, the main problem with the Montevideo Treaties is not the approach adopted (i.e.: universalism or territorialism) but, more importantly, the fact that most of the problems these Treaties pretend to solve, are outdated. Indeed, at the end of the 19<sup>th</sup> century, the focus lied on liquidation issues, resulting in rules which solely provided solutions to problems arising from the liquidation procedure (as the handling of the remaining assets and the preference of "local" creditors over "foreign" creditors on the debtor's assets). Currently, the focus has switched to reorganization procedures and the problems that may multinational companies trying to restructure their debt differ, encounter as they pretend to continue in business, even if its corporate structure is modified as some of its creditors turn into shareholders. In this scenario, when the company to be reorganized has assets in several countries (or at least in more than one), which is a very common situation in this *globalized* world, conflicting

situations may arise as to the scope of a local reorganization procedure and the effects of such reorganization procedure in other countries.

Furthermore, the Montevideo Treaties and the Bustamante Code have not been uniformly ratified by Latin American countries, so the applicable law is not standard on this matter through Latin America. Indeed, the 1889 Montevideo Treaty was ratified by Peru, Bolivia, Colombia, Uruguay, Paraguay and Argentina; while the 1940 Treaty was ratified only by Uruguay, Paraguay and Argentina. On the other hand, the Bustamante Code was ratified by most of the Central America countries (Cuba, Haiti, Dominican Republic, Panama, Nicaragua, Honduras, Guatemala, El Salvador and Costa Rica) plus Venezuela, Ecuador, Peru, Bolivia, Brazil<sup>4</sup> and Chile.

As a result of this mixture of conventions, an international case involving Argentina and Uruguay elements, should, for instance, be decided pursuant to the 1940 Montevideo Treaty, while the 1889 Montevideo Treaty should be applied to a case involving Argentina and Colombia elements. Additionally, there is no specific convention that shall be applicable to international cases involving countries which are not parties to the same treaty (as Argentina with Brazil or Chile). In this situation, the applicable law shall be the one stated for multinational bankruptcies in the local bankruptcy law of the country where the case is pending, which not many Latin American insolvency frameworks foresee, and if they do, they are normally not updated to the current times<sup>5</sup>.

---

<sup>4</sup> Regarding the Bustamante Code and the situation in Brazil previous to the passing of law n° 11,101, see Thomas Benes Felsberg, "Cross-Border Insolvencies and Restructurings in Brazil" (January 27, 2003), available at the web of the International Insolvency Institute at [http://www.iiiglobal.org/country/brazil/Cross%20Border%20\(012703\)%202.pdf](http://www.iiiglobal.org/country/brazil/Cross%20Border%20(012703)%202.pdf)

<sup>5</sup> For example in Argentina article 4 of the Argentine Bankruptcy Law N° 24,522 provides some rules aimed to solve some of the conflicting situations that may arise in an international insolvency case. Said rule states: "[Foreign reorganization proceedings]: *The declaration of a concurso ("reorganization proceeding") in a foreign country is a cause for the opening of the reorganization in the country, by request of the creditor whose credit is to be paid in Argentina. Notwithstanding international treaties, the foreign reorganization proceeding cannot be invoked against creditors whose credits are to be paid in Argentina, to dispute rights that these pretend over property existing in the territory not to declare void any acts executed with the debtor. [Plurality of proceedings]: once bankruptcy is declared in the country, the creditors who participate in foreign reorganization proceedings shall be entitled to the remainder,*

Globalization of transactions and the improvement of financing access bring about the growing need to harmonize bankruptcy and reorganization proceedings across borders. Sovereignty arguments should surrender to the evident reality that those involved in cross-border bankruptcy proceedings want the same results that they would seek in a domestic case: reasonable notice, access and participation, predictability, enforcement and fair and transparent distribution of assets.

World widely, the territoriality vs. universality debate has been superceded. Today, discussions concentrate on: (i) recognition in a country of a foreign insolvency proceeding; (ii) accessibility to court of administrators of foreign insolvency proceedings; and (iii) international cooperation between judges and administrators of foreign insolvency proceedings<sup>6</sup>. Indeed, as opposed to the Montevideo Treaties, which only foresaw these issues incidentally, international organizations like the World Bank, the United Nations and the International Monetary Fund are prompting the adoption by domestic legislation of cross-border insolvency principles which provide for solutions to these new issues<sup>7</sup>.

In conclusion, it is true that Latin American countries have been aware of the problems caused by international bankruptcies for more than a hundred years. However, treaties and local rules once suitable for cross border

---

*once the credits filed in it are satisfied. [Reciprocity] The filing of a creditors proof of claim of a credit payable in a foreign country, and that does not belong to a foreign proceeding, is subject to the evidence that, reciprocally, a creditor whose credit is payable in Argentina can be filed and paid –in equal conditions- in a foreign proceeding open in the country where the credit is payable*". For a comprehensive analysis of the Argentine current bankruptcy system on this subject, see, Rouillon, Adolfo A.N. "Rules of international private law, priorities on insolvency and the competing rights of foreign and domestic creditors, under the Argentine insolvency law", available at <http://www.iiglobal.org/country/argentina/Argentina-Cross-borderInsolvencyRegime03-14-03.pdf>.

<sup>6</sup> These are the subjects treated in the UNCITRAL Model Law on Cross-Border Insolvency, adopted in 1997, which refers to: foreign assistance for an insolvency proceeding taking place in the enacting State; foreign representative's access to courts of the enacting State; recognition of foreign proceedings; cross-border cooperation; and coordination of concurrent proceedings. See [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html)

<sup>7</sup> For further analysis of international legal reform efforts, see Jay Lawrence Westbrook, "Multinational Companies in General Default: Chapter 15, the ALI principles and the EU Insolvency Legislation", American Bankruptcy Journal, winter 2002, 76 Am. Bankr. L.J. 1; and the information provided at the

insolvencies have proved to be outdated, calling for urgent reforms in order to provide an appropriate legal framework to handle current issues on multinational default<sup>8</sup>. Further, as different from the current trend of Common Law countries, cooperation proceedings are extremely uncommon between Latin American courts.

The delay in such update though is not free of consequences. As the World Bank stated, there is a relation with the improvement of the insolvencies laws and the economic health of a country: *“In a world driven by credit, the challenge is to develop systems that foster commercial confidence and predictability by providing the means for effective response to default conditions. Handled properly, creditor rights and insolvency laws can contribute to the economic health of countries by providing a safety valve for financial distress, reducing asset deterioration, and restoring balance to commercial relationships”*<sup>9</sup>.

### III. Second Part

#### 3.1. The traditional approach to Latin American multinational default: local filing and ancillary proceeding

Most Latin American companies have pursued their restructuring in local jurisdiction. However, the increased amount of foreign debt (specially, U.S. bonds) have forced many to seek assistance in foreign courts (most notably, the United States) in order to prevent foreign creditors from

---

Insol International web site ([www.insol.org](http://www.insol.org)) and [www.iiiglobal.org](http://www.iiiglobal.org); <http://www.globalinsolvency.com/insol>; [http://www.worldbank.org/ifa/ipg\\_eng.pdf](http://www.worldbank.org/ifa/ipg_eng.pdf).

<sup>8</sup> For further analysis on the need to reform Latin American insolvency systems, see Malcolm Rowat and Jose Astirraga, “Reforming Insolvency Systems in Latin America”, Public Policy for the Public Sector, The World Bank Group – Finance, Private Sector and Infrastructure Network, Note no. 187, available at <http://rru.worldbank.org/Documents/PublicPolicy/Journal/187rowat>.

<sup>9</sup> The World Bank “Principles and Guidelines for Effective Insolvency and Creditor’s Rights Systems”, April 2001, [http://www.worldbank.org/ifa/ipg\\_eng.pdf](http://www.worldbank.org/ifa/ipg_eng.pdf). Focusing on Latin American, see “Impact of Global Market Developments on Latin America: Reexamining the Foundations of Trust”, Gordon W. Johnson and Daniel F. Alonso (available at [http://siteresources.worldbank.org/GILD/ConferenceMaterial/20168306/LA%20Corporate%20Insolvency%20\(Johnson\).pdf](http://siteresources.worldbank.org/GILD/ConferenceMaterial/20168306/LA%20Corporate%20Insolvency%20(Johnson).pdf)).

distracting assets and attention from the local restructuring. The filing of a Section 304 petition (pursuant to the U.S. Bankruptcy Code) by a foreign representative has been almost standard procedure in businesses which file for a reorganization proceeding in their home countries. Indeed, as most of the foreign creditors are based in the United States, most of the local filing cases with international elements include a “304 filing” in such country<sup>10</sup>.

This traditional approach has been followed by many Argentine companies which had to restructure their debts after the 2001 crisis undergone by the country. As it is known, this general crisis caused the abrogation of the Argentine Convertibility Law and a sharp devaluation of the local currency (Argentine Peso) -which had been pegged to the U.S. Dollar on a 1 to 1

---

<sup>10</sup> Several recent cases evidence that the filing of a 304 petitions by Latin American companies has become a common trend. For instance, Corporación Durango, SA de CV (a Mexican company) initiated an insolvency proceeding under Mexico’s recently amended *Ley de Concursos Mercantiles* with the District Court for Civil Matters for the District of Durango, Mexico on 18 May 2004, for the purpose of restructuring approximately US\$800 million of unsecured indebtedness. Since the majority of the company’s outstanding indebtedness was U.S. Dollar denominated and governed under U.S. law, three days later Corporación Durango commenced an ancillary proceeding under section 304 of the U.S. Bankruptcy Court to protect itself and various of its operating guarantor subsidiaries from any creditors commencing legal actions or exercising any remedies in the United States while Corporación Durango was attempting to reorganize in Mexico. Another example is provided by two Peruvian companies - Empresa Transportes Aero del Peru S.A. (a Peruvian Airline) and Caldas (Peruvian bank)- which commenced insolvency proceedings in Peru, and whilst these were pending, filed for 304 recognition in favor of their home proceedings. Indeed, in *In re Empresa de Transportes Aero del Peru, S.A.*, 263 B.R. 367 (S.D. Fla. 2001), the Bankruptcy Court entered a preliminary injunction in favor of a Peruvian airline to stay actions against it, on the request of its chief executive officer who affirmed that he had been appointed its representative under Peruvian law. When it later became uncertain whether the reorganization had failed and whether a trustee had been appointed in Peru, the Bankruptcy Court in Florida appointed an American fiduciary to handle the reorganization there. On appeal the District Court held that in order for the U.S. court to have jurisdiction, there had to be a foreign proceeding and it remanded to the Bankruptcy Court to determine what happened when the reorganization efforts failed, whether there was a foreign representative, and what the relevant provisions of Peruvian law were. It did not accept the proposition that the Bankruptcy Court could effectively convert the case into a U.S. proceeding. By contrast, in *In re Petition of Caldas*, 274 B.R. 583 (Bankr. S.D.N.Y. 2002), a Section 304 petition was sustained where the petitioners were representatives of a Peruvian bank in intervention proceedings in Peru, appointed by the Superintendency of Banking and Insurance, and the applicable provisions of Peruvian law were fully explained to the court. Recently, on June 17 2005 Varig, Brazil’s largest air carrier, filed an application for the commencement of a judicial reorganization proceeding pursuant to the recently enacted Bankruptcy and Restructuring Brazilian Law (Law No. 11,101) in the Commercial Bankruptcy and Reorganization Court of Rio de Janeiro. Anticipating the impossibility to orderly administrate its bankruptcy proceeding in Brazil if U.S. creditors were not restrained from commencing legal proceedings or taking other actions against the carrier, Varig’s foreign representative sought a temporary restraining order and preliminary injunction under section 304 to enjoin and restrain U.S. creditors from seizing Varig’s U.S. assets or repossessing aircraft landing in United States airports. Said petition was granted by the U.S. Bankruptcy Code (Judge Drain), on June 27, 2005, finding that entry of an injunction on the United States against U.S. creditors would contribute to an economical and expeditious administration of the debtors estate consistent with the relevant factors set forth in Section 304 (c) of the U.S. Bankruptcy Code.

basis for the previous ten years. Furthermore, the Argentine Emergency Laws enacted thereafter set forth a mandatory conversion of all existing obligations originally denominated in U.S. Dollars to Argentine Pesos at the rate 1 US\$ equal to 1 AR\$, adjusted by an inflation coefficient known as CER<sup>11</sup>.

Of course, the Argentine Emergency Laws became applicable only to those obligations subject to Argentine law, and *not to all obligations* owed by Argentine debtors, therefore leaving unchanged the terms and conditions of obligations subject to foreign law. As a result, most – if not all – Argentine companies with outstanding amount of debt not subject to Argentine law became immediately insolvent (in the sense of the balance sheet test: the value of its assets was largely superceded by the value of its liabilities), mainly because their “foreign” obligations were not reached by the emergency rules (and therefore remained in U.S. Dollars), while their liquid assets and future cash flow would be in Argentine pesos<sup>12</sup>.

A textbook example of the results of Argentina’s recent collapse is provided by Multicanal<sup>13</sup>, the second largest cable operator in Argentina, serving approximately 945,000 subscribers as of June 2003<sup>14</sup>. Multicanal’s main revenues were at that time (and are at present) primarily derived from monthly subscription fees for cable service, connection fees and advertising in Argentine pesos.

---

<sup>11</sup> The one to one “*pesification*” rule was the general rule for all obligations, except for the banking deposits which were subject to a US\$ 1 to AR\$ 1,40 conversion rate plus a coefficient known as “CER”.

<sup>12</sup> Exporting companies constitute an exception to this common pattern as their income remains in U.S. Dollars and most of their costs were converted to Argentine pesos.

<sup>13</sup> Multicanal’s example was followed by several other Argentine companies that had to restructure their obligations after the crisis. Cablevisión S.A. (another Argentine cable operator) in May 2003 filed its restructuring proposal as an APE (similar to U.S. prepackaged plans) pursuant to sections 69 to 76 of the Argentine Bankruptcy Law. As prevention, given that most of its debt was –as Multicanal’s– represented by notes subject to U.S. law, it filed a petition in a U.S. court under section 304 of the U.S. Bankruptcy Law seeking recognition of the local proceeding, which was granted on November 9, 2004. On July 2005, the Argentine court approved Cablevisión’s APE.

<sup>14</sup> About 90% of Multicanal’s operations are in Argentina, with virtually all of the remainder in Paraguay and Uruguay, and has no on-going business in the United States, except for sporadic purchases of goods and materials.

Between 1997 and 2001 Multicanal issued five series of U.S. Dollar-denominated notes under indentures qualified under the U.S. Trust Indenture Act, governed by New York law, and providing for payment in New York<sup>15</sup>. Said debt, together with its bank debt, both U.S. Dollar-denominated, represented substantially all of Multicanal's debt for money borrowed, in an aggregate principal amount of U.S. \$509 million, representing 97% of Multicanal's total debt (around US\$ 525 million in December 2001).

Due to the high level of Dollar-denominated debt and a peso revenue structure, Multicanal was particularly hard hit by Argentina's economic crisis. By April 2002 Multicanal had defaulted on payments due on all notes. Subsequently, a series of involuntary petitions for involuntary liquidation (*quiebra*) petitions were filed in Argentine courts by Argentine retail note holders. Multicanal stayed these petitions by depositing in escrow an amount sufficient to cover the alleged claims filed by petitioners.

In January 2003, in an effort to move forward with its restructuring, Multicanal announced a restructuring proposal under sections 69 to 76 of the Argentine Bankruptcy Law No. 24.522, which provides for an *acuerdo preventivo extrajudicial* (locally known as APE), similar to U.S. prepackaged plans. An APE is a privately negotiated debt restructuring, supported by a qualified majority of unsecured creditors, that is submitted to an Argentine court for judicial approval. The APE rules were substantially amended in May 2002 as assistance to the Argentine companies in default so they can restructure their obligations orderly<sup>16</sup>.

---

<sup>15</sup> Over 80% of the noteholders were U.S. Individuals and institutions, but the holders also included a significant number of Argentine individuals who had purchased and held its Dollar-denominated debt.

<sup>16</sup> The rules governing the APE were amended in May 2002 by Law N° 25,589, largely in response of the Argentine economic crisis, to increase its scope and effect. The 2002 amendments, which incorporated certain existing provisions applicable in a *concurso preventivo* proceeding, provide (i) for the imposition of a stay on all claims affected by an APE upon its filing; and (ii) that the terms of the APE would be binding upon all holders of unsecured claims affected by the APE, not only on the consenting creditors. Court confirmation of an APE requires a majority of creditors -in number- and 2/3 in total outstanding amount of the affected unsecured indebtedness. Affected creditors may object to confirmation of an APE for an Argentine court based on the inaccuracy of the company's statements of

Multicanal's proposal to creditors consisted of three options: the cash option, the par option and the combined option. Those creditors who elected the combined option would receive \$440 of Multicanal 7-year notes bearing interest at a fixed 7% annual rate or an economically equivalent floating rate, as elected by the noteholder, and 641 Class C shares for each \$1,000 of existing debt tendered. Those creditors who elected the par option would receive \$1,050 of Multicanal's 10-year notes for each \$1,000 of existing debt tendered bearing interest at rates that would increase over time from 2.5% to 4.%. Those creditors who elected the cash option would receive 30% of the principal amount of the notes in cash plus a minimal amount of interest at a rate of 2% per annum from the date on which the APE was approved to the date on which noteholders received payment. The stock to be distributed to the noteholders who elected the combined debt and equity option would be capped at 35% of Multicanal's equity.

In April 2004, the Argentine National Commercial Court No. 4, Secretary No. 8 approved Multicanal's APE. The decision adopted by said Court was appealed by various creditors, and whilst the Appellate Court was reviewing the decision, one of Multicanal's main creditor (a U.S. bondholder affiliated to a renowned distress fund) filed an involuntary bankruptcy petition before the New York courts pursuant to the U.S. Bankruptcy Code, alleging Multicanal's default on due bonds<sup>17</sup>.

Multicanal's board of directors moved to dismiss the involuntary proceeding in favor of section 304 recognition, which allows for the opening of a case ancillary to a foreign proceeding in order to enjoin any action (or the

---

assets and liabilities, the failure to obtain the requisite vote needed for approval, or on the ground that the proposal made by the debtor in the APE is abusive or fraudulent.

<sup>17</sup> In particular, the U.S. bond holder (Argentinean Recovery Company, a Delaware limited liability company owned by WRH Partners Global Securities, L.P. (Huff) commenced two actions against Multicanal in the Supreme Court of the State of New York seeking a money judgment for principal and interest on all notes. It alleged that the provisions of U.S. law incorporated in the indentures governing Multicanal's bonds precluded any restructuring process that was not consistent with procedures provided under U.S. bankruptcy law.

continuance of any action) against a debtor whose property is directly reached by a foreign proceeding provided certain factors are met. Said factors are: (1) just treatment of all holders of claims against or interests in such estate; (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; (3) prevention of preferential or fraudulent dispositions of property of such estate; (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title; (5) comity; and (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns<sup>18</sup>.

Multicanal's creditor responded by filing a motion to dismiss Multicanal's 304 petition, alleging that provisions of U.S. law incorporated in the indentures governing Multicanal's bonds (Trust Indenture Act, section 316(b)) precluded any restructuring process that was not consistent with procedures provided under U.S. Bankruptcy Code.

On August 27, 2004 the United States Bankruptcy Court of the Southern State of New York rendered a decision on the 304 petition. Judge Gropper, found that Multicanal's board of directors was an appropriate "foreign representative," and that the APE was a form of insolvency proceeding entitled to recognition under Section 304, so it should be given full force and effect in the United States to the same extent that it was given full force and effect in the Republic of Argentina, binding all of Multicanal's creditors

---

<sup>18</sup> Since its enactment in 1978, Section 304 has permitted a representative of a foreign debtor in liquidation or reorganization proceeding in another country to petition a U.S. bankruptcy court for relief in aid of the debtor's restructuring or insolvency proceeding in a foreign jurisdiction. Such aid included an injunction to prevent any entity from interfering with or attaching assets of the foreign debtor in the United States, an order staying all litigation against the foreign estate, vacating attachments and remitting property abroad for administration in the foreign case. On April 25, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act 2005, making relevant amendments to the Bankruptcy Code on the international area. By far, the most important change regarding international insolvencies was the repealing of Section 304 of the Bankruptcy Code which had provided a major avenue by which many Latin American businesses sought recognition of a foreign insolvency proceeding in U.S. Courts. The Act introduced a new chapter to the U.S. Bankruptcy Code (Chapter 15) substantially incorporating the Model Law on Cross Border Insolvency adopted by the UNCITRAL on May 30, 1997. Although Section 304 was repealed from the Code by the Act, there is no discussion that Section 304 case law will be used for the new Chapter 15 cases where the issues in discussion are the same.

in the United States.

However, Judge Gropper found that the APE discriminated against United States retail holders, and, if not cured, the criteria of Section 304 (c) would not be satisfied and comity could not be extended to the APE<sup>19</sup>. Therefore, the ruling's effectiveness was subjected to the condition that Multicanal cured such discriminatory element. The alleged discrimination relied in that U.S. retail holders had been treated unfairly because they had been excluded from the par option and the combined option (available to the other noteholders) and offered only the cash option. Therefore U.S. retail holders were provided with a distribution of significantly lesser value.

Multicanal then proposed to remedy the discrimination against United States retail noteholders by offering them the same election of cash or securities that was made available to all other holders in the United States and Argentina. On January 6, 2005 the Bankruptcy Court approved the APE, as amended, and issued its final order to that effect, granting the Section 304 petition subject to the implementation of a cure for the United States retail holders, permanently enjoining all creditors of Multicanal from taking any actions in the United States, which would impede administration of the APE.

However, the discussion continued as one of Multicanal's creditors –Huff-

---

<sup>19</sup> Although the Court found that Multicanal had a good reason for offering cash to U.S. retail holders, it noted that section 304 of the Bankruptcy Code requires "*just treatment of all holders of claims against interests in such estate*" and that section 304 provides for the "*protection of claim holders in the United States against prejudice and inconvenience*". However, when construing the section 304 requirement regarding that the "*distribution of proceeds of the estate [should be made] in accordance with the order prescribed by the U.S. Bankruptcy Code*", the Court advised that Multicanal's U.S. appellants had misconstrued the standards of section 304 given that such requirement does not imply that American creditors should receive the same distribution in the foreign proceeding as they would in a proceeding under United States law nor that they should be provided with the remedies they would under a U.S. Bankruptcy Code proceeding. Despite the foregoing, the Court warned that it is not to ignore that a requirement of good faith is incorporated to Section 304 through the concept of comity and just treatment of all holders of claims and interests. If not pursued in "good faith" –which shall be probed elastically and on a case by case basis- the foreign proceeding should not be recognized. And in doing so, Judge Gropper considered that a key element of good faith is just treatment to all creditors or prevention of preferential treatment. Such requirement implicates general due process standards, i.e. a comprehensive procedure for an orderly and equitable distribution of the debtor's assets among all of its creditors, and the avoidance of discrimination.

appealed the decision before the United States District Court for the Southern District of New York alleging that the discrimination was not entirely cured as the securities were not registered pursuant to the Securities Act of 1933.

On September 6, 2005 –while the case was pending before the United States District Court- Multicanal reported that it had filed a Form F-4 registration statement with the SEC which, Multicanal asserted, should moot further litigation. Huff responded that said registration did not include all options extended to creditors, but only of those offered to cure the earlier discriminations -- that is, only of those offered to the U.S. retail holders, and to creditors that had voted against the APE or that had abstained from the vote. Such appellant contended that the registration was discriminatory against the class that previously had voted in favor of the APE, thus suggesting that the securities offered via an exemption (non registered) are less valuable than the registered securities.

Last September 28, 2005, the United States District Court (Judge Hellerstein), confirmed the Bankruptcy Court's decision in all respects except for the effectiveness of Multicanal's proposed cure. The District Court remanded the case to the Bankruptcy Court to consider the sufficiency, for the purposes of Section 304 of the Code, of Multicanal's proposed registration (assuming that it becomes effective) or, alternatively, to consider whether Multicanal can prove the availability of an exemption to the registration obligation. In doing so, the Court rejected Multicanal's arguments that the securities to be were exempted from registration on the basis of Section 3 (a) (9) of the Securities Act of 1933. Although it seems that Multicanal will eventually prevail in the litigation, the "discriminatory issue" remains unsettled at the time of this article.

Meanwhile, in its local forum (Argentina) Multicanal obtained an important victory when the National Court of Appeals on October 4<sup>th</sup>, 2005 decided to

confirm the approval of its APE. Despite the pending litigation in the United States, it is beyond question that Multicanal's restructuring was successful.

### 3.2. Conclusions from the "Multicanal" case

The "Multicanal" case allows us to draw some conclusions. First, Latin American companies facing multinational default may find their proper local "forums" the most convenient for a restructuring procedure regardless of the fact that most of their creditors are foreign and their obligations are denominated in U.S. Dollars. And in doing so, Section 304 (now Section 1507) of the Bankruptcy Code has proved to be a useful tool to protect the debtor's assets and prevent legal actions in the United States.

Holders of bonds that seek to challenge a foreign debtor's restructuring process are likely to file legal actions in other countries (i.e. the United States) alleging that the restructuring process being held locally conflicts with the applicable law set forth at the bond issuance time (i.e. the Trust Indenture Act). Further, these creditors may also file bankruptcy petitions in the United States trying to jeopardize the local filing.

If the dissident foreign creditor manages to prove in the U.S. court that its rights are not being respected within the local bankruptcy proceeding, he would most probably be able to maintain its legal actions in the United States, therefore putting the whole restructuring process in jeopardy. Conversely, if the debtor convinces the court that the local proceeding fully respects the U.S. bond holder rights, the local proceeding should be able to receive recognition in United States as a "local proceeding" in the terms of Section 304 of the Code (now, Section 1507). Once such recognition is obtained, an order staying any procedure in the U.S. and enjoining further litigation in said country will most probably followed, therefore allowing the local restructuring process to be completed successfully. Clearly, one of the key issues to achieve a successful restructuring is whether the local

bankruptcy law equally respects the rights of both local and foreign creditors.

The importance of the “Multicanal” U.S. decision lies in the setting of the minimum standards that a “foreign” (non U.S.) proceeding -and, thus, the local bankruptcy laws- should respect to be entitled to receive recognition in the United States. According to Judge Gropper, the principle that should govern every decision on the matter is whether the foreign proceeding allows for the economical and expeditious administration of the foreign estate, consistent with the factors set forth in such section<sup>20</sup>. Such “consistency” however does not imply that the U.S. creditor should receive the same distribution in the “foreign” proceeding as he would in a U.S. proceeding nor that he should be provided with all the remedies that the U.S. Bankruptcy Code provides.

Another key factor is comity. It shall be granted when fundamental standards of procedural fairness are observed and state and federal law and public policy are not violated. It is noteworthy that the Court emphasizes that the real issue is not whether the same procedures would be followed under U.S. law but whether there is fundamental due process afforded to all creditors, as was the case of Multicanal and the Argentine law.

Finally, Judge Gropper’s way of analysis (granting comity to local proceedings which respect foreign creditors’ rights and complies with a set of minimum standards) provides undeniable support to legal scholars and institutions who have been working on uniform principles of bankruptcy law

---

<sup>20</sup> Just treatment of all holders of claims, protection of U.S. claim holders against prejudice and inconvenience in the processing of claims in the foreign proceeding, prevention of fraudulent dispositions of property of the estate, and distribution of proceeds of such estate in accordance with the order prescribed by the U.S. Bankruptcy Code and comity.

to be adopted worldwide<sup>21</sup>.

#### **IV. Third Part**

##### **4.1. An alternative to local filings: filing for reorganization pursuant to Chapter 11 of the U.S. Bankruptcy Code**

Instead of pursuing a local filing, other Latin American companies with foreign debt have chosen a different approach for achieving a successful restructuring. The perfect example for this alternative approach comes from Chapter 11 of the U.S. Bankruptcy Code filing for reorganization carried out by the renowned Colombian airline company Avianca<sup>22</sup>.

On March 21, 2003 Aerovías Nacionales de Colombia S.A. (“Avianca”), the principal airline of the Republic of Colombia and its wholly owned U.S. subsidiary (“Avianca Inc.”) filed Chapter 11 of the U.S. Bankruptcy Code petitions before a Federal New York Court.

U.S. creditors moved to dismiss the cases contending that a U.S. court should not hear a case involving an enterprise that had not filed a proceeding in its home jurisdiction but had its principle place of business, as well as a majority of its employees and creditors in Colombia<sup>23</sup>. Indeed, such creditors basically argued that: (i) the filing of Avianca on the United States implied “forum shopping”; (ii) it was neither in the best interest of the debtor nor of its creditors to pursue such reorganization in the United States; and (iii) that the selection of a U.S. court would create delays and uncertainties for U.S. creditors and would benefit non U.S. creditors, as the latter would not be reached by the Bankruptcy Code, therefore, being able

---

<sup>21</sup> Several international organizations (most notably The World Bank and UNCITRAL) have been working lately on this area, with many important documents produced that should be used as a guideline for this task.

<sup>22</sup> In re Aerolíneas Nacionales de Colombia S.A. Avianca and Avianca, inc. (303B.R.1). The court decision was issued on December 23, 2003.

<sup>23</sup> Avianca informed having 3100 employees in Colombia and only 28 in the United States.

to request payment of their claims normally. Hence, they requested the Court to order the reorganization proceeding to proceed in Colombia.

Avianca's defense relied in that Colombian insolvency legislation (law No. 550, enacted on 1999) did not grant an effective scenario to restructure its debt. Moreover, being that its principal creditors were U.S.-based and that its main obligations were subject to U.S. legislation and jurisdiction, a restructuring proceeding under Colombian law would not be successful. This position was sustained not only by Avianca but also by other U.S. creditors.

The court found that Avianca had substantial property in the United States, making it clearly eligible for relief in such country. Its contacts with the United States had two origins: on the first place, Avianca rented its entire fleet of 31 planes to American corporations; secondly, it had issued bonds subject to U.S. Law in the United States for an amount of US\$ 75,000,000<sup>24</sup>. At the date of the filing, Avianca had an outstanding debt of US\$ 290,000,000 with the owners of the planes, and approximately US\$ 20,500,000 with bond holders.

The presence in the United States of these important creditors, as well as the willingness of the airline's major Colombian creditors to participate in and respect the U.S. proceedings, made the reorganization in the U.S. a reasonable possibility. Therefore, under article 109 of the U.S. Bankruptcy Code –which requires the existence of property in the United States in order to file a bankruptcy petition in said country- the judge concluded that there were no grounds to dismiss or suspend the case on the sole argument that the debtor was a foreign corporation.

The court also declined to support a principle expounded by the movants

---

<sup>24</sup> Actually the bonds were issued by the Bank of New York (BONY) pursuant to a trust agreement, simultaneously with the assignment by Avianca to said trust of the credit rights deriving from credit cards.

that the U.S. Court should require a foreign debtor to file in its home court and then proceed under section 304, finding that section 304 was never meant to be an exclusive remedy and that the debtor had provided convincing reasons why it had not filed in Colombia and that it could do so later on.

Notwithstanding the aforementioned, the court recognized that if the creditors' interests and those of the debtor would have been better served if the petition was dismissed, the court would have rejected Avianca's case. Secondly, it also had the power to reject it if a foreign proceeding existed, and pursuant to Section 304 of the Code said dismissal was recommended. Nonetheless, these arguments did not convince the court to reject the case. On the contrary, considering Avianca's principle financial problems were located in the United States, it decided to open the case sustaining that: *"normally a reorganization is a consensual process [...], it depends on the will of the debtor's principal creditors to agree a reorganization plan. The fact that most of Avianca's principal creditors are in the country, and others in Colombia are willing to participate in this proceeding is one of the most significant factors that support the reorganization filing here"*.

Furthermore, the court expressly mentioned that despite the filing of a reorganization in the United States, Avianca maintained the possibility to file a reorganization proceeding in its country, and if that was the case -*"... the American case should coordinate with the Colombian case taking into account the best interest of the creditors and the two respects of the laws of both countries"*.

Finally, the judge rejected the argument that it is inadequate for American courts to accept jurisdiction over reorganization cases of companies whose principal activities are in a foreign country. The judge concluded that while in international cases courts should grant priority to the local forum, (i.e. the main center of gravity, where the international company is located), courts

may decide to coordinate the proceeding together with a foreign proceeding or -as the case under analysis- “... *exercise its power until the maximum extension of the jurisdiction.*”

In November 2004, Avianca won court approval of a plan to exit bankruptcy which had been voted in favor by more than 95% of Avianca’s creditors, successfully emerging from the process set forth on Chapter 11, and overcoming its insolvency situation<sup>25</sup>. Such plan gave a 75% ownership stake of Avianca to OceanAir Linhas Aereas – member of the Brazilian Grupo Synergy. Grupo Synergy OceanAir was to invest US\$ 44.5 million in Avianca over the next 22 months to purchase the equity from Valores Bavaria S.A. and the Colombian Federation of Coffee Growers. The Coffee Federation would assume US\$18.5 million in debt in exchange for a 25% stake.

#### 4.2. Conclusions from the Avianca case

Avianca’s case sets forth many conclusions on international insolvency. Firstly, it represents a statement of the jurisdiction of U.S. courts to accept their jurisdiction in international insolvency cases that have contacts with the United States, independently if such companies have or not in said country its domicile, or a commercial representation and regardless if the company did not file for reorganization in its home country. This will enable international companies in financial difficulties with insolvency risk to analyze the possibility of restructuring in the United States, in case that the bankruptcy regime in their countries does not provide for a favorable scenario to accomplish the restructuring of their debt.

However, it should be noted that the precedent is at the same time risky for those Latin American countries whose insolvency laws are not sufficiently adapted to modern times. In effect, if Avianca’s example is followed by

---

<sup>25</sup> For further information on Avianca’s case, see <http://www.iiiglobal.org/country/usa/Avianca1.pdf>.

other Latin American companies, it could end in the creation of a special forum to attend international insolvency cases, whose principal consequence would be the loss of the local country's jurisdiction to resolve insolvency cases of their main important companies.

These reasons should encourage Latin American countries to update their insolvency laws, incorporating the proper amendments in order to offer an efficient and orderly restructuring proceeding.

## **V. Conclusions**

It is undeniable that centralizing an insolvency proceeding will frequently minimize the time, expense and administrative burdens of managing full cases in multiple jurisdictions. It is also evident that, on top of providing the optimal result for a debtor, it provides certainty to its creditors by preventing certain creditors from gaining an advantage over others by virtue of differing judicial systems.

In an ideal or even an orderly world, an international enterprise should file its restructuring proceeding in one jurisdiction only, without having to seek assistance of plural courts. And in doing so, it would be easiest and perhaps less expensive to file it in the jurisdiction where it has its principal place of business or "center of main interests". However, it is clear that under the current globalizing markets, companies have dispersed not only assets but mostly debtors in different countries. Therefore, attempting to effect a reorganization without being able to obtain jurisdiction over all or substantial part of its creditor body and its assets is deemed to fail. It seems to be that currently, it is a flat rule that a foreign debtor cannot maintain a proceeding in a bankruptcy court without a parallel proceeding abroad.

Whether a distressed company can successfully restructure its debt depends on many factors, such as the company's debt structure, its cash generation capabilities, the composition of its creditor constituencies and the willingness of the company's stakeholders to negotiate constructively and in good faith. Of equal importance though is the legal environment within which the restructuring will be undertaken. We have seen that successful restructurings mainly depend on the acceptability of the proposed plan by creditors. However, creditors –mainly foreign creditors– will never accept a plan under a law that grants priority to local creditors, nor that does not guarantee a fair and orderly process. In such cases foreign creditors would file legal actions in a jurisdiction where their rights will be equally respected. “Multicanal” shows that not any plan will be accepted by a foreign court and that – despite having obtained a local confirmation – new arguments may be raised if the proposal is discriminatory.

While United States appears to have adopted a clear set of rules in cross border insolvencies (not only with its recent passing of its Chapter 15 based on the UNCITRAL Model Law but also with the body of useful precedents on the matter) Latin American regulatory framework is outdated and based in treaties of the nineteen century structured upon the “liquidation” proceeding, which have lost importance vis-à-vis the “reorganization” proceeding. Further, coordination between Latin American courts is still an undeveloped matter.

As different as they may appear the decisions in “Multicanal” and “Avianca” shows a common underlying lesson: insolvency law is converging and international restructuring proceedings are decided by different courts located in different countries, with the aim of guaranteeing a non discriminatory proceeding. This trend – coupled with the efforts made by international organizations as The World Bank and UNCITRAL – will eventually give rise to internationally accepted principles on insolvency law

upon which national bankruptcies laws should be based. Harmonization seems inevitable; Latin America should be ready to take advantage of this new reality, otherwise it put in jeopardy its ability to provide major companies a friendly local forum to restructure its obligations.