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Mexico's new Commercial Bankruptcy Law (*Ley de Concursos Mercantiles*, or LCM), which came into force on May 13 2000, is expected to improve the position of creditors dealing with the insolvency of local companies. Although there have been relatively few cases of creditors using the new regime in the three years since its enactment, the LCM appears to provide for more rapid resolution of corporate reorganizations than was the case with the suspensions of payments model under the former Bankruptcy and Suspension of Payments Law (*Ley de Quiebras y Suspensión de Pagos*, or LQSP). In some cases it has already led to the liquidation of company assets on a faster timetable than was possible under the LQSP.

The LCM requires the use of insolvency specialists trained and supervised by a newly-formed Federal Institute of Specialists in Commercial Bankruptcy (*Instituto Federal de Especialistas en Concursos Mercantiles*, or IFECOM), which promises greater professionalism and efficiency in the handling of bankruptcy or insolvency cases.

Although it has so far been little used, the new regime is likely to be in great demand in the next few years as a number of large Mexican companies are continuing to struggle with financial difficulties and may become subject to proceedings. Some large companies have already become involved, including Bufete Industrial (in a voluntary proceeding) and Grupo Tribasa (in an involuntary proceeding).

It is clear that the LCM is not the panacea for which many creditors were hoping. Debtors have resorted, sometimes successfully, to federal constitutional-rights proceedings (*amparos*) to challenge certain bankruptcy decisions on constitutional grounds and thereby delay case resolution, and some provisions of the law are unclear and await clarification by the courts. One area of uncertainty involves the treatment of the holders of bonds or notes and indenture trustees as creditors under the LCM.

Loans and bonds

Under Article 4(I) of the LCM, recognized creditors gain their status through a judicial decision on the recognition, classification and ranking of credits. At the outset of a proceeding under the LCM it is therefore important to determine what persons are entitled to have their claims recognized, classified

and ranked. Although the law does not contain a precise definition of creditor (*acreedor*), in the case of loans there is normally little doubt that the creditor is the entity or other person that made or acquired the loan, and the creditor will normally have a promissory note issued in its name. It is not always clear who the creditor is in the case of bonds, particularly when they have been issued under a trust indenture governed by New York law (we have not had to address the issue of whether fiscal agency agreements or English law-governed instruments would be treated differently).

Under a New York trust indenture, in which an indenture trustee is appointed to represent the holders of bonds issued thereunder, the creditor on particular bonds would normally be the holder, as defined in the indenture. A common indenture definition of holder would be, with respect to registered bonds, "the person whose name is recorded in the Register as the absolute owner thereof", the Register being the register maintained by the registrar for the bonds. Often such a register will only show the names of holders of registered bonds, and it is common practice for such instruments to be issued in the name of a nominee institution such as Euroclear, the Depository Trust Company (DTC) or its affiliate Cede & Co, which represent the ultimate beneficial holders or investors having accounts with the nominee institution.

The indenture typically permits the bonds issued to the nominee institution in certain limited situations to be replaced by instruments issued directly to the actual investor. This is not usually done, in order to keep the holdings in a more convenient book-entry form. This can, however, complicate matters when it becomes necessary to identify the creditor for purposes of a proceeding under the LCM. If a Mexican issuer has become subject to a filing under the LCM, it may be difficult to cause it to issue new bonds in the name of such investors to make it easier for them to be represented in the proceeding.

The indenture trustee as creditor representative

The indenture trustee is normally not an investor in bonds issued under its trust indenture and therefore has no economic interest in it. Since the nominee holders are unlikely to include the indenture trustee itself, it may be difficult for the indenture trustee to be treated as a creditor for purposes of the LCM. The LCM is not as explicit as Section 501(a) of the US Bankruptcy Code, which expressly permits an indenture trustee to file a proof of claim. However, trust indenture provisions authorize the indenture trustee in default situations to "proceed to



protect and enforce the rights vested in it ... by such appropriate judicial proceedings as the Trustee may deem most effectual to protect and enforce any of such rights, either at law or in equity or in bankruptcy or otherwise”, to quote a typical indenture provision.

Therefore, although the indenture trustee may not itself be a creditor, it may be an authorized representative of all of the creditors under the indenture. If an indenture trustee has filed a proof of claim (*solicitud de reconocimiento de crédito*) on behalf of the holders of all bonds issued under a trust indenture, this should be deemed an adequate and sufficient filing as to all such bonds. The indenture will normally provide that, in the event of any proceedings brought by the trustee, the “Trustee shall be held to represent all holders, and it shall not be necessary to make any holders parties to such proceedings”.

However, we are aware of at least one case in which individual investors managed to win separate recognition by a Mexican bankruptcy judge of their individual holdings even though: (i) the indenture trustee had filed a proof of claim on behalf of all holders; (ii) the trustee had been recognized by the court as the legitimate representative of the investors as a whole; (iii) the separately recognized investors did not have bonds issued in their own names; and (iv) such investors demonstrated their indirect participations in the bonds by producing documentation of their accounts with the holders of record shown in the register.

As a result of this ruling, the proof of claim filed by the indenture trustee was reduced by the amounts of the claims that were separately recognized. This decision seems to reflect an incorrect interpretation of the definition of holder under the trust indenture and may have unfortunate consequences.

Consequences of separate recognition

Separate recognition of bondholder claims despite an overall proof of claim filed by the indenture trustee on behalf of all holders would appear to give the separately recognized

investors the right to participate directly in the proceeding and to receive a direct distribution of assets upon liquidation of the debtor. The first result might make it more difficult to develop a coordinated position on behalf of all bondholders. The latter result would run counter to the interest of the indenture trustee in recovering its fees and costs. A trust indenture normally provides that any payments received by the indenture trustee from the debtor, whether upon the debtor’s liquidation or otherwise, must be applied first to pay the trustee’s fees and costs before being distributed to bondholders. This so-called trustee’s lien might be thwarted by a direct distribution to separately recognized holders, which would particularly impact the other holders represented by the indenture trustee. Such a distribution would result in the other holders bearing a disproportionate share of such fees and costs, since the indenture trustee could not deduct them from distributions made to the separately recognized investors.

The indenture trustee may be forced to seek bankruptcy court approval for all such distributions to be made through the indenture trustee, notwithstanding any separate recognition. Failing such approval, the indenture trustee would have to seek recovery from the separately recognized holders of the portion of such fees and costs they failed to cover, at least to the extent that such fees and costs relate to actions taken for the benefit of all bondholders. If such holders do not pay over such portion to the trustee, the trustee may be forced to sue them for the amount outstanding, presumably in the courts of New York.

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Risks of bondholder inaction

In addition to the risk that some bondholders will be overly aggressive, and seek separate recognition as creditors, there is the risk of bondholders failing to take action when action is needed. The bondholder community is often widely dispersed, and retail holders in particular may be unable or unwilling to take decisive action to protect their interests in an insolvency situation. Some holders may expect to rely on the indenture trustee to independently act to protect their interests, but this is a hope that is often unwarranted.

The trust indenture will normally give the indenture trustee discretion to act in many situations, but will not obligate it to act unless it is instructed to do so by a sizable percentage of holders and is adequately indemnified for the costs and expenses that it may incur in doing so. Under New York law, an indenture trustee may be required to act as a prudent man would, even in the absence of instructions and indemnification, but this will not ensure that all actions that might usefully be taken to protect bondholders' interests are in fact taken. There may be occasions in which the indenture trustee might productively act to protect the interests of holders, for example by undertaking legal actions to challenge a debtor's fraudulent transfers or improper claims by competing creditors. These actions will not necessarily be taken by an indenture trustee in the absence of appropriate instructions and indemnification.

The risk of bondholder inaction may be higher in the case of insolvencies in Mexico than in other countries, simply because of the relatively new and untested nature of the LCM. An example of this risk can be found in the process by which foreign creditors are notified of the initiation of proceedings under the LCM. In the case of Bufete Industrial, the voluntary filing was made on December 17 2001, and under Article 122 of the LCM the deadline for creditors to file their claims is: (i) within 20 days after the last publication of the decision accepting the bankruptcy filing; (ii) within the period set by the law for filing objections to the provisional list; or (iii) within the period allowed for appealing the bankruptcy court's decision recognizing claims.

In this case the bankruptcy judge initially ruled that foreign creditors appearing in the company's books were to be notified



by letters rogatory, but due to extensive delays in processing the letters the judge subsequently elected to send a notice of the proceeding to the identified foreign creditors by international courier service, requiring them to submit their claims within 45 days after receipt of the notice. Some of these notices were served on individuals not in a position to make a timely filing of a proof of claim on behalf of the creditor. The indenture trustee for \$100 million in bonds issued by Bufete Industrial was sufficiently aware of the course of the proceeding that it was able to file the claim in a timely manner, but it is easy to imagine situations in which an indenture trustee may be unprepared, to the detriment of holders who may expect the indenture trustee to act despite the absence of express instructions and indemnification.

Conclusions

The *Ley de Concursos Mercantiles* of Mexico poses a number of challenges for holders of bonds issued under trust indentures governed by New York law, as well as for the indenture trustees party thereto, because of the ambiguity or lack of clarity of the provisions of the LCM when applied to trust indentures. This requires the holders and indenture trustees to exercise special caution when Mexican companies that have issued bonds under such indentures become subject to proceedings under the LCM.

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