THE GUIDE TO RESTRUCTURING

THIRD EDITION

Editors
Joy K Gallup and Michael L Fitzgerald

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Publisher's Note

Latin Lawyer and LACCA are delighted to publish the third edition of *The Guide to Restructuring*.

Edited by Joy K Gallup and Michael L Fitzgerald of Baker & McKenzie LLP, the Guide brings together leading practitioners from throughout the region and across a variety of disciplines to provide guidance designed to benefit all those advising on restructurings on Latin America.

Restructurings are, by their nature, both international and deeply domestic; while moves to standardise and draw together the legislative framework in the region demonstrate both the benefits and challenges of this trend. Understanding the commonalities, but also the differences, in black letter law and common practice in this area is thus critical. The Guide draws on the expertise of highly sophisticated practitioners to analyse the latest happenings in order to provide readers with the tools that they need. Its aim is to be a valuable resource for insolvency and restructuring advisers of all stripes as they play their part in the complex economic situation facing Latin America today.

We are delighted to have worked with so many leading individuals to produce *The Guide to Restructuring*. This third edition expands on the previous two editions with the addition of chapters on the Mexican Insolvency Law, equity versus debt in Mexican restructurings, the impact of the banking crisis in Mexico, and a broader look at the growing importance of ESG in restructurings.

If you find it useful, you may also be interested in the other Guides in the Latin Lawyer series, including *The Guide to Infrastructure and Energy Investmen*t, *The Guide to Corporate Crisis Management*, *The Guide to International Arbitration in Latin America*, *The Guide to Mergers & Acquisitions*, *The Guide to Environmental, Social and Corporate Governances* and *The Guide to Corporate Compliance*.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

Liz Rutherford-Johnson
Latin Lawyer
London, September 2023

CHAPTER 4

Chapter 11 as a Restructuring Option for Latin American Companies

Pedro A Jimenez and Joy K Gallup[1]

Many Latin American companies have used Chapter 11 of the United States Bankruptcy Code (the Bankruptcy Code) as a tool to effectuate a consensual balance sheet restructuring, especially for debt denominated in US dollars or governed by US law. The onset of the covid-19 pandemic also showed that Chapter 11 can also be used to effectuate a full financial and operational restructuring, as seen recently in the Chapter 11 cases of *Aeroméxico*, *Avianca* and *LATAM Airlines*, among others. This chapter discusses the various features of Chapter 11 and the types of Chapter 11 cases that are available to aid a Latin American company's restructuring.

Chapter 11 is available to foreign companies

Whether a company can file for Chapter 11 in the United States is governed by Section 109 of the Bankruptcy Code. Section 109, in relevant part, provides that any company that is incorporated or maintains its principal place of business in the United States, or has assets in the United States, is eligible to commence a case under Chapter 11. As many, if not most, Latin American companies are organised and maintain their principal place of business outside the United States, those companies typically rely on the 'property requirement', that is to say that those companies satisfy eligibility because they maintain assets in the United

1 Pedro A Jimenez is a partner at Paul Hastings LLP and Joy K Gallup is a partner at Baker & McKenzie LLP.

States. Case law interpreting the 'property requirement' has uniformly held that any property, regardless of size, will satisfy the 'property requirement', making Chapter 11 readily available to Latin American companies.[2]

In addition, and unlike many Latin American insolvency schemes, there is no requirement that a Latin American company be 'insolvent' to be eligible to commence a Chapter 11 case. This is an important distinction as an otherwise solvent company, as discussed below, can readily use Chapter 11 to achieve a successful restructuring where its existing equity interests are preserved.

The tools for a successful restructuring

Although every company deciding to use Chapter 11 has its own very specific business reasons for doing so, there are a number of tools available for any company, once in Chapter 11, to maximise the probability of success of its restructuring efforts.

Automatic stay

Generally regarded as one of the bedrock protections provided to companies in Chapter 11, the automatic stay protects a company and its assets from a broad range of enforcement or legal actions so that the company can instead focus its time in Chapter 11 on formulating, negotiating and implementing a successful reorganisation plan. At its core, the automatic stay acts as an injunction that comes into effect as soon as the Chapter 11 case commences and that prohibits most parties from commencing or continuing any enforcement or legal action against the company in Chapter 11 and its assets. The automatic stay is intended to apply worldwide, meaning that a lawsuit commenced, or a foreclosure or any other action to take possession or control over property outside the United States against a company that is in Chapter 11, would violate the automatic stay. The breadth and reach of the automatic stay was most recently reiterated and confirmed in the Chapter 11 case of *Grupo Aeroméxico*. There, the US bankruptcy judge found that the automatic stay (1) enjoined a creditor of Aeroméxico from continuing a lawsuit commenced in Spain against Grupo Aeroméxico to recover

2 *In re McTague*, 198 B.R. 428, 432 (Bankr. W.D.N.Y. 1996) (property requirement is met with showing of even a 'dollar, a dime or a peppercorn' located in the United States); *In re Cenargo Int'l, PLC*, 294 B.R. 571, 603 (Bankr. S.D.N.Y. 2002) (bank accounts, clearing accounts and stocks constitute property); *In re Glob. Ocean Carriers Ltd*, 251 B.R. 31, 39 (Bankr. D. Del. 2000) (retainers paid to US lawyers constitute property in the United States).

on amounts due to the creditor and (2) also applied to any acts by that creditor in Spain to attempt to seize Grupo Aeroméxico funds in bank accounts maintained in Spain.[3]

Debtor-in-possession financing

Another valuable tool is the ability of a company to obtain financing while in Chapter 11, which is commonly referred to as debtor-in-possession (DIP) financing. This can often be a tremendous lifeline for a company with severe liquidity constraints and that may have trouble obtaining financing outside Chapter 11 because of its financial condition. DIP financing is intended to provide a company with sufficient working capital to continue operating its business while it attempts to execute a successful restructuring. Lenders are incentivised to lend to companies in Chapter 11 by providing them with the ability to obtain a first-priority lien on all, or substantially all, the debtor's assets (potentially including assets that are already subject to a lien), as well as granting the lender with the highest priority claim against the Chapter 11 debtor's estate. A trend that has emerged in more recent Chapter 11 cases involving Latin American companies is a company's ability to turn to its shareholders to provide some or all of the DIP financing not only as a potential source to tap into lower costs of financing but also as a mechanism to allow existing shareholders to remain in the capital structure, especially where it is unclear whether their existing equity has any continuing value. For instance, the DIP financing structure ultimately used in the Chapter 11 cases of *Avianca* and *LATAM Airlines* involved existing shareholders providing a certain portion of the overall DIP financing, and that portion of the financing being repaid through the issuance of new equity by the reorganised company.[4]

Ability to continue business in the ordinary course

Because the primary objective in Chapter 11 is to foster the environment necessary to assist companies in reorganising their business and exiting as a healthier business, unlike in many insolvency systems in which a trustee is automatically appointed to take over the operation of the business, in Chapter 11, a company's board of directors and management remain in control of the company's business and continue to manage the business as they did prior to the Chapter 11 filing. The company may continue with its normal business activities in the 'ordinary

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3 *In re Grupo Aeroméxico, et al.*, Case No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020).

4 *In re Avianca Holdings S.A. et al.*, Case No. 20-11133 (MG) (Bankr. S.D.N.Y. 2020); *In re LATAM Airlines Grp., S.A. et al.*, Case No. 20-11254 (JLG) (Bankr. S.D.N.Y. 2020).

course' (such as sales, purchasing raw materials or inventory, and performance of post-filing contractual obligations) without court approval, although actions outside the ordinary course of business (such as pledging of collateral or borrowing money, sales of assets, assuming or rejecting contracts or leases, or any transactions with people within the company) require court approval.

Rejection of burdensome contracts and leases

A company in Chapter 11 may determine that its successful restructuring could depend, in part, on its ability to shed contracts or leases that have become too expensive or inconsistent with the company's business plan going forward. Chapter 11 permits a company to 'reject' any contract or unexpired lease if the company has determined that it is better off without it. This is a very powerful tool for a company seeking to use Chapter 11 as a way to effect an operational restructuring as it allows the company to stop performing under the contract or lease, and leave the counterparty to the contract or lease with only an unsecured claim for any damages.

One recent decision from the United States Bankruptcy Court for the District of Delaware, however, has cast some doubt on the unfettered power of a US Bankruptcy Court to permit a company in Chapter 11 from assuming or rejecting a contract, at least in a situation where there are pending disputes under the contract, the contract in question is governed by foreign law and, perhaps most importantly, the other party to the contract is not subject to the personal jurisdiction of courts in the United States.[5]

Ability to pay certain pre-bankruptcy claims

Like DIP financing, another valuable tool to help minimise the effects of Chapter 11 on a company's underlying business is the ability to obtain authority to pay certain pre-filing claims. Typically, within the first 48 hours of commencing a Chapter 11 case, a company has a hearing to consider certain requests made to the bankruptcy court, including requests to pay pre-filing claims of vendors and other creditors without whom the company could not continue to operate its business or who, because they are located outside the United States and outside the jurisdiction of the US bankruptcy court, the company needs to pay to avoid any adverse action against the company or its assets.

5 *In re Alto Maipo Delaware, LLC, et al.*, Case No. 21-11507(KBO), decided 26 April 2022.

Ability to sell assets

Another option available to a distressed company in Chapter 11 to maximise the value of its assets is the ability to sell some or all of its assets as a part of an overall strategy to maximise recoveries for creditors. Asset sales can be accomplished as part of a company's reorganisation plan, but more often are conducted as stand-alone transactions pursuant to Section 363 of the Bankruptcy Code. Asset sales in bankruptcy (or Section 363 sales, as they are commonly referred to) can be an effective way to maximise the value of certain assets by allowing a company to sell assets while simultaneously leaving behind any claims or liabilities associated with those assets (with certain exceptions) and without exposing the potential buyer to any subsequent claims for fraudulent conveyance or successful liability.

The power of a Section 363 sale was in full display in the Chapter 11 cases of *Alpha Credit*,[6] a group of speciality finance companies and lenders operating in Colombia and Mexico, where Alpha Credit was able to successfully utilise a Section 363 sale as a mechanism to substantially increase the sales price of its Colombian loan portfolio, especially as compared with what it would likely have received for these assets outside Chapter 11.

Classification and voting

As a general rule, all claims or interests within a particular class must be substantially similar to the other claims or interests within the class. However, claims or interests that are substantially similar may be placed in separate classes if there is a valid business or financial reason for doing so (note, however, that they cannot be separated solely for plan confirmation voting purposes). Voting on a plan requires that a class of claims obtain at least 66.66 per cent in amount and 50.1 per cent in the number of votes for that class to be deemed to accept the plan, but those thresholds are calculated based only on the votes actually cast.

This is an extremely valuable tool for a company in Chapter 11 since the company can obtain approval of its reorganisation plan to effectuate the restructuring of one or more classes of obligations without the high thresholds that are typically needed in a traditional out-of-court restructuring. For example, take the case of a Latin American company attempting to restructure an unsecured bond of US$200 million. Outside Chapter 11, the company may need the support of 90 or 95 per cent of its bondholders to be able to successfully restructure the bond

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6 Alpha Credit's Chapter 11 cases are styled as *In re Alpha Latam Management, LLC, et al.*, Case No. 21-11109(JKS), currently pending in the United States Bankruptcy Court for the District of Delaware.

(leaving a sufficiently low amount that the company could then deal with when those holdout bonds become payable). If the company were also to include as part of its out-of-court restructuring a side-by-side pre-packaged reorganisation plan and a vote on that plan (see 'Pre-packaged and out-of-court restructuring', below), the company would have obtained enough votes to confirm that plan if just US$133.2 million in bonds voted in favour of the plan (as opposed to the US$190 million in bonds it would need for its out-of-court restructuring to be feasible), and that assumes that all US$200 million in bonds were to vote on the reorganisation plan. If only US$150 million of those bonds voted on the reorganisation plan, the company would only need to obtain US$100 million in bonds to vote in favour of the plan, a significantly lower threshold than the US$190 million that the company determined it needed to complete the restructuring out of court.

Perhaps most importantly, if a company has satisfied the aforementioned voting thresholds, the treatment provided under the reorganisation plan for the company's creditors applies as to all creditors in that class, not just those who voted in favour of the plan. Thus, in the US$200 million unsecured bond example, if the company in Chapter 11 were to have satisfied the voting threshold, all holders of the bond would be bound by the new proposed terms, eliminating any issues with holdouts.

Exclusivity

A company in Chapter 11 has the exclusive right to propose a reorganisation plan within 120 days of filing. The deadline can be, and usually is, extended but not beyond 18 months after the Chapter 11 filing date. Although exclusivity is an issue that is monitored closely in a traditional Chapter 11 case, which could last many months, it is usually not an issue in a pre-packaged Chapter 11 case since the company typically can enter and exit Chapter 11 very quickly – most pre-packaged Chapter 11 cases can be completed in 60 days or less.

Principal parties in a Chapter 11 case

In addition to the company that is the subject of the Chapter 11 case, there are a number of other key parties with meaningful roles. The first is the bankruptcy court judge, who has to approve the various requests of the company, including approval of its reorganisation plan, and has to rule on objections asserted to any matter the company is asking for approval to pursue. Another principal party is the Office of the United States Trustee, which is an arm of the United States Department of Justice tasked with acting as the watchdog to ensure compliance by the company, especially prior to the Official Committee of Unsecured Creditors

being appointed in the Chapter 11 case. The remaining principal parties include various types of creditors, such as both the official and unofficial committees of creditors, the pre-filing bank lenders and any DIP financing lenders. In large cases, as well as the Official Committee of Unsecured Creditors, there are often one or more unofficial or ad hoc groups of creditors who participate actively in the case. Other parties include employees, contract counterparties, lessors, suppliers, vendors, customers and the company's equity holders.

Pre-packaged and out-of-court restructuring

A Chapter 11 'pre-packaged' reorganisation plan (a Chapter 11 Pre-pack) is one in which a company has already conducted its solicitation of votes on the reorganisation plan and has received votes in a sufficient amount and number to satisfy the voting threshold discussed above.[7] Typically, a company seeking to effectuate a Chapter 11 Pre-pack will enter into pre-filing negotiations with the principal creditors to agree the terms of the reorganisation plan, and will, as discussed below, provide all the documents necessary for each affected creditor to vote on the reorganisation plan, including the disclosure statement, reorganisation plan and plan ballot (collectively, the Chapter 11 Pre-pack Materials). If the company is using the Chapter 11 Pre-pack as an alternative to an out-of-court restructuring, the company can circulate the Chapter 11 Pre-pack Materials at the same time as its exchange offer or other out-of-court restructuring documents to maximise efficiency.

Advantages of a Pre-pack

The primary advantages of a Chapter 11 Pre-pack are certainty and efficiency. Given that the company would have already conducted its solicitation of votes on the reorganisation plan prior to commencing the Chapter 11 case, the company has the benefit of certainty that it has the necessary votes to confirm the reorganisation plan. Similarly, with many bankruptcy courts having specific rules for Chapter 11 Pre-pack cases, a company seeking to take advantage of this option can minimise its stay in Chapter 11; most Chapter 11 Pre-packs are typically concluded within 30 to 45 days. Thus, although it may take a considerable amount

7 An alternative to a traditional Chapter 11 Pre-pack, in which the company is unable to solicit votes on the plan of reorganisation in advance of commencing the Chapter 11 case, is what is referred to as a 'pre-negotiated Chapter 11 case', in which the company has negotiated the terms of the plan of reorganisation and creditors have agreed to support a plan, with the terms of that plan and the creditors' contractual obligation of support recorded in a plan support agreement or restructuring support agreement.

of time in pre-filing negotiations to develop a suitable reorganisation plan that meets with the approval of sufficient parties to satisfy the voting threshold, once the company has secured sufficient votes in support of the reorganisation plan, the company can proceed to file its Chapter 11 Pre-pack case with little to no risk of approval of the plan by the bankruptcy court.

Using a pre-pack alongside an out-of-court restructuring

There are several reasons why many companies prefer to use out-of-court restructuring options. Companies often fear the negative perception that their customers might have regarding a bankruptcy filing, even if the actual effects on their operations are minimal. However, the biggest deterrent is often the anticipated time and expense involved in filing a bankruptcy case that could end up becoming protracted, if the same debt restructuring outcome could be achieved outside a court process, whether through negotiations or otherwise.

If a company has bonds that are traded in the Rule 144A/Regulation S market, a possible capital markets solution is to offer to exchange those bonds for new bonds of the debtor with restructured terms, such as extended maturity dates, payment in kind instead of cash interest or principal payments, additional collateral or guarantees, and sometimes more restrictive covenants or other terms as a trade-off between providing the debtor with some relief from its debt burden while also providing the creditors with added protection. These same terms could also be embedded in a reorganisation plan or agreed between the company and bondholders in a Chapter 11 Pre-pack.

As discussed above, a company may have the option of soliciting votes for the approval of a Chapter 11 Pre-pack prior to the filing of a bankruptcy petition in combination with an exchange offer (particularly if the bonds are the primary class of debt being impaired under the reorganisation plan). An advantage of combining the capital markets solution with the solicitation of the votes for the Chapter 11 Pre-pack is that the filing of the bankruptcy petition would be a fall-back option, in case the number of bondholders that have accepted the exchange offer is insufficient for the plan to be viable from the company's perspective. In circumstances where there is just an exchange offer, the company can only restructure the bonds that are tendered and accepted for exchange, not the entire class of debt represented by those bonds, whereas in a Chapter 11 case, the entire class of debt gets the same treatment whether each debt holder voted to accept it or not.

In a combined exchange offer and Chapter 11 Pre-pack solicitation, the reorganisation plan would still need to be developed prior to the solicitation and if the exchange offer were successful, it would function as a way of implementing the economics of the plan to restructure the bonds. If the exchange offer was not

successful, however, the exchange offering memorandum would double as a bankruptcy solicitation statement, so appropriate disclosure and voting procedures would need to be included to make sure that when approval of the reorganisation plan is presented to the bankruptcy court, there is no room to challenge the solicitation process.

Traditional Chapter 11

Although the use of a Chapter 11 Pre-pack is an extremely powerful tool, a prepackaged Chapter 11 case is not always feasible because of the issues that have led to the company commencing the Chapter 11 case; for instance, industry issues (such as the travel and hospitality industries, which have been more heavily affected by the covid-19 pandemic than others), operational efficiencies (legacy liabilities, including employee and pension obligations) or the need to obtain additional working capital through the use of DIP financing.

Although it is less common to see a Latin American company use a traditional Chapter 11 case, the *Grupo Aeroméxico*, *Avianca* and *LATAM Airlines* cases have demonstrated that Latin American companies can resort to a traditional Chapter 11 case and still navigate the challenges that come with a Latin American company remaining in Chapter 11 for an extended period.

For the aforementioned airlines, a traditional Chapter 11 case was necessary because each of them was in desperate need of DIP financing to have the working capital necessary to withstand the prolonged effects of the covid-19 virus and related safety measures on passenger flights, including business travel.

Additionally, a fully established Chapter 11 case also provided each airline with the opportunity to address certain operational restructuring initiatives, such as addressing labour and fleet reduction costs, especially given an expected decrease in the number of passenger flights for a protracted period.

Restructurings are, by their nature, both international and deeply domestic. Understanding the commonalities, but also the differences, in black letter law and common practice in this area is thus critical.

The third edition of *The Guide to Restructuring* – edited by Joy K Gallup and and Michael L Fitzgerald of Baker McKenzie – is designed to assist restructuring advisers of all disciplines, and affected companies, as they negotiate complicated restructurings. This Guide delivers specialist insight to our readers across the region – advisers, practitioners, corporate decision-makers and court officials – to help them navigate this complex process.

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