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PREFACE

Latin American Debt in the 1990s: A New Scenario for Creditors and Debtors

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When the elephants dance, warns the old adage, the dandelions should watch out. Private sector borrowers in countries that experience a foreign exchange liquidity shortage will strongly sympathize with the dandelions. A private sector entity, particularly one that has its own reliable source of foreign currency earnings, may be perfectly creditworthy when viewed in isolation. The company's predicament results entirely from its location in a country whose aggregate foreign exchange inflows are insufficient to pay for the country's necessary imports and external (that is, foreign currency-denominated) debt service. It is the common practice of governments when facing such difficulties to enact foreign exchange control regimes that require all (or most) of the foreign currency earned by public and private sector enterprises in the country to be sold up to the central bank in return for local currency. This centralized pool of foreign exchange is then doled

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out by the government for such purposes, and in such priorities, as the government sees fit.

As a consequence, even the most solvent private sector company may find itself irresistibly drawn into its government's external debt difficulties. But the fate of a private sector borrower that earns foreign exchange in these circumstances is much more preferable to one that sells its goods or services domestically for local currency. The former at least enjoys, by virtue of its foreign currency income, a natural hedge against currency devaluation. The latter can only watch with concern as the government's debt problems result in a currency devaluation, a slowdown in the local economy and a tightening of credit in the domestic capital markets. Even when it is permitted to purchase foreign exchange for the purpose of servicing its external obligations, a borrower in this position may find the cost of that foreign exchange (in devalued local currency) prohibitively high.

The rating agencies have long recognized that even the most creditworthy private sector borrower cannot resist its government's call for a centralization of foreign exchange nor can it avoid being swept up in its government's debt problems. "Sovereign ceiling" is the rating agencies' shorthand expression for the proposition that no private sector borrower in a developing country can achieve an external debt rating higher than that of its own sovereign unless the transaction is structured so as to intercept an off-shore stream of foreign currency revenue for the benefit of the debtholders, or other special circumstances exist.[1]

Unlike the predominantly syndicated bank lending of the late 1970s (which was directed mostly to sovereigns and state owned or guaranteed enterprises), private sector borrowers have been the principal beneficiaries of private capital flows in this decade.[2] Inevitably, therefore, the external debt position of private sector borrowers will be a centerpiece of concern should liquidity problems recur in one or more of these countries. The possibility of private sector defaults cannot be ignored. Both private sector borrowers and their creditors may therefore be forced to confront issues such as how and where debt renegotiations will take place, the pros and cons of a bankruptcy alternative to renegotiation, and the availability to the creditors — both at

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1 Taylor, "Securitizations Can Overcome 'Sovereign Ceiling'," in Duff & Phelps Credit Rating Co., *Perspectives on Emerging Markets*, Jan. 1995, at 5; *Apasco Outdoes The Sovereign*, EUROMONEY, Sept. 1995, at 20.

2 World Bank, *World Debt Tables* 1994-95, Vol. 1 at 10.

the theoretical and at the practical levels — of legal remedies such as attachment of assets, set-off and litigation.

Oddly enough, private sector borrowers during the global debt crisis of the 1980s did not have much occasion to worry about these issues. In many of the countries undergoing a generalized external debt restructuring during the 1980s, formal programs were established pursuant to which the host government agreed to assume the outstanding indebtedness of private sector borrowers in return for payment of the local currency equivalent of the amount due to the central bank or other monetary authority. These programs often conveyed a measure of foreign exchange risk protection to the original private sector borrowers.[3] Over time, these programs operated to transform most private sector debt into sovereign debt of the host country.

If liquidity problems again afflict one or more developing countries, the fate of private sector borrowers is not clear. Not only is the stock of private sector debt far larger today (both in nominal terms and as a percentage of overall credit exposure in most countries) than it was in 1982, the special circumstances that induced the governments of the debtor countries to assume or guarantee private sector debt in the 1980s may not be replicated in the future. In addition, the lenders of the 1990s (principally bondholders) will almost certainly respond differently to the financial problems of their LDC borrowers than did the lenders of the 1970s (principally commercial banks). They may, for example, show far less reluctance to pursue their legal remedies. The precarious position of private sector borrowers in the current environment was highlighted by the Mexican devaluation crisis of December 1994. Although the risk of widespread default by Mexican private sector borrowers was averted, this risk seemed disturbingly imminent to many observers.[4]

The pressing nature of these concerns led Northwestern University School of Law to organize[5] and host a colloquium in the spring of

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[3] The Mexican program involved the establishment of a trust, *Fideicomiso para la Cobertura de Riescos Cambiarics* (FICORCA). *See* El Koury, *Mexico's Foreign Exchange Programme for Private Sector Companies*, INT'L FIN. L. REV., July 1983 at 18. The principal author of the FICORCA program was a promising young economist by the name of Ernesto Zedillo; a man who was later to advance in life. The Philippine program was called Circular 1076. *See* Lee Buchheit, *Details of the Philippine Debt Repayment Programme*, INT'L FIN. L. REV., Dec. 1985, at 15.

[4] Craig Torres and Paul B. Carroll, *Fear of Mexican Defaults Stalks Peso*, WALL ST. J., Feb. 17, 1995, at A6, col. 1.

[5] Planning of the conference was the joint responsibility of Prof. Ralph Reisner, Dean David Van Zandt and William Elwin, Associate Dean. They were assisted by an Advisory Committee which included Lee Buchheit, Esq. of Cleary, Gottlieb, Steen & Hamilton; Ambassador

1995 which brought together noted legal and financial experts from throughout the hemisphere.[6] The agenda for that conference is outlined in Appendix A. The articles appearing in this symposium are an outgrowth of the conference. For the most part, these articles focus on the unique issues arising from foreign currency debt exposure of the private sector.

An introductory article, *"Cross-Border Lending: What's Different This Time,"* by Lee Buchheit, analyzes the principal differences in cross-border lending practices in this decade in comparison with those of former periods. The article by Messrs. Darrow, Darrow, Doetsch, Jauregui-Rojas and Nader S., *"Restructuring Strategies For Mexican Eurobond Debt,"* focuses on the issues likely to arise in the context of the restructuring of Mexican private sector Eurobond debt. Rory MacMillan's contribution, *"Proposals for Sovereign Debt Workout Systems,"* explores alternate models for the renegotiation of sovereign debt. The article entitled *"A Brief Incursion Into Brazilian Bankruptcy Law,"* by Antonio Mendes, examines the potential impact of Brazilian bankruptcy laws on the rights of foreign creditors. The domestic impact of the 1994 Mexican peso crisis and the Mexican Government's response to the ensuing economic dislocations, with particular reference to the banking sector, are reviewed in the article entitled *"Mexico's Banks After the December 1944 Devaluation - A Chronology of the Government's Response"* by Messrs. Karaoglan and Lubrano. The symposium closes with *"Remedies and Judicial Enforcements."* In this article, six conference panelists analyze a hypothetical private sector debt problem in terms of the legal remedies available to the creditors.

Emilio J. Cardenas; Troland S. Link, Esq. of Davis, Polk & Wardell; Danforth Newcomb, Esq. of Shearman & Sterling; and Roger Thomas, Esq. of Cleary, Gottlieb, Steen & Hamilton.

6 Speakers at the conference included: David Barnard of Linklaters & Paines, London; Lee Buchheit of Cleary, Gottlieb, Steen & Hamilton, New York; Emilio J. Cardenas, Ambassador of Argentina to the United Nations; Peter V. Darrow of Mayer, Brown & Platt, New York; Doug A. Doetsch of Mayer, Brown & Platt, Chicago; Jonathan L. Greenblatt of Shearman & Sterling, Washington DC; Thomas Heather of Rich, Heather & Mueller, Mexico City; Kevin Keogh of White & Case, New York; Troland S. Link of Davis, Polk & Wardwell, New York; Paul M. McGonagle of First National Bank of Chicago, Chicago; Antonio Mendes of Pinheiro Neto-Advogados, Sao Paolo, Brazil; Danforth Newcomb of Shearman & Sterling, New York; James E. Roselle of First Chicago Corp.; Mark M. Rossell of Shearman & Sterling, New York; Pablo G. Schefel of Standard & Poor's, New York; Kenneth Telljohann of Lehman Bros., New York; and David E. Van Zandt, Dean of Northwestern University School of Law, Chicago.