Latin American Debt Obligations in the 1990s: Risk Strategies: Remedies and Judicial Enforcement

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SYMPOSIUM

LATIN AMERICAN DEBT OBLIATIONS IN THE 1990s: RISK STRATEGIES

REMEDIES AND JUDICIAL ENFORCEMENT

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FACTS

Colmo, S.A. is a private sector company located in the Republic of El Paraiso.

Colmo, S.A. manufactures household appliances. Approximately 60% of Colmo's revenues are derived from sales within El Paraiso; the balance comes from exports to the United States and Europe.

Colmo does business overseas principally through its two wholly-owned subsidiaries, Colmo America, Inc. (a New York company) and Colmo U.K. Limited (a U.K. company).

The outstanding indebtedness of the Colmo Group (compromising the parent company and its two subsidiaries) consists of the following:

(i) large floating-rate borrowings by Colmo, S.A. in the local capital markets in El Paraiso (equal to about U.S.$100 million equivalent), some of which are secured by mortgages on the company's plant and equipment;

(ii) an unsecured $25 million revolving (syndicated) loan facility arranged by Bigbank, N.A. (a U.S. bank) for Colmo America. This facility, which is governed by the law of the State of New York, benefits from a full guarantee issued by the parent, Colmo, S.A.; and
A £50 million Eurobond issue by Colmo U.K., listed on the London Exchange. These bonds are governed by the law of England. They are unsecured but carry a full guarantee of the parent, Colmo, S.A.

As a result of a prolonged current account deficit, El Paraiso has been forced to devalue its currency by 50% and domestic interest rates have risen to 70% per annum. This situation has rendered it unlikely that Colmo will be able to meet its foreign currency debt obligations for the balance of this year. The company's chief financial officer, with laudable candor, issued the following statement to the domestic news media:

Naturally, in light of El Paraiso's unexpected currency devaluation, the Colmo Group companies will not be in a position to pay their external debt obligations falling due for the balance of this year, at least. But everyone knows that this circumstance is an Act of God, and Act of State and a condition of flagrant force majeure for which the Colmo Group is not legally or morally responsible.

DISCUSSION

Pre-Default Strategy

Question 1: (To Mr. David Barnard)

Each of the £50 million Eurobond issued by Colmo U.K. and the $25 million revolving loan facility for Colmo America contain a “material adverse change” event of default. Under this clause, an event of default may be declared if 25% of the bondholders (in the case of the Eurobond) or 50% of the banks (by exposure, in the case of the syndicated loan agreement) determine that either the borrower or the guarantor (Colmo, S.A.) has experienced “a material adverse change in its financial condition.”

Mr. Barnard, what legal or tactical considerations would be relevant in counseling a group of the Colmo U.K. bondholders in this situation?

Answer: (Mr. Barnard)

To marshal (or even to locate) 25% of the bondholders in order to declare the requisite event of default may prove difficult, particularly where the issue took the form of a straight sale of paper to a wide and disparate class of investors. This position can be contrasted with a co-ordinated placement of notes to a limited (and easily identified) market in which case the problem may not arise.

On the assumption that the “material adverse change” determination can be made, however, (and that the determination does entitle
acceleration of rights under the bonds) the bondholders must assess whether their interests are in fact served by acceleration. The consequences of acceleration must be balanced against the likely consequences of doing nothing [or seeking a less antagonistic resolution - discussion of work-out?].

A number of questions arise. How easily will it be to sue and obtain judgment against the issuer and guarantor? What are the prospects of then successfully enforcing a judgment obtained in any relevant jurisdiction? Will a technical win result in an actual recovery? Will affirmative action now trigger cross-default clauses in other loan documentation? If so, the bondholders may find that they are the first to “press the button” but end up the last in line in the ensuing fight for assets.

If the decision is to accelerate and to then to sue, the relevant English court procedure may differ as between the UK issuer and the foreign guarantor.

Commencing proceedings (by service of a writ and statement of claim) against Colmo UK should be relatively straightforward. Assuming that the company then gives notice that it will defend the claim, the bondholders are likely to be advised to apply to the English court for “summary judgment.” Where successful, this application (made on affidavit evidence only and based upon the premise that the defendant has no defense to the claim) provides a speedy mechanism for obtaining judgment without proceeding to trial. The risk with this otherwise attractive procedure (as you would expect given the potential prejudice to a defendant with legitimate defenses) is that the application is relatively easy to defeat. All the defendant need do is establish that there is some issue in dispute that ought to be tried (or some other reason for trial) and in all likelihood a trial will be ordered. An unequivocal and immediately persuasive event of default upon which the bondholders can rely is therefore to be preferred.

As to the El Parasian guarantor the first question is where to sue. Do the bondholders attempt to sue in England and enforce in El Paraiso? Alternatively, do they sue in El Paraiso (with the difficulties inherent in asking the foreign court to interpret an English law document) and enforce in England? If so against what? The procedures and likely risks with each course will have to be assessed.

If the choice is to proceed in England, and Colmo S.A. has no agent for service there and denies the jurisdiction of the English court, the bondholders have a further problem. They will need to resort to provisions of English procedure permitting, in certain circumstances,
service of proceedings outside the court’s jurisdiction (i.e., in El Paraiso). This will inevitably complicate and prolong the process described above.

The arguments against “pressing the button,” while other opportunities to recover the debt remain unexplored, are persuasive.

Post-Default Strategy

**Question 2:** (To the Panel)

Should the bank lenders to Colmo America now be running to the courthouse? If so, which courthouse?

**Answer:** (Mr. Thomas Heather)

Colmo America, Inc. creditors shall begin an action before the U.S. courts, against Colmo America, Inc., in order to secure any assets or properties located in the U.S. owned by Colmo America, Inc. In addition, under the terms of the respective loan agreements and guarantees, Colmo America, Inc. creditors may demand compliance of the guarantee granted by Colmo, S.A. before a U.S. court.

Nevertheless, enforcement of a valid final award granted against Colmo, S.A. by a foreign court will be subject to any prior proceedings against Colmo, S.A. in Mexico, and to the rules for the enforcement of final awards contemplated under Mexican law.

**Answer:** (Ambassador Emilio J. Cardenas)

The loan was made to Colmo, S.A.’s American subsidiary (Colmo America, Inc.) and is governed by the Law of the State of New York. One can assume that monies under it were disbursed and are to be paid in New York and that both the debtor and the guarantor have submitted themselves to the jurisdiction of the courts of the State of New York.

It can also be assumed that there are assets of both the debtor and guarantor in the jurisdiction of New York, justifying an action therein.

Lenders should try to collect in the New York courts. Debtor and guarantor should be served notice “in personam” of the respective court actions.

In the event of non-payment or insufficiency of assets in New York, should bankruptcy proceedings start in New York, against Colmo, S.A., as guarantor, it must always be kept in mind that such action is - under Argentine law - a valid cause for the commencement
of similar procedures in Argentina, at the request of the debtor himself or of a creditor whose credit against the guarantor must be paid in Argentina.

As a rule, a foreign bankruptcy procedure cannot be invoked against creditors whose credits must be paid in Argentina neither to dispute rights claimed by them over assets existing within its territory nor to annul transactions entered into by them with the creditor.

Should the bankruptcy be adjudicated in Argentina, creditors from the foreign procedures shall proceed on the “balance” remaining after the other creditors verified in the bankruptcy have been satisfied.

The verification of a creditor whose credit is payable abroad (like Bigbank, N.A.) and who does not belong to a foreign bankruptcy procedure is conditioned upon the prior showing of evidence that, on a reciprocity basis, a creditor whose credit is payable in Argentina may verify and recover - in similar terms - its credit in a bankruptcy procedure instituted in the country where such credit is payable.

Collection of ordinary claims in a foreign country made after the local bankruptcy procedure is commenced will be applied to the dividend which may belong to the beneficiary of such collection on account of ordinary claims.

Secured creditors (like those holding mortgages over Colmo, S.A.’s plant and equipment) are given priority in Argentina over common - unsecured - creditors.

**Question 3:** (To Mr. Barnard)

What should the Colmo U.K. bondholders be thinking (assuming the presence of a cross-default clause in the bonds)?

**Answer:** (Mr. Barnard)

We should preface any remarks with the observation that the liquidity or even solvency problems of a parent company (and guarantor) do not of themselves mean that a subsidiary will be unable to meet the payments due on its obligations. It may be, and remain, a solvent subsidiary of an insolvent parent.

Again the bondholders must assess the merits of “waiting and seeing” as against the consequences of affirmative action and triggering cross-defaults in other loan documentation. Precipitate action (even though legitimate) by the bondholders might ultimately prove counter-productive to their interests.
As compared to the position under question 1, relying upon a cross-default when seeking summary judgment is likely to be more attractive than a subjective bondholders' "determination." It will not, however, be entirely impenetrable to challenge, requiring for example a clear demonstration of the initial default (and therefore creating greater capacity for a debate on the facts). Still clearer defaults, if they take place, would be preferable.

**Question 4:** (To the panel)

What remedies (such as attachments, injunctions and so forth) are available to creditors of the Colno Group in your respective jurisdictions to conserve the defendants' assets pending a judgment?

**Answer:** (Mr. Barnard)

One possibility in England is to seek a "Mareva injunction" (a form of order not available in the U.S.). The English courts will in certain circumstances freeze the assets of a defendant who would otherwise move or dissipate them to frustrate the effect of any judgment. The Mareva has been termed the "nuclear weapon" in the litigator's arsenal and accordingly will only be used sparingly.

The application for a Mareva injunction is usually made ex parte (i.e. without the other party being present) and on affidavit. The plaintiff will have to establish: (i) a substantial cause of action falling within the jurisdiction of the English court and a good arguable case; (ii) that the defendant has assets within, and (where an extra-territorial order is sought) without, the jurisdiction; and (iii) evidence of likely dissipation of those assets by the defendant. This third element presents a relatively high threshold to any applicant.

The injunction itself will only be as effective as the third parties who handle or have control over the defendant's assets (for example the banks) are responsive. This means they must be given notice of the injunction before the defendant is able to give instructions to move or dispose of the assets.

[The insolvency of multi-national companies with assets and creditors in different jurisdictions can give rise to particular difficulties. In *Felixstowe Dock and Railway Company v. United States Lines Inc.* 2 W.L.R. 109 (1989) the English court upheld a Mareva injunction preventing a U.S. corporation (in Chapter 11) from removing its assets from England. This was done even though the English based creditors did not have secured claims. The decision was based on balancing the competing interests of the parties. It should be noted, however,
that the order merely froze the assets in England for a reasonable period during which a winding-up could be commenced. It did not give the English creditors a better right than other unsecured creditors.]

Answer: (Mr. Heather)

If the Colmo America Group creditors hold negotiable instruments (promissory note, letter of credit, etc.) issued or guaranteed by the Colmo Group, under Mexican law an executive action may be brought before the Mexican courts, which action will confer on creditors the right to perform a pre-judgment attachment of the assets or properties of the Colmo Group in Mexico, in order to secure creditors' rights until a valid final resolution is awarded to the creditors by the Mexican court.

Such action would be subject to any prior bankruptcy or suspension of payments procedure initiated by the Colmo Group.

In addition, please be advised that under Mexican Law there are several remedies against judicial orders as well as attachment prior to judgment and in aid of execution.

Answer: (Ambassador Cardenas)

Attachments can be obtained.

Question 5: (To the panel)

What substantive defenses might the Colmo defendants be expected to raise in resisting enforcement of these debt obligations?

Answer: (Mr. Barnard)

Colmo foreshadows an argument based on force majeure. If sound, this argument excuses the contracting parties from further performance. It is highly unlikely, however, that any material adverse change or deterioration in a company's financial position would be found at trial to amount to a force majeure. If reference to force majeure in loan documentation is unqualified or undefined, and this is unusual, English courts are prone to demand that the performance of the relevant obligation was actually prevented and not merely hindered or made more onerous by the relevant event.

Similarly, any argument that the agreement to pay has been frustrated because of a change in financial conditions is unlikely to find favor.
Case law has established that the frustration of a contract takes place when there supervenes an event "which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated...that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances..." (National Carriers Ltd. v. Panalpina (Northern) Ltd. (1981 C.A. 675)).

That said, speculative arguments raised by the defendants at the summary judgment stage, even though subsequently proved flawed at trial, may nonetheless defeat the application (see question 1, above).

Answer: (Mr. Farah)

Under Mexican law a currency devaluation is not considered an act of God or force majeure. Therefore, to the extent an action is brought before the Mexican courts, the Colmo defendants may only bring procedural exceptions, such as lack of notification or personality, payment, inconvenient forum, etc., as the case may be.

Answer: (Ambassador Cardenas)

Should the debtor, because of the devaluation, invoke force majeure, such defense will probably not be accepted by Argentine courts.

Question 6: (To Messrs. Newcomb and Barnard)

In light of the CFO's press release, the Colmo U.K. bonds and interests in the Colmo America loan facility may be purchased in the secondary market at 50% of their face value. An investor, Mr. Dred Raptor, has acquired some of the bonds and an interest in the loan at that price. In your view, does the fact of a discounted purchase of these debts affect Mr. Raptor's entitlement to enforce his claims in the courts of New York or England against the respective obligors for all overdue amounts?

Is your answer to this question affected in any way by whether all (or most) of the other creditors have agreed to restructure their credits?

Answer: (Mr. Barnard)

The fact that Raptor bought the bonds at a discounted price will not affect his rights to enforce his claims in England. He would be suing for the payment of a debt, not damages. The price he paid for the bonds is therefore immaterial.
The position may be different, however, had Raptor bought the bonds after a judgment had been given on the debt. This raises a question as to whether or not trading a judgment debt is a violation of process and can be challenged as “savouring of maintenance or champerty.”

As a matter of public policy, English courts treat as illegal any agreement by a third party (with no legitimate interest in the litigation) to fund, assist or encourage disputes between parties. Such “wanton and officious intermeddling” is known as “maintenance.” Champerty is a particular kind of maintenance: the maintenance of an action in consideration of a promise to give the maintainer a share in the proceeds or subject matter of the action.

Public policy objections (and by implication the doctrine of champerty) led the English Court of Appeal in Re Paris Skating Rink Co. (5 Ch. D. 959 (1877)) to hold that the assignment of a debt due from a company coupled with the right to proceed in a winding-up already commenced by the assignor was void. There is clearly an argument that trading in debt after a judgment has been given is similarly objectionable.

Neither is Raptor’s entitlement to enforce affected if all (or even most) of the other creditors have agreed to restructure their credits. Creditors’ rights can be compromised in three ways:

(i) with the consent of the creditor;
(ii) without the consent of the creditor in circumstances where the majority of creditors have a contractual or statutory right to commit the minority to a particular course;
(iii) under relevant insolvency legislation where a particular proposal may be endorsed by the court or a duly appointed representative.

Unless any of these situations applies, Raptor’s rights will be unaffected. We must question, however, the wisdom of him pursuing alone.

Bankruptcy

**Question 7:** (to Messrs. Cardenas, Mendes and Heather)

If the laws of El Paraiso resemble the laws of your respective countries, is there any point at which Colmo, S.A. would be *forced* to initiate a bankruptcy proceeding for itself or its subsidiaries? Are there any liabilities for the directors or officers of Colmo, S.A. if the company fails to do so?
When Colmo, S.A. reaches a point where it cannot pay its debts, the respective Board of Directors must file for bankruptcy. A failure to do so may entail the personal liability of directors and managers.

Under Mexican law, if Colmo, S.A. does not initiate the bankruptcy procedure within three days after it ceases the payment of its obligations, the bankruptcy may be declared as guilty, in which case the corresponding officers and directors of the company will have a criminal and a civil liability for such bankruptcy.

Pursuant to Brazilian law, declaration of bankruptcy is made by the competent court upon request by a comerciante (businessman) or by a creditor. The competent court is that of the judicial district where the debtor has his principal place of business, or branch if the debtor is headquartered outside Brazil.

Declaration of bankruptcy may also be requested by any creditor whose liquid obligation has not been paid.

While the law imposes on the debtor the obligation to apply for its own bankruptcy whenever it becomes insolvent, application for bankruptcy by the debtor himself is a rare event. Debtors facing financial difficulties normally seek different alternatives, i.e., an out-of-court composition with creditors to avoid failure, or, if this is not feasible, they may seek protection through a court approved concordata.

A concordata is a privilege granted by law to comerciantes, pursuant to which a comerciante will be able to settle his obligations towards unsecured creditors on a time basis, by means of total or partial payments as sanctioned by court. The purpose of law in granting the debtor this privilege, to the detriment of creditors, is to avoid bankruptcy, which would be a greater hardship to creditors.

There are no liabilities for the directors or officers of Colmo, S.A. if the company fails to apply for its bankruptcy, but such failure may prevent Colmo, S.A. from applying for the benefit of a concordata.

In practice, before allowing creditors to apply for the company's bankruptcy, or before forfeiting the right to apply for a concordata, debtors in financial difficulties most times seek the benefit of a concordata.
Question 8: (To Mr. Greenblatt)

You represent Bigbank, the agent under the revolving loan to Colmo America. In the face of this situation, does the prospect of a bankruptcy proceeding in El Paraiso involving Colmo, S.A. worry you?

Under what circumstances, if any, could orders originating from a bankruptcy tribunal in El Paraiso interfere with the enforcement of your client’s rights as a creditor of Colmo’s subsidiary in the United States?

Answer: (Mr. Greenblatt)

This question raises legal and practical considerations. First, the legal considerations.

A preliminary question is: does the bankruptcy tribunal in El Paraiso have the authority to issue orders enjoining my client from taking action against the assets of the debtor (Colmo, S.A.)? Recall, the debtor in the El Paraiso proceedings is the guarantor of the debt owed to my client. Therefore, my concern about the El Paraiso proceeding is not limited to the enforcement of my client’s rights against the U.S. subsidiary. It also relates to my client’s rights against the El Paraiso guarantor.

Assuming the answer to the first question is in the affirmative, the next question is: does the tribunal have authority to issue orders enjoining my client from taking action against the assets not of the debtor, but of its U.S. subsidiary? Although I am not familiar with the laws of El Paraiso, I would expect the answer to that question to be in the negative. Unless there is a reason to pierce the corporate veils of the parent and subsidiary corporations, the bankruptcy of the parent should not result in the entry of orders having an effect upon the subsidiary - even a wholly owned subsidiary. There would also be a question as to whether the El Paraiso tribunal would have jurisdiction over the U.S. subsidiary enabling it to enter orders with respect to the U.S. corporation.

Finally, assuming the El Paraiso tribunal does have the authority to enter orders enjoining actions against the assets of Colmo S.A.’s U.S. subsidiary, there is the practical question of whether my client has any reason to fear the violation of such an order. Do the El Paraiso tribunal’s orders purport to have worldwide effect? Would they be recognized by a U.S. court? And, does my client do business in El Paraiso such that it should be concerned about the possible ramifications of violating the tribunal’s orders?
In sum, although I would wish to investigate the legal and practical questions raised by the commencement of a bankruptcy proceeding of Colmo, S.A. in El Paraiso, the prospects of such a proceeding may not have a great impact on my client’s ability to receive payment from its borrower, Colmo, S.A.’s U.S. subsidiary.

**Question 9:** (to Messrs. Cardenas, Mendes and Heather)

If the laws of El Paraiso resemble the laws of your respective countries,

(i) At what point could Colmo, S.A. voluntarily seek the protection of the bankruptcy laws in your country?

(ii) Could such a proceeding seek a “reorganization” of the company, or must it involve a liquidation of the company?

(iii) Is there any basis in your law for involving Colmo America or Colmo U.K. in a bankruptcy proceeding of the parent in El Paraiso?

**Answer:** (Ambassador Cardenas)

Under Argentine law, reorganizations are possible. Should the respective debtor proposal to the creditors be accepted, liquidation can be avoided.

**Answer:** (Mr. Mendes)

(i) Under applicable law, the debtor that, without reason, does not pay at maturity a liquid obligation must, within 30 days, petition the court for the declaration of his own bankruptcy, stating cause for his failure, the state of his business affairs, and supplying to the court the required documentation, which includes a current balance-sheet and the list of creditors with their respective credits.

(ii) Most times, rather than applying for bankruptcy, the debtor company will apply for a *concordata*, which is a privilege granted by law to *comerciantes*, pursuant to which a *comerciante* will be able to settle his obligations towards unsecured creditors on a time basis, by means of total or partial payments as sanctioned by court.

In the case of a preventive *concordata*, the debtor must offer the payment to the creditors:

(a) of 50% of the total debt, if payment is to be made at sight; or

(b) of 60%, 75%, 90% or 100% of the debt if payment is to be made within six, twelve, eighteen or twenty four months respec-
tively. In the latter two instances, at least 2/5 of the amount owed must be paid during the first year.

(iii) Given the fact that Colmo America and Colmo U.K. are subsidiaries of Colmo, S.A., and as such totally independent companies, they will not be directly affected by the bankruptcy or concordata of Colmo, S.A.

There will certainly be indirect effects on both subsidiaries, as suppliers and other creditors will, most likely, cease to provide credit facilities to them.

Cross-default provisions may also be triggered, permitting creditors of the subsidiaries to accelerate their respective credits.

Another effect is that the shares of Colmo, S.A. in its subsidiaries, Colmo America and Colmo U.K., may have to be sold, or else these subsidiaries may have to be liquidated, in order to provide to Colmo, S.A. funds with which to satisfy its own obligations.

Answer: (Mr. Heather)

(i) Under Mexican law, whenever a person ceases the payment of its obligations, a bankruptcy procedure may be initiated. Such procedure may be initiated by law, by a voluntary petition of the corresponding person or its creditors. Therefore, if Colmo, S.A. ceases the payment of its obligations, it may voluntarily request the authorities to begin a bankruptcy procedure.

(ii) Under Mexican law, a person has the right to be placed in a suspension of payments before being declared bankrupt. The goal of the debtor is to restructure its debts with its creditors through the assistance of the Court, in order to avoid bankruptcy. Under a suspension of payments, the court allows the debtor to continue its business and retain possession of its assets. Nevertheless, such procedure may not be considered as a reorganization procedure of the company.

(iii) Both subsidiaries are part of the assets of Colmo, S.A. Therefore, any resolution or procedure affecting Colmo, S.A., shall involve both subsidiaries.

Question 10: (to Mr. Barnard)

Is there any basis under the laws of England for commencing an involuntary bankruptcy proceeding against the parent company, Colmo, S.A. in England?
Answer: (Mr. Barnard)

In theory the English court does have a wide jurisdiction (in effect a discretion) to wind-up overseas companies. It is permitted to wind-up unregistered (including overseas) companies by, inter alia, Section 220 of the Insolvency Act 1986. Specifically that act provides that an unregistered company may be wound-up if it is unable to pay its debts (Section 221 (5)). The court must be satisfied that the “inherent requirements of jurisdiction” (in addition to statutory requirements) are met before making a winding-up order in respect of a foreign company. The petitioner will therefore have to demonstrate a proper connection with the jurisdiction (e.g., by establishing that the company has some asset or assets within the jurisdiction and that there are one or more persons concerned in the proper distribution of the assets over whom the jurisdiction is exercisable. See Megarry J. in Re Compania Merabello San Nicholas S.A. Ch. 75 (1973)).

As a practical matter, however, petitioning for the winding-up of Colmo, S.A., is unlikely to be advisable on our facts. The only apparent asset in England is the shareholding in the U.K. subsidiary. Any action in England is almost certainly best directed at that company.

Question 11: (To Mr. Greenblatt)

Do you see any advantages to commencing a preemptive bankruptcy proceeding against Colmo America in the United States in these circumstances? Is there any basis in U.S. law for seeking an involuntary bankruptcy of the parent, Colmo, S.A., in a U.S. bankruptcy court?

Answer: (Mr. Greenblatt)

First, I do not see any great advantages to commencing a preemptive bankruptcy proceeding against Colmo America. Unless other creditors are in the process of seizing assets of Colmo America, or Colmo America is fraudulently conveying assets or making preferential transfers to creditors, or the management of Colmo America is dishonest or inept, a bankruptcy proceeding is not likely to assist in curing the problems that led to Colmo America’s difficulty in making the payments owed to my client. Indeed, aside from being costly, a bankruptcy proceeding may complicate my client’s ability to negotiate a resolution with its borrower, because the bankruptcy process is open to all creditors (including the bondholders) and anything agreed upon by my client and Colmo America will require bankruptcy court approval upon notice to all parties in interest. For these reasons, I would
be reluctant to commence a bankruptcy proceeding against Colmo America.

Moreover, the decision to commence an involuntary proceeding must be carefully taken. Such a proceeding must be filed by three or more entities, each of which is the holder of a claim that is not the subject of a bona fide dispute. For relief to be entered against the debtor in an involuntary case the court must find that the debtor is generally not paying such debtor's debts as such debts become due. Pursuant to 18 U.S.C. 156, the filing of such a petition is a criminal offense if the bankruptcy case is dismissed because of a knowing attempt by a bankruptcy petition preparer in any manner to disregard the requirements of Title 11, United States Code. For these reasons, an involuntary bankruptcy case should not be filed unless the preparer of the petition is comfortable that the requirements for the filing of such a petition are met.

With respect to the question of whether there is a legal basis to file an involuntary bankruptcy case in the United States against Colmo, S.A., assuming the requirements discussed above can be met, there is the question of whether Colmo, S.A., can be a debtor under the U.S. Bankruptcy Code. 11 U.S.C. 109 provides that only a person that resides or has a domicile, a place of business, or property in the United States may be a debtor. Thus, a foreign entity may be a debtor in a U.S. bankruptcy proceeding, but only if it meets these requirements. It appears that Colmo, S.A., does not have a domicile or place of business in the United States. The only open question is whether it has property in the United States. If it does, and if the other requirements of 11 U.S.C. 109 are met, there may be a legal basis (putting aside whether there is a good strategic basis) for seeking an involuntary bankruptcy of Colmo, S.A., in the United States.

**Question 12:** (to Messrs. Cardenas, Mendes and Heather)

Assuming again that the laws of El Paraiso resemble the laws of your respective countries, in a bankruptcy of Colmo, S.A.,

(i) Would foreign creditors suffer any disadvantage or discrimination?

(ii) What claims, if any, against Colmo, S.A. would be entitled to a priority or privilege in such a bankruptcy?

(iii) Would certain obligations (such as intra-group debt) be subordinated to the claims of third-party creditors?
(iv) At what point, if at all, would the claims of foreign creditors be converted into their local currency equivalent for purposes of participating in a bankruptcy proceeding in your country?

*Answers to 12 (Mr. Mendes)*

(i) Foreign creditors do not suffer any disadvantage or discrimination in relation to local creditors, except for the effects of the conversion of their creditors from foreign currency into local currency, which will be discussed in response to sub-question iv.

(ii) The order of classification of credits in the bankruptcy of a Brazilian company is as follows:

(a) credits relating to indemnification for on-the-job accidents;
(b) credits relating to obligations under labor law;
(c) fiscal and para-fiscal credits held by federal, state and municipal agencies. Social security contributions are at the same rank with federal taxes;
(d) the disbursements and expenses incurred by the bankruptcy estate, namely:

(1) court costs pertaining to bankruptcy proceedings and respective motions and appeals, and court costs pertaining to lawsuits in which the bankruptcy estate is defeated;
(2) loans made to bankruptcy estate by the *sindico* or other creditors;
(3) expenses incurred with attachment, seizure, appraisal, maintenance, administration and sale of the assets, the *sindico*’s fee inclusive;
(4) expenses pertaining to illness and funeral of the bankrupt *comerciante* who dies in poverty in the course of bankruptcy proceedings;
(5) taxes which fall due during the processing of bankruptcy;
(6) indemnification for on-the-job accidents which occur in the course of proceedings in the event the bankrupt continues to operate its business;
(7) court costs paid by the creditor which filed the request for bankruptcy; and
(8) obligations resulting from valid commitments undertaken by the *sindico*.

(e) claims secured by guarantees *in rem*;
(f) credits that have a special privilege on certain assets; these are determined by applicable law, such as the credit for rental payments in the real estate where the bankrupt used to carry on its business;

(g) credits with a general privilege, also determined by applicable law, such as credits due retirement and pension plans;

(iii) Intra-group credits, provided that they represent legitimate obligations, are treated like any other credit and will not be subordinated to third-party creditors.

(iv) All credits denominated in foreign currency shall be converted into local currency at the exchange rate prevailing in Brazil on the date of declaration of bankruptcy, and the amount so determined shall be the amount to be considered for all purposes of the Brazilian Bankruptcy Law.

The same applies for unsecured foreign creditors in the case of concordata proceedings.

Answer: (Mr. Heather)

(i) Under Mexican law, foreign creditors will have the same rights and obligations as any national creditor.

(ii) Creditors’ rights will be subject to the priorities granted by Mexican law to fiscal and labor claims, as well as to the bankruptcy or suspension of payment procedure expenses.

(iii) No, under Mexican law that criteria is not considered in order to rank creditors claims. Intra-group debt will be considered as a third-party creditor.

(iv) In bankruptcy and suspension of payment procedures, debts are accelerated and interest stops accruing with the declaration. Therefore, the Mexican courts will consider foreign currency debts accelerated, and will convert such debt into Mexican currency at the exchange rate effective on the date the bankruptcy or suspension of payments is declared.

Such criteria is based on judicial precedents which we do not agree with since the Mexican Monetary Law (the Monetary Law) provides that in the event that proceedings are brought in Mexico seeking performance of payment obligations in Mexico, the party owing amounts may discharge its obligations by paying any sums due in a currency other than Mexican currency, in Mexican currency at the rate of exchange prevailing in Mexico on the date when payment was made.
Nevertheless, the Mexican courts have applied the acceleration of debt criteria instead of applying the provision of the Monetary Law.

*Answer:* (Ambassador Cardenas)

See above, answer to question #2.

**ENFORCEMENT**

**Question 13:** (To Messrs. Cardenas, Mendes and Heather)

The Colmo U.K. bondholders have sued and obtained a judgment against Colmo U.K. and Colmo, S.A. in the High Court of Justice in London.

Under what circumstances would such a judgment be enforced in your country?

*Answer:* (Mr. Mendes)

Given the fact that Colmo, S.A. and Colmo U.K. are independent companies, a judgment against Colmo U.K. would have no effect whatsoever vis-a-vis Colmo, S.A., unless Colmo, S.A. were to be a guarantor of the obligations of Colmo U.K.

In the latter case a foreign judgment against Colmo, S.A. itself (but not against Colmo U.K. only) could be enforced in Brazil.

The requirements for enforcement of foreign judgments in Brazil are discussed below:

Any judgment rendered by a competent foreign court against a Brazilian company would be recognized and enforced by the courts of Brazil without re-examination of the issues, provided that: (i) such judgment is obtained in compliance with the legal requirements of the jurisdiction of the court rendering such judgment; (ii) such judgment is for the payment of a certain amount of money; (iii) service of process in the relevant action was made personally on the Brazilian defendant, either through a properly appointed agent for service of process domiciled abroad, or, if made directly against the defendant in Brazil, in compliance with applicable requirements of Brazilian law; (iv) such judgment does not contravene Brazilian public policy; (v) such judgment is final in the jurisdiction where rendered; and (vi) the applicable procedure under the law of Brazil with respect to the enforcement of foreign judgment is complied with.
Answer: (Mr. Heather)

A valid final award rendered by the competent foreign board (court of arbitration), would be enforced by the courts of Mexico without a retrial on the merits provided:

(a) such award is obtained in compliance with the legal requirements of the jurisdiction of the board rendering such award;

(b) such award is rendered in an in personam action as opposed to an in rem action;

(c) process in the action has been served personally to the defendant or a duly appointed agent;

(d) the obligation for which enforcement is sought does not violate Mexican law or public policy (orden publico);

(e) a rogatory letter from the arbitration board that rendered the award is available to the Mexican court before which enforcement of the award is requested, which rogatory letter complies with the procedural formalities provided for under Mexican law and a Spanish translation of the documents required in such proceedings prepared by a court-approved translator would have to be approved by the court after the defendant had been given the opportunity to be heard with respect to the accuracy of the translation, and proceedings would thereafter be based upon the translated documents;

(f) such award is final in the jurisdiction where obtained;

(g) the action in respect of which such award is rendered is not the subject matter of a lawsuit among the same parties pending before a Mexican court;

(h) the courts of such jurisdiction recognize the principles of reciprocity in connection with the enforcement of Mexican awards in such jurisdiction; and

(i) the requirements to establish the authenticity of the documents evidencing the final award must be met.

Answer: (Ambassador Cardenas)

Should no bankruptcy procedures be started against Colmo, S.A., a foreign judgment against such company, as guarantor for the U.K. bondholders can be enforced under “executor” procedures.