



Liquidation Of Multinational Companies: IMPLICATIONS FOR MEXICAN SUBSIDIARIES

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Introduction

Globalization is having a growing impact on U.S. companies, not only when they are healthy but also when they encounter financial difficulties. In some cases, U.S. companies that are in chapter 11 proceedings find that the companies that are prepared to buy them out of bankruptcy are foreign companies, including those from Latin America. For example, in recent months a Brazilian company, JBS, negotiated the acquisition of Pilgrim's Pride, which had filed for chapter 11 reorganization in December 2008;² and Asarco, which has been in chapter 11 since 2005, is on the verge of being rescued by its Mexican parent Grupo Mexico.³

Perhaps the more frequent situation in which there is interplay between Latin America and U.S. companies in bankruptcy involves the company which has operations in Latin America, typically through subsidiaries organized under local law. This was the situation facing Pilgrim's Pride, which has a large Mexican operation conducted through its Mexican subsidiary. Fortunately for Pilgrim's Pride, it looks set to emerge from chapter 11 with the help of the acquisition by JBS of Brazil, which may have been attracted by the possibility of expanding its presence not only in the U.S. but also into Mexico.

In some instances, the U.S. multinational company may not be so fortunate and may wind up in a chapter 7 liquidation proceeding, in which the trustee will be challenged by not only the customary problems faced by a U.S. liquidation, but also the complications resulting from the company's foreign operations and/or subsidiaries. This article will attempt to outline some of the main issues which the bankruptcy trustee must face in that context, focusing on the example of Mexico, where a large number of U.S. companies currently have operations.

Preliminary Considerations

The nature of the issues facing the U.S. trustee will of course depend greatly on the financial condition of the Mexican operations. If there are Mexican subsidiaries that are also in severe financial difficulties, it may be necessary to consider a separate filing for bankruptcy under Mexican law; the fact that the U.S. parent has become subject to a proceeding under the U.S. Bankruptcy Code⁴ does not mean that its Mexican subsidiaries have become subject to comparable proceedings. The U.S. trustee may also have to consider initiating an ancillary proceeding under Mexican law, to deal with assets and liabilities of the parent in Mexico, whether or not the Mexican subsidiaries themselves become subject to a Mexican proceeding.

A sale of relatively healthy Mexican subsidiaries, or pursuing preference claims against Mexican creditors of the parent, may offer the potential for recovering some value for the estate of the U.S. parent. Or, there may be contracts between the U.S. parent and one or more Mexican parties that require renegotiation or assignment to third parties, in order to realize value for the U.S. parent's estate. And finally, it may be necessary to manage litigation, either in the U.S. or in the Mexican courts, which involves the U.S. parent and/or one or more of its Mexican subsidiaries—either litigation already pending or which may be brought by or against one or more of the members of the corporate group—which will require the U.S. trustee to consider various aspects of cross-border litigation.

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Bringing Actions under the Mexican Insolvency Law Bankruptcy Filing by the Mexican Subsidiary

One of the first things the trustee should determine with respect to the U.S. debtor's Mexican subsidiaries is the scope and nature of their assets and liabilities and whether they are themselves insolvent. If they are, the trustee may want to consider initiating a voluntary proceeding under the Mexican Insolvency Law (the *Ley de Concursos Mercantiles* or LCM).

The LCM was enacted in 2000⁵ and is a substantial improvement over its predecessor, a Bankruptcy and Suspension of Payments Law which had been in place since the 1940s. The LCM is more streamlined than its predecessor, with more definite timeframes and even express provisions for prepackaged bankruptcies. There have been cases (most notably that of Corporacion Durango) in which the debtor has filed under the LCM and emerged from reorganization within twelve months, a phenomenon not known under the old law. The filing of a bankruptcy under the LCM does offer the advantage of an automatic stay. For these reasons, the U.S. trustee may be inclined to place the Mexican subsidiaries into bankruptcy to help preserve their value.

However, there are some significant disadvantages of filing under the LCM. For one thing, there are still risks of significant delays and costs despite the LCM's advances over the old law, in part because of the issue of labor claims. Article 224 of the LCM provides that labor claims arising under Article 123 of the Mexican Constitution and related provisions of the Federal Labor Law



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have a superpriority, even over secured claims, and a failure to reach an early agreement with labor claimants can result in serious delays, particularly with labor tribunals being very protective of labor claims. In one bankruptcy case we are familiar with, the total labor claims represent a significant percentage of the debtors' estate, but there is a secured creditor which is digging in its heels against the payment of these claims out of the mortgaged asset, causing significant delays in the case. This has frustrated the realization of the quicker timetable for liquidation contemplated by the LCM, with the result that the case has dragged on for over 7 years, with no end in sight.

Apart from the issue of labor claims, the administrative and legal costs of a liquidation under the LCM can be substantial, and may significantly reduce the net value of the subsidiary. A prepackaged bankruptcy may reduce both the timing and risk factors, but may not always be practical. The trustee should carefully consider whether a prepackaged bankruptcy is possible in the particular case and, if not, whether the effect of expected delays and costs would pose an unacceptable risk to the realization of significant value to the debtor's estate at the end of the Mexican proceeding.

If creditors of a Mexican subsidiary commence an involuntary proceeding under the LCM, the trustee should determine whether there are documented intercompany loans from the U.S. debtor to the subsidiary that would make the U.S. debtor a major claimant against the Mexican subsidiary. In a U.S. proceeding, such claims can run the risk of being re-characterized as equity investments or of being otherwise subordinated to the claims of unrelated creditors pursuant to the doctrine of equitable subordination; but this risk would generally not arise under the LCM. As a result, the U.S. debtor in such a situation may be able to steer the Mexican proceeding toward a more favorable result than it would be able to do otherwise. However, this approach still risks engendering substantial costs and delays; a more expeditious approach may be to negotiate with the creditors of the Mexican subsidiary with a view to arriving at an agreement which can help preserve the value of the subsidiary to the debtor's estate, perhaps by the trustee causing the U.S. debtor to pay off some or all of the claims against the Mexican subsidiary.

Bringing an Ancillary Proceeding in Mexico

Independent of the issue of the financial condition of any Mexican subsidiary, the trustee must determine whether the U.S. debtor itself has assets in Mexico, such as monies in a Mexican bank account in its name. If the trustee has difficulty transferring these assets back to the U.S., perhaps because they have been attached or otherwise blocked from being transferred, the trustee should consider whether to initiate, on behalf of the U.S. debtor, an ancillary proceeding in Mexico comparable to a proceeding brought under chapter 15 of the U.S. Bankruptcy Code.⁶ An ancillary proceeding may be the most expeditious way of escaping from the effect of the attachment or blocking.

The effect of an ancillary proceeding under the LCM would be to make the U.S. debtor's assets and liabilities in Mexico essentially subject to the outcome of the U.S. proceeding under the U.S. Bankruptcy Code. The goal would be to treat the assets in Mexico as part of the overall estate, and to include (without duplication) claims brought in Mexico with the overall body of

claims brought in the U.S. proceeding, so that any ultimate distribution of assets to creditors will involve all of the assets on a global basis. Normally, this inclusion process should be started while the U.S. debtor is still in a reorganization phase under chapter 11. If it is not begun prior to the initiation of the chapter 7 phase it may still be started thereafter, but the debtor's chapter 7 accounting of assets and liabilities would have to be expanded.

Selling the Mexican Subsidiaries

If the trustee determines that the Mexican subsidiaries represent potential value for the U.S. debtor's estate, it may wish to explore whether to carry out a sale of the subsidiaries pursuant to § 363 of the U.S. Bankruptcy Code. As between a sale of the shares the U.S. debtor holds in its subsidiaries and a sale of their assets, each has its pluses and minuses. The sale of shares is normally the simplest from the standpoint of transaction costs, in that a single share purchase agreement may be sufficient, but the risks are often greater, particularly from a tax point of view.

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capital gains tax is calculated either as a percentage (currently 25%) of the sale price or as a percentage (currently 30%) of the actual capital gain as evidenced by an accounting audit. Although the rate applicable to the actual capital gain is higher, the accounting audit may show that the actual capital gain is low enough that it would be to the parties' advantage to choose to apply the higher rate. However, the parties should consider the time required to conclude the audit and the need for the seller to appoint an audit representative before the Mexican tax authorities, which may delay the closing of the sale beyond the optimal time for closing. Negotiation of the share purchase agreement may require extensive negotiation over issues such as indemnities, including tax indemnities, against losses and claims which the buyer may become subject to as a result of acquiring the shares.

A sale of the subsidiary's assets located in Mexico is likely to be subject to the Mexican value added tax, which is currently 16% (recently raised from 15%) of the sale price. Calculation of the base value for determining the tax may require an appraisal of the relevant assets, which may be somewhat time-consuming but not as much as the above-mentioned audit for capital gains tax purposes. Documentation of asset sales may be more extensive than that which would be involved in a share sale, not only because sales may be negotiated with separate buyers but also because different types of sale contracts may be appropriate for different types of assets. Bills of sale are often the most important evidence of ownership of assets, so locating and delivering

the bills of sale will be a key part of the closing process.

Upon the Mexican subsidiary's receipt of the purchase price for the sale of any of its assets, it is normally free to repatriate such proceeds to the U.S. parent without the need for any Mexican governmental approval—unlike the case in some other countries such as Brazil, where a foreign exchange restrictions may affect the repatriation of capital.⁷

The trustee should keep in mind that after the Mexican subsidiaries sell off their assets and then distribute the proceeds thereof to the U.S. parent, the subsidiaries must—after having paid all liabilities—be dissolved and liquidated. This involves hiring a Mexican liquidator, holding shareholder meetings to approve the liquidation, having an accountant to prepare the liquidation balance sheet, publishing the balance sheet in a couple of Mexican newspapers in order to give creditors notice thereof, and paying the liquidator a fee to act as legal representative of the shareholders before the Mexican tax authorities for the statutory period of 10 years.

Depending on the financial and tax history of the Mexican subsidiaries, they may have substantial tax loss carryforwards that can be sold to other companies; but not necessarily to just any company—tax rules may necessitate a sale to a buyer in the same industry as that of the seller. In this regard, as with other tax issues raised by prospective sales of shares and/or assets, the trustee should retain experienced tax advisors who are able to assist in determining potential tax pitfalls as well as advantages in pursuing the various strategies for selling the Mexican subsidiaries and/or their assets.

From the U.S. perspective, the trustee will have to keep in mind the kinds of documentation that will be needed in order to obtain Bankruptcy Court approval of the sale(s) under § 363 of the U.S. Bankruptcy Code. One issue that may come up in this context is that of whether the sale documents create ongoing liabilities for the trustee or the U.S. debtor's estate. Given the goal of reaching a final resolution of claims against the estate, the Bankruptcy Court or the creditor community may be uncomfortable with documentation that may create contingent liabilities for the estate, such as indemnities against tax claims that may arise several years into the future.⁸

Making Preference or Fraudulent Transfer Claims against Mexican Parties

If the U.S. debtor incurred obligations to Mexican parties and made payments to such parties within the preference period, or made fraudulent transfers to Mexican parties, the trustee may wish to pursue these claims. If the putative defendants do not have assets in the U.S. that are capable of being readily located, and the trustee wishes to obtain a judgment in the U.S. that can eventually be enforced against parties in Mexico, the trustee should be aware that service of process against the defendants must satisfy Mexican require-

ments for due process in order for any such judgment to be enforceable through the Mexican courts (or to be a persuasive lever in any negotiations short of an enforcement action).

Mexican due process in this context requires that service of process be carried out through an officer of a Mexican court; service by mail or a private process server will not satisfy Mexican due process requirements. Unless it is possible to make personal service in the U.S. on the Mexican defendant who is an individual or (in the case of a defendant that is a Mexican company) on an attorney-in-fact of the Mexican defendant, service of process will have to be carried out through a letter rogatory process, i.e. by having the U.S. court issue a letter rogatory (letter of request) to a Mexican court requesting the latter's assistance in effecting service of process on the defendant.

The letter rogatory must be issued in accordance with the applicable provisions of the Mexican Commercial Code, which permit the use of the procedure contemplated by the Inter-American Convention on Letters Rogatory ("the Convention"). Both the U.S. and Mexico are signatories to the Convention, which involves the use of "Central Authorities" in the two countries. The Mexican Commercial Code and the Convention also permit letters rogatory to be delivered through other methods, including by the parties. For example, the plaintiff may send an apostilled and notarized certified copy of the letter rogatory directly to its Mexican counsel with instructions to deliver it, together with a Spanish translation prepared by a certified Mexican translator, directly to the Mexican court. The court will then direct one of its officers to deliver the summons and complaint (in English and Spanish) to the defendant, and after service is made, the court officer will deliver an affidavit of service to the Mexican court, which will thereupon return the letter rogatory to the U.S. court—either through the Convention procedure via Central Authorities or, if the plaintiff has elected the more direct approach, through the plaintiff's counsel in Mexico and the U.S.

A possible alternative to the letter rogatory route would be to bring an ancillary proceeding in Mexico under Title 12 of the LCM, and seek a return of the funds arguably paid as a preference

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or fraudulent transfer. Article 300 of the LCM authorizes the Mexican bankruptcy court supervising such a proceeding to grant any "remedy which, pursuant to Mexican legislation, may be granted to the inspector, the conciliator or the receiver."⁹ In accordance with Articles 112 et seq. of the LCM, the Mexican bankruptcy judge may be persuaded to order the return of the funds to the debtor. Although the notification process in such an ancillary proceeding will be more formalistic than service by mail in a U.S. proceeding, it is

likely to be more expeditious than service pursuant to letters rogatory. If a favorable order were granted, the trustee's Mexican counsel would still have to pursue enforcement of the order

against the Mexican party's assets as in the case of enforcing a foreign judgment, but at least this would avoid the complications of obtaining letters rogatory for such purpose.

As with any proceeding, the trustee should assess the putative defendant's collectability. Before undertaking service of process through a letter rogatory, or an ancillary proceeding under the LCM, the trustee should determine the likelihood of enforcing any eventual judgment or Mexican bankruptcy court order against the Mexican party. If a party's assets cannot be identified or located prior to initiating service of process or a Mexican ancillary proceeding, the trustee may have to conclude that the likely results of the exercise will not justify the legal expense involved, which might be the fees and costs of U.S. and Mexican counsel, the Mexican translation expense and possibly Mexican notarial fees or (in the case of a Mexican ancillary proceeding) Mexican bankruptcy court costs.

In a case involving a U.S. judgment, after obtaining a final judgment and identifying assets in Mexico that a judgment can be executed upon, it will be necessary to have the U.S. court issue a new letter rogatory to the Mexican court requesting its assistance in enforcing the judgment. Upon delivery of the Spanish translation of the letter rogatory to the Mexican court, the trustee's Mexican counsel would request that the judgment be recognized (homologated) and that attachment of identified assets be ordered. After attachment, the non-cash assets would normally be auctioned off and the cash proceeds of the auction would be paid in Mexican currency to the trustee's representative for forwarding to the trustee. A similar attachment process may be required to enforce a clawback order of a Mexican bankruptcy judge in an ancillary proceeding under Title 12 of the LCM.

Negotiating or Renegotiating Contracts with Mexican Parties

When conducting an initial analysis of the business of the debtor and its Mexican subsidiaries, the trustee should become familiar with the major contracts, or sets of contractual relationships, to which the Mexican subsidiaries are subject. Part of the value of the Mexican subsidiaries may be reflected by these contracts. Additionally, the liquidation of the U.S. debtor may affect some of these contracts and the subsidiaries' business prospects. For example, if the subsidiaries' business had previously depended on a supply of products (or component parts or raw materials) through the U.S. parent, and that cannot continue because of the parent's liquidation, it may be that the parts or materials can be sourced from other companies either within or outside Mexico.

The trustee may conclude that the Mexican companies should negotiate new supply contracts to replace those with the U.S. parent on which the Mexican companies had previously relied. If the subsidiaries will be sold, through a sale of either shares or assets, the buyer may be a candidate to be the supplier replacing the U.S. parent. If the supplier will be unrelated to the Mexican subsidiaries, the dynamic for negotiation of the new supply contracts will be different than it would be for a contract with an affiliated supplier.

In any event, delays in negotiating such contracts can have a dramatic impact on the value of the Mexican subsidiaries' busi-

ness. Customers may flee because of the uncertainty associated with not knowing where the supply of products, parts or materials will originate. The trustee may be racing to negotiate new contracts to avoid a collapse of the Mexican companies' customer base, which may mean a collapse of the companies' prospective sale value. It may be that the supply contract issue will have to take priority over other issues affecting the Mexican subsidiaries, given its importance to the sale value.

One issue which may come up in the negotiation of contracts is that of compliance with the Foreign Corrupt Practices Act in the U.S. or equivalent legislation in other countries; a U.S. company seeking to ensure compliance with the FCPA may wish its Mexican contracting party to agree to act in compliance with the FCPA, and the Mexican party may or may not be comfortable with agreeing to such compliance.

Management of Litigation in the Mexican Courts

Apart from the possibility of pursuing preference or fraudulent transfer claims in the Mexican courts (discussed above), there are other situations in which the Mexican subsidiaries or the U.S. debtor parent may become subject to litigation in Mexico. For example, suits may have been brought against the Mexican companies as a result of prior business activities in Mexico, foreign creditors may have sued these companies based on prior borrowings by the companies or because they have guaranteed obligations of the parent, and the Mexican companies may have brought suits based on contract claims against Mexican customers or suppliers. Such proceedings may have been brought in Mexico City (the Federal District) or in outlying states, or even in courts outside of Mexico; and the proceedings in Mexico may be in state courts or federal courts.

As is the case in many countries, litigators in Mexico seem to speak a different language than their colleagues who are corporate or transactional practitioners, in that the language used in court filings is often more formal than language used in contracts and corporate documents. Enforcement of contracts may become complicated due to the use of the amparo proceeding, a kind of constitutional-rights proceeding which is often used in contractual or commercial litigation and can complicate the course of what might otherwise seem to be a simple contract or commercial claim. Litigation can consequently take many years to resolve, unless the claim is based on a negotiable instrument (such as a promissory note), in which case an expedited proceeding may be available with the possibility of pre-judgment attachment of the identified assets of the defendant.

For the trustee who finds the U.S. debtor or any of its Mexican subsidiaries involved in Mexican litigation or who wishes to consider the potential risks and rewards of pursuing claims in the Mexican courts, the challenge can be daunting. Where possible, in negotiating a contract not involving a negotiable instrument, the trustee may wish to advocate for the inclusion of an arbitration clause in the contract. Where it is too late for either a contract or a negotiable instrument, the trustee may be forced to rely on counsel able to supervise Mexican litigators and report on the progress thereof in language which the trustee can understand.

Conclusion

A U.S. trustee handling the liquidation of a multinational com-

pany must be prepared for complications not found in domestic cases. When the U.S. debtor has subsidiaries in Mexico, there have been some cases that give guidance as to some of the key issues that are likely to arise, and we have tried to outline the issues in this article. As stated, acting quickly will often be the key to maximizing the value of the subsidiaries to the U.S. debtor's estate; but this does not mean acting rashly or without considering the full range of issues that are presented by the existence of Mexican subsidiaries. The trustee must decide whether a Mexican bankruptcy proceeding is appropriate and whether there are preference or other claims to be pursued against persons in Mexico.

In many cases, the most expeditious way to realize value will be to sell the subsidiaries under § 363 of the U.S. Bankruptcy Code, but in order to do this effectively, the trustee must determine whether an asset sale or a share sale makes more sense and what the contractual, tax and litigation ramifications are to such a sale. If the sale approach does not work, then a separate liquidation or bankruptcy proceeding in Mexico may be necessary. ♣

Footnotes:

- ¹ This article benefited from comments of Strasburger partners Mark Andrews (Washington DC) and Duane Brescia (Austin).
- ² See Robinson-Jacobs, Karen. "Bankruptcy judge approves Pilgrim's Pride exit plan." *The Dallas Morning News* 11 December 2009 <http://www.dallasnews.com/sharedcontent/dws/bus/stories/DN-pilgrim_11bus.ART.State.Edition1.3cf54cc.html>.

- ³ See Kamp, Dick. "Grupo Mexico Pays 1.8 Billion in ASARCO Environmental Settlement." *WillcoxRangeNews.com*, 16 December 16 2009 <<http://www.willcoxrangeneews.com/articles/2009/12/16/news/news16.txt>>.
- ⁴ 11 U.S.C. § 101 *et seq.*
- ⁵ Published in the *Diario Oficial de la Federación* on May 12, 2000. Amendments to the LCM were published in the *Diario Oficial* on December 27, 2009.
- ⁶ See Title 12 of the LCM which, like chapter 15 of the U.S. Bankruptcy Code, generally follows the UNCITRAL Model Law on Cross-Border Insolvency (UN Sales No. E 99V 3, 1999).
- ⁷ Cf. The Economist Intelligence Unit Brazil: Forex regulations: Exchanging and remitting funds: Overview, October 6, 2009 <http://www.eiu.com/index.asp?layout=VWArticleVW3&article_id=1964890381&showarchive=true®ion_id=&channel_id=220004022&country_id=1480000148&rf=0&category_id=390004039&archive_link=index%2Easp%3Flayout%3DVWCategoryVW3%26region%5Fid%3D%26channel%5Fid%3D220004022%26country%5Fid%3D1480000148%26rf%3D0%26category%5Fid%3D39004039>.
- ⁸ The bankruptcy court may require an auction process to be conducted if the value of the subsidiary being sold would justify holding one or more auctions to ensure that the sale price is the best and highest price. If there have been extensive marketing efforts prior to filing a 363 motion or the assets are rapidly dwindling in value, it is possible that the trustee could convince the judge that an auction is not necessary.
- ⁹ LCM Art. 300(VI).