ARBITRATION AS A TOOL IN SUPPORT OF INSOLVENCY PROCEDURES (CONCURSO MERCANTIL)

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I. INTRODUCTION

It is evident that international arbitration, as a generally efficient and viable alternative to contractual, and more generally, commercial dispute settlement before national courts, has grown exponentially in the last decade.[1] Moreover, there have been several recent and transcendental cases in which renowned multinational companies[2] have had to seek the protection of insolvency laws, with the peculiarity that they were simultaneously in the middle of an arbitration process. Among the most recent of these are the bankruptcy proceedings of Lehman Brothers in 2008, and Nortel – the telecommunications giant – in 2009. In both cases, the multinationals had a considerable number of arbitrations pending against them at the time of requesting protection from the relevant bankruptcy courts. The conclusion of the bankruptcy courts, which reasoning is also reflected in doctrine, was that, as a general rule, the companies were required to comply with their arbitration clauses and any arbitral awards, despite being subject to an insolvency proceeding.[3] These cases have thus presented arbitration proceedings and insolvency proceedings as competing, rather than compatible, procedures.

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[1] INTERNATIONAL CHAMBER OF COMMERCE, RETHINKING TRADE AND FINANCE. ICC GLOBAL SURVEY ON TRADE AND FINANCE 2011 (2011).

[2] The term "company" is purposely used, just as it is employed in the Ley de Concursos Mercantiles (LCM).

[3] *See generally* VESNA LAZIC, ARBITRATION AND INSOLVENCY PROCEEDINGS: CLAIMS OF ORDINARY CREDITORS (1999) (comparing the most relevant provisions of Dutch, French and American Law). *See also* Mette H. Kurth, *The Arbitration Act and the Bankruptcy Code Collide*, 43 UCLA L. REV. 3 (1996).

It is not the purpose of this article to analyze these cases in detail, but rather to expose concrete ideas as to how insolvency proceedings and arbitration may not only coexist, but how arbitration may become a useful tool in support of ongoing insolvency proceedings. In particular, arbitration may be an efficient way of managing and resolving discrete, complex financial issues, and cross-border insolvency disputes.[4]

II. THE NEED FOR EXPERTISE IN THE RESOLUTION OF DISPUTES INVOLVING COMPLEX FINANCIAL INSTRUMENTS AND CALCULATIONS

Recent litigation arising out of the global financial crisis of 2008-2009, illustrates the need for specialized assistance in resolving disputes arising out of complex financial instruments. In Mexico, the turbulence of the financial markets in 2008 severely affected the foreign exchange market as well as foreign exchange rates. An avalanche of unexpected, and unpredictable, events followed which led to billions of U.S. dollars in losses to a significant number of Mexican companies as a consequence of the use, and in some cases the abuse, of complex derivative products.[5] These events were widely reported, both in the national and international press. Furthermore, the complicated process of determining companies' closing positions, clarifying the terms of the derivative products and the apparent lack of bilateralism of the parties' obligations under these instruments, resulted in lawsuits before New York courts, in which the companies sought to nullify the derivative products for which they had contracted.[6]

Notwithstanding that all of the claims presented by the relevant companies against their creditor banks were ultimately unequivocally rejected by the New York courts, the complexity of the calculations involved in these disputes forced the courts to delegate to a

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[4] Some authors have been lukewarm in their response to similar proposals. *See, e.g.*, STEVEN P. FINGIO & DUNCAN SPELLER, A PRACTICAL GUIDE TO INTERNATIONAL COMMERCIAL ARBITRATION: ASSESSMENT, PLANNING AND STRATEGY. (2010).

[5] In the last quarter of 2008, several companies listed on the Mexican Stock Exchange reported that their derivative agreements had generated significant losses, including Controladora Comercial Mexicana (US $1,080 million), Vitro (US $227 million), Cemex (US $271 million) and Alfa (US $250 million).

[6] *See, e.g.*, J. Aron & Company v. Controladora Comercial Mexicana, S.A.B. de C.V., Index No. 603225/2008 (Sup. Ct., NY County); Credit Suisse International v. Vitro Envases Norteamerica, S.A. de C.V., Index No. 600298/2009 E (Sup. Ct., NY County); Deutsche Bank AG v. Vitro Envases Norteamérica, S.A. de C.V., Index No. 600612/2009 (Sup. Ct., NY County) Korea Life Insurance Company v. Morgan Guaranty Trust Company of New York, 269 F. Supp. 2d 424 at 431.

third party financial expert the determination of the liquid and due amount in favor of the banks.[7] Ultimately, a compromise was reached in accordance with which both the companies and the banks yielded on their claims in order to permit a restructuring which put an end to the controversy, and consequently, preserve the company as an ongoing concern. As a general matter, these companies have since made a steady recovery and have maintained a constant rate of recovery and growth, following the temporary distress they suffered from their dealings with complex derivative products.[8]

In the context of this article, what it important about these cases is that, within the bankruptcy process, the courts found it permissible – and indeed necessary – to request a third party expert, or a panel of experts, to evaluate and rule on a specific, technical/financial issue which was beyond the scope of the judge's expertise. These third party experts or panels of experts were also able to make suggestions to the creditors, to the debtor, or to the conciliator. An example of the specific type of financial question which might be referred to such experts would be, in the opinion of the author, the complex subject of margin calls on non-conventional derivative products. In a scenario where an agreement by the parties (the company, the other creditors and the counterparty) is not reached, it would be well worth the effort to refer such a controversy to an arbitration tribunal comprised of experts in this field, whose award would of course be binding, therefore avoiding further expense and economic loss, as well as providing a more efficient and effective process for all the parties involved.

Indeed, complex financial issues may hinder and delay insolvency proceedings even from their inception. Pursuant to the Mexican insolvency law (*Ley de Concursos Mercantiles*), in order for a judge to declare a company in bankruptcy, the court must first

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[7] As counsel to certain parties involved and in light of the duty of confidentiality towards my clients, I cannot provide further details of these proceedings.

[8] *Expansión*, May 2, 2011; "*La Comer se beneficia de su reestructura,*" available at: http://www.cnnexpansion.com/negocios/2011/06/15/la-comeratraera-mas-clientes-con-julio

The survey held by CNN Expansión.com, expects the company to register a 150% increase in its quarterly utilities, and an increase of 3% in sales. available at: http://www.cnnexpansion.com/negocios/2011/06/15/la-comeratraera-mas-clientes-con-julio

confirm that there was a general payment default.[9] However, in determining whether there has been a general payment default, there may well be a dispute as to the quantum of the company's accrued obligations, or as to which assets may be considered liquid. Why not settle disputes of this nature efficiently through an expedited arbitration led by experts on the subject matter?

The use of arbitration with relation to discrete questions requiring financial expertise may assist in the efficient resolution of insolvency proceedings. The fact is that, once the insolvency procedure (*concurso mercantil*) is commenced (or admitted), it is essential that the process advance efficiently towards recognition and classification of the competing creditor claims.[10] Whilst in complex cases there may be a contractual basis to determine the liquid and due amounts which correspond to a particular creditor's claim, disputes may arise among the conciliator, the creditor (or alleged creditor), the company and even the receiver, as to the calculation of such liquid and due amounts. A binding resolution made by an independent third party expert would certainly assist in the efficient resolution of such disputes.

There is a wide range of highly complex financial questions which may helpfully be submitted to an arbitration process using expert determinations within the context of an insolvency proceeding (*concurso mercantil*). Other examples include determining: the validity of the amounts of the related credits; the liquid and due amount with regard to derivatives; the valuation and/or sale of assets during the insolvency proceedings; the classification of certain securities; the differences with respect to the interpretation of the pre-packaged plans, including interpretations related to the implementation of the restructuring agreement (*convenio concursal*).

It is interesting to observe that, in some jurisdictions, courts have indeed had recourse to alternative means of dispute settlement (mediation and arbitration), in order to resolve discrete issues in connection with insolvency proceedings, which have in turn contributed to the orderly restructuring of the companies, maximizing their value and

[9] Ley de Concursos (LCM), arts. 9-10.

[10] LCM, art. 125 (providing the requirements for credit recognition applications).

maintaining an appropriate balance between debtor and creditor.[11] In Brazil, Fifth Civil Court of Sao Paulo ordered a defaulting company in the textile industry, and an American branch of a Brazilian bank, to submit to a mandatory arbitration process in order to determine the amount to be recognized as a joint credit.[12] In the European Union, within bankruptcy procedures, certain technical disputes (for example, the cost of transferring professional athletes) have been submitted to arbitration proceedings, either as a result of a petition made by the disputing parties, or *sua sponte* by the court of jurisdiction.[13]

III. ARBITRATION MAY ASSIST IN THE RESOLUTION OF CROSS-BORDER INSOLVENCY DISPUTES

International arbitration may contribute as a tool to simplify some aspects of multinational insolvency procedures. In fact, consideration has already been given to the creation of an arbitration and international insolvency committee within the United National Commission on International Trade Law (UNCITRAL)[14].

Arbitration could even be of assistance in the resolution of disputes as to which jurisdiction is the proper seat for the principal insolvency procedure when dealing with a single multinational debtor.[15] In multinational insolvencies, it is common for the debtor's assets to be considered as separate and independent estates, each one subject to the exclusive jurisdiction of the courts located in the same place as the assets. This leads to disputes as to which jurisdiction is the actual center of operations of the defaulting multinational, in order to determine which court has jurisdiction over the principal insolvency procedure. Furthermore, serious disputes may arise among creditors located in different countries regarding the use, and the distribution and liquidation of the assets located in different jurisdictions. These disputes have surfaced in a large number of insolvency proceedings involving multinational debtors, particularly because, as a general

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[11] See, e.g., Zimmerman v. Continental Airlines, Inc., 712 F. 2d 55 (3d Cir. 1983). *See also* JAN KLEINHEISTERKAMP, INTERNATIONAL COMMERCIAL ARBITRATION IN LATIN AMERICA (2005).

[12] Fernando Eduardo Serec, *Court Embraces Derivatives Arbitration*, Int'l L. Office, June 4, 2009, *available at* www.internationallawoffice.com.

[13] Phillip K. Wagner, *When International Insolvency Law Meets Arbitration*, 3 DISP.RESOL. INT'L, 56 (2009).

[14] *See* Zack A. Clement, *Background Memorandum for the International Insolvency Institute's proposal to UNCITRAL concerning International Insolvency/Arbitration*, Fulbright & Jaworski LLP, November 2006.

[15] *See generally* LCM, arts. 296-297.

matter, national laws based on the UNCITRAL Model Law on International Commercial Arbitration (as is the case in Mexico[16]) do not provide with sufficient precision the manner in which this type of dispute is to be resolved.

For example, Article 296 of the Ley de Concursos Mercantiles provides, in rather general terms, the factors which determine whether a foreign insolvency proceeding will be recognized as the principal, or a non-principal, proceeding. Article 296 provides in its relevant part:

> The Foreign Proceeding will be recognized:
>
> As the Principal Foreign Procedure, if it is being processed in the State where the Merchant has its principal place of business, or
>
> As the Non-Principal Foreign Procedure, if the Merchant has an establishment pursuant to the terms set forth in Article 279, Section IV of this Law, in the territory of the State of the foreign venue.

This type of broad formula may cause uncertainty between the multinational debtor and its various creditors scattered in different jurisdictions. If an arbitration and international insolvency commission existed, arbitration could be used as a tool to determine, from the beginning of the process, the jurisdiction for the principal proceeding and would result in a more streamlined and efficient bankruptcy proceeding.[17]

IV. CONCLUSIONS

Insolvency proceedings under Mexican law (*concurso mercantil*) and arbitration are two very different procedures. Each one has its own specific objectives and is designed to protect certain legal interests. The insolvency proceeding is a procedure which is considered to be in the public interest insofar as it has the purpose of protecting and

[16] LCM, art. 12.

[17] In the bankruptcy cases of the Italian multinational, Parmalat, and of the Maxwell group, the battle among the respective authorities to decide which court had jurisdiction to undertake the principal procedure took several full years to be resolved.

conserving companies.[18] Arbitration is a means, a process, which has as its purpose the resolution of a dispute outside of the national courts.[19]

Despite their different nature and objectives, however, one should avoid the simple assertion that no dispute which may surface in the context of insolvency may be referred to arbitration. Both as a matter of fact (the necessity for expertise) and law (as experience shows us) these procedures may co-exist insofar as arbitration may be a useful and efficient support tool in the insolvency process, especially in cases involving complex financial instruments or multinational proceedings.

The possibility of providing for discreet issues to be the subject of arbitration proceedings as a part of the insolvency process is ripe for reconsideration in Mexico. Indeed, as early as 1987, Mr. Salvador Rocha Diaz proposed an extrajudicial institution as an alternative that could co-exist with Mexico's bankruptcy legislation in order to support traders in crisis and in that way ensure the preservation of the company and its jobs.[20] Now, more than ten years after its enactment, Mexico's Ley de Concursos Mercantiles has shown some signs of exhaustion, giving rise to an extensive, yet inconclusive set of amendments which became effective in February of 2014. Without doubt, it is nevertheless necessary to continue to work to maintain the competitiveness of the insolvency framework of Mexico, and to search for adjustments which will promote greater legal certainty and efficiency in order to facilitate the financial restructuring of companies in distress. While further evaluating the Ley de Concursos Mercantiles and the institutions which stem from it, introducing arbitration as an instrument that could enhance the effectiveness of insolvency proceedings should be considered, therefore avoiding the disadvantages of following the traditional system which rests solely on the calendar and technical competence of a national judge.

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[18] LCM, art1.

[19] FRANCISCO GONZALEZ DE COSSÍO, ARBITRAJE 12-18 (2008) (discussing the nature of arbitration).

[20] LCM Congressional Declaration of Purpose.