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More, Better, Faster: Gauging the Effectiveness of Mexican Insolvency Reform

Michael D. Good,¹ Managing Principal, South Bay Law Firm, Torrance, California, USA

1. Introduction

Time is money. The NAFTA region's market-oriented national governments have sought to help private enterprise save both. In Mexico, these efforts have resulted in significant legislative reform: In 2000, the legislature completely overhauled Mexico's bankruptcy scheme, resulting in fundamental structural changes to Mexican insolvency law. The aim of such measures was to help address the challenges of financial globalisation, the need to attract foreign investment and credit, and the proliferation of regional and global trade agreements.

But have Mexico's reform efforts worked? This article suggests that two primary features of those efforts – the expedited pace of insolvency proceedings and the establishment of a separate governmental agency charged with overseeing them – appear to be generating real savings in time and, in at least some cases, money.

2. Overview

2.1. Legislative reforms

The changes to Mexico's bankruptcy legislation,² though significant, are embodied in a relatively simple, two-step process – debtors receive an opportunity to reorganise, followed by liquidation in the event reorganisation efforts prove unsuccessful. Upon the filing and admission of a proper petition³ and approximately 35 days after the appointment⁴ of an initial *visitador* (examiner),⁵ the presiding court will issue a judgment

granting or denying a *concurso* proceeding (analogous to an order for relief under US law). If a *concurso* is granted, the court then appoints a *conciliador* (conciliator) and the debtor thereafter has a period of up to 185 days (extendable to 360 days) in which to negotiate with its creditors over the terms of an acceptable plan of reorganisation. If the debtor cannot successfully negotiate an acceptable plan within the one-year conciliation period, if the conciliator seeks liquidation at an earlier point, or if the debtor seeks liquidation directly rather than through a reorganisation, the court may enter a judgment of bankruptcy. At this point, a *sindico* (trustee) is appointed and a liquidation of the debtor's assets proceeds⁶ in a manner similar to that under Chapter 7 of the US Code.

Mexico's new law has accelerated the pace of insolvency proceedings. As will be explored in some detail below, insolvency proceedings that commonly took four years or more to complete now routinely require less than 12 months.

2.2. IFECOM's composition and involvement

Among the changes implemented by Mexico's 2000 reform efforts was the establishment of a quasi-judicial administrative agency – the *Instituto Federal de Especialistas de Concursos Mercantiles* (IFECOM) – for the oversight of bankruptcy cases. IFECOM's primary point of contact with the insolvency system is through a registry of specialists – professionals appointed at various stages of insolvency proceedings. The registry is comprised of public and private practitioners, and as of

Notes

- 1 The author wishes to thank Dr. Luis Manuel C. Méjan, Director General of Mexico's *Instituto Federal de Especialistas de Concursos Mercantiles* and a member of the International Insolvency Institute, for his very helpful comments in preparing this article. The views and opinions expressed here (and any errors or omissions) are the author's own. For questions or comments regarding this article, contact mgood@southbaylawfirm.com or to lmc@cjf.gob.mx.
- 2 These reforms are enacted through Mexico's *Ley de Concursos Mercantiles* (LCM).
- 3 LCM Arts 20, 22, 23.
- 4 LCM Arts 40 and 42. Interim relief is available pursuant to LCM Art. 37.
- 5 LCM Art. 29.
- 6 LCM Arts 197-216.

year-end 2007, included 66 *Visitadors*, 99 *Conciliadores*, and 92 *Sindicados*.⁷ Admission to the register is selective: during the first six months of 2007, eight applicants were admitted to the Official Register, seven applicants were under consideration, and 24 had been rejected.⁸ Another eight applications were reviewed, six admitted, and five stricken for various reasons during the latter half of that year.⁹

The work of the Institute itself is broad, encompassing direct consultative and technological support for appointed specialists at various stages of proceedings, research and assistance regarding matters of technical expertise for federal judges who require it, and direct interface with debtors, creditors, various governmental agencies and legislative bodies, and the public at large. Some specific instances of IFECOM's direct involvement in insolvency proceedings are covered in the discussion below. In addition, the Institute's Accountancy Committee recently completed its work on an 'Accounting Guide for the Bankruptcy Process'.¹⁰ The Institute continues to collaborate with authorities of the Mexican financial system in studying a proposed *ad hoc* insolvency law tailored to the banking sector.¹¹

3. Mexico's bankruptcy reform – is it working?

Are these reforms truly working? Specifically, are they producing the type of insolvency proceedings that can attract foreign credit and 'approximate' the insolvency

schemes of neighbours such as the US? The following discussion attempts to provide the reader with a picture of the 'real-world' changes wrought by Mexico's reformed system, and – only very briefly – mention areas of further possible development.

3.1. Asset base and leverage of debtors

Though the law itself imposes no requirements, a recent empirical study of Mexican insolvency proceedings prepared by Mario Gamboa-Cavazos and Frank Schneider (both of Harvard University)¹² indicates that the size of Mexican debtors remains roughly the same under the old and new laws: in the sample reviewed, debtor firms had median assets of approximately USD 5M.¹³ However, firms entering insolvency under the new law exhibited higher leverage: a median of approximately USD 7.7M in obligations, versus USD 3M under the old. This indicates that, along with reform, the median leverage of debtor firms has increased from 0.9 to 1.37.¹⁴

In addition to over-leverage, other data suggests that debtor firms commonly have significant liquidity problems: IFECOM's reporting indicates that of 192 examiners' reports produced in connection with insolvency petitions initiated under the new law from its inception up to and including the first half of 2007, approximately 82% of the companies then in insolvency proceedings satisfied the LCM's 'liquidity' requirement¹⁵

Notes

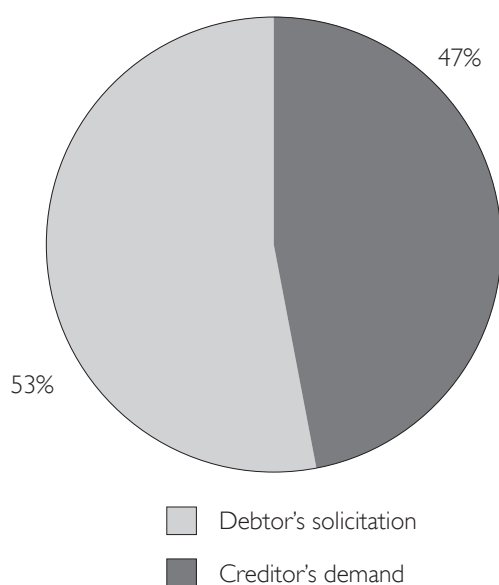
- 7 See *Poder Judicial de la Federación Consejo de la Judicatura Federal Instituto Federal de Especialistas de Concursos Mercantiles Informe Semestral 21 de Mayo de 2007 a 20 de Noviembre de 2007* ('15th Bi-Annual Report of the Council Of The Federal Judicature's Federal Institute Of Bankruptcy Proceedings Specialists') (IFECOM 15) at p. 6. A copy of this report is available online, and in Spanish, at <www.ifecom.cjf.gob.mx/PDF/informes/15.pdf>, 10 July 2008. An English-language translation is on file with the author.
- 8 See *Poder Judicial de la Federación Consejo De La Judicatura Federal Instituto Federal de Especialistas de Concursos Mercantiles Informe Semestral 21 de Noviembre de 2006 a 20 de Mayo de 2007* ('14th Bi-Annual Report of the Council Of The Federal Judicature's Federal Institute Of Bankruptcy Proceedings Specialists') (IFECOM 14) at p. 6. A copy of this report is available online, and in Spanish, at <www.ifecom.cjf.gob.mx/PDF/informes/14.pdf>, 10 July 2008. An English-language translation is on file with the author.
- 9 IFECOM 15 at p. 6. This selectivity indicates the Institute's commitment to the recognised professional excellence of its appointed professionals. Consistent with that same commitment, the Institute has endorsed recent proposed reforms that would elevate the professional fees of appointed specialists from priority 'wage claims' the equivalent of 'administrative expenses' as that term is contemplated under analogous US law. See IFECOM 15 at p. 13.
- 10 See IFECOM 15 at p. 10.
- 11 IFECOM 14 at p. 11; IFECOM 15 at p. 10.
- 12 Portions of the data and conclusions reviewed for this article appear as a working paper by Mario Gamboa-Cavazos and Frank Schneider entitled 'Bankruptcy as a Legal Process' (1 June 2007 draft) (GC), available online through author or title search at <www.ssrn.com>, 10 July 2008. A copy is on file with the author. As described at p. 13 of that paper, the data set draws from a stratified random sample of bankruptcy cases administered under either the old or the new law. Cases administered under the old law were drawn from the archives of the Supreme Court of Justice of the Federal District. Cases ruled on under the new law were drawn from the archives of IFECOM. For both sources, cases were selected to represent the distribution of bankruptcy filings for the period of 1991 to 2005. In particular, the paper's authors used the courts' registers and the institute's database to construct a list of all nonfinancial firm filings throughout the relevant period. The authors then generated a series of random numbers associated to filings and chose cases for every year. For each selected case they further verified that the dockets were in fact available and complete at the archive.
- 13 GC at p. 17.
- 14 GC at p. 17.
- 15 LCM Articles 9 and 10 together impose a liquidity requirement on voluntary and involuntary 'Merchant' insolvencies. Specifically, a petition for business reorganisation requires a determination of 'generalised default', itself determined by: (I) a showing that at least 35% of the debtor's 'past due' obligations are at least 30 days delinquent as of the date of the petition; and (II) the debtor's 'liquid assets' (as defined in Article 10) are insufficient to 'cover' at least 80% of these 'past due' obligations.

– and of these, the average reported liquidity (i.e., the ratio of liquid assets to outstanding liabilities) was only 3.6%.¹⁶

Gamboa-Cavazos and Schneider suggest that this trend toward over-leverage and under-liquidity results from:

- The requirement, under the new law, of a demonstration of insolvency as defined in terms of liquidity (see discussion at n. 15 above);
- The fact that debtors are now much more reluctant to file without the weapons of delay previously available to them; and
- The frequency of involuntary bankruptcy: Tabular statistical data set forth in IFECOM’s reporting¹⁷ (and reproduced at Figure 1 below) shows an almost even split between ‘voluntary’ (53%) and ‘involuntary’ (47%) petitions over the life of the new law.¹⁸

Figure 1: Origin of proceeding



3.2. Faster – and better – outcomes

The Gamboa-Cavazos-Schneider study indicates dramatic differences in the speed and outcome of the reformed Mexican insolvency process:¹⁹

Outcome	Median time required (new law)	Median time required (old law)
Reorganisation	771	2655
Liquidation	1288	3039
Failure ²⁰	998	3478
Settlement out-of-court	357	–

- Unsecured creditors appear to recover somewhat less under the new law (USD 0.04) than under the old law (USD 0.18); secured creditors presently recover more (USD 0.50) than before (USD 0.18).
- Bank creditors recover more presently (USD 0.42) than previously (USD 0.18); non-financial creditors recover less (USD 0.18 (old) versus USD 0.02 (new)).

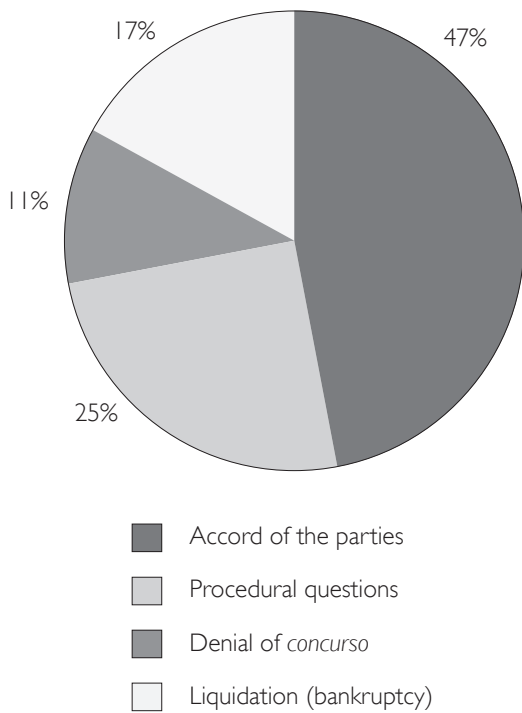
As suggested by this data, insolvency under the new law is much faster, regardless of the outcome. Further, secured and institutional creditors appear to fare somewhat better under the new law than do unsecured, non-institutional creditors. These results are not surprising given the apparent reluctance of firms to initiate proceedings (thereby resulting in more acute financial distress when a firm does enter proceedings) and secured creditors’ improved position under the new law. Gamboa-Cavazos and Schneider have further suggested that improved returns for secured creditors under the new law are attributable, in part, to shorter time to resolution (which minimises deterioration of assets and diminution of claims).²¹

The new law also appears to encourage settlements: In *concurso* proceedings terminated during the second half of 2007, 47% were reportedly due to an accord of the parties – while 17% went to liquidation, 11% were denied access to *concurso* proceedings, and 25% were subject to appeal.²²

Notes

16 This average excludes four companies with much higher liquidity ratios which – if included in the sample – would have skewed the average upward to 11%. IFECOM 14 at p. 13.
 17 See IFECOM 15 at *Apéndice 1 (ESTADÍSTICAS CONCURSALES)*, (Appendix 1: *Concurso* Statistics) (IFECOM 15-1) at Figure 2 (reproduced as Figure 1). A copy of this Statistical Appendix is available online at <www.ifecom.cjf.gob.mx/PDF/informes/15-1.pdf>, 10 July 2008.
 18 GC at pp. 17-18 and general discussion therein.
 19 GC at 18-19. All figures are medians for their respective measures.
 20 ‘Time to completion’ in this case indicates median time to determination of failure.
 21 GC at pp. 18-19.
 22 IFECOM 15-1 at Table 20 (reproduced as Figure 2).

Figure 2: Cause of termination of proceedings

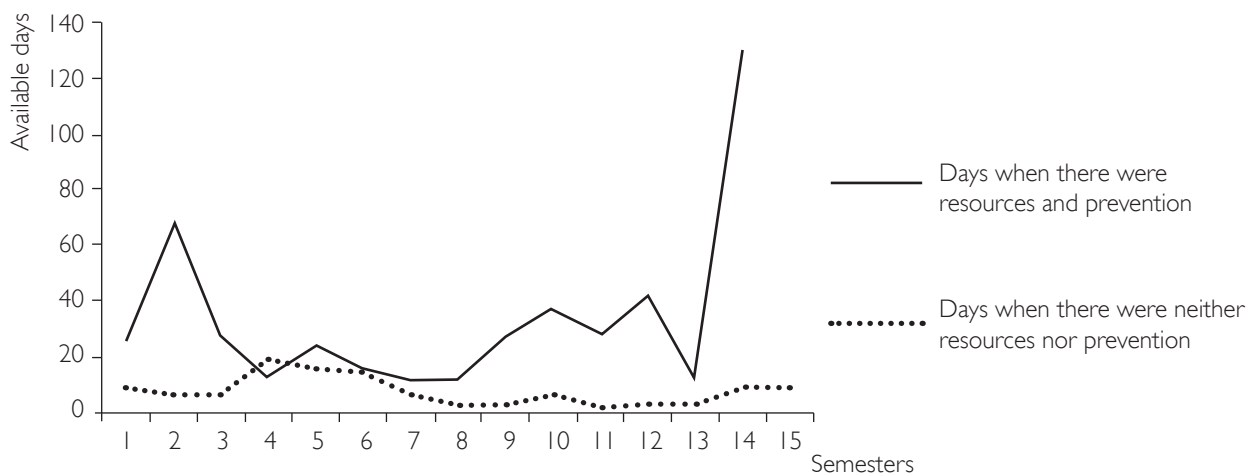


3.3. Quicker process

Like insolvency outcomes, each component phase of the insolvency process is itself much quicker under the new law. A principal driver of this change appears to be the new law’s ‘liquidation trigger’, which provides bankrupt firms only one year (360 days) in which to reorganise before an automatic liquidation occurs. Whereas delay (typically implemented through often-frivolous litigation and appeals) previously afforded debtors a powerful negotiating weapon, the new law effectively turns the former negotiation dynamic on its head. Debtors must now evaluate whether – and under what circumstances – they will contest the administration of their case and risk liquidation. Consequently:

- Filing and admission times are relatively rapid. For operating cases pending during 2007, the average time from the application for bankruptcy to its acceptance was nine days.²³
- Appointment of a *conciliador* likewise occurs quickly – the Gamboa-Cavazos-Schneider study indicates 30 days (median) under the new law, far more rapidly than the 200-day median under the old. IFECOM likewise reports the average time from acceptance and appointment of an examiner to the issuance of a *concurso* judgment during the first half of 2007 was 27 days in the Federal District (i.e., Mexico City); 24 days in other districts.²⁴ During the latter half of 2007, this average trended upward to 32 days overall.²⁵ Gamboa-Cavazos and

Figure 3: Days between presentation of debtor’s request or creditors’ demand and admission



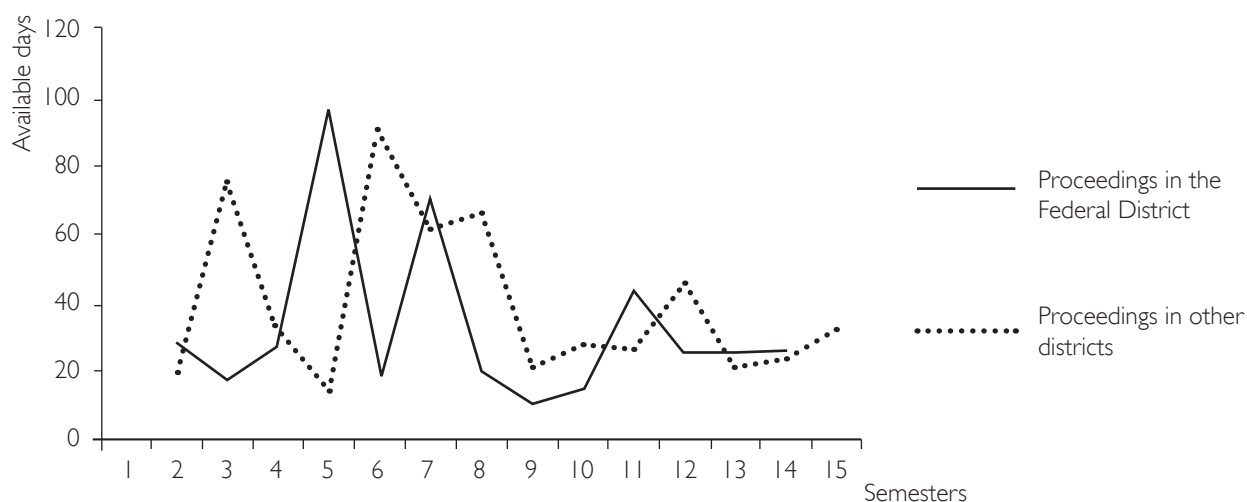
Notes

23 See IFECOM 14 at p. 11; IFECOM 15 at p. 11. IFECOM’s 14th Bi-Annual Report notes that, in one exceptional case excluded from the average, the time from application to acceptance was 129 days. IFECOM 14 at n. 9. See also IFECOM 15-1 at Figure 24 (reproduced as Figure 3). Note that this time is increased in instances where the petition is contested.

24 IFECOM 14 at p. 11. Note that this average time appears slightly faster than the median time to appointment reported in the Gamboa-Cavazos-Schneider study, discussed below.

25 IFECOM 15 at p. 11. See also IFECOM 15-1 at Figure 25 (reproduced here as Figure 4).

Figure 4: Days between admission of debtor’s request or creditors’ demand and investigation order



Schneider attribute this change to the ‘highly efficient selection ... of [appointees] which is carried out by [IFECOM]’²⁶ – a change from former law, where debtors had unrestrained ability to object and appeal an official’s appointment.²⁷

- From appointment of an examiner to the issuance of a report – or a determination that a complete report is not possible – required an average of 69 days during the first half of 2007.²⁸ During the second half of 2007, that average decreased to only 26 days.²⁹
- Registration of claims is likewise much shorter – Gamboa-Cavazos and Schneider’s study record a 156-day median under the new law, nearly a year shorter than the old law’s 476-day median. The same study suggests three possible causes for

this:³⁰ centralised claims registration under the trustee’s control, streamlined claims processing and noticing procedures for claims analysis and objections,³¹ and – perhaps most importantly – the disincentive to file frivolous claims objections.

- Possibly the most striking time difference between the old law and the new regards plan confirmation. From appointment of a *conciliador* to plan confirmation previously took almost four years (median: 1327 days). With reform, confirmation time has been cut to approximately nine months (median: 272 days).³² According to IFECOM, the average time from the appointment of a *conciliador* to confirmation judgment dropped from 227 days to 85 days over the first and second halves of 2007.³³

Notes

26 GC at 20-21.

27 GC at 21.

28 IFECOM 14 at p. 11.

29 IFECOM 15 @ p. 11. See also IFECOM 15-1 at Figure 26 (reproduced here as Figure 5).

30 GC at 21.

31 IFECOM’s Bi-Annual Reports indicate an emphasis on the use of technology in this process. In particular, the Institute has developed and refined existing software applications and other technologies employed by the examiner and by the subsequently-appointed conciliator, with the goal of improved access and transparency for all parties. Further applications are being developed at IFECOM for use by trustees operating in liquidation. IFECOM 14 at p. 5. In further aid of efficiency, the Institute has on at least 32 occasions provided further, direct consultation and support to specialists in the field. IFECOM 15 at p. 5.

32 GC at 22.

33 See IFECOM 15-1 at Figure 27 (reproduced here as Figure 6). See also IFECOM 14 at p. 11. A review of this data indicates that, in fact, more recent *average* times reported by IFECOM are far shorter than the *median* times reported in the Gamboa-Cavazos-Schneider study. IFECOM’s data over the life of the new law indicates that the average *concurso* proceeding moves from admission to request for plan approval – and ultimately, to confirmation – in less than six months. These averages are ‘rolling’, i.e., calculations based on reported statistics then available to the Institute, as amended by new data. IFECOM attempts to eliminate statistical distortions by eliminating the highest and lowest value of each sample. From judgment to recognition, emergence and prioritisation of claims required an average of 85 and 147 days, respectively, during the first and second halves of 2007. See IFECOM 14 at p. 12; IFECOM 15 at p. 11.

Figure 5: Days between *concurso* order and examiner's report or determination that a complete report is not possible (including formulation of allegations)

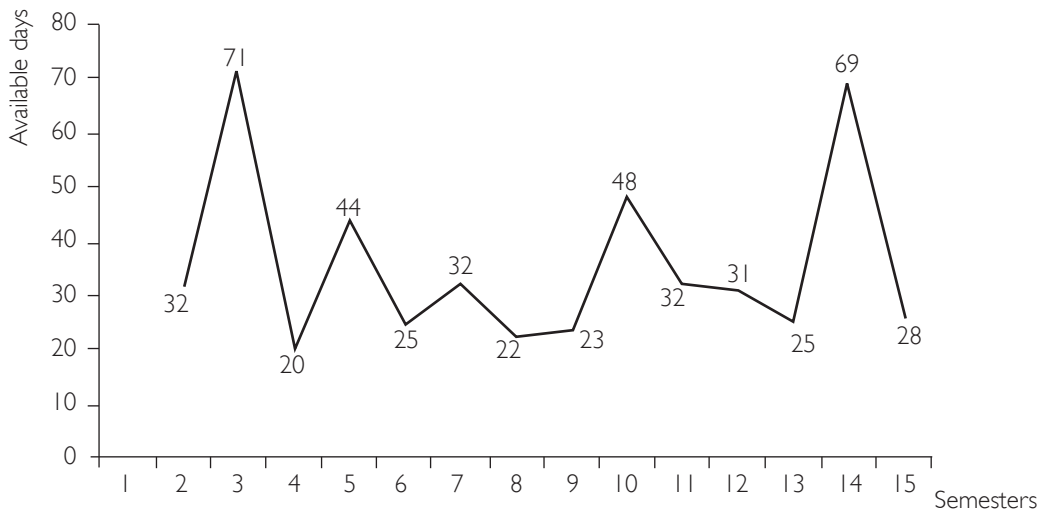


Figure 6: Days between the presentation of the debtor's request or creditors' demand and the *concurso* declaration

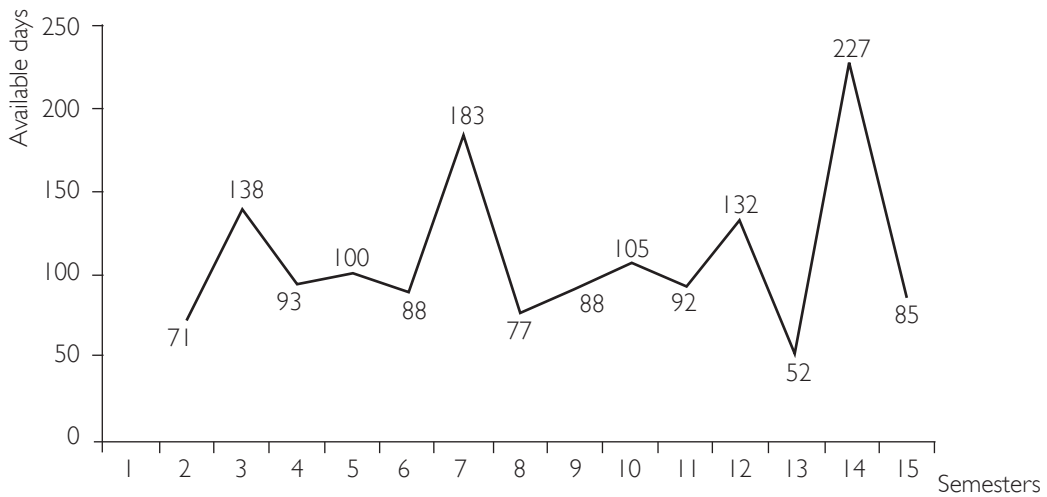
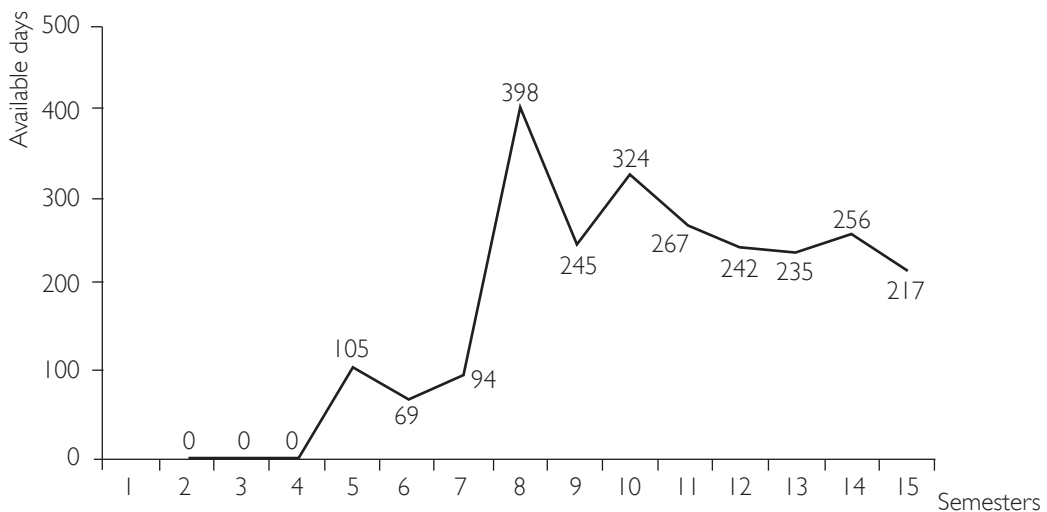


Figure 7: Days between *concurso* order and bankruptcy order



- When *concurso* proceedings do not work, Mexican law mandates bankruptcy liquidation. During the first half of 2007, the average time from initial appointment of a *conciliador* to a judgment of bankruptcy was 256 days – with this figure trending downward to 217 days during the latter half of 2007.³⁴
- Once in bankruptcy, the primary time difference between proceedings under the old law and the new arises during ‘occupation’ – i.e., the initial phase of liquidation when the *sindico* takes possession of the bankrupt estate. Formerly, such occupation required over four months (median: 131 days); now it requires approximately three weeks (median: 23 days).³⁵

Gamboa-Cavazos and Schneider suggest that all of these timing differences – particularly as regard claims processing and plan confirmation – owe to litigation disincentives.³⁶

3.4. Direct IFECOM involvement

Another overlooked but important source of efficiency under the new law appears to be direct involvement of IFECOM specialists and the Institute’s consultation. During 2007 alone, the Institute consulted extensively with its specialists through its Judicial Committee (834 consultations);³⁷ its Economic-Finance Committee (47 consultations); and its Administrative Committees (25 consultations);³⁸ and resolved judicial questions over specialists’ fees (47 occasions).³⁹

3.5. Less – and quicker – litigation

Gamboa-Cavazos and Schneider’s study indicates that the new law has spawned much less litigation than its predecessor:⁴⁰

- Under the old law, the median number of litigation filings for an entire proceeding (i.e., reorganisation and liquidation phases) was 23; under the new law that median has been reduced to only seven.⁴¹
- Of these filings, debtors account for a median number of 15 under the old law; creditors account for five.⁴² Under the new law, by contrast, debtors account for a median of only two filings per case; creditors account for three.⁴³
- Further results indicate that litigation is resolved more quickly. Appeals for both debtors and creditors take far less under the new law than they did under the old. Though debtors’ defences still take more median time to resolve than creditors’ defences, this delay is now a threat to debtors rather than a strategic bargaining tool.⁴⁴

These findings are viewed as ‘evidence of a shift in the relative bargaining power of parties in bankruptcy’.⁴⁵

4. Conclusion and possible future developments

Mexico’s market-oriented approach to insolvency administration is perhaps best summarised by IFECOM’s Director-General, Dr. Luis Manuel C. Méjan Carrer:

‘In sum, it is perhaps appropriate to consider the assertion of Economic Nobel Prize winner John F. Nash, author of *A Theory of Games*, who suggested that whatever the economic undertaking (in our case a bankruptcy proceeding), to be successful,

Notes

34 IFECOM 14 at p. 12; IFECOM 15 at p. 11. See also IFECOM 15-1 at Figure 30 (reproduced here as Figure 7).

35 GC at 22.

36 GC at 22 (‘Once all outstanding claims are registered, the judge must issue a resolution validating or approving the registry. This resolution is appealable by the debtors and creditors alike. Appeals under the old law, nonetheless, were a powerful source of delay since they took many months to be resolved. Even when appeals did not impose a stay on the procedure, they did impose some paralysis because the confirmation of a plan under the old law required 75 percent agreement [by creditors]. Evidently many creditors could not exert their voting rights if their claims were under review by an appellate court. The shortened period to confirm a plan under the new law provides support to [the] [h]ypothesis [that restrictions on the ability to litigate at key stages of the bankruptcy process shorten procedural time and curb delay by parties]’).

37 See IFECOM 14 at p. 6 (reporting 450 consultations); IFECOM 15 at p. 5 (reporting 384 consultations).

38 IFECOM 15 at p. 5.

39 IFECOM 14 at p. 6; IFECOM 15 at p. 5. As noted, the Institute provides a technical resource for federal judges endeavouring to administer Mexico’s reformed insolvency process. As of 2007, the Institute’s Judicial Committee responded to approximately 166 judicial inquiries for professional opinions or written materials on technical issues. IFECOM 14 at p. 6; IFECOM 15 at p. 6.

40 GC at 23.

41 GC at 23.

42 GC at 23.

43 GC at 23.

44 GC at 24-25: ‘What are these results suggesting? On the one hand, the reform was successful at curbing the amount of debtor litigation, a source of considerable delay according to many practitioners of the old law. On the other hand, the shift in venue from local to federal courts mandated by the reform seems to have had an impact only at the appellate court level. This may seem an incomplete accomplishment of the reform, but really it is not ... [A]ppeals were and continue to be an instrumental dilatory force’. GC at 25.

every party involved must be prepared to seek the “second-best” option and sacrifice the “best option”. The utility of [Mexican] bankruptcy proceedings is based on this philosophy, and thereby serves as a tool for resolving firms’ liquidity problems.’⁴⁶

To these ends, and under this leadership, Mexico presses on with successful insolvency reform, including:

4.6. Post-Petition Financing

Presently, Mexican law provides no formal mechanism for post-petition ‘debtor-in-possession (DIP) financing’; moreover, the over-leveraged financial condition in which many *concurso* candidates find themselves suggests that post-petition credit is not for every firm. However, improved creditor control (particularly for secured creditors) and dramatically increased speed of proceedings indicates that the

general legal environment is becoming much more hospitable for such financing arrangements, whenever the debtor’s capital structure permits them.

4.7. Pre-Packaged or Pre-Arranged Bankruptcies

As a result of legislative study undertaken with the encouragement of the Mexican Supreme Court, several senators have advanced reforms that include provisions for pre-packaged or pre-arranged bankruptcies. These reforms were enacted in late 2007, and are now effective. In IFECOM’s view, such procedures will be beneficial since they will afford interested parties who perceive value in the troubled enterprise a means of ‘jump-starting’ the insolvency process before the liquidity problems now typical of many *concurso* debtors effectively foreclose an effective rehabilitation.⁴⁷

Notes

45 GC at 23.

46 IFECOM 14 at p. 14 (*‘Resulta conveniente pensar en la aseveración del Premio Nobel de Economía, John F. Nash, autor de una Teoría de los Juegos, quien sostuvo que para que cualquier proyecto económico, en nuestro caso, un concurso mercantil, pudiera tener éxito, todas las partes involucradas deben estar dispuestas a obtener su mejor segunda opción, sacrificando lo que para todos representa la primera mayor opción. Sobre esta filosofía se construye la utilidad del concurso mercantil como herramienta de solución a las empresas con conflictos de liquidez’*).

47 IFECOM 15 at p. 13.

International Corporate Rescue

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