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# MEXICAN INSOLVENCY LAW

John A. Barrett, Jr.†

## INTRODUCTION

A decade ago, the only reason for international legal practitioners to be concerned with insolvency and securitization issues in Mexico appeared to be academic curiosity. With the collapse of the oil industry in the early 1980s, Mexico had huge international debts it could not repay and the economy spiraled into a period of hyperinflation.<sup>1</sup> In 1982, Mexico nationalized its banks.<sup>2</sup> Prior to 1989, when Mexico's president, Carlos Salinas de Gortari, issued the Foreign Investment Regulations (the "Foreign Investment Regulations")<sup>3</sup> that liberalized the 1973 Law to Promote Mexican Investment and to Regulate Foreign Investments (the "1973 Law"),<sup>4</sup> government consent to majority foreign ownership of a Mexican business was required and very difficult to obtain. Additionally, taking a security interest in real property was often cumbersome given that fee title to certain agricultural lands could not be privately held<sup>5</sup> and property within 100 kilometers of Mexico's borders and within 50 kilometers of its coasts (the "Restricted Zone") could not be owned by foreigners.<sup>6</sup> Given these developments, international investors and creditors had little interest in Mexico as a potential market.

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<sup>1</sup> M. Delal Baer, *North American Free Trade*, FOREIGN AFFAIRS, Fall 1991, at 132-33. See generally MEXICO 2000, at 33-39 (Polyconomics, Inc., 1990).

<sup>2</sup> Baer, *supra* note 1, at 136.

<sup>3</sup> Reglas de la Ley para Promover la Inversion Mexicana y Regular la Inversion Extranjera, Diario Oficial de la Federación [D.O.] (May 16, 1989).

<sup>4</sup> Ley para Promover la Inversion Mexicana y Regular la Inversion Extranjera, D.O. (Nov. 9, 1973) [hereinafter "1973 Law"].

<sup>5</sup> Edward Bely, *Privatization Mexican Style*, DELOVIE LYUDI, October 1992, at 42; MEXICO 2000, *supra* note 1, at 10. The "ejido" system governs the use of agricultural lands. Only life estates were granted under the "ejido" system.

<sup>6</sup> MEX. CONST. art. 27 (corresponds to art. 36 of the 1973 Law, *supra* note 4).

In the six years of President Salinas' administration, Mexico underwent a phoenix-like rebirth. In 1987, near the end of Miguel de la Madrid's presidential term, Mexico joined the General Agreement on Tariffs and Trade.<sup>7</sup> In the late 1980s, an Economic Solidarity Pact was formed between government, business and labor to help bring inflation under control.<sup>8</sup> By 1993, Mexico had inflation of around 9 percent.<sup>9</sup> As already noted, the Foreign Investment Regulations were introduced in 1989 to permit foreign investors to own 100 percent of Mexican businesses.<sup>10</sup> Maximum tariffs were reduced from 100 percent, with tariff schedules often creating actual duties that were considerably higher, to 20 percent with an average tariff of nine percent.<sup>11</sup> The Mexican Constitution was amended on June 27, 1990 to permit private ownership of commercial banks and the Mexican financial system was further reformed in July of that year by the promulgation of the Credit Institutions Law<sup>12</sup> and the Financial Groups Law.<sup>13</sup> Following these reforms, Mexico privatized its banking industry, completed at the end of 1992, as well as privatized the vast majority of Mexico's other paras-tatal industries.<sup>14</sup> Much of the money derived from the privatization process was used to pay off a significant portion of Mexico's external debt. In 1991, a new intellectual property law was promulgated.<sup>15</sup> The "ejido" system, governing use of agricultural lands, was also reformed to permit private ownership of "ejido" land in Mexico.<sup>16</sup>

As a result of these and other changes, private sector interest in Mexico was revitalized. Direct foreign investment into Mexico more than doubled between 1985 and 1990, and has con-

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<sup>7</sup> Baer, *supra* note 1, at 133; *Mexico: Respect Restored*, ECONOMIST, February 13, 1993, at 3, 6.

<sup>8</sup> See generally MEXICO 2000, *supra* note 1, at 6, 41.

<sup>9</sup> Mexico Service, Volume XIII, No. 2, February 5, 1993, at 2; MEXICO 2000, *supra* note 1, at 39; *Mexico: Respect Restored*, *supra* note 7, at 3.

<sup>10</sup> MEXICO 2000, *supra* note 1, at 9.

<sup>11</sup> MEXICO 2000, *supra* note 1, at 11; *Mexico: Respect Restored*, *supra* note 7, at 3.

<sup>12</sup> Ley de Instituciones de Credito, D.O. (July 18, 1990).

<sup>13</sup> Ley para Regular las Agrupaciones Financieras, D.O. (July 18, 1990).

<sup>14</sup> Bely, *supra* note 5, at 42.

<sup>15</sup> Ley de Fomento y Proteccion de la Propiedad Industrial, D.O. (June 27, 1991).

<sup>16</sup> See *supra* note 5 and accompanying text.

tinued to grow at a rapid pace since that time.<sup>17</sup> In 1993, the United States had \$41.6 billion in exports to Mexico.<sup>18</sup> Investors from around the globe began flocking to Mexico as a newly opened market full of investment opportunities.

Much of this excitement can be attributed to the North American Free Trade Agreement ("NAFTA"),<sup>19</sup> which went into effect on January 1, 1994. The NAFTA elevates the status of many of the changes made by President Salinas by executive decree and has created additional opportunities for foreign investors. Under the NAFTA, North American businesses may now participate to an extensive degree in the financial services sector in Mexico.<sup>20</sup> Historically, many types of financial services, such as mortgage lending, that are common in other parts of the world have played only a limited role in Mexico and create significant opportunities for investors.<sup>21</sup>

In connection with the ratification of the NAFTA, Mexico promulgated a new foreign investment law that took effect on January 1, 1994 (the "Foreign Investment Law").<sup>22</sup> In addition to implementing many of the changes mandated by the NAFTA for the benefit of North Americans, the Foreign Investment Law greatly expands opportunities for investors from other countries and permits Mexican companies with foreign equity participation to own property in the Restricted Zone for certain construction and development purposes.<sup>23</sup>

Together with the greatly expanded volume of trade with Mexico that has been occurring in recent years and the significant increase in foreign investment activities into Mexico come the inevitable risks: debtors may not pay their bills and a percentage of newly formed ventures will eventually become insolvent. These risks have been made all the more evident by the

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<sup>17</sup> U.S. DEP'T OF STATE, 1990 MEX. TRADE REPORT, NAT'L TRADE DATA BANK.

<sup>18</sup> U.S. DEP'T OF STATE, 1993 MEX. TRADE REPORT, NAT'L TRADE DATA BANK.

<sup>19</sup> Canada-Mexico-United States: North American Free Trade Agreement, 32 Int'l Legal Materials 605 (1993) (hereinafter NAFTA).

<sup>20</sup> *Id.* at ch. 14.

<sup>21</sup> U.S. DEPARTMENT OF STATE, MEXICO-MORTGAGE FINANCING TRENDS 1994, NATIONAL TRADE DATA BANK.

<sup>22</sup> Ley de Inversion Extranjera, D.O. (Dec. 27, 1993) [hereinafter Foreign Investment Law].

<sup>23</sup> Jorge A. Vargas, *Mexico's New Foreign Investment Act*, 4 MEXICO TRADE AND LAW REPORTER, No. 2 (1994).

recent devaluation of the Mexican peso.<sup>24</sup> Given these risks, any business person planning on extending credit into Mexico should be interested in the ability of creditors to obtain secured collateral and to proceed against such collateral for the fulfillment of debts and have a basic understanding of the insolvency process in Mexico. Additionally, the number of multijurisdictional bankruptcies has grown significantly in recent years. When coupled with the likely expansion of numerous additional businesses into Mexico, cross border insolvencies involving an entity with assets, a branch, or a subsidiary in Mexico will certainly increase in the years to come.<sup>25</sup>

This article addresses these concerns by providing a legislative background for bankruptcy and insolvency in Part I. Part II will present an overview of the secured lending regime in Mexico, with a description of the Mexican insolvency process in Part III, and a review of suspension of payments in Part IV. After reviewing these Mexican law matters, this article will consider cross border insolvency issues in Part V and will highlight certain differences between insolvency proceedings in Mexico and in the United States in Part VI. Part VII will conclude Mexico needs an updated and efficient means of transacting secured credit and multi-national insolvencies.

## I. THE LEGISLATIVE FRAMEWORK FOR BANKRUPTCY AND INSOLVENCY

Unlike the United States,<sup>26</sup> Mexico's legal system is based on civil law, derived from the Napoleonic Codes, and not from

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<sup>24</sup> The peso-dollar exchange rate had been relatively stable between 1991 and 1994. The exchange rate on January 3, 1993 was 2.950 new pesos to the dollar. WALL ST. J., Jan. 3, 1993. On January 1, 1993, Mexico converted its currency at a rate of 1,000 pesos equals 1 new peso and on January 3, 1994, the rate was 3.1050 new pesos to the dollar. *Id.* However, on December 20, 1994 the exchange rate dropped dramatically to 3.9750 new pesos to the dollar. WALL. ST. J., Dec. 20, 1994. The rate has continued to tumble and was at 7.45 new pesos to the dollar on March 9, 1995. WALL ST. J., Mar. 9, 1995.

<sup>25</sup> See generally *The Law and Practice of International Insolvencies, Including a Draft Cross-Border Insolvency Cocordat*, in NORTON BANKRUPTCY LAW AND PRACTICE (2d ed. 1993).

<sup>26</sup> Louisiana is a jurisdiction that borrows from both the common law and civil law traditions.

common law.<sup>27</sup> Mexico has both federal and state civil statutes and courts.

Commercial insolvency is a federal law matter in Mexico. Business bankruptcies are controlled by the Law of Bankruptcy and Suspension of Payments (hereinafter referred to as the "Bankruptcy Law").<sup>28</sup> Both statutory entities and individuals engaged in business in Mexico have their insolvency processes governed by this law.<sup>29</sup> However, there are a number of types of organizations whose bankruptcies have distinct rules applicable to them.<sup>30</sup> These entities are: banks and auxiliary credit institutions, insurance companies, public corporations (i.e., companies in the business of providing a public good, such as airlines and railroads, not merely publicly-traded corporations), and bonding institutions. Given the special rules for certain types of entities and other concerns, such as tax claims and protection of employees, there are a number of other federal statutes intimately involved with the business bankruptcy proceeding. These laws include the Federal Labor Law,<sup>31</sup> the Tax Code of the Federation,<sup>32</sup> the Credit Institutions Law,<sup>33</sup> the General Law of Mutual Insurance Institutions and Societies,<sup>34</sup> and the New Federal Law of Bonding Institutions.<sup>35</sup>

On the other hand, personal, nonbusiness insolvencies are governed by the relevant provisions of the state civil code in the state having jurisdiction over the insolvency. The state determined to have jurisdiction is based on the domicile of the debtor.<sup>36</sup> A nonbusiness insolvency proceeding is known as a

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<sup>27</sup> David W. Banowsky & Carlos A. Gabuardi, *Secured Credit Transactions in Mexico*, 28 INT'L LAW. 263, 264 (Summer 1994) [hereinafter Banowsky].

<sup>28</sup> Ley de Quiebras y de Suspension de Pagos, D.O. (April 20, 1943) [hereinafter Bankruptcy Law].

<sup>29</sup> Bankruptcy Law, *supra* note 28, art. 1 & 4.

<sup>30</sup> See generally Agustin Berdeja, *Debt Collateralization and Business Insolvency: A Review of the Mexican Legal System*, 1993 A.B.A. THIRD NAT'L INST. ON MULTINATIONAL COM. INSOLVENCY, 27-28, 55-59.

<sup>31</sup> Ley Federal del Trabajo, D.O. (April 1, 1970).

<sup>32</sup> Codigo Fiscal de la Federacion, D.O. (December 31, 1981).

<sup>33</sup> Ley de Instituciones de Credito, D.O. (July 18, 1990).

<sup>34</sup> Ley General de Instituciones y Sociedades Mutualistas de Seguros, D.O. (January 3, 1990).

<sup>35</sup> Nueva Ley Federal de Instituciones de Fianzas, D.O. (January 3, 1990).

<sup>36</sup> Richard A. Gitlin and Rona R. Mears, 2 INTERNATIONAL LOAN WORKOUTS AND BANKRUPTCIES 536, 537 (Butterworth Legal Publishers, 1989) [hereinafter Gitlin]; Berdeja, *supra* note 30, at 27.

"concurso," not as a bankruptcy.<sup>37</sup> Although this article will focus on the Bankruptcy Law, the civil codes of the various states in Mexico tend to be extremely similar to one another and the rules and procedures governing a concurso are similar to those governing a bankruptcy.<sup>38</sup> In the Federal District (Mexico City), nonbusiness insolvencies are governed by the Civil Code for the Federal District in Common Matters and for the Entire Republic in Federal Matters (hereafter the "Civil Code").<sup>39</sup> When analyzing securitization and other issues not dealt with by federal law, the Civil Code is used as the basis for the descriptions contained in this article.

The Bankruptcy Law was enacted in 1943 and has undergone only one minor revision, in 1987, in the last 50 years.<sup>40</sup> The Bankruptcy Law was patterned on the bankruptcy laws of Spain in effect at that time.<sup>41</sup> The law has many ambiguities and inconsistencies which frequently lead to inconsistent interpretation and application by courts.<sup>42</sup> Commentators on Mexican bankruptcy law frequently state the need for reform to the bankruptcy law given the significant problems arising out of the law in its current form.<sup>43</sup>

Given that insolvent entities will often continue operating during lengthy insolvency proceedings, Mexican insolvency proceedings should not be seen as overly friendly to the creditor.<sup>44</sup> In fact it is common for many of the assets of the bankruptcy estate to be consumed in the course of the insolvency proceeding.<sup>45</sup> However, the lack of available additional credit for an insolvent business makes the Mexican equivalent of a reorganization difficult to accomplish. Therefore, the Mexican insolvency laws should not be seen as overly debtor-oriented either.<sup>46</sup>

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<sup>37</sup> Gitlin, *supra* note 36, at 537.

<sup>38</sup> Banowsky, *supra* note 27, at 266; Gitlin, *supra* note 36, at 537.

<sup>39</sup> Código Civil para el Distrito Federal en Materia Comun y para toda la Republica en Materia Federal, D.O. (September 1, 1932) [hereinafter Civil Code].

<sup>40</sup> Berdeja, *supra* note 30, at 2.

<sup>41</sup> Gitlin, *supra* note 36, at 531.

<sup>42</sup> Gitlin, *supra* note 36.

<sup>43</sup> Gitlin, *supra* note 36, at 531.

<sup>44</sup> Gitlin, *supra* note 36, at 534 and 545.

<sup>45</sup> Gitlin, *supra* note 36, at 534.

<sup>46</sup> Gitlin, *supra* note 36, at 534 and 531.

## II. SECURED CREDIT IN MEXICO: AN OVERVIEW

Just as in the United States, security interests may be taken in Mexico in both real and personal property.<sup>47</sup> As is typical in most jurisdictions, the various methods for taking a security interest in property are designed to give the secured creditor a means of having guaranteed repayment of the debt owed to him or her. This is done by giving the creditor the ability to demand the sale of the secured asset, and to ensure that he or she has a preferential right to the proceeds of the sale over other creditors of the debtor. However, at least one of the common mechanisms for taking security interests in Mexico, the use of a trust, is not ordinarily used in the United States.<sup>48</sup>

With regard to real property, the most common method for taking a security interest is to take a mortgage ("hipoteca") in the real estate of the debtor.<sup>49</sup> If properly executed, a mortgage creates a lien in favor of the creditor to secure the obligation owed by the debtor.<sup>50</sup> When the value of the property subject to the mortgage exceeds 365 times the Federal District's daily minimum wage, it must be in the form of a public deed.<sup>51</sup> A "public deed" is one that has been notarized under the formalities of Mexican law.<sup>52</sup> The mortgage must be recorded in the Public Registry of Property and Commerce in the jurisdiction where the property is located to be valid against third parties.<sup>53</sup> Failure to record the mortgage will not invalidate it as between the parties, but will cause it to have no effect against the interests of third parties in the property. Mexican law defines real property broadly, and, as a result, a mortgage is a proper method to take a security interest in a surprising range of items, from livestock to aircraft.<sup>54</sup>

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<sup>47</sup> See generally Banowsky, *supra* note 27, for an in depth discussion of secured credit in Mexico.

<sup>48</sup> See generally Gitlin, *supra* note 36, at 521; Banowsky, *supra* note 27, at 269-70.

<sup>49</sup> See generally Civil Code, *supra* note 39, § 2893 et seq.; Banowsky, *supra* note 27, at 266-269; Gitlin, *supra* note 36, at 521.

<sup>50</sup> Banowsky, *supra* note 27, at 268.

<sup>51</sup> Berdeja, *supra* note 30, at 8.

<sup>52</sup> Banowsky, *supra* note 27, at 264-65.

<sup>53</sup> Banowsky, *supra* note 27, at 268; Berdeja, *supra* note 30, at 9.

<sup>54</sup> Civil Code, *supra* note 39, § 2893.



In general, Mexico does not embrace self-help remedies. There are no rights to private foreclosure sales, so all sales must be carried out judicially.<sup>55</sup> Jurisdiction will always fall to a Mexican court, which will apply Mexican law to the proceeding.<sup>56</sup> Upon the creditor's filing a pleading, the court will publish the foreclosure petition and the debtor will have five days to respond.<sup>57</sup> Upon the expiration of such period or after dismissing any objections made by the debtor, the property is appraised by an expert and sold through a public auction.<sup>58</sup> All bids must be made for at least two-thirds of the appraised value of the property.<sup>59</sup>

Although there are generally no restrictions on foreign creditors taking security interests in Mexican assets, there are various provisions in the Foreign Investment Law and its regulations that prohibit ownership of certain types of assets by foreigners.<sup>60</sup> The most significant of these restrictions has historically been ownership of land in the Restricted Zone, but other types of real property and fixtures have similar restrictions.<sup>61</sup> Although these restrictions will prohibit a foreign creditor from owning such assets upon foreclosure, a security interest in such assets can be obtained by a foreigner.<sup>62</sup> Obviously, upon the judicial sale of such assets, the assets must be sold to someone permitted to own them under Mexican Law.<sup>63</sup> Additionally, the Foreign Investment Law permits foreign-owned Mexican companies to own property in the Restricted Zone. This can be done upon receiving a permit from the Foreign Investment Commission, for certain limited purposes, including construction and development operations.<sup>64</sup> Therefore, it may now be possible for foreign creditors to own property in the Restricted Zone upon foreclosure through use of a foreign-

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<sup>55</sup> Gitlin, *supra* note 36, at 524; Banowsky, *supra* note 27, at 287.

<sup>56</sup> Gitlin, *supra* note 36, at 523.

<sup>57</sup> Civil Code, *supra* note 39, § 1404.

<sup>58</sup> Civil Code, *supra* note 39, § 1404; *See generally* Berdeja, *supra* note 30, at 10; Banowsky, *supra* note 27, at 289.

<sup>59</sup> Berdeja, *supra* note 30, at 10.

<sup>60</sup> *See generally* Gitlin, *supra* note 36, at 523; Berdeja, *supra* note 30, at 9-10; Foreign Investment Law, *supra* note 22.

<sup>61</sup> *See* Foreign Investment Law, *supra* note 22; Vargas, *supra* note 23.

<sup>62</sup> Gitlin, *supra* note 36, at 523; Berdeja, *supra* note 30, at 9-10.

<sup>63</sup> Gitlin, *supra* note 36, at 523; Berdeja, *supra* note 30, at 9-10.

<sup>64</sup> Vargas, *supra* note 23.

owned Mexican subsidiary, provided it will proceed with developing the property.

Unfortunately, under the Bankruptcy Law, certain types of creditors have a superpriority claim in bankruptcy over secured creditors, which potentially diminishes the value of secured credit in Mexico.<sup>65</sup> It should be noted, however, that these superpriority claims are narrow in scope. An alternative method for obtaining a security interest in real property in Mexico is through the use of a trust ("fideicomiso").<sup>66</sup> Unlike the mortgage situation, where the debtor retains ownership of the property and the creditor has a lien on the property, use of a trust to create a security interest in real property requires the debtor to convey the real estate to a trust administered by a Mexican bank.<sup>67</sup> The creditor is designated as the beneficiary of the trust. The trust document directs the trustee to sell the property upon default under the credit obligation, with the proceeds of the sale to be delivered to the beneficiary.<sup>68</sup> In order for a foreigner to obtain an interest in a real estate trust, whether pertaining to land, water, or fixtures, a permit is required from the Ministry of Foreign Relations.<sup>69</sup>

A major advantage of the trust mechanism is that the property in the trust is no longer considered part of the debtor's estate. Thus the superpriority claims described above will not apply to the trust property.<sup>70</sup> The sale of the trust property may also be an example of an exception to the general rule under Mexican constitutional law that there is no right to a private foreclosure sale, although this issue has been debated by Mexican scholars.<sup>71</sup>

Security interests may be obtained over personal property through several different mechanisms, including the use of a bank trust, as described above.<sup>72</sup> A common method to create a security interest in personal property is the use of a pledge

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<sup>65</sup> Superpriority claims are discussed *infra*, Sections III.D & VI(x).

<sup>66</sup> See *supra* note 48 and accompanying text.

<sup>67</sup> Banowsky, *supra* note 27, at 269-70; Gitlin, *supra* note 36, at 521; Berdeja, *supra* note 30, at 15.

<sup>68</sup> Gitlin, *supra* note 36, at 521.

<sup>69</sup> Gitlin, *supra* note 36, at 523.

<sup>70</sup> Berdeja, *supra* note 30, at 15.

<sup>71</sup> Berdeja, *supra* note 30 at 18; Gitlin, *supra* note 36, at 524.

<sup>72</sup> Berdeja, *supra* note 30, at 11.

("prenda").<sup>73</sup> A pledge of personal property grants a security interest in the property to the creditor for fulfillment of the debtor's obligation. The difficulty with a pledge is that in many cases the assets covered by the security interest must be given to the creditor or his depository in order for the pledge to exist.<sup>74</sup> However, under certain circumstances the debtor may become the depository. There are two types of pledges, civil and commercial.<sup>75</sup> The commercial pledge has specially tailored rules to meet the needs of the business community.<sup>76</sup> Under a civil pledge, the goods must be delivered either physically or constructively to the creditor.<sup>77</sup> For constructive delivery, the pledge must be evidenced either by a private contract in writing or by a public deed.<sup>78</sup> Commercial pledges involve various types of negotiable instruments and the instrument usually must be delivered to the creditor.<sup>79</sup> Delivery, when required, creates practical difficulties if the debtor requires use of the equipment, inventory or other assets given as a pledge.

Once a pledge is created, the creditor or his depository may hold the pledged property until the debtor's obligation is fulfilled. In all events the pledge must be evidenced in writing.<sup>80</sup> Since a constructive pledge has effect against third parties' interests only after the date the pledge is created, it is important to clearly establish the date of the pledge's execution. This can be done through public registry or by executing the document before a notary public.<sup>81</sup>

As noted above, self-help remedies are generally not available in Mexico.<sup>82</sup> Pledges are enforced by a creditor who brings a court action petitioning for a decree which requires sale of the

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<sup>73</sup> See generally Banowsky, *supra* note 27, at 270-79; Berdeja, *supra* note 30, at 11-12; Gitlin, *supra* note 36, at 52.

<sup>74</sup> Banowsky, *supra* note 27, at 270; Berdeja, *supra* note 30, at 12.

<sup>75</sup> Berdeja, *supra* note 30, at 12; Banowsky, *supra* note 27, at 270.

<sup>76</sup> Berdeja, *supra* note 30, at 12; Banowsky, *supra* note 27, at 270.

<sup>77</sup> See also Berdeja, *supra* note 30 at 12; Banowsky, *supra* note 27, at 270.

<sup>78</sup> Civil Code, *supra* note 39, §§ 2859-60.

<sup>79</sup> Banowsky, *supra* note 27, at 270; Berdeja, *supra* note 30, at 12. Delivery, when required, creates practical difficulties if the debtor requires use of the equipment, inventory or other assets given as a pledge.

<sup>80</sup> Civil Code, *supra* note 39, § 2860; Banowsky, *supra* note 27, at 270.

<sup>81</sup> Berdeja, *supra* note 30, at 14-15; Banowsky, *supra* note 27, at 272, 276 & 279.

<sup>82</sup> See *supra* note 55 and accompanying text.

pledged goods by public auction.<sup>83</sup> Alternatively, with the express agreement of the debtor, pledged goods may be sold without a court filing.<sup>84</sup> Unlike the provisions of the Uniform Commercial Code in the United States, Mexican law will not cut off liens of a third party creditor due to a buyer of goods in the ordinary course of business.<sup>85</sup> A third alternative for taking a security interest in personal property is to retain title to assets sold to a debtor until payment for such assets has been made in full.<sup>86</sup> To accomplish this, the written sales contract must set forth that title will not pass until payment has been made in full. Advantages to this form of security interest are that it allows the debtor to take possession of the asset, and it keeps the asset outside of the debtor's estate in the case of bankruptcy.<sup>87</sup>

The sales contract must be registered to protect the creditor against the claims of third parties. However, once the contract is registered, any superpriority claims in bankruptcy will not apply since title to the asset is not in the bankrupt party.<sup>88</sup> If the document is not registered, a good faith third party purchaser without notice of the security interest could prevent separation of the asset from the bankruptcy estate.<sup>89</sup> In the event the obligation is not paid in a timely manner, the creditor may bring an executory action to foreclose on the debt.<sup>90</sup> An executory action allows the debtor only three days to present defenses to execution on the property. The creditor may purchase the goods through an auction for no less than the amount received at the last auction of similar goods.<sup>91</sup> However, if the creditor receives a court order allowing repossession of the goods, the creditor must return to the debtor all payments received, less depreciation and a fair rental amount.<sup>92</sup>

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<sup>83</sup> Berdeja, *supra* note 30, at 12. *See generally* Banowsky, *supra* note 27, at 288-289; Gitlin, *supra* note 36, at 525-26.

<sup>84</sup> Berdeja, *supra* note 30, at 12.

<sup>85</sup> Gitlin, *supra* note 36, at 521.

<sup>86</sup> Civil Code, *supra* note 39, § 2312; Código de Comercio Art 371. *See generally* Berdeja, *supra* note 30, at 11; Banowsky, *supra* note 27, at 280.

<sup>87</sup> Berdeja, *supra* note 30, at 11 & 14.

<sup>88</sup> Berdeja, *supra* note 30, at 14.

<sup>89</sup> Berdeja, *supra* note 30, at 14.

<sup>90</sup> Berdeja, *supra* note 30, at 14; Banowsky, *supra* note 27, at 280.

<sup>91</sup> Berdeja, *supra* note 30, at 14; Banowsky, *supra* note 27, at 280.

<sup>92</sup> Berdeja, *supra* note 30, at 14; Banowsky, *supra* note 27, at 281.

A fourth alternative for obtaining a security interest in personal property, a purchase money financing agreement, is similar to the title retention contract. Under a purchase money financing agreement, a creditor loans money to the debtor so that the debtor may purchase materials and equipment.<sup>93</sup> The loan is guaranteed by the assets acquired with the loan. This type of arrangement is evidenced by a loan document setting forth the terms of the transaction and the security interest being created. The loan contract must be executed before a notary public or a commercial public registrar and must be registered to protect the rights of the creditor against third parties.<sup>94</sup> Enforcement of a purchase money financing security interest is accomplished the same way as enforcement of a pledge. The creditor must petition the court for sale by public auction of the property in which the security interest exists.<sup>95</sup>

A general right of setoff exists under Mexican law, outside of bankruptcy. However, in cases where assets have been deposited by one party with another, including bank accounts, the rights of the parties to set off applicable debts and credits against each other do not exist unless both parties have so agreed in writing.<sup>96</sup> With regard to unsecured creditors, all the assets of a debtor are available to satisfy the claim of a creditor by attachment (with the exception of certain limited items, such as wages, which may not be garnished).<sup>97</sup> Pre-judgment attachment may be granted in instances where the unsecured creditor can demonstrate that the debtor is likely to hide, damage or alienate the assets to be attached.<sup>98</sup> However, a bond in an amount equal to the value of the assets attached must be posted by the creditor.<sup>99</sup> It should also be noted that under limited circumstances a receiver can be appointed to oversee a debtor's assets at the request of a creditor.<sup>100</sup>

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<sup>93</sup> See Berdeja, *supra* note 30, at 13.

<sup>94</sup> See Berdeja, *supra* note 30, at 15.

<sup>95</sup> See Berdeja, *supra* note 30, at 17.

<sup>96</sup> Gitlin, *supra* note 36, at 524; Berdeja, *supra* note 30, at 18.

<sup>97</sup> Gitlin, *supra* note 36, at 524-25.

<sup>98</sup> Berdeja, *supra* note 30, at 19.

<sup>99</sup> Gitlin, *supra* note 36, at 524.

<sup>100</sup> Gitlin, *supra* note 36, at 526.

### III. THE INSOLVENCY PROCESS IN MEXICO

#### A. *Bankruptcy Administration and Regulation*

As has been noted, business bankruptcies are conducted under the federal Bankruptcy Law and nonbusiness "concurors" are conducted under state law.<sup>101</sup> Mexican bankruptcy principals are very similar to those in the United States.<sup>102</sup> The Bankruptcy Law contemplates two procedures: liquidation of the bankrupt's assets and suspension of payments to creditors, which is similar to a Chapter 11 reorganization proceeding.<sup>103</sup> For clarity, all references to a bankruptcy in Section III shall mean a liquidation proceeding.

A bankruptcy proceeding may be initiated voluntarily by a debtor or involuntarily by a creditor.<sup>104</sup> At the commencement of the bankruptcy proceeding, the assets of the debtor constitute a judicial legal entity of sorts, known as a "masa."<sup>105</sup> The masa is made up of all the assets comprising the bankruptcy estate that will be liquidated to pay the creditors' claims against the debtor.<sup>106</sup> The principal parties involved in the bankruptcy proceeding are the debtor, the trustee ("sindico"), the inspector/creditor representative ("interventor") and the court. Unlike a United States bankruptcy proceeding, creditors have a relatively limited role; their primary function being to appoint the inspector and to vote on various proposals.<sup>107</sup>

The trustee is the single most important person involved in the bankruptcy proceeding.<sup>108</sup> The trustee supervises the bankruptcy estate, subject to review and supervision by the court and the inspector.<sup>109</sup> The "sindico" or trustee is in charge of the administration of the bankruptcy once empowered by the court,<sup>110</sup> subject to supervision by the court. The trustee oversees the operation of the assets of the bankruptcy estate, which

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<sup>101</sup> See Gitlin, *supra* note 36, at 537 and text accompanying note 36.

<sup>102</sup> Gitlin, *supra* note 36, at 531.

<sup>103</sup> See Gitlin, *supra* note 36, at 531; Berdeja, *supra* note 30, at 7.

<sup>104</sup> Bankruptcy Law, *supra* note 28, art. 5.

<sup>105</sup> Gitlin, *supra* note 36, at 531.

<sup>106</sup> See Bankruptcy Law, *supra* note 28, arts. 115 & 116.

<sup>107</sup> Gitlin, *supra* note 36, at 533.

<sup>108</sup> See generally, Bankruptcy Law, *supra* note 28, arts. 46-57.

<sup>109</sup> Gitlin, *supra* note 36, at 531.

<sup>110</sup> Bankruptcy Law, *supra* note 28, art. 197.

may include continuing normal operations of the business.<sup>111</sup> The trustee also makes a list of assets of the bankrupt, collects and deposits monies of the bankrupt and prepares the list of creditors.<sup>112</sup> The trustee has the power to propose various arrangements to the creditors for their approval.<sup>113</sup> Proposals could include a decision to continue the entity as a going concern or to sell the assets of the bankrupt in liquidation. The trustee must prepare an accounting of the administration of the bankruptcy estate every three months.<sup>114</sup> The court will initially nominate three proposed trustees and the proposed trustees will be sequentially contacted until one accepts the position.<sup>115</sup> The trustee may be a Chamber of Commerce, a Chamber of Industry, or a bank assigned by the Department of the Treasury.<sup>116</sup>

The inspector or intervenor is a representative of the creditors and oversees and inspects the activities of the trustee.<sup>117</sup> The court will initially appoint a temporary inspector until a creditors' meeting has been convened to appoint the permanent inspector(s).<sup>118</sup> The inspector's role is to safeguard the creditors' interests. One, three or five inspectors may be appointed.<sup>119</sup>

The Attorney General of Mexico is a potential additional party to a bankruptcy proceeding in Mexico. The Attorney General is charged with representing the public and social interests of Mexico in bankruptcy proceedings through the District Attorney ("ministerio publico").<sup>120</sup> The Attorney General will be heard before the court issues any orders or resolutions regarding the bankruptcy if he or she feels the interests of the various

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<sup>111</sup> See Bankruptcy Law, *supra* note 28, arts. 198-202 & 48-III.

<sup>112</sup> Bankruptcy Law, *supra* note 28, art. 46 & 198. See also Berdeja, *supra* note 30, at 36.

<sup>113</sup> Bankruptcy Law, *supra* note 28, art. 48. The trustee may present to the creditor's meeting proposals for agreement after approval from the Court. Bankruptcy Law, *supra* note 28, art. 48(I). See also Gitlin, *supra* note 36, at 534.

<sup>114</sup> Bankruptcy Law, *supra* note 28, art. 50.

<sup>115</sup> Gitlin, *supra* note 36, at 534.

<sup>116</sup> Bankruptcy Law, *supra* note 28, art. 28; Berdeja, *supra* note 30, at 36.

<sup>117</sup> Bankruptcy Law, *supra* note 28, art. 58.

<sup>118</sup> Bankruptcy Law, *supra* note 28, art. 59.

<sup>119</sup> Bankruptcy Law, *supra* note 28, art. 58.

<sup>120</sup> See generally Gitlin, *supra* note 36, at 535; Berdeja, *supra* note 30, at 32.

parties to the proceeding may be unfair to the state.<sup>121</sup> An additional power of the Attorney General is that it may file a bankruptcy proceeding against a delinquent debtor.<sup>122</sup>

### B. *Courts and Commencement of Proceedings*

Historically, Mexico has not had distinct bankruptcy court or bankruptcy judges.<sup>123</sup> A bankruptcy proceeding may be filed in a state court of first instance ("juez de primera instancia") or the district court ("juez de distrito") having jurisdiction over the bankrupt entity.<sup>124</sup> However, in an attempt to improve insolvency proceedings in Mexico, special courts were created in 1988 in the Federal District to hear only insolvency cases.<sup>125</sup> The proper court for filing a bankruptcy petition is the domicile of the debtor, which can be either its place of incorporation or principal place of business.<sup>126</sup> In order for a debtor to commence a bankruptcy proceeding, the debtor need only file with the court an allegation that it has ceased paying its obligations.<sup>127</sup> There is no specific point at which a debtor must file bankruptcy.<sup>128</sup> However, if an insolvent company is forced into bankruptcy proceedings by another party and the company is found to be bankrupt, there are circumstances under which the directors, and possibly the company's auditor, could be found guilty of mismanagement of the bankrupt company.<sup>129</sup> If mismanagement is found, criminal sanctions may be imposed.<sup>130</sup>

For a creditor to institute a bankruptcy proceeding, the creditor must prove that the debtor has ceased paying its obli-

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<sup>121</sup> Bankruptcy Law, *supra* note 28, art. 11.

<sup>122</sup> Bankruptcy Law, *supra* note 28, arts. 9.

<sup>123</sup> Gitlin, *supra* note 36, at 532.

<sup>124</sup> Bankruptcy Law, *supra* note 28, art. 13-A.

<sup>125</sup> See generally Gitlin, *supra* note 36, at 532; Berdeja, *supra* note 30, at 21. Hernandez Romo, Miguel Angel, Jorge Eurique Borbolla and John A. Barrett, *Overview on Security Agreements and Bankruptcy Proceedings in Mexico*, 1993 A.B.A. SEC. BUS. LAW.

<sup>126</sup> Bankruptcy Law, *supra* note 28, art. 13-A.

<sup>127</sup> See Bankruptcy Law, *supra* note 28, arts. 1 & 6; Gitlin, *supra* note 36, at 538.

<sup>128</sup> Gitlin, *supra* note 36, at 537.

<sup>129</sup> Gitlin, *supra* note 36, at 537.

<sup>130</sup> According to Section II of Article 94 of the Bankruptcy Law, criminal penalties apply to a bankruptcy, unless evidence that they should not be applied is proven, if the bankrupt does not file for bankruptcy within three days of when it ceases paying its creditors. Bankruptcy Law, *supra* note 28, art. 94-II.



gations.<sup>131</sup> Good and bad faith of the debtor is irrelevant to obtaining bankruptcy relief, although proving bad faith is relevant to other matters, such as criminal liability.<sup>132</sup> A single creditor may file for an involuntary bankruptcy proceeding. However, in order for a court to accept a bankruptcy, it must find that the debtor has at least two outstanding creditors that have not been timely paid.<sup>133</sup> The debtor may contest an involuntary proceeding within five days of its notification.<sup>134</sup>

Upon a party making a bankruptcy filing with the court, the court examines the case to determine whether or not to accept the bankruptcy. If the technical requirements for a bankruptcy are met, the court must accept the bankruptcy.<sup>135</sup> Upon accepting the bankruptcy, the court issues a declaration of bankruptcy and notifies the debtor, the District Attorney, the inspector, and the creditors.<sup>136</sup> Notification may be made personally, by mail or by telegram. In instances where a creditor's address is not known, notification will be published.<sup>137</sup>

Involuntary bankruptcy filings are uncommon. No major Mexican corporation has been forced into bankruptcy in the last 20 years. Mexican law does not contemplate non-judicial liquidation of bankrupt entities, with the exception of special procedures applicable to insurance companies and bonding institutions.<sup>138</sup>

### C. *Effects of Commencement of Bankruptcy Proceeding*

Once the court issues a bankruptcy declaration, all the bankrupt entity's assets, with certain minor exceptions in the personal bankruptcy case, become part of the bankruptcy estate and are administered by the trustee.<sup>139</sup> The trustee may continue to operate the business in its normal course, upon ap-

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<sup>131</sup> Berdeja, *supra* note 30, at 33; Gitlin, *supra* note 36, at 538.

<sup>132</sup> Berdeja, *supra* note 30, at 33; Gitlin, *supra* note 36, at 538.

<sup>133</sup> Berdeja, *supra* note 30, at 33; Gitlin, *supra* note 36, at 538.

<sup>134</sup> Bankruptcy Law, *supra* note 28, art. 11. Evidence may be brought forth at the hearing that would follow and a decision would then be rendered granting or denying the bankruptcy. Bankruptcy Law, *supra* note 28, art. 11.

<sup>135</sup> Gitlin, *supra* note 36, at 539.

<sup>136</sup> Bankruptcy Law, *supra* note 28, arts. 11 & 16.

<sup>137</sup> Bankruptcy Law, *supra* note 28, art. 16.

<sup>138</sup> Berdeja, *supra* note 30, at 61.

<sup>139</sup> Bankruptcy Law, *supra* note 28, arts. 83 & 115. See also Berdeja, *supra* note 30, at 38-39.

proval of the court. Sales of assets in the normal course of business do not need the further approval of the court.<sup>140</sup> Specific court approval will be required for sales outside of the ordinary course.<sup>141</sup> Technically, the judge directs the bankruptcy proceedings and possesses broad authority to determine how it should proceed. However, the court usually will not take any action in connection with the bankruptcy proceeding except upon a motion of the trustee, the investigator, the creditors, the debtor or the District Attorney.<sup>142</sup>

All assets of the bankrupt, wherever located, will be handled through the Mexican court, even though there may be difficulties in enforcing the court's orders covering assets located outside of Mexico.<sup>143</sup> A branch of a foreign corporation located in Mexico may be declared bankrupt, in which event the Mexican bankruptcy proceeding covers only assets of the Mexican branch and creditor transactions with the branch.<sup>144</sup>

All creditors must file any claims against the bankruptcy estate within forty-five business days of notification of the bankruptcy proceeding.<sup>145</sup> However, the court may, in its discretion, grant extensions to foreign creditors until the creditors meeting to list the bankruptcy estates creditors.<sup>146</sup> Typically, extensions are granted for twenty, forty or sixty business days.<sup>147</sup>

Generally, all claims against the bankruptcy estate are stayed by the bankruptcy declaration and must be joined in the bankruptcy proceeding.<sup>148</sup> Although this is similar to the automatic stay occurring in bankruptcy filings in the United States, there are several important exceptions in Mexico.<sup>149</sup> With regard to commercial creditors, if a proceeding has been instituted to foreclose on a mortgage or pledge, that proceeding may be

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<sup>140</sup> Bankruptcy Law, *supra* note 28, arts. 200 & 201. *See also* Gitlin, *supra* note 36, at 532.

<sup>141</sup> Bankruptcy Law, *supra* note 28, arts. 200 & 201. *See also* Gitlin, *supra* note 36, at 532.

<sup>142</sup> Bankruptcy Law, *supra* note 28, arts. 200 & 201. *See also* Gitlin, *supra* note 36, at 532.

<sup>143</sup> *See also* Gitlin, *supra* note 36, at 537.

<sup>144</sup> *See also* Gitlin, *supra* note 36, at 537.

<sup>145</sup> Bankruptcy Law, *supra* note 28, art. 15.

<sup>146</sup> Bankruptcy Law, *supra* note 28, art. 223.

<sup>147</sup> Gitlin, *supra* note 36, at 539.

<sup>148</sup> Bankruptcy Law, *supra* note 28, arts. 126 & 127.

<sup>149</sup> Gitlin, *supra* note 36, at 536.

pursued to completion, including the sale of the collateral.<sup>150</sup> Additionally, any claims by laborers will be pursued with the labor board and through the labor court to determine the workers' rights and the amount of the claims.<sup>151</sup> Finally, the Mexican tax authorities may act outside the scope of the bankruptcy court.<sup>152</sup> Once wage claims and foreclosures on pledges or mortgages have been completed, the claims and sales proceeds will be submitted to the bankruptcy court for purposes of determining the payment priority, without review as to the amount of claims.<sup>153</sup>

Upon issuance of the bankruptcy declaration, set-off rights no longer exist for creditors, with a few specifically delineated exceptions, including post-petition creditors.<sup>154</sup> Although secured creditor liens will be recognized in bankruptcy, certain other forms of pre-existing liens, such as an attachment on all assets of the debtor for payment of an unsecured debt, will not be effective once a bankruptcy declaration has been made.<sup>155</sup> Creditors may also petition the court to have various assets excluded from the bankruptcy estate.<sup>156</sup> Assets that may be excluded include property that has not been fully paid for by the bankrupt, property subject to an installment sales arrangement and property held by the bankrupt in deposit, lease, trust, or similar circumstances pursuant to which the bankrupt does not possess title to the property.

Once the court issues a bankruptcy declaration, all debtor's obligations are considered matured and interest stops accruing on those obligations.<sup>157</sup> However, interest will continue to accrue on obligations secured by a mortgage or a pledge, even after the bankruptcy declaration, to the extent of the collateral.<sup>158</sup>

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<sup>150</sup> Bankruptcy Law, *supra* note 28, art. 126. See also Berdeja, *supra* note 30, at 38; Gitlin, *supra* note 36, at 536.

<sup>151</sup> Bankruptcy Law, *supra* note 28; See also Berdeja, *supra* note 30, at 38; Gitlin, *supra* note 36, at 536.

<sup>152</sup> Bankruptcy Law, *supra* note 28; See also Berdeja, *supra* note 30, at 38; Gitlin, *supra* note 36, at 536.

<sup>153</sup> Bankruptcy Law, *supra* note 28, art. 127. See also Berdeja, *supra* note 30, at 38.

<sup>154</sup> Bankruptcy Law, *supra* note 28, art. 128-IV.

<sup>155</sup> See generally Gitlin, *supra* note 36, at 541.

<sup>156</sup> Bankruptcy Law *supra* note 28, arts. 158-162.

<sup>157</sup> Bankruptcy Law, *supra* note 28, art. 128-III.

<sup>158</sup> Bankruptcy Law, *supra* note 28, art. 128-II.

With certain limited exceptions, Mexican law provides that the only currency recognized for payment of debts in Mexico is the peso. Under normal circumstances, court orders for payment of obligations denominated in another currency will require payment of the peso equivalent of the foreign currency denominated debt, calculated at the rate of exchange at the time payment is made.<sup>159</sup> However, in the bankruptcy context, the rate of exchange is fixed at the time of the bankruptcy declaration.<sup>160</sup> Given the lengthy time period that can pass from the bankruptcy declaration to its completion, the possibility for substantial devaluation of an obligation owed to a creditor must be considered even if the debt is denominated in a currency more stable than pesos. Given the recent volatility of the peso, this concern is particularly acute.<sup>161</sup>

The Mexican court will review certain transactions occurring prior to the bankruptcy and invalidate fraudulent and preferential transfers, similar to a United States bankruptcy proceeding.<sup>162</sup> Whereas United States Bankruptcy Law<sup>163</sup> establishes a fixed period for the court to review to see if any fraudulent or preferential transfers occurred, Mexican law does not prescribe a set length of time to be reviewed.<sup>164</sup> The review period should be tied to when insolvency first occurred, but is ultimately determined by the judge, in his or her sole discretion.<sup>165</sup> Typically, the court will examine all transactions occurring within six months prior to the bankruptcy petition filing.<sup>166</sup> However, cases exist where the review period was five or even ten years.<sup>167</sup>

Additionally, once a bankruptcy declaration has been made, performance of executory contracts is suspended.<sup>168</sup> The

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<sup>159</sup> Banowsky, *supra* note 27, at 286.

<sup>160</sup> *Amparo directo 1197/88, Segundo Tribunal Colegiado en Materia Civil del Primer Circuito, Informe 1988, 257*, (17 de octubre de 1988), (Unanimidad de votos).

<sup>161</sup> See *supra* note 24 and accompanying text.

<sup>162</sup> Bankruptcy Law, *supra* note 28, art. 15.

<sup>163</sup> U.S. Bankruptcy Code, 11 U.S.C. §§ 544-547 (1994).

<sup>164</sup> Gitlin, *supra* note 36, at 540-41.

<sup>165</sup> Berdeja, *supra* note 30, at 40.

<sup>166</sup> Berdeja, *supra* note 30, at 40.

<sup>167</sup> Gitlin, *supra* note 36, at 541.

<sup>168</sup> See generally Bankruptcy Law, *supra* note 28, arts. 139-157. See also, Gitlin, *supra* note 36, at 542-43.

debtor/trustee has the option to accept or reject the contract. The other party to the contract may suspend performance until the election is made to accept or reject the contract. If the contract is rejected, the other party to the contract may file a claim on such contract against the bankruptcy estate. Bankruptcy does not rescind leases where the debtor is the lessor, but rescinds leases where the debtor is the lessee upon payment of an indemnity.<sup>169</sup> Repurchase contracts are treated in a similar manner upon the declaration of bankruptcy.<sup>170</sup>

A bankruptcy may be classified as *fortuitous*, *culpable* or *fraudulent*.<sup>171</sup> A *fortuitous* bankruptcy is one in which the company has been managed properly, the bankruptcy could not have been foreseen by the company's management and was caused by circumstances beyond the control of the company.<sup>172</sup> A *culpable* bankruptcy is caused by management acts outside the scope of prudent management.<sup>173</sup> A *fraudulent* bankruptcy involves intentional deceitful practices such as camouflaging a company's liabilities or deliberately reducing assets of the company.<sup>174</sup> Both *culpable* and *fraudulent* bankruptcies can result in prison terms for anyone directly involved in the acts leading to the bankruptcy, as well as for the corporation's directors, managers and auditors.<sup>175</sup>

Although the time lines for bankruptcy proceedings appear very short under the provisions of Mexican law, the highly technical nature of Mexican court proceedings will frequently permit substantial delays. Thus, a summary collection proceeding will probably be concluded within a year, and an ordinary collection action, even if few defenses are available, may take two years.<sup>176</sup> Bankruptcy cases generally run for three or more years, and there have been cases that have lasted in excess of fifteen years.<sup>177</sup>

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<sup>169</sup> Bankruptcy Law, *supra* note 28, art 153.

<sup>170</sup> Bankruptcy Law, *supra* note 28, art. 153.

<sup>171</sup> Bankruptcy Law, *supra* note 28, art. 91.

<sup>172</sup> Bankruptcy Law, *supra* note 28, art. 92.

<sup>173</sup> Bankruptcy Law, *supra* note 28, arts. 93-94.

<sup>174</sup> Bankruptcy Law, *supra* note 28, arts. 96-98.

<sup>175</sup> Bankruptcy Law, *supra* note 28, arts. 96 & 99.

<sup>176</sup> Banowsky, *supra* note 27, at 287.

<sup>177</sup> Gitlin, *supra* note 36, at 545.

#### D. *Creditors and Classes of Creditors*

As in the United States, the treatment accorded to various claims depends on the type of claim involved. The bankruptcy court will give different consideration to various classes of creditors claims that may be recognized.<sup>178</sup> As noted above, after notice of the bankruptcy declaration has been given to creditors, they have forty-five business days to file their claims so that they may be properly classified.<sup>179</sup> Failure of a priority creditor to file in a timely manner will result in a loss of priority for its claims.<sup>180</sup> The creditors then meet to create a list of all the creditors.<sup>181</sup> After this meeting, the court classifies and prioritizes the claims. Claims are evaluated both in terms of their validity and their priority.<sup>182</sup> Claims that have been recognized by final judgment in a prior commercial proceeding (such as a foreclosure of a mortgage) are recognized by the bankruptcy proceeding, without re-examination by the judge, except as to the potential priority of the claim.<sup>183</sup>

Mexican bankruptcy proceedings recognize six classes of creditors with the following order of priority:<sup>184</sup>

(a) "Singularly privileged creditors." These are superpriority creditors whose claims trump even a secured creditor. Employees of the bankrupt with wage claims for the year prior to the bankruptcy declaration are in this category, as are creditors extending credit after the bankruptcy declaration has been made. However, labor claims have priority over post-petition creditors.

(b) "Secured and mortgage creditors." These are creditors having a lien on assets of the debtor. They enjoy a priority over other creditors to the extent of the proceeds available from the security.

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<sup>178</sup> See generally Berdeja, *supra* note 30, at 47-50.

<sup>179</sup> See Gitlin, *supra* note 36.

<sup>180</sup> Bankruptcy Law, *supra* note 28, art. 224.

<sup>181</sup> Bankruptcy Law, *supra* note 28, arts. 226-259. See also, Berdeja, *supra* note 30, at 46-47.

<sup>182</sup> Bankruptcy Law, *supra* note 28, art. 260.

<sup>183</sup> Berdeja, *supra* note 30, at 45.

<sup>184</sup> Bankruptcy Law, *supra* note 28, arts. 261-70. See also Berdeja, *supra* note 30, at 46-49; Gitlin, *supra* note 36, at 539-40.

(c) "Tax claims." These are claims from the federal treasury against the debtor. The amount of the claim is determined by the federal treasury, not by the bankruptcy court.

(d) "Creditors with special privilege." These are unsecured creditors who by statute have some form of special privilege or preferential right. They include commission agents, personal property vendors, carriers and building contractors.

(e) "Common creditors from mercantile transactions." These are business creditors of the debtor.

(f) "Common creditors by civil law." These are creditors owed a debt arising out of litigation.

Foreign creditors, whether secured or unsecured, will not be treated differently from Mexican creditors to the extent that under Mexican law their claims are enforceable, and, if appropriate, perfected.<sup>185</sup> However, the priority of a foreign creditor's claim will be based on Mexican bankruptcy law, and not upon the priority such creditor may be entitled to under the laws of such creditor's home jurisdiction. Additionally, a foreign creditor must be careful to ensure its powers of attorney, granted in connection with filing its claims, conform to the Protocol of Uniformity of Powers of Attorney (1940).<sup>186</sup> Improper Powers of Attorney can result in the foreign claims not being timely filed under Mexican law.

Once the amount and priority of claims has been determined, all assets of the debtor will be ordered liquidated and the creditors shall be paid.<sup>187</sup> In a corporate bankruptcy proceeding, all debts are discharged through the proceeding and there are no exempt assets.<sup>188</sup> In the bankruptcy of an individual, there are certain obligations, such as alimony, which are not discharged. There are certain limited assets that are exempt from the bankruptcy proceeding.<sup>189</sup> Historically, the number of individual bankruptcies in Mexico has been very limited, but this has changed in recent years.<sup>190</sup>

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<sup>185</sup> Gitlin, *supra* note 36, at 540-44; Berdeja, *supra* note 30, at 23.

<sup>186</sup> Gitlin, *supra* note 36, at 525.

<sup>187</sup> Bankruptcy Law, *supra* note 28, arts. 276-80.

<sup>188</sup> Bankruptcy Law, *supra* note 28, art. 115.

<sup>189</sup> Bankruptcy Law, *supra* note 28, art. 115.

<sup>190</sup> Gitlin, *supra* note 36, at 541.

Mexico is very rigid in adhering to the distinction between various corporate entities. There is no consolidation of estates between affiliated corporate entities in bankruptcy or transferring of liability from one entity to another.<sup>191</sup> Unlike United States law, which places certain limits on the ability of a corporation to guarantee the debts of an affiliated corporation (based on the extent to which a benefit is derived by the guaranteeing corporation), Mexican corporations (other than those in the financial services sector), if properly structured, can guarantee any other entity's indebtedness.<sup>192</sup> However, such guaranties are enforceable only if the charter and bylaws of the guaranteeing entity permit such guaranties. Given the distinction between affiliated entities adhered to in Mexican law, it is not surprising that intercompany debt is treated on a parity with all other bankrupt corporation debts of the same class.<sup>193</sup>

Mexican law does not contain a concept of subordination in connection with the distribution of a debtor's assets. However, under certain circumstances, such as fraudulent conduct by an insider, the court might attack a transfer, mortgage or security interest of such party by undoing the transfer in question or treating the insider as a junior creditor.<sup>194</sup>

#### IV. SUSPENSION OF PAYMENTS UNDER THE BANKRUPTCY LAW

Under the Bankruptcy Law, a debtor may file either for bankruptcy (liquidation) or for a suspension of payments proceeding. The debtor, as a matter of right, may always commence with a suspension of payments proceeding, even if an involuntarily bankruptcy proceeding has already been filed against the debtor.<sup>195</sup> The concept underlying the suspension of payments proceeding is the same as the one justifying a Chapter 11 proceeding in the United States: to give the debtor a chance to restructure its liabilities so that it may continue as an

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<sup>191</sup> Gitlin, *supra* note 36, at 542.

<sup>192</sup> Gitlin, *supra* note 36, at 522-23.

<sup>193</sup> Gitlin, *supra* note 36, at 542.

<sup>194</sup> Gitlin, *supra* note 36, at 542.

<sup>195</sup> Bankruptcy Law, *supra* note 28, arts. 394 & 399. However, pursuant to article 396, certain people have lost the right to seek suspension of payments protection based on their prior conduct. This group includes, among others, those who have been convicted of fraud and those who have violated the terms of a prior suspension of payments agreement. Bankruptcy Law, *supra* note 28, art. 396.



ongoing concern. However, unlike a Chapter 11 proceeding, suspension of payments proceedings simply create a period of time during which the debtor is relieved from paying its obligations and additional interest stops accruing on obligations,<sup>196</sup> except for obligations secured by mortgages or pledges (which continue to accrue interest to the extent of the collateral).<sup>197</sup> At the end of a successful suspension of payments proceeding, a debtor will have restructured the time for repayment, and possibly the amount, of its obligations to provide it with an opportunity to continue operations.<sup>198</sup> However, the debtor is not required to restructure or reorganize any of its business operations in connection with a suspension of payments proceeding.

Many insolvency proceedings commence as suspension of payments proceedings.<sup>199</sup> However, most insolvency proceedings eventually end up in liquidation. Although accurate records are not readily available, it is believed that in the last twenty years, no more than 30 companies that sought relief under the suspension of payments procedure have successfully restructured.<sup>200</sup>

In general, the rules applicable to liquidation proceedings apply to suspension of payments proceedings.<sup>201</sup> Only the debtor may request suspension of payments protection. The debtor's petition must be accompanied by a proposed plan for restructuring/relief from the debtor's current indebtedness.<sup>202</sup> Unlike a Chapter 11 proceeding, initially only the debtor may propose the plan of restructuring;<sup>203</sup> and unlike a liquidation proceeding, the debtor remains in possession of its assets and may continue operating the business in its ordinary course.<sup>204</sup> In a suspension of payments proceeding, as in a Chapter 11 proceeding, claims against the debtor are stayed. However, certain

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<sup>196</sup> See generally Berdeja, *supra* note 30, at 62.

<sup>197</sup> Bankruptcy Law, *supra* note 28, art. 128-II.

<sup>198</sup> However, the amount owed by the debtor may not be reduced to less than 35 cents on the dollar and the delay in repayment cannot exceed two years from the date of approval of the plan. Bankruptcy Law, *supra* note 28, arts. 317-18.

<sup>199</sup> Gitlin, *supra* note 36, at 531.

<sup>200</sup> Gitlin, *supra* note 36, at 531.

<sup>201</sup> Berdeja, *supra* note 30, at 61.

<sup>202</sup> Bankruptcy Law, *supra* note 28, arts. 394-95.

<sup>203</sup> Bankruptcy Law, *supra* note 28, art. 398.

<sup>204</sup> Bankruptcy Law, *supra* note 28, arts. 394 & 410.

debts are exempt from this stay, including wages, alimony and debts secured by real property.<sup>205</sup>

A trustee is involved in the suspension of payments proceeding but serves in a capacity similar to the inspector in the liquidation process. The trustee serves as a liaison between the creditors and the debtor and oversees certain acts undertaken by the debtor.<sup>206</sup> At the discretion of the creditors, an inspector may be appointed. However, the judge does not have the power to appoint an investigator on his or her own initiative.<sup>207</sup>

There is little creditor participation in the suspension of payments process.<sup>208</sup> The creditors meet to discuss the claims they have and they must also meet to approve or reject the proposed plan of debt restructuring.<sup>209</sup> Any creditor may also request conversion of a suspension of payments proceeding to a liquidation proceeding at any time. The creditors, both in a liquidation proceeding and in a suspension of payments proceeding, are entitled to one vote per creditor, regardless of the amount of a creditor's claim. Generally, resolutions of the creditors' meetings are taken by a simple majority vote, although there are circumstances that require special majorities or approval based on the amount of claims represented. Ultimately, this results in a sliding scale for approval of plans depending on the amount being offered to each creditor under the plan and the time for payment under the plan.<sup>210</sup>

If a plan for restructuring payments is not approved by the creditors, the suspension of payments proceeding will be converted to a liquidation proceeding.<sup>211</sup> As a result, it is common for creditors and debtors to collaborate prior to the filing of the suspension of payments petition.<sup>212</sup> After the plan has been ap-

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<sup>205</sup> Bankruptcy Law, *supra* note 28, arts. 408-09.

<sup>206</sup> See Bankruptcy Law, *supra* note 28, art. 416; Gitlin, *supra* note 36, at 531.

<sup>207</sup> Bankruptcy Law, *supra* note 28, art. 417.

<sup>208</sup> Gitlin, *supra* note 36, at 531.

<sup>209</sup> Bankruptcy Law, *supra* note 28, arts. 407 & 418.

<sup>210</sup> Bankruptcy Law, *supra* note 28, arts. 79, 317, 318 & 319. For example, if only 35 cents is offered on each dollar of debt and payment is to be made immediately, seventy-five percent of the total value of the claims must approve the plan, but if 55 cents were offered, the approval required would drop to sixty-five percent. However, if payment of such 55 cents will be delayed for six months, the required approval goes back to seventy-five percent of the total value of the claims.

<sup>211</sup> Bankruptcy Law, *supra* note 28, art. 419.

<sup>212</sup> Berdeja, *supra* note 30, at 67.

proved by the creditors, it must also be approved by the court.<sup>213</sup> However, even after approval, a creditor may make a motion to the court to transfer the debtor into a liquidation proceeding.<sup>214</sup>

The assets of the debtor are frequently depleted prior to a successful plan being completed.<sup>215</sup> This is due to the fact that the debtor may continue its normal business operations during the proceeding, the significant lack of liquidity most businesses face when filing for suspension of payments, and various fees of officials and tax authorities that are applied in connection with the process. It is also frequently difficult for an insolvent entity to obtain additional credit in connection with its reorganization, in spite of the superpriority afforded such credit. In part, this is due to past experience which has shown that the assets of insolvent companies are usually consumed by the ongoing operations of the business during the insolvency proceedings.<sup>216</sup> In connection with obtaining additional credit for the debtor to continue its business operations, the trustee's nonobjection and the judge's approval are also usually required.<sup>217</sup>

## V. CROSS-BORDER ASPECTS OF INSOLVENCY AND CREDITOR'S REMEDIES

### A. *Recognition of Foreign Judicial Awards*

Mexican courts will apply Mexican law to determine whether a foreign judicial award is enforceable in Mexico.<sup>218</sup> Although a judgment rendered outside of Mexico can be enforced in Mexico and against a debtor's Mexican property, the procedure is technical and, therefore, enforcement of foreign judgments in Mexico is uncommon. In order for a foreign judgment to be recognized in Mexico, the judgment must concern an obligation that would be enforceable under Mexican law.<sup>219</sup> A gambling debt enforceable in Nevada would not be enforceable

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<sup>213</sup> Bankruptcy Law, *supra* note 28, art. 420.

<sup>214</sup> Bankruptcy Law, *supra* note 28, art. 422.

<sup>215</sup> Gitlin, *supra* note 36, at 523-24.

<sup>216</sup> Gitlin, *supra* note 36, at 523-24.

<sup>217</sup> Bankruptcy Law, *supra* note 28, arts. 411 & 416; Berdeja, *supra* note 30, at 70-71.

<sup>218</sup> Civil Code, *supra* note 39, art. 12. *See also* Berdeja, *supra* note 30, at 25-27; Gitlin, *supra* note 36, at 543-44.

<sup>219</sup> Gitlin, *supra* note 36, at 543.

in Mexico, but repayment of a properly constituted loan could be enforceable.

The court whose judgment is sought to be enforced in Mexico must have jurisdiction over the matter in dispute pursuant to Mexican law.<sup>220</sup> Any proceeding to attach or foreclose on property in Mexico commenced outside of Mexico would be unenforceable, because Mexican law requires such proceedings to commence in the jurisdiction where the property is located.<sup>221</sup> The foreign judgment must be on an action *in personam*, not *in rem*, and service must have been made on the defendant in accordance with the provisions of Mexican law.<sup>222</sup> At a minimum, this means the service must be made at the domicile of the defendant. Additionally, if service is to occur in Mexico, the foreign court will need to issue letters rogatory to the Mexican court requesting that service of process be made on the defendant in Mexico. A foreign judgment will not be enforced in Mexico if the same issues are pending before a Mexican court at the time enforcement of the foreign judgment is sought.

In order to enforce a foreign judicial award, it must also be a final judgment, capable of authentication by the Mexican courts, and presented with letters rogatory from the foreign court that requested enforcement by the Mexican court. Finally, the Mexican court will consider whether a Mexican judgment of a similar type would be enforced by the court requesting enforcement in Mexico.

#### B. *Foreign Access to Mexican Courts*

Foreigners generally may take security interests in Mexican assets and have enforceable rights under Mexican law, identical to those afforded Mexican nationals.<sup>223</sup> This would not be the case if foreigners did not have equal access to Mexican courts. A trickier issue arises with respect to when foreign law may be applied by a Mexican court. Foreign law will be applied when Mexican law or a treaty to which Mexico is a party requires foreign law to be applied. Pursuant to the Civil Code of

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<sup>220</sup> Berdeja, *supra* note 30, at 25-26.

<sup>221</sup> Gitlin, *supra* note 36, at 523-24.

<sup>222</sup> Gitlin, *supra* note 36, at 527; Berdeja, *supra* note 30, at 25-26.

<sup>223</sup> See discussion *supra* part III.C. Berdeja, *supra* note 30, at 22-23; Gitlin, *supra* note 36, at 526-27.

the Federal District, only Mexican law will be applied in Mexico unless through the agreement of contracting parties another law is validly designated as controlling.<sup>224</sup>

A similar issue exists with regard to the recognition of foreign claims in Mexico. Foreign claims may be pursued in a Mexican court to the extent that the court has jurisdiction to hear the claim.<sup>225</sup> However, strict compliance with the formalities of Mexican law will be required to have claims enforced in Mexico. Of particular importance is that a foreign party's Powers of Attorney comply with the Protocol on Uniformity of Powers of Attorney (1940). Mexican court jurisdiction may be based upon the election of the parties in their contract. However, for the election of Mexican jurisdiction to be valid, the elected forum, Mexico, must be either the domicile of one of the parties, the place of performance of the contract, or the place where the subject matter of the contract is located.<sup>226</sup>

Selection of forum by contract will be invalidated if a choice of forums is stipulated and only one party benefits from the choice of forums, or if the selection constitutes a fraud in law or is contrary to Mexican public policy.<sup>227</sup> If the parties have not included a choice of forum provision in the contract, the Mexican court can still have jurisdiction over a foreign claim if Mexico is the place for performance of the contract, the domicile of either party or the location of the subject matter of the contract.<sup>228</sup> Parties to a contract involving a Mexican party should be cautious in designating that performance is to occur outside of Mexico if the courts in the place for performance may not enforce the obligation created under the contract. If the debtor is located in such other country and the contract will not be performed in Mexico, a Mexican court may not have jurisdiction.

Foreign creditors should also undertake careful consideration before deciding to submit to the jurisdiction of a Mexican court if the debtor has assets outside of Mexico. Submission to the Mexican court will probably result in the obligation being construed under Mexican law, which may be less advantageous

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<sup>224</sup> Berdeja, *supra* note 30, at 22-25; Gitlin, *supra* note 36, at 543-44.

<sup>225</sup> Berdeja, *supra* note 30, at 23-25.

<sup>226</sup> Berdeja, *supra* note 30, at 23-25.

<sup>227</sup> Berdeja, *supra* note 30, at 23-25.

<sup>228</sup> Berdeja, *supra* note 30, at 23-25.

to the foreign creditor, and may result in either the claim being litigated in Mexico or the assets outside of Mexico being turned over to the Mexican court for disposition.<sup>229</sup>

C. *Recognition of Non-Mexican Insolvency Proceedings*

The Bankruptcy Law provides, as a general rule, that a foreign bankruptcy decree will not be recognized in Mexico.<sup>230</sup> However, as was explained in section V.A. regarding recognition of foreign judgments, if all of the conditions for recognition of a foreign judgment were adhered to with respect to a bankruptcy proceeding, the Mexican court should honor the decree in Mexico.<sup>231</sup> All the Mexican Bankruptcy rules, such as the preconditions for declaring bankruptcy, the processes by which the bankruptcy was pursued, and that the parties were served with notice, must have been adhered to. Since Mexican law requires that insolvency must be filed in the domicile of the debtor,<sup>232</sup> a bankruptcy proceeding filed against a debtor outside of its domicile would clearly not be enforced in Mexico.

Mexican law does not contain any provision for ancillary proceedings in Mexico while a bankruptcy is proceeding in another jurisdiction.<sup>233</sup> Thus, it would be nearly impossible to obtain a stay over proceedings in Mexico. However, the trustee or administrator of a bankruptcy estate in another jurisdiction may be able to obtain control over various assets in Mexico upon showing proper evidence of such person's authority and right to such property under the Mexican law.<sup>234</sup>

Similarly, it should be remembered that a branch of a foreign company can be declared bankrupt in Mexico and that only the branch's assets and transactions between the branch and various creditors will be included within the scope of the bankruptcy proceeding.<sup>235</sup> It should also be remembered that in a Mexican bankruptcy proceeding, all the assets of the bankrupt, wherever located throughout the world, will be included within the bankruptcy estate. As has been noted, enforcement of an

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<sup>229</sup> Gitlin, *supra* note 36, at 544-46.

<sup>230</sup> Bankruptcy Law, *supra* note 28, art. 14.

<sup>231</sup> Gitlin, *supra* note 36, at 543; Berdeja, *supra* note 30, at 76.

<sup>232</sup> Bankruptcy Law, *supra* note 28, art 13.

<sup>233</sup> Gitlin, *supra* note 36, at 536.

<sup>234</sup> Gitlin, *supra* note 36, at 543.

<sup>235</sup> Bankruptcy Law, *supra* note 28, arts. 13 & 83.

order of a Mexican court concerning assets of the bankruptcy estate located outside of Mexico may face difficulty in certain jurisdictions. However, if a representative of a creditor subject to a Mexican court decree is located in Mexico, such representative could be subject to sanctions for the creditor's failure to comply with the order.

#### D. *Conventions*

Mexico is a party to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the 1975 Inter-American Convention on International Commercial Arbitration (OAS) and the 1984 Inter-American Convention on International Competence for Extra-Territorial Validity of Foreign Judgments. It is also a signatory to the Protocol of Uniformity of Powers of Attorney (1940) and the Consular Convention of 1942 (between the United States and Mexico). Finally, Mexico signed the Inter-American Convention on Letters Rogatory (OAS) on January 30, 1975. Mexico is not a signatory to either the Bustamante Code or the Treaties of Montevideo.

### VI. SUMMARY OF MAJOR DISTINCTIONS BETWEEN UNITED STATES AND MEXICAN BANKRUPTCY AND REORGANIZATION PROCEEDINGS

#### (i) Timeframes for Proceeding Are Technically Shorter in Mexico.

Under the Bankruptcy Law, bankruptcy proceedings are required to proceed at a fast pace. However, in practice the timeframes involved in bankruptcy proceedings in Mexico are considerably longer than those in the United States, frequently involving many years. For example, the period allowed for creditors to submit claims against the bankruptcy estate is forty-five business days from the date of notification. However, the notification to creditors may be delayed for over a year.

#### (ii) The Scope of Automatic Stay.

Mexican law excludes various types of proceedings, including wage claims and actions to foreclose on security interests under mortgages and pledges, from the scope of the stay imposed by the filing of a bankruptcy proceeding.

#### (iii) Appointments of Trustees and Inspectors Are Routine.

In bankruptcy proceedings in Mexico, both liquidations and suspension of payments proceedings, a trustee is appointed, although the role of the trustee is different in each type of proceeding. Additionally, an inspector is always appointed in a liquidation proceeding, and may be appointed in a suspension of payments proceeding at the discretion of the creditors.

(iv) Independent Reporting.

The trustee in bankruptcy under Mexican law has significant reporting requirements to both the court and the creditors, even in the suspension of payments proceeding. The trustee must compile an inventory of the assets of the bankrupt and a balance statement, examine the books, and file periodic reports on the administration of the bankruptcy estate.

(v) Exclusive Authority to Propose Plan.

Only the debtor has the ability, initially, to propose a restructuring plan in a suspension of payments proceeding.

(vi) Consequences of Default Under Restructuring.

The Mexican court is extremely strict in forcing the insolvent debtor into bankruptcy (liquidation) if its plan of reorganization is not timely approved and adhered to.

(vii) Judicial Authority.

Bankruptcy court judges in Mexico are not, in general, limited to hearing solely bankruptcy cases, and their authority is not limited to the powers granted under the provisions of the bankruptcy laws (with the exception of the special bankruptcy courts of the Federal District). In liquidation proceedings, other court proceedings are not merely stayed but are joined to the bankruptcy.

(viii) Costs of Proceeding.

Mexican bankruptcy courts do not charge fees. However, the trustee and investigator are both paid. Given the extensive length of most bankruptcies, these fees can become considerable costs.<sup>236</sup>

(ix) Reorganization versus Suspension of Payments.

The Mexican suspension of payments regime does not require a restructuring of the business organization. It is designed solely to restructure the time, and possibly the amount, of debt to be repaid.

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<sup>236</sup> Gitlin, *supra* note 36, at 525-26.



(x) **Superpriority Claims.**

Secured creditors in Mexico can have their security eroded in the bankruptcy proceeding based on superpriority claims of laborers, new creditors to the bankruptcy estate and tax liens.

(xi) **Approval of Creditors.**

Creditors generally receive one vote per creditor. Under certain circumstances, approval requires the vote of greater than fifty percent of the creditors or a certain percentage of the amount of claims outstanding. There are no provisions comparable to the "cram-down" provisions under the United States bankruptcy law.

(xii) **Pre-Bankruptcy Review.**

In Mexico, the period for reviewing potentially fraudulent transfers and preferential payments is left to the discretion of the court. Although this is frequently tied to the time at which it appears the debtor became insolvent, the judge need not limit the period in such a manner.

## VII. CONCLUSION

Mexico's bankruptcy law is old and relatively poorly constructed. It has not been updated to reflect the changes that have occurred in the modern world of complex multi-national corporations and sophisticated commercial financing. A Mexican bankruptcy proceeding is also time consuming and expensive, with restructurings of debt rarely leading to a successful rehabilitation of the debtor.

Given Mexico's historically protectionist policies, Mexico has not previously had to develop a strong body of law regarding cross-border insolvency and secured creditor concerns. However, with the recent opening of Mexico to increased foreign investment and trade, the need for updated, efficient means for dealing with secured credit and multi-national insolvency is clear.

Mexico has long recognized the need for reforms in these areas. The Mexican Bar Association and the Deregulation Unit of the Ministry of Commerce and Industrial Development have already undertaken several in-depth studies concerning reforming the procedural and bankruptcy statutes. Recently, new bankruptcy legislation has been proposed. However, given the

current level of interest by foreigners in moving into the Mexican market under the NAFTA, it appears likely that many of the necessary reforms will come only after Mexican and foreign businessmen have muddled through problems arising out of an antiquated, ambiguous statute, unless a new bankruptcy code is enacted soon.