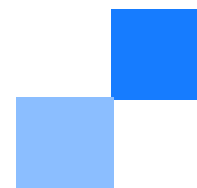


Mexico

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SECURITY AND PRIORITIES

1. What are the most common forms of security taken in relation to immovable and movable property? Are any specific formalities required for the creation of security by companies?

Immovable property

The following types of security are available for immovable property:

- **Mortgage.** A mortgage is a security interest to secure the payment of monetary obligations. The debtor keeps the possession, custody and safeguard of the immovable property, but the creditor has the right to sell the property if the debtor defaults on its payment obligations. Mortgaged property can be sold by the mortgagee for repayment of an unpaid loan, even if title to the property has been passed to a third party by the mortgagor.
- **Industrial mortgage.** A financial institution can secure its loans with a mortgage granted over all assets (immovable or movable) of a company. The debtor can operate and manage the company, and sell and replace the mortgaged assets with the creditor's authorisation.
- **Naval mortgage.** A vessel can be mortgaged in the same way as an ordinary mortgage.
- **Aeronautic mortgage.** An aircraft can be mortgaged in the same way as an ordinary mortgage.
- **Guarantee trust.** Assets can be conveyed to a trustee, which must be a financial institution. If the debtor defaults, the trustee can sell the asset through either:
 - the method established in the trust instrument; or
 - summary proceedings before the court.

The proceeds of sale are then delivered to the beneficiary (the creditor).

Movable property

The following types of security are available for movable property:

- **Civil pledge.** Possession of the asset is transferred to the creditor or a third person, by either legal or actual delivery. If the debtor defaults on its payment obligations, the creditor can sell the pledged asset through summary proceedings before the court.
- **Commercial pledge.** A commercial pledge works in the same way as a civil pledge but is granted over a movable commercial asset. A commercial pledge can also be made over the assets purchased with a loan.
- **Pledge without transfer of possession.** This works in the same way as a civil pledge, except that possession of the pledged asset remains with the debtor. The debtor cannot transfer or convey title of the pledged asset, unless authorised by the creditor.
- **Securities pledge.** This is an agreement that deposits securities traded on the Mexican stock exchange in a special account. If the debtor defaults, the securities are sold on the stock exchange and the proceeds of sale are used to pay to the creditor.
- **Industrial mortgage.** See above, *Immovable property*.
- **Guarantee trust.** See above, *Immovable property*.

Formalities

The following formalities apply:

- **Mortgage.** A mortgage can only be created by those who have power of attorney to convey title. All mortgages must be:
 - created by a notary deed (except for ordinary mortgages for property worth less than 365 times the daily minimum wage, in which case it must be in writing and witnessed by two people); and
 - filed with the Public Registry of Property (*Registro Público de la Propiedad*), National Maritime Public Registry (*Registro Público Marítimo Nacional*) or Aeronautic Registry (*Registro Aeronáutico*) as appropriate.

Minimum information required in a mortgage deed includes:

- the name of the mortgagor;

- identification of the mortgaged property (for a naval mortgage, this is the registration number, port of registration, nationality and flag of the vessel).

In addition, the following are also required to create an aeronautic mortgage:

- a certificate of registration;
- certificates of encumbrances;
- certificates of circulation;
- a current concession title;
- a current licence.

A mortgage can be extinguished by any of the following:

- full payment of the loan;
- expiry of the limitation period within which the creditor must collect any unpaid debt and, if necessary, sell the mortgaged property;
- the creditor cancelling or substituting the mortgage;
- expropriation of the mortgaged property (that is, the government acquires privately owned property for use that benefits the public interest);
- judicial auction of the mortgaged property.

■ **Civil Pledge.** A civil pledge is effective when both:

- there is a written agreement with a clear date of execution;
- the property is legally or actually delivered to the creditor.

■ **Commercial Pledge.** A commercial pledge is effective when any of the following occur:

- the pledged assets are delivered to the creditor;
- title to the pledged assets is delivered or endorsed to the creditor;
- the pledged assets are deposited in a warehouse accessible only by the creditor;
- the credit instrument is delivered to the creditor, if it is payable to the bearer or non-negotiable and, if necessary, is registered;
- the credit instrument is endorsed to the creditor (that is, the debtor identifies the creditor on the instrument to validate it), if it is nominative and, if necessary, is registered;
- the pledged assets or the credit instrument is deposited with a third party, if they are payable to the bearer and the third party is acting as a depository;

- the contract is filed with the Public Commercial Registry as required (*Article 326, Law for Credit Instruments and Transactions 1932 (Ley General de Títulos y Operaciones de Crédito)*);

- the requirements for a credit on books have been met (*Law of Financial Institutions 1990 (Ley Instituciones de Crédito)*).

■ **Pledge without transfer of possession.** A pledge without transfer of possession must be in writing, identifying:

- the location of the pledged assets;
- the minimum consideration that that debtor should receive for the sale of the pledged assets;
- third parties to whom the debtor can sell the pledged assets;
- the destination of the proceeds of sale; and
- any information that the debtor needs to give the creditor for the sale or transfer of the pledged assets.

If the value of the pledged assets exceeds 250,000 investment unities (*unidades de inversión*), the pledge must be ratified before either a public notary or a public broker (*corredor público*).

A pledge must also be filed with the Public Commercial Registry (*Registro Público de Comercio*).

■ **Securities pledge.** A securities pledge must comply with the following requirements to be effective:

- it must be in writing;
- the securities must be delivered;
- it must be registered with the relevant registry;
- an institution must be appointed to safeguard the securities.

The law allows parties to agree to use out-of-court foreclosure proceedings. However, this agreement can be declared void on the basis that it is unconstitutional.

■ **Guarantee trust.** A guarantee trust must be in writing, identifying:

- the place where the estate of the trust is located;
- the minimum consideration that the trustee should receive for the sale of the assets subject to the trust;
- third parties to whom the trustee can sell the assets subject to the trust;
- the destination of the proceeds of sale;

- any information that the debtor needs to give the creditor for the sale or transfer of the assets subject to the trust;
- how the value of the assets subject to the trust should be determined.

If the value of the pledged assets exceeds 250,000 investment unities, the pledge must be ratified before either a public notary or a public broker.

2. Where do creditors and shareholders rank on the bankruptcy of a company?

The Bankruptcy Code 2000 regulates the insolvency of companies and individuals exercising commerce as an ordinary course of business.

Claims rank in the following order (*Bankruptcy Code*):

- Charges for bankruptcy, such as inspector's fees and judicial expenses.
- Singularly privileged creditors. These are creditors claiming:
 - mortuary expenses when the bankruptcy judgment is made after an individual debtor's death;
 - hospital and medical expenses in connection with an individual debtor's illness which was the cause of death, when the bankruptcy judgment is made after the debtor's death.
- Secured creditors.
- Labour and tax claims. This includes any labour or tax claim provided that it is owed before the bankruptcy order is granted.
- Creditors with special privilege. These are creditors that are recognised by law as having a special privilege or a right to retain certain assets.
- Unsecured creditors.

The shareholders' capital investment secures the payment of recognised debts. Therefore, shareholders cannot claim any payment obligation from the company until all other debts are paid.

3. Are there any mechanisms used by trade creditors to secure unpaid debts?

The following can be used by trade creditors to secure unpaid debts:

- **Retention of title clause.** This allows the creditor to retain title over goods until full payment for the goods is made. If the debtor becomes bankrupt, the creditor can claim for the unpaid debt and claim to recover possession of the property (*acción separatoria*).

- **Consignment agreement (comisión mercantil).** This is an agreement that allows a consignor (usually a wholesale merchant) to deliver goods to a consignee (usually a distributor or reseller) without transferring the title. The consignee must either:
 - pay the agreed price to the consignor, if the goods are sold to third parties; or
 - return the unsold goods to the consignor.

The creditor has the right to retain the goods subject to the contract that is in its possession and it cannot be disposed of the goods until full payment is made.

In addition, the following provisions apply to trade creditors (*Bankruptcy Code*):

- The seller of goods can retain possession and title of goods subject to a transaction until a bankrupt debtor either pays the price in full or guarantees payment.
- The buyer of movable or immovable property can require delivery of possession and title from a bankrupt debtor once full payment is made, provided that the sale was complete before the bankruptcy order was made.
- A seller can recover title of goods if full payment is not made, even if the sale of goods is not complete at the time a bankruptcy order.
- Legitimate owners can recover assets in possession of a debtor if title has not passed and the assets are identifiable.

RESCUE AND BANKRUPTCY PROCEDURES

4. Please briefly describe rescue and bankruptcy procedures that are available in your jurisdiction. In each case, please state:

- The objective of the procedure and, where relevant, prospects for recovery.
- Companies to which it can potentially apply.
- How it is initiated, when and by whom.
- Substantive tests that apply (where relevant).
- How long it takes.
- The consents and approvals that are required.
- The effect on the company, shareholders and creditors.

The Bankruptcy Code aims to protect insolvent companies (and individuals exercising commerce as an ordinary course of business), their chances of survival and the rights of their legitimated creditors. All references to a company below include individual commercial debtors.

Business reorganisation and conciliation

- **Objective.** Conciliation aims to achieve an agreement between a debtor and its creditors to avoid bankruptcy proceedings by reorganising the business so that it can become viable again.
- **Companies.** This process can be used by any commercial entity recognised by the Commercial Code 1889.
- **How, when and by whom.** Business reorganisation can be begun, at any time, by:
 - any of the company's creditors or the General Attorney filing a written complaint at court;
 - the company filing a written request at court.
- **Substantive tests.** When a written complaint is filed by any of the company's creditors or the General Attorney, business reorganisation is granted by the court if all of the following criteria are met:
 - the company has failed to pay two or more of its creditors;
 - the debts have been overdue for at least 30 days and represent 35% of the company's total debt at the time the complaint is filed;
 - the company lacks sufficient funds to repay at least 80% of all outstanding debts at the time the complaint is filed.

When a written request is filed by the company, business reorganisation is approved if either:

- debts have been overdue for at least 30 days and represent 35% of the company's total debt at the time the request is filed; or
 - the company lacks sufficient funds to repay at least 80% of all outstanding debts at the time the request is filed.
- **How long.** Business reorganisation must be completed within 90 business days of the complaint or request being accepted by the court.

A conciliation agreement must be reached within 185 calendar days of the business reorganisation judgment being published in the *Official Gazette*. The company can extend this period by 90 days on two occasions, but the conciliation stage cannot exceed 365 days.

During conciliation, all foreclosure proceedings relating to an attached asset are stayed. However, there is no stay of proceedings for other proceedings to enforce a mortgage or pledge.

- **Consents and approvals.** To be enforceable, a conciliation agreement must be approved by the company and by creditors representing 50% of both:
 - the total amount of the company's liabilities of all recognised unsecured creditors;
 - the total amount of the company's liabilities of all recognised secured creditors.

However, the conciliation agreement is presumed to be approved by all unsecured creditors if it includes provisions for the:

 - full payment of debts due or overdue at the time of the business reorganisation judgment being made, within 30 days of the agreement being executed;
 - payment of debts not yet due under the terms and conditions originally agreed by the parties.
- **Effect.** Once business reorganisation is granted by the court, a conciliator is appointed to oversee the reorganisation and negotiations with creditors. The first step in this process is to identify the company's creditors. Any outstanding payment obligations at the time that business reorganisation is granted are considered overdue. Any existing claims against the company are stayed during business reorganisation and conciliation proceedings.

During proceedings, the court:

- issues injunctions or restraining orders to preserve the company's assets;
- orders the company to stop any payments to any creditor;
- orders the company to continue running the business under the supervision of the conciliator.

Once business reorganisation has begun, secured creditors can either:

- participate in the proceedings as secured creditors for the value of their security interest;
- continue with foreclosure proceedings (that do not relate to attached assets) already begun. The creditor has priority over the proceeds of sale and any remaining proceeds are applied to the bankrupt's estate. If the proceeds do not cover the debt, the creditor becomes an unsecured creditor for the outstanding amount.

Bankruptcy

- **Objective.** Bankruptcy is used to wind up the company and distribute its assets to creditors.
- **Companies.** Any commercial entity recognised by the Commercial Code can be subject to bankruptcy proceedings.

- **How, when and by whom.** Bankruptcy can be declared at any time before, during or after business reorganisation and conciliation proceedings, if requested by the company.

If business reorganisation and conciliation proceedings have begun, the court can declare a company bankrupt if either:

- the conciliation period (*see above, How long*) ends without reaching an agreement;
 - the conciliator requests bankruptcy on the basis that the company and its creditors are unwilling to reach an agreement.
- **Substantive tests.** See above, *How, when and by whom*.
 - **How long.** There is no time frame within which bankruptcy must be completed.
 - **Consents and approvals.** Approval is only required from the court to begin or end bankruptcy proceedings. If bankruptcy is ended by an agreement between the company and its creditors before the end of the bankruptcy process, the rules for conciliation apply.
 - **Effect.** Once bankruptcy is declared, a trustee is appointed to run the business and administer the winding up of the company. The first step is to identify the company's creditors. The trustee must sell the business by whatever method is most profitable. Any existing claims against the company are stayed during bankruptcy proceedings.

During proceedings, the court:

- issues injunctions or restraining orders to preserve the bankrupt's estate;
- prohibits the company's managers from running the business.

5. Are there any procedures (other than formal rescue or bankruptcy procedures) that can be invoked by creditors to recover their debt?

There are two ways in which an unsecured creditor can secure an unpaid debt (both of which must be used before bankruptcy is filed for):

- **Attachment of debtor's assets.** Creditors whose credit includes an executive title, such as credit instruments or loan agreements, can file for summary commercial proceedings after the debt becomes due to attach a debtor's assets. These assets are then sold and the creditor has a preferential right to the proceeds of sale. However, the use of proceeds to repay the creditor is subject to the priority of any perfected security interest.
- **Precautionary measures.** A creditor can apply to the court before or during ordinary commercial proceedings for a pre-

cautionary attachment of debtor's assets. The creditor must prove one of the following:

- that the debtor intends to disappear without paying its debts;
- that the debtor does not have enough assets to repay all its debts and that there is reasonable fear that the debtor may hide or destroy the assets it does have;
- when a claim relating to particular assets is being made, there is reasonable fear that the debtor may hide or destroy those assets.

LIABILITY AND TRANSACTIONS

6. Are there any circumstances in which a director, parent company (domestic or foreign) or other party could be held liable for the debts of a bankrupt company?

A director can be held liable for the debts of a bankrupt company in the following circumstances:

- If any action or misconduct causes the company to default in any way.
- If shareholders' investments are not properly recorded in the company's books.
- If dividends paid to shareholders do not comply with legal requirements.
- If accounts, dockets or any other information required by law are not properly maintained.
- If shareholders resolutions are not properly adopted.

Directors can be personally liable if they give a personal guarantee or create a similar personal liability agreement, such as a collateral obligation. Directors can also be civilly and criminally liable if they perform certain acts without the consent of a meeting of shareholders or the board of directors (*see Question 7*).

Generally, a parent company cannot be held liable for the bankruptcy of its subsidiary as all separately incorporated companies act in their own legal capacity and hold their own assets. An exception to this general principle of law applies if the benefits of transactions of a subsidiary are diverted to its parent company.

Any person who executes a contract with, or performs an act for, the company in bad faith is liable for damages to the bankruptcy estate.

Shareholders can be held liable for the debts of a bankrupt company up to the value of their shares. They can also be held jointly liable with the company if:

