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# Mexico: Financial contagion derived from insolvency

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**The Insolvency Law is the most public part of private law because, although it shares its concepts, its application and regulation deviate due to the severity of its principles, as in practice, in front of a debtor, we usually have several dozen creditors claiming their credits from the general breach of the merchant's obligations. Thus, with a bank loan, only one supplier is affected, but against the secured creditor there is opposition by the subordinate and against the tax credit they oppose the labour credits; this show the universality of private and public interests which determine the particular character of the Insolvency Law.**

Considerable differences exist with private law. For example, *verbi gracia* before the principle of *prior in tempore*, and *prior in iure* is faced by the *Par Conditio Creditorum* that implies the principle of community of losses. In another example, the date of rescission, the period of suspicion and the fraudulent acts of the creditor force the insolvency committees to regulate differently from the *Actio pauliana*.

Thus, the bankruptcy lawyer cannot conform to dogmas and must be open to reanalysing the institutions of private law; he/she cannot be just an excellent mercantilist, a prominent litigator, a learned tax attorney, a skilled criminal or a labourer. The scholar of bankruptcy law, in some ways, must be all of them at the same time.

The task is not easy. Those who practice bankruptcy law are like a doctor specialising in intensive care, who takes time to analyse the critical state of the patient, to find a prognosis and decide on the best solution to stabilise and rehabilitate the patient.

With this medical analogy, I wanted to use the title of this article to refer to the impact of the commercial insolvency of a merchant with respect to third parties (subordinate or not) who, by guaranteeing the obligations of the merchant, will inevitably be affected by the general failure to comply with the obligations of payment of the principal debtor's credits and subsequently by the bankruptcy status.

Therefore, a contagion effect occurs because of the bankruptcy or insolvent parties and spreads to the third parties who probably had no financial problems or, if they did previously have financial problems, this contagion would aggravate such problems and put them at financial risk.

Such a problematic scenario results in many questions as to whether the legal default in its double interpretation of prohibition of payment and stays of executions should be understood as a medicine that is for the exclusive benefit of the merchant seeking insolvency or a broad-spectrum drug that encompasses the accumulation of payment obligations that are generally not fulfilled and also its underlying effects on non-insolvent third parties.

Let me begin by analysing the legal nature of an accessory contract or, as they are more commonly known, a guarantee agreement.

According to established law, while a principal contract is one whose existence and validity does not depend on the existence or validity of a pre-existing or a previously concluded contract, the accessory contract does not exist alone, but depends on the existence of an obligation or a previously concluded contract.

Considering the above, a position that we could propose is that the accessory contract, which is totally dependent on the principal, thus affects the main contract in its enforceability of the accessory and, therefore, the suspension of the enforceability and execution of the principal decreed by the insolvency judicial authority will naturally affect the accessory causing economic repercussions.

The interpretation becomes complex when the guarantee of the principal obligation is not constituted by way of an accessory contract but by means of a joint and several obligation, in which each obligor, irrespective of whether

it is the principal debtor or the joint debtor, under the terms of Article 1987 of the Civil Code reports the obligation to provide, each in itself and in its entirety, the benefit due, so that although it is the same debt, each principal or joint obligor is responsible for the entirety.

Thus, Article 1989 of the Civil Code provides that if the creditor claims the entire debt of a debtor and becomes insolvent, the creditor is in a position to claim it from the others; a matter that in a literal interpretation of the law shows that in terms of solidarity obligations, the obligation is independent of the solvency of each of the obligors, thus being a second position that could be adopted with respect to the individual.

Finally, an interim proposal would result in a casuistic analysis of the manner in which the obligation was established. That is, if the joint obligor, as the guarantor, did not receive any benefit from the subscription of the obligation, then the obligation would be signed as a collateral guarantee that could be adjusted to the provisions of the first proposal, whereas if the obligor was part of the contract and received some benefit from having subscribed to the obligation, then it could be adjusted to what was stated in the second.

These theories have been, to a greater or lesser extent, regulated in the history of the Mexican bankruptcy legislation. However to date, the commercial insolvency law regulates the point in question in a very abstract way, in which it recognises that it is in the public interest to preserve companies and to prevent the breach of the payment obligations of the insolvent merchant from jeopardising the viability of those with which it maintain a business relationship.

In such circumstances, the absence of more explicit and profound articulation with respect to the individual opens the debate as to whether the non-bankrupt third-party guarantors of the obligations of the common debtor will receive the benefit of legal arrears in respect of the execution of the guarantees granted only in respect of the debtor's obligations.

Those that maintain a favourable position to the extension of the effects of the legal guidelines with respect to the non-insolvent third-party guarantors, will allege that it is in the public interest that the current bankruptcy law expressly makes patent in the first cited article with respect to the insolvency exception regime; thus pondering a more appropriate interpretation of this interest of private law institutions, which will seek to obtain the necessary encapsulation of the economic wear-and-tear generated by the common debtor in a certain and defined environment that is limited to the parts of its insolvency proceedings in order not to disseminate it unnecessarily, in which case, it would be ordered that all the guarantors of any kind to whom the execution of the guarantees granted in favour of the original bankruptcy had a significant impact, would go to request their own mercantile insolvency, incurring the expenses necessary for this proceeding, and in general, affecting the terms of their own fulfilment obligations to the detriment of their own business as well as labour, tax, and other relations.

In support of this position it is to be considered that the extension of the legal guidelines should not exceed the lapse of existence of the insolvency proceedings, before being extended to accessory obligations which would be subject to the same terms and conditions as those prevailing with respect to the principal obligations subject to commercial insolvency, so that an extension would be adjusted to a limited period of time and in order to obtain a bankruptcy agreement that will integrally resolve the financial impact without causing an unjustified contagion to other third parties.

In contrast, those who hold a position contrary to the extension of the effects of legal arrears in respect of non-insolvent third-party guarantors, must argue that the creditor who obtained a guarantee from a third party has the undeniable right to claim at any time the collection of its credit from the third-party guarantor, so that if the principal is subject to a situation of insolvency, only a bankruptcy state of the guarantors could benefit them in the same circumstances to be opposable against the creditor, as such guarantors freely and voluntarily assumed the granting of the guarantee and also the risk of the solvency of the principal obligor.

According to these positions, such a situation is not easy to discern.

On the one hand, according to the most public part of bankruptcy law, it would seem unfair to think that the law benefits the principal obligor

in a situation of general breach not envisaged by the guarantors, allowing the obligor to refrain from making the payment of his obligations and to abstract the terms agreed with his creditors to the detriment of all other third-party guarantors who, without protection of any kind, will be immediately claimed and, in their case, forced to pay for the obligations of others.

On the other hand, according to the most elementary principles of private law relating to bankruptcy law, it could be unjustifiably argued that a secured creditor has to wait one day or, in the worst legal scenario, 180 days and its extensions according to the terms of a bankruptcy proceeding, to obtain the payment of a credit that was prudently guaranteed, dividing the insolvency risk of the principal debtor among the third parties to whom it is intended to protect. Thus, it would seem unfair to the said creditors that the risk and actual loss of the insolvency of the principal obligor must be transferred to the creditor and not to those who guaranteed their obligations.

According to the above, this issue looks like a set of scales in which the just seems to be subject to the private or public conception of insolvency law from the perspective of the common debtor, the secured creditors and the guarantors. However, in finding a solution there cannot be an absolute position. However, in looking at all views there must be a healthy balance in the equitable sharing of benefits and damages between the affected parties by ensuring their rights, but also in considering the public interest that is the legal principle of this matter.

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