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 most common types of security for immovable property are:

- **Mortgage.** If a mortgage is taken as security interest, the debtor retains possession and legal title of the secured property. However, the creditor is given a right to sell the property if the debtor defaults. The creditor can pursue a forced sale if the debtor has transferred legal title of the property to a third party.
- **Industrial mortgage.** A financial institution can secure its loans by taking a mortgage over all of a company's assets. Provided that the financial institution agrees, the company can continue to operate as usual, and the secured assets can be sold and replaced in the ordinary course of business.
- **Naval mortgage.** This is a mortgage taken over a vessel.
- **Aeronautic mortgage.** This is a mortgage taken over an aircraft.
- **Guarantee trust.** Assets can be conveyed to a trustee, which must be a financial institution. If the debtor defaults, the trustee can sell the assets by either:
  - following the method set out in the trust agreement; or
  - initiating summary proceedings before the court.

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

Movable property

The most common types of security for movable property are:

- **Civil pledge.** Possession of the pledged asset is transferred to the creditor or a third person, by either legal or actual delivery. If the debtor defaults, the creditor can sell the pledged asset by initiating summary proceedings before the court.
- **Commercial pledge.** This works in the same way as a civil pledge (*see above*), but is granted over a movable commercial asset. A commercial pledge can also be granted over assets purchased with a loan.
- **Pledge without transfer of possession.** This works in the same way as a civil pledge (*see above*), except that the debtor retains possession of the pledged asset. The debtor cannot transfer or convey title of the pledged asset, unless authorised by the creditor.
- **Securities pledge.** This is an agreement that involves securities traded on the stock exchange being deposited in a special account. If the debtor defaults, the securities are sold on the stock exchange and the sale proceeds are used to pay 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 granted by a party who has legal title to the property or has a power of attorney to convey title on someone else's behalf. All mortgages must be:
  - created by a notary deed (except for an ordinary mortgage over property worth less than 365 times the daily minimum wage, which 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.

  A mortgage deed must specify the debtor's name and identify the secured property (for a naval mortgage, the vessel's registration number, port of registration, country of manufacture and flag must be cited).

  In addition, the following are required to create an aeronautic mortgage:
  - a certificate of registration;
  - certificates of any encumbrances;

- a certificate of circulation (that is, a document stating that the aircraft is fit to navigate);
- a current concession title (that is, the government's permission for a company to engage in business related to aerial transportation); and
- a current licence.

- **Civil pledge.** This takes effect if there is a written agreement with a clear date of execution, and the property is legally or actually delivered to the creditor.
- **Commercial pledge.** This takes effect when any of the following occur:
  - the pledged asset is delivered to the creditor;
  - title to the pledged asset is delivered or endorsed to the creditor (the debtor can sign a negotiable document to endorse title of the pledged asset to the creditor);
  - the pledged asset is deposited in a warehouse to which only the creditor has access;
  - the credit instrument (such as shares, promissory notes or written evidence of a debt) is:
    - delivered to the creditor, if it is payable to the bearer;
    - non-negotiable; and
    - registered with the issuer of the credit instrument, where necessary (for example, nominative shares must be entered in the stock certificate register).
  - 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, where necessary, is registered;
  - the pledged asset or the credit instrument is deposited with a third party, if it is payable to the bearer and the third party is acting as a depository;
  - the contract is filed with the Public Commercial Registry (*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)*). A credit on books is commonly known as commercial credit, and gives a creditor the right to receive property or money owed to the debtor in cases of default. A commercial credit contract must be entered into, and the security interest must be noted in the debtor's accounting books.
- **Pledge without transfer of possession.** This must be in writing and identify:
  - the location of the pledged assets;
  - the third parties to whom the debtor can sell the pledged assets;
  - any information that the debtor must give the creditor before selling or transferring the pledged assets;
  - the minimum consideration that the debtor should receive if it sells the pledged assets; and
  - the destination of the sale proceeds.

  If the value of the pledged assets exceeds 250,000 investment unities (*unidades de inversión*), the pledge must be formally approved by 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.** This must comply with the following formalities:
  - it must be in writing;
  - it must be registered with the appropriate registry;
  - the securities must be deposited in a special account (if the securities are in a publicly owned company) or delivered to the creditor (if the securities are in a privately owned company);
  - an institution must be appointed to safeguard the securities.
- **Guarantee trust.** A guarantee trust must be in writing and identify:
  - the location of the assets subject to the trust;
  - the third parties to whom the trustee can sell the assets subject to the trust;
  - any information that the debtor needs to give the creditor before modifying, selling or transferring the assets subject to the trust;
  - how the value of the assets subject to the trust should be determined;
  - the minimum consideration that the trustee should receive if it sells the assets subject to the trust; and
  - the destination of the sale proceeds.

  If the value of the assets subject to the trust exceeds 250,000 investment unities, either a public notary or a public broker must formally approve the trust.

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

The Bankruptcy Code 2000 (*Ley de Concursos Mercantiles*) (Bankruptcy Code) regulates the insolvency of both companies and individuals that carry out commerce as part of their ordinary course of business.

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

- Bankruptcy expenses, such as inspectors' fees and legal costs.
- Secured creditors' claims.
- Employment and tax claims owed before the bankruptcy order is granted.
- Claims of creditors with special privilege. These are creditors that are recognised by law as having a special privilege or a right to retain certain assets (creditors in this category are those that provide a service to the debtor).
- Unsecured creditors' claims.
- Shareholders.

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

Trade creditors can use the following to secure unpaid debts:

- **Retention of title clause.** This allows the creditor to retain title to goods until it receives full payment for them. If the debtor becomes bankrupt, the creditor can make a 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 title to the goods. 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 consignee has a right to retain goods that are in its possession, subject to the contract, until the consignor pays the full amount for the services provided.

The following judicial measures are available for trade creditors to secure unpaid debts:

- **Attachment of the debtor's assets.** In cases involving a credit instrument or loan agreement, the creditor can file for summary commercial proceedings after the debt becomes due. If the creditor's application is successful, an attachment can be made to the debtor's assets. These assets are then sold and the creditor has a preferential right to the sale proceeds (subject to any higher ranking security interest). However, once business reorganisation (*see Question 5*) has begun, the attached assets cannot be sold to recover the debt. The Bankruptcy Court can set aside an attachment of assets at any time.
- **Precautionary attachment of the debtor's assets.** A creditor can apply to the court before or during ordinary commercial proceedings for a precautionary attachment of the debtor's assets. To obtain a precautionary attachment, the creditor must prove one of the following:
  - that the debtor intends to abscond without paying its debts;
  - that the debtor does not have sufficient assets to cover all its debts and there is reasonable cause to believe that the debtor may hide or destroy the assets it does have;
  - if a claim relating to particular assets is being made, there is reasonable cause to believe that the debtor may hide or destroy those assets.

  Once business reorganisation (*see Question 5*) has begun, the assets subject to the precautionary attachment cannot be sold to recover the debt. The Bankruptcy Court can set aside a precautionary attachment of assets at any time.

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

- A seller can retain possession and title of goods until a bankrupt debtor either pays the price in full or guarantees payment.
- A buyer of movable or immovable property from a bankrupt debtor can require possession and title to be transferred to it once the price is paid in full, provided that the sale was complete before the bankruptcy order was made.
- A seller can recover the goods' title if it does not receive full payment, even if the sale was not complete before the bankruptcy order was made.
- Legitimate owners can recover assets in a debtor's possession provided that title has not passed to the debtor and the assets are identifiable.

4. Are there any procedures (other than the formal rescue or insolvency procedures described in *Question 5*) that can be invoked by creditors to recover their debt?

If business reorganisation (*see Question 5*) has begun, a secured creditor can either:

- Participate in the procedure to claim the value of its security interest.
- Continue with already existing proceedings to enforce its security.

If the secured property is sold, the secured creditor can recover its money first (subject to bankruptcy expenses (*see Question 2*)) and any remaining sale proceeds belong to the bankruptcy estate. If the sale proceeds are not sufficient to cover the debt in full, the creditor can claim the outstanding amount as an unsecured creditor.

Before recovering its secured debt, the creditor must attribute some value to its security. If the foreclosure value is higher than the value given by the creditor, the creditor can only recover up to the amount it had valued and will be considered an unsecured creditor for the remainder. The conciliator and the trustee can object to the foreclosure if it is against the business reorganisation proceedings' best interests.

RESCUE AND INSOLVENCY PROCEDURES

5. Please briefly describe rescue and insolvency 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.**
- **How the procedure is formally concluded.**

Business reorganisation

Business reorganisation is the only insolvency procedure available for companies and is governed by the Bankruptcy Code. It aims to protect insolvent companies, improve their chances of survival and safeguard their creditors' interests. Business reorganisation is made up of two stages: conciliation and bankruptcy. The most recent reforms of the Bankruptcy Code also allow companies to file a prepackage plan business reorganisation (*see below, Prepackage plan*) making the business reorganisation open in the conciliation stage. All references to a company below include individual commercial debtors.

Conciliation

- **Objective.** The aim of conciliation is for a company to reach an agreement with its creditors to avoid bankruptcy by reorganising the business so that it can become viable again.
- **Companies.** The procedure is available to any company that carries out commerce as part of its ordinary course of business.
- **How, when and by whom.** Business reorganisation can be started at any time by the company, its creditors or the Attorney General filing a written request at the court.
- **Substantive tests.** When a company files a request for business reorganisation, the court approves the conciliation stage if either:
  - debts have been due 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 pay at least 80% of all outstanding debts at the time the request is filed.

  When any of the company's creditors or the Attorney General file a request for business reorganisation, the court approves the conciliation stage if:
  - the company has failed to pay two or more of its creditors;
  - debts have been due for at least 30 days and represent 35% of the company's total debt at the time the request is filed; and
  - the company lacks sufficient funds to pay at least 80% of all outstanding debts at the time the request is filed.
- **How long.** The conciliation stage must begin within 90 working days after the court has received a written request for business reorganisation.

  A conciliation agreement must be reached within 185 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.
- **Consents and approvals.** To be enforceable, a conciliation agreement must be approved by the company and by creditors representing 50% of the total value of both secured and unsecured claims. However, all unsecured creditors are deemed to approve the conciliation agreement if it provides that:
  - debts due at the time of the business reorganisation judgment must be paid in full within 30 days of the conciliation agreement; and
  - debts not yet due must be paid under the terms and conditions originally agreed by the parties.
- **Effect.** Once the court grants the business reorganisation, 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 debts at the time that business reorganisation is granted are considered to have fallen due. All existing claims against the company are stayed. Assets subject to an attachment or precautionary attachment cannot be sold to recover a debt (*see Question 3*). However, there is no stay on proceedings to enforce a mortgage or pledge. Secured creditors are free either to participate in the business reorganisation to claim the value of their security interest or to continue

with proceedings already begun, to enforce their security (provided that their security is not over attached assets). If they cannot recover the debt in full from the sale proceeds of the secured property, these creditors can also claim the outstanding balance by participating in the business reorganisation as unsecured creditors (*see Question 4*).

During the conciliation stage of business reorganisation, the court must order a company to stop making payments to any creditor. In addition, the court can issue injunctions or restraining orders to preserve the company's assets. It can also order the business to be carried on either by the conciliator or by the company under the conciliator's supervision (*see Question 8*).

- **Conclusion.** The conciliation stage of business reorganisation concludes when the court either approves the agreement that the company has reached with its creditors or orders the bankruptcy stage to begin (*see below, Bankruptcy*).

Prepackage plan

- **Objective.** The aim of the prepackage plan is to begin the business reorganisation in the conciliation stage, and it has the same objectives as normal conciliation.
- **Companies.** This is the same as for conciliation (*see above, Conciliation: Companies*).
- **How, when and by whom.** The prepackage plan business reorganisation must be started by a brief signed by the company and its creditors representing at least 40% of the company's total debts.
- **Substantive tests.** When a company and its creditors representing at least 40% of the company's total debts file a request for prepackage plan business reorganisation, the court approves the conciliation stage if both:
  - the company states under oath that either:
    - debts have been due 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 pay at least 80% of all outstanding debts at the time the request is filed.
  - the filing includes the proposal for a business reorganisation plan duly signed by the company and its creditors representing at least 40% of the company's total debts.
- **How long.** There is no specific time frame for a prepackage plan business reorganisation, however, it should be considered to be subject to the same time frames provided for the conciliation (*see above, Conciliation: How long*).
- **Consents and approvals.** To be enforceable, an agreement must be approved by the company and by creditors representing 50% of the total value of both secured and unsecured claims. Any proposal made by the conciliator must meet the conditions provided in the proposal for business reorganisation plan. However, all unsecured creditors are deemed to approve the conciliation agreement if it provides that:
  - debts due at the time of the business reorganisation judgment must be paid in full within 30 days of the conciliation agreement; and
  - debts not yet due must be paid under the terms and conditions originally agreed by the parties.
- **Effect.** This is the same as for conciliation (*see above, Conciliation*).
- **Conclusion.** The prepackage plan business reorganisation concludes when the court either approves the agreement that the company has reached with its creditors or orders the bankruptcy stage to begin (*see above, Bankruptcy*).

Bankruptcy

- **Objective.** The aim of bankruptcy is to wind up a company and distribute its assets to creditors.
- **Companies.** This is the same as for conciliation (*see above, Conciliation: Companies*).
- **How, when and by whom.** Bankruptcy can be declared at any time before, during or after the conciliation stage, if requested by the company.

  If the conciliation stage has begun, the court can declare a company bankrupt if either:
  - the conciliation period (*see above, Conciliation: How long*) ends without an agreement being reached; or
  - the conciliator requests a bankruptcy order to be made because the company and its creditors cannot reach an agreement.

  The company can apply for bankruptcy when filing for business reorganisation. In this event, the business reorganisation never goes through the conciliation stage.
- **Substantive tests.** See above, *How, when and by whom*.
- **How long.** There is no time frame in which bankruptcy proceedings must be completed.
- **Consents and approvals.** The court's approval is required to begin or end bankruptcy proceedings. If a company reaches an agreement with its creditors to end bankruptcy proceedings, 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 for it 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 the bankruptcy stage of business reorganisation, the court can issue injunctions or restraining orders to safeguard the bankruptcy estate. It can also prohibit the company's managers from running the business.

- **Conclusion.** The bankruptcy stage of business reorganisation concludes when either:
  - the court approves an agreement to end bankruptcy proceedings between the company and its creditors (*see above, Consents and approvals*); or
  - the company is wound up and creditors' claims have been settled.

LIABILITY AND TRANSACTIONS

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

A director can be held liable for the debts of an insolvent company if:

- His misconduct causes the company to default in any way.
- Shareholders' investments are not properly recorded in the company's books.
- Dividends paid to shareholders do not comply with legal requirements.
- Accounts, dockets or any other records required by law are not properly maintained.
- Shareholders' resolutions are not properly adopted.

Directors can be personally liable if they give a personal guarantee or enter into a similar agreement, such as one involving a collateral obligation. In addition, directors can be civilly and criminally liable if they perform certain acts without a shareholders' or a board resolution (*see Question 7*).

A parent company cannot generally be held liable for its subsidiary's debts, unless the parent company benefits from the subsidiary's transactions.

Any person who acts in bad faith when making a contract with a company or carrying out an action on its behalf can be held liable to compensate the bankruptcy estate.

Shareholders can be held liable for an insolvent company's debts up to the value of their shares. They can also be held jointly liable with the company if:

- The company is not properly constituted.
- The object of the company is against public law or public interest.
- The company does not have limited liability.

7. Can transactions that are effected by a company that subsequently becomes insolvent be set aside?

Any transactions entered into within 260 days before a business reorganisation judgment is issued (the suspect period) can be set aside if they are considered to prejudice creditors' interests. The suspect period can be extended if the conciliator, trustee or any creditor files a request before the reorganisation judgment is issued. The following are considered prejudicial to creditors' interests (*Bankruptcy Code*):

- Acts performed for no consideration.
- A company selling goods at a discount or buying goods for more than their market value.
- Transactions involving terms and conditions that do not conform to standard commercial practice.
- Cancellation of outstanding debts due to the company.
- The payment of debts not yet due.
- Contracts made in bad faith with spouses and relatives of shareholders or directors, and between parent companies or subsidiaries. Transactions with these parties are presumed to be in bad faith, unless proved otherwise.

Any agreement a company makes to settle a creditor's claim after business reorganisation begins is void. The creditor cannot enforce its rights under an agreement of this type, but can participate in the business reorganisation proceedings.

The company must perform existing contracts unless the conciliator or trustee objects. An objection can be made on either of the following grounds:

- The contract does not fall within the company's ordinary course of business.
- Performance of the contract would adversely affect the bankruptcy estate.

8. Please set out any conditions under which a company can continue to carry on business during insolvency or rescue proceedings. In particular:

- **Who has the authority to supervise or carry on the company's business?**
- **What restrictions apply?**

Once business reorganisation has begun, an insolvent company can generally continue to carry on business, unless this will harm the bankruptcy estate.

Conciliation and prepackage plan business reorganisation

During these stages, the company can continue to carry on business, but a conciliator is appointed to oversee the company's administration and accounts. In addition, the conciliator approves whether:

- Existing contracts should be performed.
- The company should incur any new debt.
- Security interests should be created or substituted.
- Assets not related to the ordinary course of business should be sold.

The conciliator can file a request at court for the directors to be removed from administering the company if he considers that this would be in the best interest of the bankruptcy estate. If the court approves this request, the conciliator takes over the company's administration.

Bankruptcy

During this stage, the company can continue to carry on business, but a trustee is appointed to administer the company. Various restrictions apply. The company can only deal with property that is not subject to sale, attachment (*see Question 3*) or other measures. A full power of attorney is available to the trustee for conveying title of the company's assets. The trustee can also cease the company's business activities if this is in the best interest of the bankruptcy estate.

INTERNATIONAL CASES

9. Please state whether:

- **Courts in your jurisdiction recognise insolvency and rescue procedures in other jurisdictions.**
- **Courts co-operate where there are concurrent proceedings in other jurisdictions.**
- **There are any international treaties relating to insolvency to which your jurisdiction is a signatory.**
- **There are any special procedures that apply to foreign creditors.**

- **Recognition.** The court recognises foreign rescue and bankruptcy proceedings provided that they do not contradict Mexican law or principles of law generally accepted in Mexico (*Chapter I, Title XII, Bankruptcy Code*).

  The filing for proceedings abroad must meet all legal requirements in the foreign jurisdiction. An administrator appointed by the foreign court must file a written request for recognition at the appropriate court in Mexico, together with proof of the foreign proceedings.

- **Concurrent proceedings.** If there are concurrent proceedings in other jurisdictions, the court only co-operates to the extent that assets are situated in Mexico. In these circumstances, the court tries to co-ordinate its decisions with those of the concurrent proceedings.
- **International treaties.** Mexico is not party to any international or bilateral treaties relating to bankruptcy. However, it is party to several international treaties relating to international procedural co-operation. Mexico drafted its current Bankruptcy Code partially based on the UNCITRAL Model Law on Cross-Border Insolvency 1997.
- **Special procedures for foreign creditors.** Foreign creditors are treated in the same way as domestic creditors.

PROPOSED REFORMS

10. Are there any proposals for reform to insolvency law in your jurisdiction?

Currently there are no proposals to reform the Bankruptcy Code.

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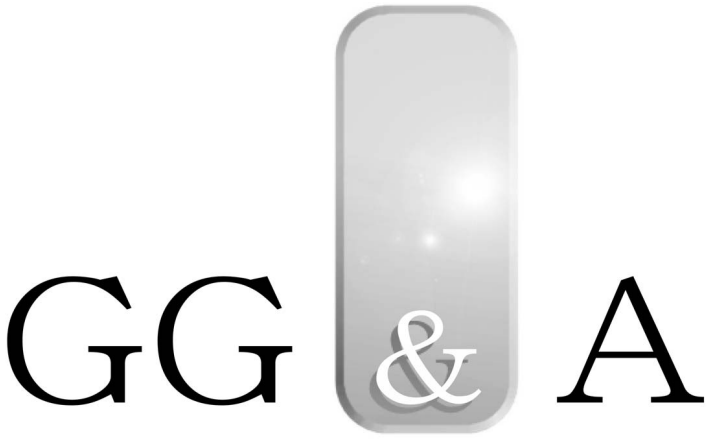

Guerra González y Asociados S.C.
ABOGADOS

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