

**THE NEW MEXICAN LAW ON COMMERCIAL INSOLVENCY**

**LEY DE CONCURSOS MERCANTILES**

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## INTRODUCTION

The growing open economy in the world, the expansion of the markets, the new e-technologies and the high tech communications and transfers have intensified considerably the globalization and the international trade. The trade is governed by the legal system in each country to provide traders, investors and lenders, legal sources to perform and enforce their transactions guaranteeing creditors' rights. It is a fact that as more big an economy is, the more business opportunities are, and correlatively there are more risks that debtors may fail to pay their debts when they become due. In this case, creditors have to face the recovery of what is owed to them by an individual actions and executions, foreclosing debtors' assets. However, sometimes this is not possible nor practical nor effective when debtor defaults generally the payment of its debts when due or the debtor is in financial distress. When debtor becomes insolvent there must be an orderly and effective insolvency legal system that protects the enterprise as an on going concern, maximize the value of the assets and equitably protect creditor's rights while debtor is financially distressed. In Mexico a new insolvency law was enacted (May 12, 2000) to update insolvency regulations to orderly and effectively conduct insolvency matters.

The new open market economy of Mexico and the new legal regulations make investors from around the globe began flocking to Mexico as a newly opened market full of investment and business opportunities.

In 1986 Mexico joined the General Agreement on Tariffs and Trade (GATT); thereafter, the financial legal system was amended to permit private ownership of commercial banks and the establishment of an autonomous and independent central bank; the "ejido system", governing use of agricultural lands, was reformed to permit private ownership; a new foreign investment law was enacted to permit one hundred percent foreign investment of Mexican business and equity participation to own property in the restricted zone for certain construction and development purposes. Other laws have been enacted or amended to better protect the free market, the competition and trade such as the antitrust law, electronic trade and commercial regulations on guaranties and collateral's for the better legal protection of creditor's rights and other for the control of the financial institutions.

In fact, these new regulations, the North American Free Trade Agreement ("NAFTA"), the Free Trade Agreements between México and the European Union, Israel, Chile and the most recent, the Free Trade Agreement with Honduras, Guatemala and El Salvador, have created additional opportunities for foreign investors and a great potential for trade, imports, exports and in general international business with México.

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 that debtors may not pay their debts and that a percentage of newly formed ventures will eventually become insolvent. Given these risks, any business person planning to extend credit into Mexico or doing business in 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 in a basic understanding of the insolvency process in Mexico.

It is also important that international banks and investors doing business in Mexico perform proper credit and business analysis, and have legal, valid and enforceable documentation, enabling them to have access to Mexican courts and have their rights enforced.

## **LEGISLATIVE FRAMEWORK FOR BANKRUPTCY AND INSOLVENCY**

Mexico's legal system is based on civil law, derived from the Napoleonic Codes, and not from common law. 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 new Law on Commercial Insolvency (Ley de Concursos Mercantiles), (hereafter referred to as the "LCI"), enacted on May 12, 2000. Both, statutory entities and individuals engaged in business in Mexico (merchants) have their insolvency processes governed by this law, the Federal Labor Law, the Tax Code of the Federation and other special regulations are applied to these proceedings. Commercial law is of federal nature and the new statute is in force in the Mexican Republic.

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, which state is determined based on the domicile of the debtor. A nonbusiness insolvency proceeding is known as a "concurso civil", not as a bankruptcy.

### **The New Mexican Law on Commercial Insolvency Ley de Concursos Mercantiles**

The new insolvency law was enacted and published in the Daily Gazette of the Federation of May 12, 2000 abrogating the former Law on Suspension of Payments and Bankruptcy published in 1943. The latter is only in effect and governs those bankruptcy and suspension of payments proceedings initiated thereunder before the LCI was into effect, May 15, 2000.

## Legislative History

The main purpose of the new statute is to preserve the ongoing concern; optimize the value of the enterprise while in financial distress. Reach a viable plan of reorganization, otherwise, provide for an orderly and effective liquidation proceeding, maximizing the value of the assets with equitable and lawful distribution among creditors and debtor.

The bill purpose states that an effective insolvency system must be predictable, equitable and transparent. Predictability is achieved by providing clear and precise rules, consistently applied, assuring certainty and discouraging litigation. Equity is achieved not only with equal treatment but acknowledging the differences among creditors and, mostly, avoiding fraud and favoritism. Transparency: during the course of the insolvency proceedings, interested parties must be given sufficient information to enable them to exercise their rights under the law. The judicial proceedings must be open and the rationale underlying the court's decision be made publicly available.

"...Once an enterprise has ceased generally the payment of its debts when due, the law must contribute that the parties be able to reach private settlements with no state participation as possible or, if not possible, that rights be orderly and expeditily enforced."

## Criteria Followed by the LCI

a) Preserve the on going concern and, if possible with debtor in possession, otherwise liquidate the estate, maximizing the assets value with an equitable distribution; b) Create a legal regime that favors restructures in the reorganization phase within a peremptory period of time; c) Induct relevant information flows to enable the interesting parties participate constructibly and align incentives to facilitate voluntary settlement among debtors and creditors; d) Assure certainty and predictability as to the time frame and final outcome of the insolvency proceeding as a whole; e) Respect, as possible, the terms and conditions of preexisting contractual obligations; f) Separate court tasks from administrative, commercial and financial functions, to enable courts to focus their efforts in jurisdictional decisions; g) Avoid frivolous court litigation by preventing that actions, including arbitration, brought before by or against the debtor be joined to the insolvency proceeding h) Prevent frivolous stays by means of clear procedural rules and effective protective measures; i) Simplify proof of claims recognition process; j) Respect secured creditors' rights and, regarding unsecured creditors, fix their credits to the inflation rate in Mexico; k) have an effective liquidation if reorganization is not reached; l) Prevent and punish criminal bankruptcies and; m) Provide for international insolvency cooperation, incorporating, as local law, the UNCITRAL Model Law on Cross Border Insolvency.

## **LAW ON COMMERCIAL INSOLVENCY OVERVIEW**

### **1. Unitary Insolvency Proceeding**

The LCI provides for a unitary insolvency proceeding namely Commercial Insolvency Declaration, that embodies two phases: conciliation and liquidation. If no reorganization plan is reached during the conciliation, process turns into liquidation. Upon declaration of bankruptcy, assets of the estate shall be transferred in public auction sale through a bid process. Assets may be transferred by court order. Transfer shall be performed even though proof of claims are pending.

The LCI eliminates creditor meetings for claims recognition and reorganization plan approval.

### **2. Persons subject to the LCI**

Only merchants (traders-comerciantes) in terms of the Commercial Code are subject to the LCI. Merchants embodies individuals engaged in trade, services and industry as well as commercial and business corporations.

The estate of a trust engaged in business activities is now subject to the LCI.

The LCI excludes from its regulation insurance and bonding companies as well as to the reinsurance and rebounding companies, which insolvency is governed by its special laws and regulations currently in force.

The LCI also excludes from its regulation small merchants having as unpaid debt, no more than five hundred thousand UDIS (the rate of the UDI towards the peso is \$2.94 as of March 1<sup>st</sup>, 2001). Therefore, merchants with debt less than such amount are not subject to insolvency procedure whatsoever. That is to say, they are not subject to any insolvency proceeding

Credit institutions (banks) and auxiliary credit organizations are subject to the LCI. The LCI armonizes with the special regulations of both and give the financial regulators the corresponding participation.

### **3. Holding and Subsidiary Companies**

Insolvency procedure of holding and controlled companies must be joined to the insolvency proceeding as well as to those of the controlled companies (parent and subsidiaries) by the same holding.

#### **4. Parties Involved in the insolvency proceeding:**

Court. Debtor. Creditors. Attorney General. Visitor. Conciliator. Trustee. Intervenor (inspector-creditor representative). Federal Institute of Insolvency Mercantile Experts (Institute).

#### **5. Jurisdiction**

Insolvency is of Federal exclusive court Jurisdiction, local courts have no jurisdiction to hear insolvency disputes.

#### **6. Initiation. Petition for Commercial Insolvency Declaration of a Debtor**

The petition requesting the judicial declaration of commercial insolvency (declaracion de concurso mercantil) may be initiated voluntarily by a debtor or involuntarily by a creditor or the Attorney General.

The petition must be filed before a federal district court having jurisdiction over the debtor's domicile.

It is up to debtor to initiate voluntary insolvency proceeding when has ceased generally the payment of its debts when they come due.

Merchant and petitioning creditors may withdraw bankruptcy petition with the agreement of all of them.

Creditor or creditors representing ten percent of the insolvency debt may appoint an intervenor.

#### **7. Conditions for initiation:**

- 1) There must be a debtor who is a merchant
- 2) two or more creditors
- 3) failure to make payments generally of obligations when due

#### **8. Qualifications of the general default of payment obligations:**

- i. failure to make payment obligations to at least two creditors
- ii. obligations with more than thirty days past due
- iii. obligations representing thirty percent or more of the total amount of the debtors obligations as of the petition filing date, and
- iv. the debtor lacks cash assets, as defined by the law, to pay at least eighty five percent of the total past due debts as of the petition filing debt.

## **9. Procedure Prior Order for Relief is Entered**

Petition filed by creditors or attorney General. Court admits petition. Court requests to the Institute to appoint visitor. Service of process to debtor and tax authorities is made. Debtor replies petition within nine working days. Notice to petitioner of debtor's reply. Petitioner files brief about debtor's answer. Visitor visits and inspects debtor's premises, documents and information to verify cessation of payments. Visitor must file the visitor expert report within fifteen working days as of the inspection starting. Notice to debtor, creditors and attorney General as to the visitor expert report, in order for them to file their pleadings within five working days. Order for relief is entered (judgement declaring debtor in mercantile insolvency)

## **10. Injunction Orders**

Before order for relief is entered: (i) petitioner may obtain, since the filing of the petition, attachment of debtor's assets and order of ne exeat (arraigo) and; (ii) Visitor may obtain since the visit, injunction court order: restraining debtor from making payments; sell, convey or encumber assets; transfer to third parties proceeds or securities and; granting a stay; seizure of assets and; order of ne exeat.

## **11. The Order for Relief shall state**

I. Debtor's name and domicile. II. Date of the order. III. Order to the Institute to appoint the conciliator. IV. Declaration of the opening of the conciliation phase, unless debtor had requested its bankruptcy. V. Order to debtor to surrender his accounting. VI. Order to debtor to cooperate and allow conciliator and intervention perform their duties. VII. Order to stop making payments, except those necessary for the ordinary course of business. VIII. Stay from executions and attachments except for labor credits (salaries of the last two years). IX. Suspicious period date. X. Order to conciliator to publish a summary of the order for relief. XI. Order to conciliator to record the order for relief in the corresponding public registries. XII. Order to conciliator to start conciliation phase. XIII. Notice to creditors to file their claim credits. XIV. Order for issue certified copy of the order of relief upon request.

Personal notice of the order for relief shall be made to debtor, Institute, visitor, intervention, creditors of known domicile and, tax authorities. Notice by written communication to the Attorney General and Labor Prosecutor.

The summary of the order for relief shall be published for two consecutive times in the Official Daily of the Federation and one in a national circulation newspaper. All the parties shall be considered notified of the order for relief as of the last publication.

The order for relief is subject to appeal without stay.

Conciliation and proof of claim phases start as of the last publication of the order for relief. Both phases run along in a parallel and simultaneous manner.

Notice that there is no conciliation phase when debtor requests its bankruptcy.

Notice that there are no creditors meetings for discussion of proof of claims nor for approval of the reorganization plan.

## **12. EFFECTS OF COMMERCIAL INSOLVENCY DECLARATION**

### **i) Bankruptcy Estate**

Once the court issues a commercial insolvency declaration, all assets of the debtor become part of the bankruptcy estate and are administered by the debtor. The debtor may continue to operate the business in its normal course, upon approval of the court, and sales of assets in the normal course of business do not need the further approval of the court.

### **ii) Assets Handled by Mexican Court**

All assets of the debtor, wherever located, will be handled through the Mexican court, even though there may be difficulties in enforcing orders of a Mexican court covering assets located outside of Mexico.

### **iii) Claims Joined**

Generally, all claims against the bankruptcy estate are stayed by the commercial insolvency declaration and must be joined in the commercial insolvency proceeding. With regard to commercial creditors, if a proceeding has been instituted to foreclose on a mortgage or pledge, that proceeding may not be pursued to completion, including the sale of the collateral. Additionally, any claims by laborers will be pursued with the labor board and through the labor court to determine the workers' rights as to the amount of the claims. Finally, the Mexican tax authorities may not act outside the scope of the bankruptcy court. Once wage claims and foreclosures on pledges or mortgages have been completed by the court in which they were instituted, the claims (and sales proceeds) will be submitted to the bankruptcy court, without review as to amount of claims, for purposes of determining the priority of payment.

### **iv) Set Off**

Upon issuance of the commercial insolvency declaration, set-off rights no longer exist for creditors, with a few specifically delineated exceptions including post-petition creditors.



## **v) Unsecured Debts - Attachment**

Attachment on all assets of the debtor for payment of an unsecured debt, will not be effective once a bankruptcy declaration has been made.

## **vi) Separation**

Creditors may also petition the court to have various assets excluded from the bankruptcy estate. 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 debtor in deposit, lease, trust, or similar circumstances pursuant to which the debtor does not possess title to the property.

## **vii) Matured Debts Stop Interest**

All obligations of the debtor are considered matured and interest stops accruing on obligations. However, interest will continue to accrue on obligations secured by a mortgage or a pledge even after the commercial insolvency declaration to the extent of the collateral.

## **viii) Preexisting Obligations**

All preexisting obligations become due and have to be fixed in UDIS to determine their amount. Preexisting contractual obligations are performed as agreed upon the parties, except for special provisions under the LCI. The LCI regulates the new financial transactions on securities, stock and derivatives.

## **ix) Review of Fraudulent or Preferential Acts**

The Mexican court will review certain transactions occurring prior to the commercial insolvency declaration and invalidate fraudulent and preferential transfers. The LCI prescribes a 270 calendar days length of time to be reviewed. The review period may be longer upon certain circumstances by court order.

## **x) Executory Contracts**

Performance of executory contracts shall be complied by the debtor unless opposition by the conciliator, considering it benefits the estate. The conciliator has the option to accept or reject the contract. The other party to the contract may request the conciliator if the will reject the contract. If the contract is not rejected, debtor shall perform or guarantee the contract. If the contract is rejected, or the conciliator does not answer within twenty working days, the other party to the contract may terminate the contract at any time giving notice to the conciliator. Commercial Insolvency declaration does not rescind leases where the debtor is the lessor and rescinds leases where the debtor is the lessee only upon payment of an indemnity. Repurchase contract are treated in a similar manner upon the declaration of commercial insolvency declaration.

### **13. Actions brought are not joined**

Arbitration and judicial proceedings, being prosecuted, before order for relief is entered, between debtor and third parties are not joined to the insolvency proceeding. Therefore, the LCI honors agreements of choice of jurisdiction and dispute resolutions initiated before the insolvency procedure.

### **14. Process may not be stayed**

Prosecution of the insolvency procedure may not be stayed upon ordinary dilatorily defenses or remedies.

### **15. Conciliation Phase**

During conciliation: debtor remains in possession of the assets and may continue operating the business in its ordinary course; debtor is believed from paying its obligations and additional interest stops accruing on obligations, except for obligations secured by mortgages, pledges or special collateral; claims against debtor are stayed. However, certain debts are exempt from this stay, including wages of the two last years and alimony; court actions and arbitration instituted by or against debtor are not joined to the insolvency proceeding.

Note must be taken, in the sense that the LCI privileges the enterprise rehabilitation, and, that liquidation only operates when rehabilitation is materially impossible.

Debtor remains in possession unless court orders that conciliator manages the enterprise.

Conciliation phase has a limited period of 185 calendar days as of the last publication of the order for relief.

An extension may be granted up to 90 days upon request of the conciliator or creditors representing two thirds of the recognized claims. An additional extension of 90 days may be granted upon request of debtor and creditors representing ninety percent percent of the recognized claims

Conciliator may request termination in advance of the conciliation period in case debtor or creditors do not cooperate to perform a reorganization plan (settlement or restructure) or when reorganization plan is not possible to reach.

The conciliation phase is intended to create the best conditions to be materialized in a reorganization plan. The LCI does not regulate terms nor conditions for the plan, just sets forth minimum rules for legal certainty. The LCI provides, however, mandatory notices and access to enable interested parties to exercise and protect their rights.

The LCI allows that a majority agreement be imposed to the dissenting minority, protecting minority rights, avoiding that nonintersecting minority blocks a viable reorganization plan, favorable to all under the circumstances.

To facilitate plan approval both unsecured and participating secured creditors in the plan, shall be taken into account as total base to determine majority.

Dissenting minority may object (veto) the plan proposal. Failing to object, the plan may be approved by the court.

Since approved plan is binding upon absent and dissident creditors the most favorable terms and conditions of the plan shall be allocated to them.

Upon Court's plan approval, insolvency process terminates and parties cease to perform their functions.

## **16. Proof of Claim Phase**

The conciliator must file before the court a provisional creditors list, within 30 calendar days as of the last publication of the order for relief. Upon notice and receipt, debtor and creditors may challenge and file their objections against the provisional list, within five calendar days.

The conciliator within ten working days after the above term must file before the court the final creditors list. In the next five working days the court shall issue the recognition, graduation and preferential judgment of claims.

This judgement is subject to appeal with no stay.

Creditors may file proof of claims as of order of relief is entered until the term to appeal the claims recognition judgement.

## **17. Claims Fixed in Udis**

Debts denominated in pesos or foreign currency as well as all claims shall be denominated in Unidades de Inversion (Udis) at the equivalent rate of exchange prevailing at the time the order for relief is entered. Special Tax law allows that business transactions may be denominated in Udis which value (rate) is fixed every working day by the Central Bank and published in the Daily Gazette of the Federation. The value of the creditors' rights is protected by computing them as *Unidades de Inversion* (Investment Units, UDIS). UDIS are units of account created in April 1995 by the Mexican government, with the purpose of indexing some commercial debts and paralleling their value with the official recognized rate of peso inflation. As of March 1<sup>st</sup>, 2001, the value of an UDI is \$2.94 Mexican pesos (approximately USD\$0.37). This conversion, during the Conciliation period, is made only for the purpose of facilitating the determination of the amount recognized as

due to creditors, and thus, for example, for computing their voting participation in the agreement.

### **18. Labor Claim**

As of the order for relief, enforcement of wage claims are stayed, except for those wages earned in the two prior years and labor indemnification's of the prior year.

The trustee or conciliator may place a bond in substitution of the labor attachment.

### **19. Tax Claim**

Enforcement and foreclosure of tax claims are stayed. If a reorganization plan is reached in the conciliation phase and in order to facilitate for the debtor and creditors to reach a reorganization plan, as of the order for relief, tax authority shall cancel fines, penalties, enforcement costs, etc. Additionally, debtor and conciliator may execute private agreements with employees and negotiate with tax authorities for a more convenient plan. If there is no plan performance, tax authority may include such debt cancellations in its proof of claim.

### **20. Proof of Claim**

Creditors may file proof of claim within 20 calendar days as of the last order for relief publication; ii. Within the term to object the provisional creditors list; and iii. Within the term to appeal the recognition, graduation and preferential judgement of claims.

## **21. BANKRUPTCY – LIQUIDATION**

Bankruptcy relief is entered: when debtor so requests his bankruptcy; there is no reorganization plan submitted for court approval and the time of the conciliation phase has expired or, conciliator requests the bankruptcy due to lack of cooperation on the part of debtor and creditors or, plan of reorganization is no viable.

### **22. Bankruptcy Relief :**

- i. Declares debtor lack of capacity to keep possession, dispose, or administer estate assets.
- ii. Orders that possession and administration of estate assets be surrendered to the trustee to be appointed by the Institute. Assets subject to an enforcement of a final judgement regarding prior obligations of the commercial insolvency declaration are excluded.

iii. Orders that debts shall not be paid to the bankrupt and the assets shall not be surrendered to him. If debtors default, they are order to pay twice as a fine.

## **23. Appeal**

Bankruptcy relief is subject to appeal. If the bankruptcy relief was entered upon petition of the debtor or the conciliator, the debtor may appeal with stay, that is to say, that the relief may not be enforced until the appeal be decided.

## **24.- Liquidation**

Upon bankruptcy declaration, the trustee shall proceed with the liquidation of the estate assets in public auction sale, although claim credits recognition is pending.

## **25. Creditors and Classes of Creditors**

The court classifies and prioritizes the claims. Claims are evaluated both in terms of their validity and their priority. Claims that have been recognized by final judgment in a prior commercial proceeding (such as a foreclosure of a mortgage or arbitration award) are recognized by the bankruptcy proceeding without re-examination by the judge except as to the potential priority of the claim.

Mexican bankruptcy proceedings recognize different classes of creditors with the following order of priority:

### **(a) Super Priority Creditors**

Creditors holding credits against the estate assets:

1. Employees of the bankrupt with wage claims for the two years prior to the commercial insolvency declaration.
2. Contractual credits for the administration of the estate assets.
3. Credits related to ordinary expenses for the security, maintenance and administration of the estate assets.
4. Credits related to court costs or out of court costs that benefit the estate.
5. Fees and expenses of the visitor, conciliator and trustee, strictly necessities and with court approval.

**(b) Singularly privileged creditors:** For funeral and illness of a individual debtor that died before the commercial insolvency declaration.

**(c) 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.

**(d) Tax claims:** These are claims from the federal or local treasury against the debtor.

**(e) 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.

**(f) Common creditors from mercantile transactions:** These are business creditors of the debtor, and **Common creditors by civil law:** These are no business creditors from a no commercial debt.

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.

## **26. Payment**

Upon claim recognition, creditors are paid based on their priority.

## **27. No Discharge**

If payment is not made in full of the amount recognized, creditors keeps the rights against debtor for the outstanding balance of the claim.

## **28. Termination of the Insolvency Commercial Proceeding**

The bankruptcy court shall declare termination when:

1. Plan of reorganization is approved
2. Full payment of recognized claims is made
3. Payment of the bankruptcy proportional share is made to recognized claims and there are no estate assets to liquidate
4. It is proven that the estate assets are not sufficient to pay expenses and fees for the administration of the estate.
5. At any time, upon request of debtor and all recognized creditors.

## **29. Reopening of the Insolvency commercial proceeding**

In case 3 or 4 above, the proceeding may be reopen if it is proven that in the two years following termination, there are assets to pay at least the expenses and fees for the administration of the estate.

### **30. CRIME**

Criminal insolvency action is initiated by petition of the victim who in turn may resign the criminal petition. The LCI eliminates the bankruptcy qualification and provides as a crime the fraudulent behavior or act that causes or aggravates the general default in the payment of obligations.

### **31. UNCITRAL MODEL LAW ON CROSS BORDER INSOLVENCY**

The LCI incorporates in Title XII generally, the UNCITRAL Cross Border Insolvency Model Law as domestic law.

### **32. INSTITUTE**

The LCI creates the Federal Institute of Insolvency Mercantile Experts (Institute) that shall organize, manage and appoint visitors, conciliators and trustees. The Institute is an auxiliary entity of the Federal Judiciary Board with technical and operative autonomy.

### **33. SPECIAL INSOLVENCY PROCEEDINGS**

Title Eight of the LCI contains provisions related to the insolvency proceedings of a business operating under concessions granted by the government, credit institutions and institutions auxiliary to the credit area, such as financial lessors, factoring companies and others of similar nature.

Transitory Provisions of the LCI, provides that suspension of payments and bankruptcy proceedings initiated before the new law entered into effect shall be governed by the abrogated Bankruptcy and Suspension of Payments Law.