

Mexican Legal Framework of Business Insolvency

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Conventions

In an attempt to keep the reading fluid, the author has liberally avoided the use of expressions in Spanish. The following table sets forth the correct Spanish expression or an explanation of the term otherwise employed in English.

[Law] Bill	The bill and/or <i>exposición de motivos</i> of [Law]
[Law] [#]	Article [#] in [Law]
[Law]T[#]	Transitory Article [#] in [Law]
Accession	<i>Accesión</i>
Active estate	<i>Masa activa</i>
Ancillary procedure	<i>Incidente</i>
Banco de México	Mexico's central bank
Bank restructuring	<i>Saneamiento</i>
Bankruptcy currency	<i>Cuota concursal</i>
Binding [court] precedent	<i>Jurisprudencia</i>
CCF or Federal Civil Code	<i>Código Civil Federal</i>
CCOM	<i>Código de Comercio</i>
CEF or Financial Stability Committee	<i>Comité de Estabilidad Financiera</i>
Center of main interests	<i>Centro de principales intereses</i>
CFF	<i>Código Fiscal de la Federación</i>
CFPC or Federal Code of Civil Procedures	<i>Código Federal de Procedimientos Civiles</i>
Claim against the estate	<i>Crédito contra la masa</i>
CNBV or National Banking and Securities Commission	<i>Comisión Nacional Bancaria y de Valores</i>
Cofeco or Federal Competition Commission	<i>Comisión Federal de Competencia</i>
Conciliator	<i>Conciliador</i>
Conciliatory stage or conciliation	<i>Conciliación</i>
Conservator	<i>Interventor</i>
Consignee	<i>Consignatario</i>

Consignment	<i>Consignación</i>
Cooperative	<i>Sociedad cooperativa</i>
Court	<i>Corte or juzgado</i>
CPF	<i>Código Penal Federal</i>
CPM or Federal Constitution	<i>Constitución Política de los Estados Unidos Mexicanos</i>
Damages and losses	<i>Daños y perjuicios</i>
Day	Calendar day, unless it is specified to be a business day
Decentralized organism	<i>Organismo descentralizado</i>
Devoted estate	<i>Patrimonio de afectación</i>
Economic agent	<i>Agente económico</i>
Estate	<i>Masa</i>
Federal Judicature Council	<i>Consejo de la Judicatura Federal</i>
Federal Official Gazette	<i>Diario Oficial de la Federación</i>
General partnership	<i>Sociedad en nombre colectivo</i>
ICAP or capitalization index	<i>Índice de capitalización</i>
Ifecom or Federal Institute of Specialists in Commercial Insolvency	<i>Instituto Federal de Especialistas de Concursos Mercantiles</i>
Indentured trustee	<i>Representante común</i>
Indeval	<i>S.D. Indeval, Institución para el Depósito de Valores, S.A. de C.V., a securities deposit and clearing entity</i>
Insolvency proceeding	<i>Concurso mercantil</i>
Intervenor	<i>Administrador cautelar</i>
Intervention	<i>Intervención cautelar</i>
IPAB or Institute for the Protection of Bank Savings	<i>Instituto para la Protección del Ahorro Bancario</i>
Judge	<i>Juez</i>

LBM	<i>Ley del Banco de México</i>
LCM or Insolvency Law	<i>Ley de Concursos Mercantiles</i>
LFCE or Antitrust Law	<i>Ley Federal de Competencia Económica</i>
LFDA	<i>Ley Federal del Derecho de Autor</i>
LGSC	<i>Ley General de Sociedades Cooperativas</i>
LGSM or General Law of Commercial Companies	<i>Ley General de Sociedades Mercantiles</i>
LGTOC	<i>Ley General de Títulos y Operaciones de Crédito</i>
LIC or Banking Law	<i>Ley de Instituciones de Crédito</i>
Limited liability corporation	<i>Sociedad anónima</i>
Limited liability partnership	<i>Sociedad de responsabilidad limitada</i>
Limited partnership	<i>Sociedad en comandita</i>
Liquidation	<i>Quiebra</i>
LISR	<i>Ley del Impuesto sobre la Renta</i>
LOAPF	<i>Ley Orgánica de la Administración Pública Federal</i>
LQSP or Law of Bankruptcies and Suspension of Payments	<i>Ley de Quiebras y de Suspensión de Pagos</i>
LSCS	<i>Ley sobre el Contrato de Seguro</i>
LSP or Payment Systems Law	<i>Ley de los Sistemas de Pagos</i>
Members [of the board of Ifecom]	<i>Vocales</i>
Merchant	<i>Comerciante</i>
Netting	<i>Compensación</i>
Novation	<i>Novación</i>
Office of the Attorney General	<i>Ministerio Público</i>
Passive estate	<i>Masa pasiva</i>
Prepackaged concurso	<i>Concurso mercantil con plan de reestructura previo</i>
Primary possession	<i>Posesión originaria</i>

Priority claim	<i>Crédito con privilegio especial</i>
Priority creditor	<i>Acreedor con privilegio especial</i>
Privileged labor claims	Labor obligations for previous two years' salary, benefits and severance
Proposed plan	<i>Plan de reestructura previo</i>
Public trust	<i>Fideicomiso público</i>
Purchase-and-assumption	<i>Transferencia de activos y pasivos</i>
Quasi recovery	<i>Reivindicación útil</i>
Receiver	<i>Síndico</i>
Recovery	<i>Reivindicación</i>
Removal	<i>Desapoderamiento</i>
Repurchase	<i>Reporto</i>
Repurchaser	<i>Reportado</i>
Reseller	<i>Reportador</i>
Restructuring plan	<i>Convenio concursal</i>
Secured claim	<i>Crédito con garantía real</i>
Secured creditor	<i>Acreedor con garantía real</i>
Securities loan	<i>Préstamo de valores</i>
Separation	<i>Separación</i>
SHCP or Ministry of Finance	<i>Secretaría de Hacienda y Crédito Público</i>
Singularly privileged claim	<i>Crédito singularmente privilegiado</i>
State-controlled company	<i>Empresa de participación estatal mayoritaria</i>
State-owned entity	<i>Entidad paraestatal</i>
Support	<i>Apoyo</i>
Trust	<i>Fideicomiso</i>
UDI	<i>Unidad de Inversión, an inflation-indexed unit of account. The daily value of the UDI is regularly determined and published by Banco de México</i>

UML or Model Law	UNCITRAL Model Law on Cross-Border Insolvency With Guide to Enactment
Unsecured claim	<i>Crédito común</i>
Unsecured creditor	<i>Acreedor común</i>
Usufruct	<i>Usufructo</i>
Usufruct beneficiary	<i>Usufructuario</i>
Visit	<i>Visita</i>
Visitor	<i>Visitador</i>
Winding Up	<i>Liquidación</i>

Introduction

*All of a debtor’s assets are subject to account for the performance of its obligations, except for those assets which, pursuant to law, are inalienable or cannot be attached.*¹

Insolvency is an economic phenomenon with economic, social and legal consequences. When a debtor is unable to pay its debts as they become due, the legal system provides for a mechanism to address the collective satisfaction of the claims from the assets of the debtor.

The legal framework for business insolvency² can be seen from three different approaches: (1) out-of-court restructuring; (2) court-assisted reorganization and liquidation; and (3) administrative resolution.

Out-of-court restructuring is governed by scattered substantive and procedural rules, but mostly by internationally recognized principles of conduct and professional practice in the field. Court-assisted reorganization and liquidation are governed by the Insolvency Law. The administrative resolution regime applies principally to banks, where swift regulatory action is deemed necessary.

In an adaptation and extension from another paper, G10 (2002) provides a “timeline” of financial distress for a debtor. This timeline includes four stages (or levels) of distress and the tools to overcome the situation:

Stage	Level of Distress	Tool
First	Emerging problems	Management-led correction
Second	Acute and worsening problems	Private workout
Third	Insolvency, but possible viability	Reorganization
Fourth	Insolvency and unlikely viability	Liquidation

1 CCF 2964.

2 Insolvency of non-merchants is governed by the applicable state civil codes and is not addressed herein.

When a debtor experiences emerging problems (first stage), most of the solutions rely upon the debtor's management-led corrective actions. Since, for nonfinancial sector firms, most of the cases at this stage have little or no impact on third parties, it is not relevant to delve into them from a legal framework perspective.

When management is unable to resolve emerging problems, these could evolve into acute and worsening problems (second stage). At this stage, the debtor will try to reach an out-of-court workout plan with creditors. **Part I** addresses these issues.

Part II addresses the court-assisted tools to solve cases of insolvency through reorganization or liquidation (third and fourth stages). The purpose of reorganization proceedings is to develop a reorganization plan. Since a private workout will only be effective upon consenting creditors, court assistance is sometimes necessary to achieve a successful reorganization or make broadly effective an otherwise private workout plan. The purpose of liquidation is to sell off the assets of the debtor and pay creditors with the proceeds of such sale. The line that divides reorganization from liquidation is often blurred (e.g., in the case of sales of complete lines of business or the whole enterprise as a going concern).

Part III addresses special cases of insolvency of public service concessionaires and financial sector firms, other than banks.

Part IV addresses the insolvency of banks. In the case of banks, even the emerging problems (first stage) could trigger "early warnings" that prompt preventive action from regulators.

Other specific topics relating to sundry corporate and other legal issues arising in the context of insolvency are addressed in **Part V**.

PART I

Out-of-Court Restructuring

Out-of-court restructuring is aimed at securing contractual agreements, both between lenders themselves and between the lenders and the debtor, for the restructuring of the debtor. This type of restructuring is governed by scattered substantive and procedural rules, but mostly by internationally recognized principles of conduct and professional practice in the field. There are no binding rules as to how the process is conducted or what the final product will look like, so most private workouts are carried out in an *ad hoc* fashion. The author will, however, attempt to loosely follow the principles of INSOL (2000) and those of UNCITRAL (2005) to address the relevant legal aspects of a private workout.

1. Coordinated Approach

The coordinated approach of creditors needs to overcome the inherent differences in the creditors' attitudes and interests and in the nature of their claims. Not all creditors will have the same level of interest in the restructuring. For example, secured creditors may have a preference for liquidation, while unsecured creditors may prefer the continuation of the business as a going concern; some creditors with a big exposure may be willing to devote more resources to the workout process, while others may consider it not worthwhile due to the relatively small size of their claims. To complicate things further, a workout process presents a typical case of the prisoner's dilemma: Creditors are better off if all creditors cooperate, but each creditor is better off being uncooperative.

Coordination among different creditors and different constituencies of creditors reduces the risk of asset dilapidation caused, for example, by early moving creditors attaching assets; and the cost and time to achieve restructure, for example, by pooling advisors and sharing costs and by reducing emergence of miscommunication issues.

2. Standstill Agreement

Participating creditors are expected to refrain from enforcing their claims during the negotiation period. This is achieved by entering into a standstill agreement. Standstill agreements may provide for undertakings by each creditor refraining from pursuing individual action against the debtor or its assets, challenging other participating creditors' claims and

taking any action to improve the relative position of a creditor to the detriment of other participating creditors. They also include similar undertakings from the debtor and other terms such as a sharing of information and lock-up covenants.

The validity and enforceability of undertakings by creditors refraining from exercising procedural rights is questionable [CPM 1, 8, 17; CCF 6], and specific performance may be unavailable [CFPC 421, 423].

The exchange of information raises another legal issue: Mexico does not have a rule preventing shared information from being used as evidence in a court of law, and confidentiality agreements may not be strong enough to prevent disclosure of such shared information as evidence in a judicial process [CFPC 79].

3. Interim Financing

The case where the debtor requires New Money to continue operating during the standstill period raises the question of how the New Money provider will be recognized in priority over preexisting creditors. INSOL (2000) takes a very clear position on the issue:

Where a debtor requires New Money funding, relevant creditors will be concerned that such New Money will, so far as practicable, be given priority of repayment compared with other debts in the event of the failure and insolvency of the debtor.

The simplest method of ensuring the priority of repayment for New Money is usually by the obtaining of security for its repayment over assets of the requisite value. In some cases, however, negative pledges in favor of third parties or other legal complications will either prevent the granting of security for New Money or render the benefit which will result from such security uncertain. While there are various techniques for ameliorating such problems (e.g., asset purchase arrangements, placing assets into newly formed and “ring-fenced” borrowing entities and sale and leaseback arrangements) in some cases relevant creditors will have no option but to fall back on loss-sharing arrangements between themselves designed to ensure that the New Money will be accorded priority of repayment status (e.g., by agreeing to “pool” recoveries from any insolvency of the debtor and to apply them in repayment of the New Money first or, in certain jurisdictions, by the use of subordination agreements).

One of the risks that suppliers of New Money face is that in the case of failure of the private workout and placement of the debtor *en concursa*, the privilege may be avoided. Furthermore, subordination agreements may only be enforceable amongst creditors (that is, not vis-à-vis the debtor), so the New Money provider will have to bear the additional risk of creditor insolvency. These issues are further explored in **Section 15.j** in **Part II**.

4. Rescheduling Agreement

The end-product of a private workout is a rescheduling agreement. In broad terms, a rescheduling agreement may be implemented in two forms: (1) by providing a New Money facility in the rescheduled terms, to be used to repay the old debt (the “New Facility Approach”); or (2) by changing the terms of the debt to conform to the rescheduled terms (the “Novation Approach”). Each of these approaches has its advantages and disadvantages from a legal perspective, as is discussed hereafter.

a. Settlement Risk

Under the New Facility Approach, money could get “trapped” in its route to payment to creditors. Another creditor may be able to attach the money-in-transit or the debtor may be violating a covenant with a nonparticipating creditor by incurring additional indebtedness or using proceeds in a manner inconsistent with a prior agreement.

Under the Novation Approach, there is no exchange of money; therefore, the risk of money being trapped or a covenant being violated is mitigated.

b. Validity of Original Claim

Under the New Facility Approach, the risk that the validity of the original claim will be questioned is not eliminated but is, at least, mitigated. However, the invalidity of the old claims would not, in itself, affect the validity of the new claim.

Under the Novation Approach, the original claim is still susceptible to challenge on the grounds of validity, and its invalidity would impact the validity of the new claim [CCF 2218].

This issue of the validity of the original claim is especially relevant in the case of novel or complex obligations for which there are little or no precedents, such as those arising under derivative transactions.

c. Survival of Security Interest

Under the New Facility Approach, existing secured claims would be discharged and new security interests would have to be set up for the new facility-secured claims. This means that creditors under the new facility risk losing the time preference they may have had by perfecting their security interests at an earlier time. A provision of law stipulates that, under certain conditions, a creditor whose loan proceeds are used to repay a debt will, by operation of law, be subrogated in the right of the primitive creditor [CCF 2059]. The author knows of no precedent concerning this provision of law, so the risk of losing the time preference of a security interest under the New Facility Approach could still exist.

The Novation Approach could pose a similar risk of losing the time priority of a security interest. This depends on whether the rescheduling agreement in essence constitutes a new obligation (i.e., it legally qualifies as a *novation* [CCF 2213]), in which case the creditor runs the risk of losing the time preference of its security interest, or simply a change in some of the original terms not implying a substantive change in the essence of the obligation, in which case an argument can be made in favor of the survival of the primitive security interest and its time preference. Each case requires an individual analysis to determine whether it escapes qualifying as a *novation* and its consequences on security interests.

d. Avoidance Powers

Under the New Facility Approach, care should be taken that the primitive obligation is due and payable before making a repayment, since prepayment could thereafter be set aside if the debtor were subsequently declared *en concurso* [LCM 114-V].

Under either of the two approaches, care should be taken that the rescheduling agreement does not result in the imposition of additional guarantees or in conditions that differ from current market conditions [LCM 114-III].

The reader can find more information on the subject of avoidable transactions in **Section 15.j** in **Part II**.

Regardless of the approach taken, it is worth mentioning that the rescheduling agreement will be binding only upon participating creditors. That is, nonparticipating creditors' claims will not be subject to its terms. Since a private workout will not be binding upon all creditors, court assistance is sometimes necessary to achieve a successful reorganization or make broadly effective an otherwise private workout plan. This is discussed generally in **Part II** and particularly in **Section 15.r.iv**.

5. Publicly Traded Securities

A debtor that has issued publicly traded debt securities will encounter additional complications in its workout efforts. **Section 33** in **Part V** provides further analysis on the issue.

PART II

Court-Assisted Reorganization and Liquidation

The Insolvency Law regulates business reorganization and liquidation in Mexico. The Insolvency Law became effective on May 13, 2000, repealing the Law of Bankruptcies and Suspension of Payments of 1943.

6. Stated Purpose

The stated purpose of the business reorganization procedure is (1) to preserve the enterprise³ and (2) to prevent the generalized default of payment obligations from jeopardizing the continuation of the insolvent enterprise and those enterprises with which it has dealings (i.e., prevent systemic risk) [LCM 1].

a. Preservation of the Company

There are two seemingly opposite policy positions that an insolvency law should attempt to balance: (1) preservation of an enterprise, and (2) speedier recovery to creditors. This dichotomy is clearly expressed in UNCITRAL (2005):⁴

An insolvency law needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against preserving the value of the debtor's business through reorganization (often the preference of unsecured creditors and the debtor). Achieving that balance may have implications for other social policy considerations, such as encouraging the development of an entrepreneurial class and protecting employment.

Mexico has taken the policy position to favor preservation of an enterprise over speedier recovery. Mexico made a point of this when submitting the LCM Bill by stating:⁵

The central objective [of insolvency law] was easily identified: Provide the relevant framework to maximize the value of an enterprise in [financial] crisis through its preservation, which results in the protection of employment of its human elements, avoids the negative repercussion to society at large brought by the closing of a provider of goods or services and recovers the entrepreneurial effort that such enterprise represented to its owner.

3 Please refer to **Section 10.b.iv** for a discussion on the concept of *enterprise*.

4 P. 11.

5 LCM Bill, with edits.

b. Prevention of Systemic Risk

Another driving principle of the Insolvency Law is to prevent the generalized default of payment obligations from jeopardizing the continuation of the insolvent enterprise and those enterprises with which it has dealings.

Some of the provisions of the Insolvency Law that embody this principle include its favor for enterprise preservation (*cf.* **6.a**); the continuation of the enterprise and survival of executory contracts (*cf.* **15.n.iii**); allowing setoff and netting during an insolvency proceeding (*cf.* **15.o**); and the priority afforded to post-commencement financing (*cf.* **15.q**). Another tool for preventing systemic risk is the settlement finality principle in payment and securities clearance systems (*cf.* **15.p**) that is found in the Payment Systems Law.

7. Universalism vs. Territorialism

There is broad literature on the different territorial approaches an insolvency statute can take, which the reader is encouraged to consult.⁶ It is beyond the scope of this book to address these issues in any particular level of detail. At this point, it is sufficient to say that there is some consensus among treatises that Mexico has embraced the universalism approach (or, as García (2005)⁷ puts it, a *mitigated universalism* approach). In the words of ALI México (2003):⁸

While the LCM continues to rely on the principles of unity and universality, these principles are not stated expressly but implied throughout the law...

6 See, *e.g.*, Trautman (1993) and other works referred to therein.

7 P. 107.

8 P. 107.

8. Proceeding

Insolvency regimes generally involve two types of proceedings: (1) reorganization; and (2) liquidation. While some regimes allow for conversion from one type of proceeding to another, oftentimes these are alternative proceedings. Mexico has opted to incorporate both proceedings in the Insolvency Law in a successive manner (stages): A debtor declared *en concurso* would first attempt to reach a reorganization plan and, if negotiations fail, would thereafter be declared *en quiebra*. That is, the Insolvency Law provides for a single insolvency proceeding, encompassing two successive stages. The first is the conciliatory stage. The second is the liquidation stage [LCM 3]. Prior to a debtor being placed *en concurso*, the process includes a preliminary visit stage to verify that the commencement standards have been met [LCM 30-I].

9. Venue and Administration

The issue of venue and administration of the process is of particular relevance in connection with the procedural aspects of the Insolvency Law.

In designing the insolvency law, it may be appropriate to consider the extent to which courts will be required to supervise the proceedings and whether or not their role can be limited with respect to different parts of the proceedings or balanced by the role of other participants, such as the creditors and the insolvency representative. This is of particular importance where the insolvency law requires judges to deal quickly with difficult insolvency issues (which often involve commercial and business questions) and the capacity of the judiciary is limited, whether because of its size, a general lack of resources in the court system or a lack of specific knowledge and experience of the types of issue likely to be encountered in insolvency.

To reduce the functions to be performed by the court under an insolvency law, but at the same time provide the necessary checks and balances, an insolvency law can assign specific functions to other participants, such as the insolvency representative and creditors, or to some other authority, such as an insolvency or corporate regulator. An insolvency law may provide that the insolvency representative, for example, is authorized to make decisions on a number of issues, such as

verification and admission of claims, the need for post-commencement funding, surrender of encumbered assets of no value to the estate, sale of major assets, commencement of avoidance actions and treatment of contracts, without the court being required to intervene, except in the case of a dispute concerning one of these matters. The use of this approach depends upon the availability of a body of suitably qualified professionals to serve as insolvency representatives. Creditors also can be authorized to provide advice to, or to approve certain decisions of, the insolvency representative, such as approving the sale of important assets or obtaining post-commencement finance, without requiring the court to intervene, except in the case of dispute. An insolvency law can specify the decisions that will require court approval, such as the provision of a priority ranking above the rights of existing secured creditors to secure post-commencement finance.

The court's capacity to handle the sometimes complex commercial issues involved in insolvency cases is often not only a question of knowledge and experience of specific law and business practices, but also a question of that knowledge and experience being current and regularly updated. To address the issue of judicial capacity, a special focus on the education and ongoing training of court personnel, not only of judges but also of clerks and other court administrators, will assist in supporting an insolvency regime that has the ability to respond effectively and efficiently to its insolvency caseload.⁹

The Insolvency Law adheres to the UNCITRAL (2005) recommendation to separate jurisdictional matters from administrative matters in an insolvency proceeding. The insolvency courts direct the proceedings and resolve all matters where passing a judgment or application of public force is required [LCM 7], while administrative matters within the proceedings are entrusted to insolvency experts authorized and appointed by the Federal Institute of Specialists in Commercial Insolvency, or Ifecom. A 2006 court precedent provides a clear perspective on this interplay between the courts and Ifecom:

INSOLVENCIES. AUTHORITY OF THE JUDGE GOVERNING THE INSOLVENCY PROCEEDINGS.

The LCM Bill recognizes the need for the insolvency judge to be assisted in non-legal disciplines inherent to these types of processes, such as commercial, accounting, financial or administrative disciplines, and precisely attending the need to educate the judge in special

9 UNCITRAL (2005), pp. 33-34.

areas as to why an entity (the Federal Institute of Specialists in Commercial Insolvency) was implemented with the purpose of the latter to authorize those persons who meet the requirements to serve as visitor, conciliator or receiver. However, the same LCM Bill clearly states the idea, materialized in Article 7 of the LCM, that in the insolvency proceedings, the judge is the central and governing body of the process, since the process requires intervention of the judicial authority to comply with the formalities of due process. Therefore, such institute is only an auxiliary and essentially administrative body that must be maintained at the margin of a direct intervention in insolvency proceedings, as envisioned by the lawmaker.

a. The Judge

Only federal courts sitting in the domicile of the debtor have jurisdiction over insolvency proceedings [LCM 17]. This jurisdiction rule raises two issues: one, on the exclusive jurisdiction of federal courts; and another, on the domicile of the debtor.

i. Exclusive Jurisdiction of Federal Courts

While the Federal Congress has the exclusive authority to pass commercial laws [CPM 73-X], for historic reasons federal and local courts have concurrent jurisdiction on commercial disputes [CPM 104-I]. This situation has prompted discussion regarding the constitutionality of the statutory exclusivity of federal courts in insolvency matters. O valle (2000) presents a clear explanation of the merits of this discussion:

To determine whether federal jurisdiction provided in Article 17 of the Insolvency Law violates [the constitutional principle of] concurrent jurisdiction, the type of interest affected by the insolvency process is the starting point. If one determines that only individual interests are the subject matter of such processes, the conclusion would be that there is in fact a violation to the alternative jurisdiction provided in Article 104, Section I, of the Federal Constitution. On the other hand, if one determines that not only individual interests are the subject matter of this type of process, but rather that general, public or social interests are the subject matter thereof, then the conclusion should be that Article 17 of the Insolvency Law does not violate the provisions of Article 104, Section I, of the Federal Constitution.

The issue is still divided between treatises.¹⁰ Unfortunately, there are no binding court precedents on the issue.

ii. The Domicile of the Debtor

The determination of the domicile of the debtor depends on whether the debtor is an individual or an entity.

In the case of an individual debtor, his domicile is the principal place of business of his enterprise and, in the absence of such place, the place “where he has his domicile” [LCM 4-III]. The rules that govern the domicile of the individual debtor in the absence of the principal place of business of his enterprise are, in the following order: (1) the place where he habitually resides, (2) where he actually lives and, if none, (3) wherever he is found. There is also a conclusive presumption of domicile for cases of minors, incapacitated persons, active members of the armed forces, public servants, members of the diplomatic corps, representatives of other countries or of international organizations and prisoners [CCF 29-31].

In the case of an entity debtor, its domicile shall be its corporate domicile and, if such corporate domicile is *unrealistic*, the principal place of its management [LCM 4-III]. This concept is akin to determining a debtor’s center of main interests found in Article 16.3 of the Model Law (which is adopted by Article 295 of the Insolvency Law). The concept of the *unrealistic corporate domicile* has its origins in the LQSP, the Bill of which provides:

In the case of the insolvency of an entity, a complex issue has arisen that deserves a legislative solution: It is the issue concerning the legally determined corporate domicile or the effective domicile, where as a result of subsequent changes or initial discrepancy, there is no correlation between the effective or administrative domicile and the legal domicile provided in the articles of incorporation.

¹⁰ In favor of the constitutionality: López (2001), Méjan (2001), Ovalle (2000). Against it: Quintana (2003), Acosta (2001).

A detained consideration of this problem suggests that the [LQSP Drafting] Commission propose the formula found in the second paragraph of Article 13 [of the LQSP] under which, starting from the principle of jurisdiction by reason of the legal domicile, a broad margin for cases where, due to fraud, fiction or simple discrepancy between the corporate and the administrative domicile, the latter should prevail over the former—a practical solution that also finds legal ground in the text of Article 33 of the Civil Code for the Federal District [now, the CCF], which provides footing for an interpretation in which a real criteria prevails over the purely formalistic criteria of the corporate domicile.

In summary, the domicile of the entity debtor is the principal place of its management, and there is a rebuttable presumption that its corporate domicile is the principal place of its management.

b. Ifecom

Administrative matters within the proceedings are entrusted to insolvency experts. Ifecom licenses, registers, appoints, monitors and trains insolvency experts; issues rules on procedures for compensation and random selection of specialists; and publishes industry analysis and statistics [LCM 311].

The five-member (the director general and four other members) board of Ifecom is composed of professionals in the legal, accounting, financial and economic fields. The Federal Judicature Council appoints the director general and the other four members [LCM 313-324].

c. Specialists

There are three types of specialists:

- The **visitor**, whose duties are to investigate whether a debtor is eligible for a *concurso* proceeding (i.e., whether the commencement standards have been met) [LCM 10]. The visit is described in more detail in **Section 14**.
- The **conciliator**, who is appointed only after a debtor is declared *en concurso* and who has, among other responsibilities, the duty to mediate between creditors and

the debtor to arrive at a consensual plan of reorganization (*cf.* **15.r**), present a list of claims to the court for allowance (*cf.* **16.b.ii**) and, in exceptional cases, request the removal of the debtor from the management of the business (*cf.* **16.a**) [LCM 81, 121, 130, 148].

- The **receiver**, which may or may not be the conciliator and whose principal function is to take possession of the enterprise (*cf.* **16.a**) and proceed with the sale of assets (*cf.* **16.d**) when the debtor is declared *en quiebra* (among other cases, if no restructuring plan can be reached during the conciliatory stage) [LCM 178, 197].

i. Selection

With some exceptions, only a registered professional can be designated as a visitor, conciliator or receiver [LCM 334]. To be registered, an applicant must meet the following requirements: (1) have at least five years of experience in business administration, financial advisory services, or legal or accounting activities; (2) may not be a federal public servant or part of the federal or local legislative or judicial branches; (3) exhibit renowned honesty; (4) comply with selection procedures determined by Ifecom; (5) may not have been convicted of certain crimes; and (6) may not be ineligible to hold a governmental position or a position in the financial system, or to engage in a commercial pursuit [LCM 326].

ii. Appointment, Removal and Replacement

There are numerous restrictions in the Insolvency Law to ensure that the visitor, conciliator and receiver are disinterested and have no conflicts of interest. The spouse; relatives of the debtor or of the managers of the debtor; the employees, advisors and representatives of the debtor; persons who have a direct interest in the reorganization and the close friends and open enemies of the debtor cannot act as the visitor, conciliator or receiver in such debtor's insolvency proceeding [LCM 328].

The initial appointment procedure is to be based on random selection from the experts registered with Ifecom [LCM 335]. The debtor, together with a qualified

majority of creditors, may replace the conciliator or receiver, including a person not registered with Ifecom [LCM 147 and 174]. In cases involving the insolvency of a company operating under a federal, state or municipal concession, the conciliator is appointed at the request of the concession-granting authority [LCM 240].

iii. Duties and Functions

The specialists have two levels of duties and functions: (1) those that are inherent to their specific position as visitor, conciliator or receiver, and (2) those that are common to all specialists. The main duties and functions inherent to their position as visitor, conciliator or receiver are described above (*cf.* **9.c**).

The main common duties of the specialists include (1) honest and diligent performance of their duties; (2) monitoring the performance of their assistants; (3) keeping adequate records and sharing them with the debtor and the creditors; (4) filing reports with the judge; and (5) treating certain information as confidential [LCM 332].

iv. Liability

The level of liability of the specialists is diffuse. Specialists shall be liable to the debtor and the creditors for damages and losses caused while performing their duties, for defaulting their duties and for disclosing confidential information [LCM 61].

Damages are the loss or decrease of assets suffered as a result of the failure to comply with an obligation. *Losses* are the deprivation of lawful gains that would have resulted had there been compliance with an obligation. Damages and losses must be a direct and immediate consequence of the failure to comply with the obligation, whether they have already occurred or will necessarily occur [CCF 2108-2110].

v. Remuneration

Specialists are entitled to fees for the performance of their services. Their fees shall be determined pursuant to rules issued by Ifecom and will qualify as administrative expenses (*cf.* **16.c**) [LCM 333].

d. Conservators

Conservators are representatives of creditors' interests and are entrusted with the surveillance of the conciliator and the receiver, and of actions carried out by the debtor in the management of its enterprise [LCM 62].

Any creditor or group of creditors representing at least 10 percent of the claims against a debtor *en concurso* shall be entitled to request that the judge appoint one conservator [LCM 63].

Conservators do not need to be creditors, and their fees are payable by the creditors appointing them [LCM 63].

10. Eligibility

The issue of eligibility consists of determining who is subject to the protection and discipline of the Insolvency Law.

An important threshold in designing an insolvency law focused on debtors engaged in economic activities (whether or not they are conducted for profit) is determining and clearly defining which debtors will be subject to the law. To the extent that any debtor is excluded from the law, it will not enjoy the protections offered by the law, nor will it be subject to the discipline of the law. This argues in favor of an all-inclusive approach to the design of an insolvency law, with limited exceptions. The design of eligibility provisions for an insolvency law raises two basic questions: firstly, whether the law should distinguish between debtors who are natural persons and debtors that are some form of limited liability enterprise or corporation or other legal person, each of which will raise not only

*different policy considerations, but also considerations concerning social and other attitudes; and secondly, the types of debtor, if any, that should be excluded from the application of the law.*¹¹

In principle, only “merchants” are debtors subject to the Insolvency Law [LCM 9]. However, some non-merchants are subject to the Insolvency Law, while some merchants are exempt from its application.

a. Merchants

A natural person is a *merchant* if he has legal capacity to engage in acts of commerce and does so as part of his ordinary and customary occupation [CCOM 3-I]. An entity is a *merchant* if it is formed pursuant to commercial laws [CCOM 3-II]. Foreign entities, their agencies and branches are *merchants* to the extent they perform acts of commerce within Mexican territory [CCOM 3-III].

b. Non-Merchants

Non-merchants that are subject to the Insolvency Law include (1) former merchants; (2) the estate of a deceased merchant; (3) unlimited partners of an insolvent entity; and (4) the estate of a trust devoted to an entrepreneurial pursuit.

i. Former Merchants

A merchant who suspended or terminated the operation of his enterprise may be declared *en concurso* upon the general default of the payment obligations assumed by virtue of the operation of his enterprise [LCM 13].

ii. Estate of a Deceased Merchant

The estate of a deceased merchant may be declared *en concurso* if the enterprise continued operating after the merchant’s death or, if the enterprise ceased operating

¹¹ UNCITRAL (2005), p. 38 (footnotes omitted).

after his death, if the creditors' claims have not expired. In such events, any obligations attributed to the merchant shall be payable by his estate, limited to the value of such estate [LCM 12].

iii. Unlimited Partners of an Insolvent Entity

The *concurso* of an entity results in the *concurso* of its unlimited shareholders or partners. An unlimited shareholder or partner can be released from the *concurso* if it pays the debts with its own assets [LCM 14].

In addition to special types of entities under specific laws, Mexico recognizes five basic types of commercial companies: (1) general partnerships; (2) limited partnerships; (3) limited liability partnerships; (4) limited liability corporations; and (5) cooperatives [LGSM 2].

All the partners of a general partnership and the general shareholders or general partners of a limited partnership are unlimited shareholders or partners and thus subject to being declared *en concurso* together with the issuing company. The limited shareholders or limited partners of a limited partnership, all the partners of the limited liability partnership, all the shareholders of a limited liability corporation and all the members of a cooperative are exempt from unlimited liability [LGSM 25, 51, 58, 87 and 207, and LGSC 14].

iv. Estate of Trust Devoted to Entrepreneurial Pursuit

The concept of *merchant* also includes "the estate of a trust when devoted to an entrepreneurial pursuit" [LCM 4-II]. There is some criticism¹² on the manner in which the Insolvency Law attempts to address the possibility of an insolvency of a trust estate by declaring it a *merchant* rather than by stating that it is subject to being declared *en concurso* (as it does with respect to the estate of a deceased merchant (*cf.* **10.b.ii**)). In the author's view, the most important legislative deficiency has been

12 Acosta (2001), pp. 191-195, and Quintana (2003), pp. 60-67.

the lack of a definition of what constitutes an *entrepreneurial activity*, and in which cases would a trust estate be deemed devoted to such *entrepreneurial activity*. Unfortunately, the author knows of no binding precedent on the subject for purposes of the Insolvency Law.

Tax laws regulate the concept of *entrepreneurial activities* [CFF 16] and the tax regime applicable to trusts devoted to an entrepreneurial pursuit [LISR 13]. A simplistic route of interpretation suggests that a trust is subject to the Insolvency Law if such trust is taxed as a trust devoted to an entrepreneurial pursuit. However, this interpretation has serious flaws since the tax laws do not constitute admissible secondary sources of interpretation of the Insolvency Law [LCM 8].¹³ A correct legal interpretation requires a more technically rigorous analysis.

Activity is defined as *a set of operations or tasks of a person or entity*, whereas *entrepreneurial* is defined as *belonging or pertaining to an enterprise*.¹⁴ That is, an *entrepreneurial activity* could be defined as *a set of operations or tasks of a person or entity pertaining to an enterprise*.

The concept of *enterprise* is at the heart of the concept of *entrepreneurial activity*. A recent court precedent (and, as far as the author is aware, the only available binding precedent on the subject) attempts to define *enterprise* but does so in a very imprecise manner:

ENTERPRISE. ITS CONCEPT IN ANTITRUST MATTERS.

"The elucidation of the concept must consider, in a functional manner, and include, any entity that exercises an economic activity, without regard to its legal status or legal nature; therefore, if an entity does not exercise any economic activity, it is impossible to consider it as an enterprise."

13 In an unrelated matter (the dismissal of Vitro's prepackaged concurso), the judge relied heavily on some concepts in the tax laws to issue his ruling.

14 Real Academia de la Lengua.

The above court precedent has two flaws that make it unusable for purposes of the Insolvency Law: (1) it fails to distinguish the subject (the entrepreneur: "...any entity that exercises...") from the subject matter (the enterprise); and (2) it is stated as applicable to antitrust matters, which has a naturally broader scope of application than the one needed for commercial purposes, since antitrust regulation deals with any economic activity, whether commercial or otherwise.

However, there is abundant literature on the concept,¹⁵ which allows us to construct a more technically correct concept of *enterprise* and, from there, derive the concept of *entrepreneurial activity*. In the author's view, Mantilla (1992) provides one of the most concise and straightforward definitions of *enterprise*:

[Enterprise is] the sum of tangible and intangible goods combined to obtain goods or services, or to offer them to the public, systematically and with a profitable intent.

Therefore, an *entrepreneurial activity* could be defined as *a set of operations or tasks of a person or entity pertaining to the sum of tangible and intangible goods combined to obtain goods or services, or to offer them to the public, systematically and with a profitable intent.*

So, the estate of a trust will be subject to the provisions of the Insolvency Law if such trust is engaged in a set of operations or tasks pertaining to the sum of tangible and intangible goods combined to obtain goods or services, or to offer them to the public, systematically and with a profitable intent. Needless to say, this is still an abstract concept which requires individual case-by-case analysis to determine applicability of the Insolvency Law.

15 See, e.g., Barrera (1958) with a series of references to classic treatises on the subject.

c. Excluded Merchants

Merchants that are exempt from the application of the Insolvency Law include: (1) “small merchants”; (2) state-owned entities; and (3) insurance and bonding intermediaries.

i. Small Merchants

“Small merchants” shall not be declared *en concurso* unless they voluntarily accept in writing the application of the Insolvency Law [LCM 5, T9]. This raises two issues: (1) the issue of who qualifies as a *small merchant*; and (2) the issue of its voluntary written acceptance to the application of the Insolvency Law.

1. Definition of Small Merchant

The Insolvency Law provides the definition of *small merchant* as (1) those whose total outstanding debts do not exceed 400,000 UDIs [LCM 5] and (2) during the first five years following the enactment of the Insolvency Law (i.e., until May 13, 2005), those whose total outstanding debts (computed as the sum total of the par value at the time they were originally contracted) as of the entry into force of the Insolvency Law (i.e., May 13, 2000) did not exceed 500,000 UDIs [LCM T9].

The concept of *small merchant* was not present in the LCM Bill, but was added by legislators during the course of the legislative process, arguing that the costs associated with the application of the Insolvency Law made it inefficient for small merchants.¹⁶

There is a logical flaw in the concept, since the recognized amount of debt of a debtor will only be known once the debtor has been declared *en concurso* and the process for recognition of claims (*cf.* **16.b**) has concluded. Several consequences of having been declared *en concurso* would have to be unwound by that time.

¹⁶ *Cfr.* Dictamination from the Senate’s Joint Finance and Public Credit, Commerce, Justice, and Legislative Studies Commissions.

2. Voluntary Acceptance

Small merchants shall not be declared *en concurso* unless they voluntarily accept in writing the application of the Insolvency Law. The scope of a small merchant's voluntary written acceptance is still unclear. Would a voluntary *concurso* petition qualify as such? Would a private communication to a single creditor? If so, would someone not privy to that communication be entitled to demand the declaration of *concurso*? Is the acceptance revocable? If so, does it become irrevocable at some point?

Unfortunately, the author knows of no precedent addressing any of these issues.

ii. State-Owned Entities

State-owned entities that are not formed as commercial companies shall not be declared *en concurso* under the Insolvency Law [LCMT4]. While rules governing state-owned enterprises vary from state to state, most are consistent with the federal regime. The federal regime includes three types of state-owned entities: (1) decentralized organisms; (2) state-controlled companies; and (3) public trusts [LOAPF 1]. Of these three, only state-controlled companies are formed as commercial companies and therefore can be declared *en concurso*. It is unclear whether the estate of a public trust engaged in an entrepreneurial pursuit (*cf.* **10.b.iv**) could be declared *en concurso*.

iii. Insurance and Bonding Intermediaries

Insurance companies, insurance mutualists, reinsurance companies, bonding companies and re-bonding companies shall not be declared *en concurso* under the Insolvency Law [LCMT4].

d. Branches of Foreign Debtors

The branch of a foreign debtor is subject to the Insolvency Law, but only in connection with tangible assets located, and intangible assets enforceable, in Mexico and with respect to claims held by creditors for operations with those branches [LCM 16].

The natural consequence of this provision requires “ring fencing” the estate (*cfr.* **15.d**), which raises two distinct issues: one, concerning the location of assets (active estate); and another, concerning the claims for operations attributable to a branch (passive estate). Aside from the fact that in this case the Insolvency Law clearly strays from universalism and adopts a territorial approach (*cfr.* **7**), this provision requires carrying out an analysis of the estate for which the Insolvency Law is ill-equipped:

i. Active Estate

The location of tangible assets can be relatively straightforward when dealing with realty, but can get more complicated when dealing with chattel:¹⁷ Would a transfer of an asset from the relevant branch to the debtor’s headquarters or to another branch be excluded from the estate? Would the transfer be avoided? Would the assets of different branches located in Mexico be part of the relevant branch’s estate?

The issue is further complicated when dealing with intangible assets:¹⁸ When is an intangible asset enforceable in Mexico? What is the impact of an underlying debtor relocating outside Mexico?

The Insolvency Law is silent as to these and other issues pertaining to the location of assets.

¹⁷ Please refer to the **Appendix** for a summary of the differences between real property and chattel.

¹⁸ Sommer (1998) provides an excellent analysis on the location of liabilities (an intangible asset from the creditor’s perspective), which the reader is encouraged to consult.

ii. Passive Estate

Since a branch is not a body corporate different from its principal, it is unclear what situations could qualify as “operations with those branches.” This issue is even more obscure in the Insolvency Law than it would have been under traditionally territorial statutes, since the nationality or residence of the creditor or the location of their collateral is not relevant to determining the passive estate of the branch.

The author knows of no precedent of a main proceeding¹⁹ of a branch of a foreign debtor. This lack of precedent and the silence of the Insolvency Law results in a poor and unsatisfactory framework for dealing with insolvent branches of foreign debtors. Tools imported from territorial regimes could assist in addressing some of these issues; however, being a universalist statute (*cf.* **7**), the Insolvency Law is ill-prepared for the adoption of those principles.

e. Corporate Groups

The insolvency of entities within a corporate group raises different issues.

It is common practice for commercial ventures to operate through groups of companies and for each company in the group to have a separate legal personality. Where a company in a group structure becomes insolvent, treatment of that company as a separate legal personality raises a number of issues that are generally complex and may often be difficult to address. In certain situations, such as where the business activity of a company has been directed or controlled by a related company, the treatment of the group companies as separate legal personalities may operate unfairly. That treatment, for example, may prevent access to the funds of one company for the payment of the debts or liabilities of a related debtor company (except where the debtor company is a shareholder or creditor of the related company), notwithstanding the close relationship between the companies and the fact

¹⁹ *Cf.* **18.c** on the differences between main and non-main proceedings.

that the related company may have taken part in the management of the debtor or acted like a director of the debtor and caused it to incur debts and liabilities. Furthermore, where the debtor company belongs to a group of companies, it may be difficult to untangle the specific circumstances of any particular case to determine which group company particular creditors dealt with or to establish the financial dealings between group companies.²⁰

Prior to analyzing the treatment afforded to corporate groups, it is worth first discussing the issue of *consolidation*. Consolidation doctrine can be viewed from two different angles: (1) substantive consolidation; and (2) procedural consolidation. Weil (2000)²¹ provides an excellent description of *substantive consolidation*:

Substantive consolidation, which is an equitable doctrine applied in bankruptcy cases to ensure the equitable treatment of creditors, permits the bankruptcy court to disregard the separateness of the debtor and one or more of its affiliates and to consolidate and pool the entities' assets and liabilities and treat them as though held and incurred by one entity. As a result, a single estate for the benefit of all creditors of all the consolidated corporations is created and all creditors of the various corporations are combined into a single creditor body [footnotes omitted].

Without naming it as such, Sargent (1989)²² defines *procedural consolidation* as *the joint administration of multiple debtors' estates*.

For more information on the subject of consolidation, the reader is encouraged to consult Sargent (1989).

The Insolvency Law has very little regulation concerning corporate groups. While the Insolvency Law does not recognize or give effect to the principles of substantive consolidation, it does provide for some level of procedural consolidation when dealing with corporate groups: The *concurso* of a holding company and its subsidiaries or of the subsidiaries of the same holding company will be procedurally consolidated with the same courts, but under separate dockets [LCM 15].

20 UNCITRAL (2005), p. 276.

21 P.38.

22 P.2.

For a debtor to be considered a *holding company*, the debtor must be a resident of Mexico, with no other entity holding more than 50 percent of its voting stock. So, for example, while the Mexican members of a group of companies that are themselves controlled by a non-Mexican company can be individually declared *en concurso*, their procedures would not be consolidated. It is unclear what the rationale is behind these requirements for procedural consolidation.

11. Commencement Standards

a. General

The issue of commencement standards deals with the economic or legal situation in which a debtor is found before being subject to the benefits and discipline of the Insolvency Law.

*The standard to be met for commencement of insolvency proceedings is central to the design of an insolvency law...Laws differ on the specific standard that must be satisfied before insolvency proceedings can commence. A number of laws include alternative standards and distinguish between the standard applicable to commencement of liquidation and reorganization proceedings, as well as between applications by a debtor and a creditor or creditors.*²³

UNCITRAL (2005)²⁴ distinguishes two different commencement standards: (1) the liquidity, cash flow or general cessation of payments test; and (2) the balance sheet test.

The liquidity, cash flow or general cessation of payments test *requires that a debtor has generally ceased making payments and will not have sufficient cash flow to service its existing obligations as they fall due in the ordinary course of business.*²⁵

23 UNCITRAL (2005), p. 45.

24 P. 45 et seq.

25 UNCITRAL (2005), p. 45.

The balance sheet test *is based on the excess of liabilities over assets as an indicator of financial distress.*²⁶

b. Mexico's Position

Mexico has opted for the liquidity, cash flow or general cessation of payments test as the commencement standard under the Insolvency Law: A debtor will be declared *en concurso* if it has ceased, in general, paying its debts as they become due [LCM 9].

c. General Cessation of Payments Under the Insolvency Law

The Insolvency Law establishes precise rules that determine when a debtor has ceased, in general, paying its debts as they become due. These commencement standards are (1) the failure of a debtor to comply with its payment obligations in respect of two or more creditors, and (2) the existence of the following two conditions: [x] 35 percent or more of the debtor's outstanding liabilities are 30 days past due; and [y] the debtor has insufficient current assets (cash, demand deposits, 90-day time deposits, accounts receivable maturing no later than 90 days and marketable securities realizable within 30 days) to cover at least 80 percent of its obligations that are due and payable [LCM 9 and 10].

d. Rebuttable Presumptions of Insolvency

The following cases are considered by the Insolvency Law to be facts which by themselves will result in a rebuttable presumption of insolvency [LCM 11 and 309]:

- Inexistence or insufficiency of assets available for attachment.
- Payment default under obligations due to two or more creditors.
- Hiding or being absent without leaving someone to manage or run his enterprise and who can comply with existing obligations.

²⁶ UNCITRAL (2005), p. 46.

-
- Shutting down the enterprise.
 - Resorting to ruinous, fraudulent or fictitious practices to attend to or cease fulfilling his obligations.
 - Defaulting monetary obligations under a reorganization plan (*cf.* **15.r**).
 - Any case analogous to the foregoing cases.
 - The recognition in Mexico of a foreign main proceeding (*cf.* **18.c**) with respect to the debtor.

The main consequence of a statutory presumption is that it shifts the burden of proof away from the party invoking it [CCOM 1194-1196]. That is, a creditor demanding declaration of *concurso* based on one of the legal presumptions would have to prove the facts upon which the presumption rests [CCOM 1280] but would be relieved from proving the commencement standards, while the debtor-defendant would have to prove that the commencement standards were not met.

12. Commencement

The standard to be met for commencement of insolvency proceedings is central to the design of an insolvency law. As the basis upon which insolvency proceedings can be commenced, this standard is instrumental to identifying the debtors that can be brought within the protective and disciplinary mechanisms of the insolvency law and determining who may make an application for commencement, whether the debtor, creditors or other parties.²⁷

The debtor, any creditor or the Office of the Attorney General may file an insolvency petition or demand [LCM 20, 21].

²⁷ UNCITRAL (2005), p. 45.

a. Debtor Petition

A debtor can petition for *concurso* if any of the two tests mentioned in **11.c(2)[x]** or **11.c(2)[y]** are met. The petition must be furnished with the following information [LCM 20]:

- Debtor's name.
- Debtor's domicile; corporate domicile; address of offices and establishments, including plants and warehouses; and indication of the location of the principal place of its management (*cf.* **9.a.ii**).
- A description of the causes that led to its general cessation of payments.
- Debtor's audited financial statements for the past three fiscal years.
- A list of the debtor's debtors and creditors, indicating names and domiciles, stated maturity dates of claims, the ranking of claims, main characteristics of the claims and a description of collateral.
- An inventory of all the debtor's assets.
- A list of litigation in which the debtor is involved.
- Debtor's offer to post collateral for the payment of the visitor's fees (*cf.* **14**).

b. Demand by Creditor or the Office of the Attorney General

A creditor or the Office of the Attorney General can demand the *concurso* if both tests mentioned in **11.c(2)[x]** and **11.c(2)[y]** are met. The demand must be furnished with the following information [LCM 22-23]:

- Name of the court before which the demand is made.
- Creditor's name and domicile.
- Debtor's name and domicile and, if known, the address of the offices, plants and warehouses.

-
- The facts that motivate the demand and the legal arguments invoked.
 - The petition that the debtor be declared *en concurso*.
 - Documentary proof evidencing its capacity as creditor and original or certified copies of other documentary evidence.
 - Creditor's offer to post collateral for the payment of the visitor's fees (*cfr.* **14**).

Once the judge overseeing the *concurso* proceeding admits the demand, he shall summon the debtor, who will have nine business days to contest the demand [LCM 26].

13. Temporary Measures

The Insolvency Law does not provide for automatic relief upon the filing of a petition. The debtor, the creditor demanding the insolvency, or the visitor (*cfr.* **14**) may request that the judge issue temporary measures to preserve the assets of the debtor pending a determination of whether the debtor is eligible to be *en concurso* [LCM 25, 37 and 340]. These measures may include (1) the prohibition to make payments; (2) the stay of enforcement proceedings; (3) the enjoining of the debtor from disposing of or encumbering assets, or transferring funds or valuables; and (4) the seizure of property [LCM 37].

14. The Visit

The day after a *concurso* petition is accepted for filing, the judge overseeing the *concurso* proceeding will send a copy of the petition to Ifecom ordering it to designate a visitor within five business days. The judge will order the visit and immediately notify the debtor. The visitor and his assistants will review the books and records of the debtor and prepare minutes of the visit. The purpose of the visit is for the visitor to ascertain that the commencement standards (*cfr.* **11.c**) have been met, and report his findings to the judge [LCM 29-41].

The debtor must cooperate with the visitor, allowing him access to the debtor's premises and books and records, as well as to the debtor's employees and consultants [LCM 31, 32, 34, 35].

15. Reorganization

Once the visitor has submitted his report (*cf.* **14**), the judge must render judgment of the declaration of *concurso* which, if declaring the debtor *en concurso*, shall contain, among other things [LCM 43]:

- The declaration of *concurso*.
- An order to Ifecom to appoint the conciliator.
- The opening of the conciliatory stage (or the liquidation stage (*cf.* **16**) if the debtor specifically requested his *concurso* to be opened in the liquidation stage).
- An order to the debtor to deliver books and records to the conciliator.
- An order to the debtor to suspend the payment of its indebtedness (*cf.* **15.g**).
- An order to suspend all enforcement proceedings (*cf.* **15.h**).
- A notice to all creditors, so that they may appear in the proceeding (*cf.* **15.a**).
- An order to the conciliator to record the judgment with the Public Registry of Commerce of the domicile of the debtor and of each place where the debtor has branches, agencies or assets subject to recordation.
- The retroactivity date (*cf.* **15.j**).
- The order to the conciliator to begin the claim recognition process (*cf.* **16.a**).

a. Notices

Under the Insolvency Law, notices must be given to both foreign and domestic creditors equally [LCM 44]. Further, the court shall order that appropriate steps be taken to notify any creditor whose address is not yet known [LCM 291]. Notice to non-Mexican creditors must be given individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate [LCM 291]. When a notification of commencement of a case is to be given to foreign creditors, such notice shall, among other things, provide a 45-day period for filing proofs of claim (as opposed to a 20-business-day period for Mexican creditors), specify the place for

filing such proofs of claim and indicate whether secured creditors are required to file proofs of claim [LCM 291].

b. Appeal

The judgment that declares the debtor *en concurso* (or denies such declaration) can be appealed by the debtor, the visitor, the demanding creditors or the Office of the Attorney General [LCM 49].

c. Conciliatory Stage

The stated purpose of the conciliatory stage is to conserve or save the business enterprise through a restructuring plan [LCM 3].

The conciliatory stage is designed to be completed in 185 days, although one 90-day extension may be granted if the conciliator or creditors representing two-thirds of the recognized claims so request. An additional 90-day extension may be granted if the debtor, together with creditors representing 90 percent of the recognized claims, so requests. The Insolvency Law clearly provides that in no event may the conciliatory stage be extended beyond 365 days, whereupon, if no restructuring plan is agreed to, the liquidation stage will immediately begin [LCM 145 and 167-II].

d. The Estate

From a doctrinal point of view, the *estate* is the portion of the assets of the debtor devoted to satisfy creditors' claims, over which the debtor has limited governance (during conciliation) or no governance (during liquidation).

The Insolvency Law defines *estate* as the sum of all the assets of the debtor, other than excluded assets, on which creditors can make their claims effective [LCM 4-V]. The estate includes all assets of the debtor (whether tangible or intangible, present or after-acquired, encumbered or unencumbered), but excludes nontransferable assets, those that cannot be attached and those that are not subject to adverse possession [LCM 179].

i. Nontransferable Asset

Generally, all assets are transferable. Only exceptionally, by statute (e.g., moral copyrights [LFDA 19]) or due to the nature of being inherently attached to its owner (e.g., right to his name, reputation, etc.), assets would not be transferable.

ii. Assets That Cannot Be Attached

Certain assets are not subject to attachment and are, therefore, excluded from the estate. The rationale behind prohibiting the attachment of these assets is to allow basic subsistence of their owner (*cf.* CFPC 434).

iii. Assets Not Subject to Adverse Possession

This additional classification seems unnecessary, since basically any transferable asset is subject to adverse possession [CCF 1137].

e. *De Facto Estate vs. De Jure Estate*

Treatises distinguish between the *de facto* estate and the *de jure* estate.²⁸ Upon entering into the insolvency proceedings, all assets in the possession of the debtor are presumed to form part of the estate (the *de facto* estate). To preserve and construct the *de jure* estate, the Insolvency Law provides for conservative, integrative and disintegrative measures.

It is in the interest of the estate that all integrative measures are exhausted with respect to assets not in possession of the debtor, while, in contrast, it is in the interest of third parties to exercise disintegrative measures with respect to assets in the possession of the debtor. The *de jure* estate is the result of the exercise of all integrative and disintegrative measures on the *de facto* estate. It is also in the interest of the estate that all conservative measures be exhausted with respect to assets in possession of the debtor.

28 See, e.g., Rodríguez (1951), pp. 10-11, and Zorrilla (1946), pp. 30-31.

i. Conservative Measures. Conservative measures include:

- Management of the enterprise (*cf.* **15.f**).
- Suspension of payments (*cf.* **15.g**).
- Stay of execution (*cf.* **15.h**).
- Disposition of assets (*cf.* **15.i**).

ii. Integrative Measures. Integrative measures include:

- Avoidance powers (*cf.* **15.j**).
- *Musiana* presumption (*cf.* **15.k**).

iii. Disintegrative measures.

- The most relevant disintegrative measure is the one concerning separation of third-party assets in possession of the debtor (*cf.* **15.l** and **15.m**).

f. Management of the Enterprise

Although a conciliator is appointed when a debtor is declared *en concurso*, the debtor remains in possession of its enterprise and under the control of prior management, unless the conciliator requests that the court exercise the exceptional remedy of removal (*cf.* **16.a**) [LCM 74, 81]. This position is in line with UNCITRAL (2005),²⁹ which provides that *[w]here the business is to be continued (either for sale as a going concern in liquidation or in reorganization), a greater need arises for some form of involvement of the debtor in management.*

During conciliation, the debtor shall conduct the ordinary operations of the enterprise, including making any essential expenses, while the conciliator oversees the books and records and each transaction carried out by the debtor [LCM 75].

29 P. 161.

The conciliator shall resolve issues pertaining to the assumption or rejection of contracts, any post-commencement financing, implementation or substitution of collateral and the disposition of assets out of the ordinary course of business [LCM 75].

g. Suspension of Payments

The judgment declaring the debtor *en concurso* shall include an order to the debtor to suspend the payment of its pre-commencement indebtedness, except for essential expenses for the ordinary course of business [LCM 43-VIII], labor-related payments [LCM 66] and tax claims [LCM 69]. The suspension of payments benefit is one of the most powerful tools for preserving the estate, as it legally suspends the enforcement of pre-commencement claims and allows for an orderly reorganization of the debtor's affairs.

h. Stay of Execution

Once a judgment that declares the debtor *en concurso* is entered, attachment and foreclosure on assets are stayed during the conciliatory stage, with the sole exception of cases involving privileged labor-related claims [LCM 43-IX, 65]. Like the suspension of payments benefit, the stay of execution is also a very powerful tool to preserve the estate.

The stay will apply to any and all attachment and foreclosure processes concerning the debtor's assets. It is still an unresolved matter whether the declaration of *concurso* will stay foreclosure procedures under a guaranty trust to which the debtor's assets were transferred prior to commencement.

It is worth noting that individual actions and proceedings are not stayed by the *concurso* declaration [LCM 84].

i. Disposition of Assets

During conciliation, the debtor may dispose of assets in the ordinary course of business, but will require the conciliator's consent to dispose of assets out of the ordinary course of business [LCM 75]. The reader can find further analysis on this subject in **Section 32**.

j. Avoidance Powers

*Insolvency proceedings (both liquidation and reorganization) may commence long after a debtor first becomes aware that such an outcome cannot be avoided. In that intervening period, there may be significant opportunities for the debtor to attempt to hide assets from creditors, incur artificial liabilities, make donations or gifts to relatives and friends or pay certain creditors to the exclusion of others. There may also be opportunities for creditors to initiate strategic action to place themselves in an advantageous position. The result of such activities, in terms of the eventual insolvency proceedings, generally disadvantages ordinary unsecured creditors who were not party to such actions and do not have the protection of a security interest... Many insolvency laws include provisions that apply retroactively from a particular date (such as the date of application for, or commencement of, insolvency proceedings) for a specified period of time (often referred to as the "suspect" period) and are designed to overturn those past transactions to which the insolvent debtor was a party or which involved the debtor's assets where they have certain [negative] effects... Transactions are typically made avoidable in insolvency to prevent fraud (e.g., transactions designed to hide assets for the later benefit of the debtor or to benefit the officers, owners or directors of the debtor); to uphold the general enforcement of creditors' rights; to ensure equitable treatment of all creditors by preventing favoritism where the debtor wishes to advantage certain creditors at the expense of the rest; to prevent a sudden loss of value from the business entity just before the supervision of the insolvency proceedings is imposed....*³⁰

Some types of transactions carried out prior to the declaration of *concurso* can be set aside. The transactions subject to avoidance are grouped in four categories: (1) *per se* fraudulent transactions; (2) cases of constructive fraud; (3) objective preferences; and (4) subjective preferences.

³⁰ UNCITRAL (2005), pp. 135-136.

All pre-commencement *per se* fraudulent transactions are avoidable [LCM 113]. All other avoidable transactions (cases of constructive fraud, objective preferences and subjective preferences) are avoidable if carried out within the retroactive period [LCM 114-117]. The *retroactive period* is the period that begins 270 days prior to the declaration of business reorganization [LCM 112]. The judge may extend such period to an earlier date upon the reasoned request of the conciliator, the conservators or any creditor [LCM 112].

i. Per Se Fraudulent Transactions

Transactions entered into before the declaration of *concurso* in which debtor knowingly defrauds creditors, shall be set aside if the transaction is gratuitous or, not being gratuitous, the third party shares the fraudulent intent [LCM 113].

ii. Cases of Constructive Fraud

The following transactions carried out during the retroactive period shall be set aside. These transactions are conclusively presumed to be fraudulent [LCM 114]:

- Gratuitous transactions.
- Transactions under which the debtor pays consideration of a substantially higher value, or receives consideration of a substantially lower value, than that of its counterparty.
- Transactions in which conditions or terms significantly differ from then-prevailing market conditions or from trade usage or practices.
- Any debt remission made by the debtor.
- Any payment of unmatured obligations.
- The discount of debtor's payables by the same debtor.

iii. Objective Preferences

The following transactions shall be set aside if carried out in bad faith during the retroactive period. Bad faith is rebuttably presumed [LCM 115]:

-
- Granting of collateral or additional collateral if not originally contemplated in the transaction documents.
 - Payments-in-kind if such method of payment was not originally agreed to in the transaction documents.

iv. Subjective Preferences

Transactions carried out between the debtor and its related parties during the retroactive period shall be set aside if made in bad faith. Bad faith is rebuttably presumed [LCM 116 and 117].

Related parties of an individual debtor include (1) his/her spouse, concubine, blood relatives up to the fourth degree, in-law relatives up to the second degree, and adopted relatives; and (2) commercial companies in which the debtor or any of the persons mentioned in (1) is the manager or director, or directly or indirectly, together or alone, own more than 51 percent of the outstanding equity capital or have decision-making powers at the shareholders' meetings, are entitled to appoint a majority of the directors or are otherwise entitled to make fundamental decisions for such companies. It is unclear why the definition of related parties in (2) above includes only commercial companies and not other types of entities such as civil partnerships or trusts, and whether the courts have any equitable powers to expand the concept to include them.

Related parties of an entity debtor include (1) a manager or director; (2) the spouse, concubine, blood relatives up to the fourth degree, in-law relatives up to the second degree, and adopted relatives of a manager or director; (3) individuals who directly or indirectly, together or alone, own more than 51 percent of such entity's outstanding equity capital or have decision-making powers at its shareholders' meetings, are entitled to appoint a majority of its directors or are otherwise entitled to make fundamental decisions for such entity; (4) entities sharing managers, directors or principal officers; and (5) entities that control, are controlled by or are under common control of the debtor.

In addition to the avoidance powers the Insolvency Law affords to insolvency courts, civil laws afford the common courts the power to declare void any transaction of the debtor in prejudice of a creditor through the exercise of an *Actio Pauliana* [CCF 2163]. Some of the differences between the *Actio Pauliana* and an insolvency-related avoidance include:

In the case of an *Actio Pauliana*:

- The rights on which the plaintiff's claim is based must precede in time the voidable transaction [CCF 2163].
- The voidable transaction shall cause the debtor's insolvency. Insolvency in this case means that the fair value of the assets of a debtor is less than the sum total of its debts (balance sheet test) [CCF 2163, 2166].
- The transaction would be voided only if (1) it is a gratuitous transaction; or (2) not being gratuitous, both the debtor and its counterparty acted in bad faith. Bad faith consists of the knowledge of insolvency [CCF 2164-2166].
- The transaction would only be void with respect to the creditor plaintiff [CCF 2175].

It is not clear whether an *Actio Pauliana* can be exercised during the pendency of a *concurso*.

k. *Musiana* Presumption

Marriage and concubinage are governed by civil state laws in Mexico. Most of these laws foresee two different types of patrimonial regimes applicable to marriage: (1) joint assets regime; and (2) separation of assets regime.

All assets acquired under the joint assets regime in the two years prior to the beginning of the retroactive period are conclusively presumed to belong to the debtor and, therefore, are included in the estate [LCM 188].

All assets acquired by the concubine or the spouse under the separation of assets regime in the two years prior to the beginning of the retroactive period are rebuttably presumed to belong to the debtor and, therefore, are included in the estate [LCM 187].

I. Separation

Any legitimate title-holder (not necessarily an owner) may separate individually identified assets in the debtor's possession, provided such assets were not transferred to the debtor pursuant to a final and irrevocable legal title [LCM 70]. To be separated, an asset must: (1) be in the debtor's possession; (2) be individually identified; and (3) may not have been transferred pursuant to a final and irrevocable legal title.

i. In Debtor's Possession

An asset not in the debtor's possession shall not be separated. *Possession* is a technical term that implies a *de facto* power over a certain asset and includes not only assets over which the debtor has physical possession, but also assets over which the debtor has primary possession (e.g., the debtor shall be deemed to be in possession of an asset even if the debtor has leased it out to a third person).

ii. Individually Identified

The identity of the asset is a necessary requisite for separation. Therefore, a fungible asset (e.g., money) cannot be separated unless it can be individually identified.

In the case of accession (i.e., the case where one asset is naturally or artificially incorporated into another asset), the rules for identifying assets become casuistic and generally rely on who acquires title of the resulting asset. The determination of who acquires title requires applying rules governing the question on which is the principal asset and which is the accessory asset. If, pursuant to these rules, the debtor becomes the owner of the resulting asset, the debtor may have to indemnify the owner of the incorporated asset (which claim would have to be subject to the insolvency proceedings), but if a third person becomes the owner of the resulting asset, then such third person may separate it, indemnifying the debtor. The level of

indemnification could also depend on whether accession resulted in good or bad faith of one or both of the parties (*cf.* CCF 886, *et seq.*).

Needless to say, an asset that has disappeared or has been destroyed cannot be separated.

iii. Not Transferred Pursuant to Final and Irrevocable Legal Title

Title through which the assets were transferred to the debtor shall not be a final and irrevocable legal title. Final and irrevocable legal title is that which is not subject to inexistence, annulment, revocation or resolution actions.³¹

m. Separation (continued)

The principles set forth in **15.I** constitute the general principles of *separation*; however, the Insolvency Law provides an illustrative list of cases under which a separation action can be exercised [LCM 71]. These cases can be grouped as (1) assets subject to recovery; (2) assets subject to *quasi* recovery; and (3) assets subject to a restitution duty.

i. Assets Subject to Recovery

This group includes any assets that are the subject of a recovery action. A recovery action is an *in rem* action that may be exercised by an owner of an asset against someone in possession of that asset, and is directed to obtain delivery of such asset.

ii. Assets Subject to Quasi Recovery

This group includes assets under the following scenarios. Please refer to the **Appendix** for a summary of the differences between real property and chattel.

³¹ *Cfr.* Zorrilla (1946), pp. 67-68.

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- Realty sold to the debtor, provided that the purchase price has not been paid in full and the sale has not been recorded with the Public Registry of Property.
 - Unpaid chattel sold to the debtor in a spot market transaction.
 - Unpaid assets (realty and chattel) under contracts with a recorded default resolution clause.
 - Securities issued to the debtor's benefit or endorsed over to the debtor in payment of sales made on behalf of third parties.
 - Taxes withheld by, collected by, or passed on to the debtor on behalf of the tax authorities. This is a clear diversion from the principle that assets must be individually identified to be subject to separation.

iii. Assets Subject to a Restitution Duty

This group includes assets with respect to which the debtor has a duty to restitute, pursuant to the following rules:

- Deposit, when the debtor is acting as the depositary.
- Usufruct, when the debtor is the usufruct beneficiary.
- Trust, when the debtor is acting as the trustee.
- Administration, when the debtor is acting as the administrative agent.
- Consignment, when the debtor is acting as the consignee.
- Sale, purchase, transit, delivery or collection commission, when the debtor is acting as the agent.
- Held by the debtor to be delivered to a determined third person on behalf of a third-person principal.
- Receivables held by the debtor for sales made on behalf of a third-person principal.

n. Claims and Contracts

i. Acceleration

Upon the declaration of *concurso*, all claims against the debtor shall become due [LCM 88-I].

Claims subject to conditions precedent shall be deemed as if the condition had never occurred [LCM 88-II]. Therefore, the claim shall be deemed not to exist.³²

Claims subject to a condition subsequent shall be deemed as if the condition occurred, that is, the claim shall be extinguished [CCF 1940]; however, the parties shall not be entitled to a refund of any consideration paid during the pendency of the condition [LCM 88-III].

ii. Quantification and Conversion

The claims must be quantified upon acceleration. For most term claims, this is an easy exercise, since they would be quantified at par. However, for other types of claims, the rules are casuistic:

- Claims under periodic or successive payments shall be quantified, discounting them at their present value. The discount rate shall be the one agreed to by the parties or, in the absence of an agreement, the prevailing market rate for similar transactions and, if such market rate cannot be determined, the legal interest rate³³ [LCM 88-IV].
- Claims for annuities shall be quantified at their replacement value and, in the absence of such replacement value, at their present value determined by commonly accepted practice [LCM 88-V].

³² Borja (1991), pp. 395-399.

³³ The "legal interest rate" is 9 percent per annum for claims of a civil nature [CCF 2395]. It is unclear what the "legal interest rate" is for claims of a commercial nature.

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- Claims for an uncertain or undetermined amount must be determined [LCM 88-VI].
 - Claims that cannot be quantified shall not be recognized [LCM 88-VII].

The Insolvency Law establishes provisions that are designed to protect the monetary value of claims against inflation, once they are quantified. All claims are converted into UDIs and cease accruing ordinary and default interest. Only secured claims continue to accrue ordinary interest and can be maintained in their original currency or unit of account to the extent covered by the value of the collateral [LCM 89].

iii. Executory Contracts

Achieving the objectives of maximizing the value of the estate and reducing liabilities and, in reorganization, enabling the debtor to survive and continue its affairs to the maximum extent possible in an uninterrupted manner may involve taking advantage of those contracts which are beneficial and contribute value to the estate (including contracts that will enable the continued use of crucial property that may be owned by a third party) and rejecting those which are burdensome or those where the ongoing costs of performance exceed the benefit to be derived from the contract.³⁴

As a general principle, the declaration of *concurso* does not affect the provisions of an executory contract, unless the conciliator rejects it on grounds that rejection is in the best interest of the estate [LCM 86, 92].

Any provision of an agreement that sets modifications that worsen the contractual terms for a debtor as a result of the filing of a petition or demand for, or the

³⁴ UNCITRAL (2005), p. 120.

declaration of, *concurso*, shall be deemed not included therein [LCM 87]. That is, the courts would not recognize the validity of a clause in an agreement that would give a party the right to terminate such agreement in the event of a petition or demand for, or declaration of, *concurso* of the other party.

Any party to an executory contract with the debtor shall be entitled to require the conciliator to declare whether he will assume or reject the contract. If the conciliator declares the assumption of the contract, the debtor must perform or guarantee performance thereunder. If the conciliator rejects the contract, or does not provide an answer within 20 business days, the debtor's counterparty may thereafter declare the termination of the contract [LCM 92]. An unresolved issue is whether the conciliator has the authority to decide on a partial assumption of a contract. Prevailing opinion is that no such authority exists and the contract would have to be assumed or rejected in its entirety.

A similar rule exists in the liquidation stage, when the sale of the estate is carried out as a transfer of the enterprise or parts thereof as a going concern. However, in this case, the rules and presumptions operate in an inverse sense: The receiver shall notify each counterparty that they have ten business days to decide whether to continue or reject the contract. Failure of a counterparty to respond shall be deemed as consenting to the continuation of the contract [LCM 211].

iv. Executory Contracts (continued)

The principles set forth in **15.n.iii** constitute general principles applicable to executory contracts; however, the Insolvency Law provides an exhaustive list of cases under which a specific regime applies to specific executory contracts [LCM 93-111]:

1. Purchases

In the case of purchase agreements where the debtor is a purchaser, the seller is not required to deliver the subject matter of the contract (whether realty or

chattel³⁵) unless its price is paid for or guaranteed [LCM 93]. Similarly, a purchaser debtor cannot demand delivery of unpaid goods if the debtor does not pay or guarantee payment for the purchase price [LCM 96]. If the payment is subject to an unexpired term, the seller may only demand guarantee of payment [LCM 97].

A seller shall be entitled to recover property sold pursuant to a promissory agreement or to a purchase agreement that lacks all formalities required by law. The debtor, with the conciliator's authorization, may prevent such recovery by demanding that proper formalities be met (through an *actio pro forma*) or if the action to demand annulment due to lack of formality is otherwise extinguished (e.g., by the lapse of the applicable statute of limitations) [LCM 93, 96].

A seller of unpaid property that is en route for delivery to the debtor may oppose delivery by changing the delivery consignment (if permitted by law) or by stopping the delivery, even if the seller does not have documentation to effect a change to delivery consignment [LCM 94].

In the case of the sale of property on a multiple-delivery basis (e.g., under a supply agreement) where some of the deliveries have been made but remain unpaid, the debtor must make payment for such deliveries [LCM 98]. It is unclear whether this provision of the Insolvency Law refers to all cases, or only when debtor or conciliator has elected to assume the contract.

2. Sales

In the case of purchase agreements where the debtor is a seller of realty, the purchaser shall be entitled to demand delivery of such realty after paying its price [LCM 95].

³⁵ Please refer to the **Appendix** for a summary of the differences between real property and chattel.

In the case of purchase agreements where the debtor is a seller of chattel, the purchaser shall be entitled to demand performance after paying its price if the chattel has been identified before the declaration of *concurso* [LCM 99].

3. Deposits, Mandates and Agencies, Extensions of Credit

Deposits, mandates and agencies, and extensions of credit shall remain effective, unless the conciliator determines that they should be terminated [LCM 100].

a. Deposits

A *deposit* is a contract through which a depositor agrees to receive property from a depositant, to preserve it and to return it upon demand [CCF 2516]. Deposits can be (1) *regular deposits*, if their subject matter is a non-fungible asset; or (2) *irregular deposits*, if their subject matter is a fungible asset.

The deposit survival rule shall apply to all cases where the debtor is the depositor. Where the debtor is the depositary, the rule shall apply only in the case of regular deposits. Where money (and, while not completely clear, other fungible assets) is the subject matter of the deposit, the depositary shall have an unsecured claim against the debtor, which claim shall be subject to the effects of the *concurso* [LGTOC 267].

b. Mandates and Agencies

A *mandate* is an agreement through which an agent agrees to carry out legal actions on behalf of a principal [CCF 2546]. An *agency* is a mandate applied to specific commercial transactions [CCOM 273].

Mandates and agencies shall not terminate as a result of the debtor being declared *en concurso*, regardless of whether debtor is acting as a principal or as a representative. Where the debtor is the representative, the principal has the ability to separate assets in the debtor's possession.

c. Extensions of Credit

An *extension of credit* is an agreement through which a lender makes a sum of money available to a borrower or assumes a liability of a borrower [LGTOC 291]. Extensions of credit can be *uncommitted* extensions of credit (where the lender reserves the right to restrict or terminate the extension of credit) or *committed* extensions of credit (where the lender does not reserve the right to restrict or terminate the extension of credit) [LGTOC 294].

While the Insolvency Law makes no distinction, arguably, the general rule of survival as applied to extensions of credit only applies to the case where the debtor is the borrower thereunder.

This survival rule makes little sense in the case of *concurso* of the lender, except where lending is the debtor's main activity and its enterprise is not shut down. But even in that scenario, it is hard to envision a clear-cut rule to determine whether rejection or assumption maximizes estate value.

It is worth noting that an extension of credit will survive the *concurso* declaration of a borrower; however, in uncommitted extensions of credit, the lender may restrict or terminate the extension of credit [LGTOC 294]. On the positive side, the loan could qualify for post-commencement financing status (*cfr.* **15.q**).

4. Current Accounts

A *current account* is an agreement through which the claims deriving from reciprocal remittances among the parties are accounted for as credits or debits and only upon closing the current account will the balance be deemed to constitute a claim against one of the parties [LGTOC 302].

Unless the debtor, with the authorization of the conciliator, determines otherwise, all current accounts will be closed upon the declaration of *concurso*, and the resulting balance shall be a claim in favor or against the debtor [LCM 101].

This is one of the few cases where the Insolvency Law allows some form of netting (*cf.* **15.o**).

5. Repurchase Agreements³⁶

A *repurchase agreement* is a contract under which the reseller acquires negotiable instruments in exchange for an amount of money, and undertakes to re-transfer to the repurchaser an equal amount of the same kind of negotiable instruments upon the agreed-upon terms and against the reimbursement of the same price, plus a premium [LGTOC 259].

A repurchaser may liquidate or abandon the repurchase agreement. If the repurchaser liquidates the repurchase agreement, it shall re-acquire the negotiable instruments against payment of the price, plus a premium. If the repurchaser abandons the repurchase agreement, the repurchaser will not be bound to repurchase the negotiable instruments but must pay the differences against repurchaser (i.e., the difference between the market value of the negotiable instruments and the repurchase price, plus the premium) [LGTOC 266].

The declaration of *concurso* shall terminate all repurchase agreements entered into by the debtor and repurchaser loses its ability to choose between liquidating or abandoning the repurchase agreement [LCM 102].

In the case where the debtor acted as the reseller, the repurchase agreement must be liquidated. That is, the debtor/reseller shall transfer to the repurchaser the negotiable instruments, and the repurchaser must pay the repurchase price, plus the premium [LCM 102-I].

The repurchase agreement shall be deemed abandoned in the case where the debtor acted as the repurchaser. That is, the repurchaser will not be bound to repurchase

³⁶ ALI Mexico (2003), pp. 193-196, provides some additional literature on repurchase agreements and the effects of a *concurso* with respect to repurchase agreements.

the negotiable instruments and the reseller shall have a claim against the debtor/repurchaser subject to *concurso* for the difference between the market value of the negotiable instruments and the repurchase price, plus the premium [LCM 102-II].

A further rule concerns the existence of reciprocal repurchase agreements between the debtor and its counterparty. Pursuant to this rule, all such reciprocal repurchase agreements shall be terminated on the date of the declaration of *concurso*, the rules regarding liquidation or abandonment shall be applied with respect to each agreement,³⁷ and the resulting balances are thereafter netted out. The resulting netted-out balance, if in favor of the debtor, shall be payable to the debtor within 30 days or, if against the debtor, shall constitute a claim against the debtor subject to *concurso* [LCM 102-III].

6. Securities Loans

A *securities loan* is a contract through which a lender transfers title of securities to a borrower, who undertakes to return the same amount of the same type of securities or their equivalent [CCF 2384 and CCOM 359].

Special rules in the Insolvency Law for executory securities loan contracts apply only if the contract is guaranteed with Mexican currency (i.e., pesos) or with peso-denominated securities. It is unclear why these rules apply only to these cases and not to cases of unsecured securities loans, or securities loans guaranteed with another currency or with securities denominated in another currency.

The Insolvency Law makes a direct reference to the rules applicable to executory repurchase agreements as the rules applicable to executory securities loan agreements guaranteed with pesos, and to the rules applicable to reciprocal

³⁷ The Insolvency Law is not clear on whether the rules regarding liquidation or abandonment apply. Another route of interpretation suggests that the parties keep the negotiable instruments and monies in their respective possessions and the negotiable instruments are thereafter marked-to-market.

executory repurchase agreements as the rules applicable to executory securities loans guaranteed with peso-denominated securities (*cf.* **15.n.iv.5**) [LCM 103].

Based on the statutory cross-references, we can distinguish four types of treatment in insolvency for executory securities loans: (1) those guaranteed with pesos, under which the debtor is the borrower; (2) those guaranteed with pesos, under which the debtor is the lender; (3) reciprocal securities loans guaranteed with pesos; and (4) securities loans guaranteed with peso-denominated securities, each of which is discussed below:

a. Securities Loan Guaranteed with Pesos, Under Which Debtor Is Borrower

In the case where the debtor acted as the borrower of securities, the rules for the liquidation of repurchase agreements apply (*cf.* **15.n.iv.5**); therefore, the borrower/debtor shall transfer to the lender the negotiable instruments, and the lender must reimburse the borrower with the pesos subject matter of the guarantee.

b. Securities Loan Guaranteed With Pesos, Under Which Debtor Is Lender

In the case where the debtor acted as the lender of securities, the rules for the abandonment of repurchase agreements apply (*cf.* **15.n.iv.5**); therefore, the borrower shall keep the securities and the debtor/lender shall keep the peso collateral, while the borrower shall have a claim against the lender/debtor subject to *concurso* for the difference between the market value of the securities and the peso collateral.

c. Reciprocal Securities Loans Guaranteed With Pesos

All reciprocal securities loan agreements guaranteed with pesos shall be terminated on the date of the declaration of *concurso*, the rules regarding

repayment or abandonment shall apply with respect to each agreement,³⁸ and the resulting balances are thereafter netted out. The resulting netted-out balance, if in favor of the debtor, shall be payable to the debtor within 30 days or, if against the debtor, shall constitute a claim against the debtor subject to *concurso*. This is another case where the Insolvency Law allows for netting (*cf.* **15.o**).

d. Securities Loan Guaranteed With Peso-Denominated Securities

The situation in this case is clear in the absence of insolvency: Upon termination of the securities loan agreement, the debtor and its counterparty have to exchange securities of some kind and any over- or under-collateralization issues become irrelevant in the absence of default.

However, the rule in the Insolvency Law is rather unclear. It would seem that the Insolvency Law tried to provide that each party shall keep the securities in their respective possession, these securities are marked-to-market and any over- or under-collateralization issues are resolved by the rules applicable to the repurchase netted-out balance: if in favor of the debtor, shall be payable to the debtor within 30 days or, if against the debtor, shall constitute a claim against the debtor subject to *concurso*.

7. Derivatives

Executory *contracts for difference* or *futures contracts* and *derivative financial transactions* are grouped and treated in the same manner by the Insolvency Law.

While there are no legal definitions for *contracts for difference* or *futures contracts*, these can be distinguished from ordinary purchase agreements with the special characteristic that, when the term expires, instead of the seller transferring title

³⁸ As in the case of repurchase agreements, the Insolvency Law is not clear in this respect. Please refer to the comment in fn 37.

to an asset against payment of the price, one of the parties pays to the other the difference in value of the underlying asset. Goldschmidt (2008)³⁹ provides more insight into the concept of *contracts for difference*.

A *derivative financial transaction*, pursuant to the Insolvency Law, is *that in which the parties are obligated to pay money or to surrender other property, which [are referenced to] an underlying asset or market value* [LCM 104]. There is no substantive difference between this legal concept of *derivative financial transaction* and that of *contracts for difference*.

The concept also includes *those agreements which Banco de México determines [as such] through rules of general application* [LCM 104]. Banco de México is entrusted, among others, to promote the healthy development of the financial system and propitiate the correct functioning of the payment systems [LBM 2]. As such, Banco de México has issued general rules⁴⁰ for derivative financial transactions applicable to financial intermediaries (commercial banks, broker dealers, investment companies and pension fund investment companies). These rules recognize the following transactions as *derivative transactions*: (1) futures; (2) options; (3) swaps; and (4) credit derivatives. The terms are defined as follows:⁴¹

- *Futures*: transactions for the sale or the purchase of an underlying asset or index, in which the parties agree that the obligations shall be met at the agreed-upon price and at a date that is subsequent to that of contracting.
- *Options*: transactions in which the holder, through the payment of a premium to the writer, acquires the right, but not the obligation, to buy or sell an underlying asset or index at an agreed-upon price, on one or more dates, and the writer is obligated to sell or buy, as the case may be, such underlying asset or index.

39 P. 253.

40 Circular 4/2006 and Circular 1/2002.

41 Circular 4/2006.

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- *Swaps*: transactions in which the parties agree to exchange cash flows during a determined period of time.
 - *Credit derivatives*: These can be of three different kinds: (1) credit default derivatives; (2) total return derivatives; and (3) credit-linked securities.
 - *Credit default derivatives*: transactions in which the holder pays a premium to the maker in exchange for the maker paying a consideration to the holder should a credit event occur.
 - *Total return derivatives*: transactions in which the holder pays to the maker the cash flows from a risky asset as well as the appreciations of such risky asset in exchange for the maker paying to the holder an interest rate, plus any depreciation in the risky asset. Should a credit event occur, the holder shall transfer to the maker the risky asset and the maker transfers to the holder an agreed-upon amount.
 - *Credit-linked securities*: instruments or securities that, in addition to paying a yield, have their value conditioned on the performance of a risky asset and, should a credit event occur, the issuer shall deliver to the holder the risky asset or an agreed-upon amount. It is unclear whether credit-linked securities constitute financial derivative transactions for purposes of the Insolvency Law since, while they are listed as a type of *derivative transaction* pursuant to Banco de México's regulations, they do not constitute "agreements" and are not referred to as an underlying asset or market value (but are rather referenced as a credit event).

Executory contracts for difference or futures contracts and derivative financial transactions are terminated on the date of the declaration of insolvency, and are netted out. The after-netting balance, if in favor of the debtor, shall be payable to the debtor within 30 days or, if against the debtor, shall constitute a claim against the debtor subject to *concurso* [LCM 104].

8. Leases

A *lease* is an agreement through which the lessor grants the temporary use and enjoyment of nonconsumable property, and the lessee agrees to pay a certain price as rent [CCF 2398, 2400].

The subject matter of the lease can be either realty or chattel property. Please refer to the **Appendix** for a summary of the differences between real property and chattel.

The Insolvency Law only regulates executory lease contracts with respect to realty. If the debtor is the lessor under a realty lease agreement, its *concurso* will not affect the lease. If the debtor is the lessee under a realty lease agreement, its *concurso* will not affect the lease; provided, however, that the conciliator can reject the lease, but the debtor will be liable to pay a penalty equivalent to three months' rent (or such other early termination penalty provided for under the lease) [LCM 106].

9. Lump Sum Construction Agreements

The *lump sum construction agreement* is the agreement through which a contractor undertakes to carry out, under its supervision and with its own materials, a work requested by a sponsor, who undertakes to pay the contractor a lump sum price.⁴²

An executory lump sum construction agreement shall terminate upon the *concurso* declaration of either the sponsor or the contractor, unless the parties, with the approval of the conciliator, agree to its continuation [LCM 108]. Upon early termination, the law provides for equitable payments based on actual work performed and expenditures incurred by the contractor [CCF 2635, 2638, 2639].

42 Sánchez Medal (1989), p. 339.

If the subject matter of the construction agreement is chattel property, the contractor has a right to retain such chattel property until it is paid for in full [CCF 2644]. This is especially important in the case of the *concurso* of a sponsor because that makes the contractor a priority creditor (*cf.* **16.c**).

It is oftentimes difficult to distinguish between a construction agreement and a purchase agreement of a future asset (see, e.g., Sánchez Medal (1989), pp. 340-341). The analysis should be made on a case-by-case basis. The distinction is not merely theoretical, as the construction agreement and the purchase agreement each have a different treatment under the Insolvency Law (*cf.* **15.n.iv.1** and **15.n.iv.2**).

10. Insurance

The *insurance agreement* is an agreement through which, in consideration for receiving a premium, an insurance carrier undertakes to repair damage or pay a sum of money to the insured party or the beneficiary upon occurrence of the casualty event foreseen in the contract [LSCS 1].

The Insolvency Law only regulates the cases of *concurso* of the insured party, since insurance carriers are excluded from its application (*cf.* **10.c.iii**).

The Insolvency Law distinguishes between life insurance and insurance contracts where the subject matter is an asset. With the declaration of *concurso* of the insured party, the life insurance contract is not terminated, and the insured party, with the authorization of the conciliator, can assign the policy (or carry out any other operation to the benefit of the estate) to receive a reduction of the insured capital in proportion to the premiums paid pursuant to calculations carried out by the carrier and taking into account risks assumed by the carrier [LCM 110].

The insurance carrier can terminate executory insurance contracts covering chattel (i.e., the insurance contract does not terminate automatically), but those covering realty shall remain in effect upon the declaration of *concurso* of the insured party.

The insurance contract shall terminate automatically if the conciliator does not advise the insurance carrier of the existence of the *concurso* within 30 days of such declaration [LCM 109].

11. Intuitu Personae Companies

The declaration of *concurso* of a general partner or of a shareholder in a general partnership or a limited partnership, or of a partner in a limited liability partnership⁴³ shall give the debtor the right to partially liquidate the company and obtain its liquidation quota pursuant to the latest balance sheet or, with the conciliator's authorization, continue as a partner in the issuing company [LCM 111].

o. Setoff and Netting

Netting is a form of extinction of two claims by operation of law, up to the amount of the lesser claim, and it occurs when two persons are reciprocally the debtor and the creditor to each other [CCF 2185, 2186].

For netting to occur, (1) both obligations have to be for a sum certain, or with respect to fungible assets, of the same kind and quality [CCF 2187]; and (2) both obligations must be liquid and payable [CCF 2188]. An obligation is liquid if its amount has been determined or can be determined within nine days [CCF 2189], and is payable when its payment cannot be legally refused [CCF 2190].

Netting shall not occur if: (1) one or both parties waives it; (2) one of the debts derives from unlawful eviction; (3) one of the debts derives from alimony; (4) one of the debts is an annuity; (5) one of the debts derives from an obligation to pay minimum wage; (6) the debt is of a non-nettable nature, either by statute or by the instrument from which it originates, unless both debts are of equal status; (7) the debt consists of an asset placed in deposit; and (8) the debt is a tax obligation, unless specifically authorized by law [CCF 2192].

43 *Cfr.* 10.b.iii for a brief explanation on the different types of entities.

Netting of obligations in light of *concurso* raises an important policy issue: A balance should be struck between the benefits of netting (commercial predictability, reduction of the scope of the estate and mitigation of systemic risk) and affording a privilege to some creditors not otherwise available to others. IMF (1999) provides an insightful analysis of this policy issue:

An important issue that arises in the design of an insolvency law is the treatment of a creditor who, at the time of the initiation of the liquidation proceedings, also happens to be a debtor to the estate. If the fundamental principle of equality of treatment of similarly situated creditors were applied, the outcome would be relatively straightforward: The liquidator should be able to receive the full amount owed by the creditor and the creditor's claim would be satisfied to the extent to which all other unsecured creditors get satisfied upon the liquidation of the estate. However, an alternative approach permits the creditor, in these circumstances, to exercise set-off rights against the estate after liquidation is initiated, with the effect that, depending on the size of the estate's claim on the creditor, the creditor's claim may be satisfied in full.

There are several reasons why it may be appropriate to include the right of set-off in an insolvency law. The first is that of fairness: notwithstanding the importance of equality of treatment among creditors, it is considered unfair for a debtor to refuse to make payment to a creditor but, at the same time, to insist upon payment from that creditor. In addition, since many counterparties are banks, the right of set-off is particularly beneficial to the banking system and, because of the important credit creation role of banks, is therefore considered to be of general benefit to the economy. By virtue of their core functions (lending and deposit taking), banks that have lent to an entity that has gone bankrupt will often find that they have financial obligations to the debtor in the form of deposits. A post-commencement right of set-off would allow the banks to offset their unpaid claims with the debtor's deposits even though these reciprocal claims are not yet due and payable.

Even among countries that do not provide for a general right of set-off in the context of insolvency, set-off will still normally be permitted in two circumstances: if both claims are mature at the time insolvency takes place, or if the mutual claims arise from the same transactions.

The Insolvency Law has taken the approach of allowing netting in specific cases provided therein. However, the cases in which netting is allowed are relatively broad.

In principle, from the declaration of *concurso*, the debtor's debts cannot be netted out, except for (1) rights in favor of, and obligations payable by, the debtor deriving from the same transaction which is not interrupted by the *concurso* declaration; (2) rights in favor of, and obligations payable by, the debtor maturing before the *concurso* declaration, and which can be netted out pursuant to law; (3) taxes payable by and refundable to, the debtor; (4) reciprocal claims under current account agreements (see **15.n.iv.4**); (5) rights in favor of, and obligations payable by, the debtor under repurchase agreements (see **15.n.iv.5**), securities loans (see **15.n.iv.6**) and derivatives (see **15.n.iv.7**), and under framework agreements for these transactions; and (6) broadly, rights in favor of, and obligations payable by, the debtor resulting from "any other reciprocal acts that can be reduced to cash, even if the claims are not liquid and payable by the date of *concurso* declaration but that can be made liquid and payable pursuant to their terms or according to law" [LCM 90 and 105].

p. Settlement Finality in Payment Systems

While not specifically addressed in the Insolvency Law, an important aspect in preserving the payment systems and avoiding systemic risk, in addition to netting, is the concept of *settlement finality*. According to the Bank for International Settlements,⁴⁴ one of the core principles for systemically important payment systems is that "[t]he [payment] system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day."

This means that any payment that is accepted by the system for settlement should be settled finally on the day on which it is due to the receiving participant in the system...A transaction that has been submitted to the system and has passed all its risk management tests and other requirements is "accepted by the system for settlement" and cannot be removed from the settlement process without violating [this] Core Principle... The [payment] system's rules and the legal framework within which

44 BIS (2001), pp. 29-30.

they function generally determine finality. The legal regime governing payments, the payment system and insolvency law must acknowledge discharge of any obligation to transfer money between system participants for transfers to be considered final....

The stated purpose of the Payment Systems Law is to promote the correct operation of the payment and securities clearance systems by establishing, for purposes thereof, the definitive and irrevocable nature of transfer orders processed through such systems, and the netting and liquidation deriving from those orders [LSP 1]. The Payment Systems Law thus provides that (1) all accepted transfer orders and their netting and liquidation shall be firm, irrevocable, enforceable and binding on third parties [LSP 11]; (2) any judicial or administrative resolution, including those in connection with liquidation or of an insolvency nature, shall only be effective the business day following the date on which the payment or securities system operator is notified of such resolution [LSP 11]; (3) such orders shall not impede the compensation or liquidation of accepted transfer orders up to the date on which the operator is notified of such orders [LSP 14]; and (4) no netting or liquidation of an accepted transfer order carried out up to the date on which the operator has been notified of the judicial or administrative order shall be revoked [LSP 14-II].

For a payment or securities clearance system to be recognized as a *payment system* for purposes of the Payment Systems Law, it must (1) have at least three participating financial entities; and (2) process orders for a monthly average of at least one billion UDIs [LSP 3].⁴⁵ A similar treatment is afforded to foreign recognized payment systems [LIC 46 bis 6].

⁴⁵ For 2011, only the Deposit, Management and Liquidation of Securities System (DALI) managed by Indeval; Banco de México's Account Holder Attention System (SIAC-BANXICO) managed by Banco de México; and the Interbank Electronic Payment System (SPEI) also managed by Banco de México are recognized as payment systems for purposes of the Payment Systems Law (*cf.* Banco de México publication in the Federal Official Gazette of January 7, 2011).

q. Post-Commencement Financing

The Insolvency Law provides a very poor framework for post-commencement financing. The debtor is entitled to obtain secured or unsecured post-commencement financing with the approval of the conciliator [LCM 75]. When the debtor obtains post-commencement financing for the management and operation of the estate, such financing will be considered a claim against the estate (*cf.* **16.c**) [LCM 224-II, III].

Post-commencement financing does not necessarily have to be obtained in the ordinary course of business, but will require conciliator approval if outside the ordinary course of business. Weil (2000)⁴⁶ provides an excellent illustration of the *ordinary course of business* issue in the context of post-commencement financing:

[T]he determination as to what constitutes a transaction in the ordinary course of the debtor's business is fact-specific and must be made on a case-by-case basis. For example, trade credit obtained by a debtor in possession in connection with the day-to-day operation of its business generally constitutes an ordinary course of business transaction. Monies advanced by the lender to fund the debtor's payroll and operating expenses typically are not regarded as credit obtained in the ordinary course of business.

While *en concurso*, the debtor is protected from the suspension of payments of only its pre-petition debts, so the payment of post-petition debts is not suspended (*cf.* **15.g**). This means that the debtor would not be found in contempt of court if it makes payments and repayments of post-petition debt. However, the stay of execution imposed by the *concurso* declaration applies broadly during the conciliation (*cf.* **15.h**), so a creditor will still encounter hurdles to collect a post-petition credit during conciliation in the absence of the debtor's cooperation.

ALI NAFTA (2003) argues that the legal and regulatory regime applicable to Mexican commercial banks makes post-commencement financing "extremely rare" in Mexico.⁴⁷

46 P. 200.

47 See Reporters' Note 8, pp. 106-108.

r. The Reorganization Plan

The purpose of the conciliatory stage is to reach a consensual reorganization plan [LCM 3, 148].

*Reorganization plans perform different functions in different types of proceedings. In some, the plan may be the tailpiece of the reorganization proceedings, dealing with the payout of a dividend in full and final settlement of all claims and the final structure of the business after the reorganization is complete.*⁴⁸

A reorganization plan is an agreement entered into by the debtor and the generality of creditors, which requires court confirmation to be effective. With the exception of certain labor- and tax-related claims, individual agreements entered into between the debtor and a creditor shall be null and void and will result in the creditor forfeiting its rights in the *concurso* [LCM 154].

i. Legal Nature

Very little is said about the legal nature of the reorganization plan in the Mexican legal regime. Most treatises analyze either non-Mexican insolvency laws or the repealed Law of Bankruptcies and Suspension of Payments.

The need to discuss the legal nature of a reorganization plan derives from its distinctive binding quality upon non-signing creditors, as an exception of the *res inter alios acta*, *aliis nec nocet nec prodest* principle or privity of contract doctrine (*cf.* **15.r.vi**).

Theories on the legal nature of the reorganization plan range from those that state that it has a contractual nature, to those that state that it has a procedural nature.

⁴⁸ UNCITRAL (2005), p. 209.

Contractual nature theories include (1) the concept of a forced consent on the dissenting minorities; (2) the concept of legal representation of the majorities; and (3) the theory of a joint pledge (*communio incidens pignoratitia*) on the estate. The first two derive from the third: as insolvency statutes assume all creditors have a joint pledge on the estate, acts related to its administration and disposition are determined by majorities and their decisions are therefore imposed on minorities.

Procedural nature theories state that (1) the plan's binding nature is the result of a judicial resolution; (2) the plan is a procedural contract; and (3) the plan constitutes a statutory obligation (a contractual obligation for the signing parties, and a statutory obligation for non-signing creditors).

Brunetti (1945)⁴⁹ and Rodríguez (1997)⁵⁰ provide an excellent and concise explanation of these theories and both conclude that the reorganization plan has a mixed nature (contractual and procedural). However, both authors differ on an important substantive point: whether the reorganization plan has relative or absolute effects; i.e., whether the reorganization plan affects (benefits) the debtor only, or the claim as a whole.

This is not just a theoretical issue. Whether a creditor could have a claim against a guarantor or co-obligor of the debtor for the full original claim, or for the claim as adjusted by the reorganization plan, would depend on the position taken. The answer could vary, depending on whether the creditor signed the reorganization plan. Arguably, a signing creditor would have a claim against a guarantor or co-obligor of the debtor for the claim as adjusted by the reorganization plan [CCF 1991, 2842, 2847] and may even risk losing the guaranty [CCF 2846, 2847].

However, the issue is not clear in the case of a non-signing creditor. Following Brunetti, the reorganization plan would have relative effects: The plan amounts to a *pacto de non petendo* between the creditor and the debtor only, which does not

49 Pp. 298-303.

50 Comment to LQSP 296.

extend to guarantors or co-obligors.⁵¹ That is, the guarantors and co-obligors would be bound by the original pre-petition terms.

In contrast, for Rodríguez, the reorganization plan would affect the claim as a whole, so the guarantor or co-obligor would enjoy the benefits afforded by the reorganization plan.⁵²

Unfortunately, neither Brunetti's or Rodríguez's comments refer to the Insolvency Law, nor are there any court precedents to assist in answering this question.

ii. Proposal

Only the conciliator has the authority to propose a reorganization plan [LCM 148]. So, while the conciliator may in fact solicit (or even get unsolicited) proposals from the debtor and/or creditors, it is ultimately the conciliator who will propose the plan. This is why the Insolvency Law does not address issues of exclusivity periods, multiple plan proposals and eventualities of the like, and does not impose any restrictions on the number of proposals or the number, timing or extent of changes that the conciliator is entitled to make to a proposed plan.

iii. Content

While the Insolvency Law includes precise rules as to the content of the restructuring plan, it provides liberty to the parties to determine the economic substance [LCM 153]. The Insolvency Law even allows restructured loans to be maintained in their original currency or unit of account instead of UDIs [LCM 159].

A reorganization plan must provide for (1) the payment regime for claims against the estate, singularly privileged claims and tax claims; (2) the payment regime for claims of secured creditors and priority creditors who do not sign the plan, with respect

51 Brunetti (1945), pp. 302, 319.

52 Rodríguez (1997), comment to LQSP 356.

to their corresponding collateral or privilege [LCM 153]; (3) the creation of sufficient reserves to pay the differences that could result from appealed claims and tax claims that are pending determination [LCM 153]; (4) with respect to claims of unsecured creditors that did not sign the plan, an extension of term and/or a haircut not larger than that applicable to the group of unsecured creditors who did sign the plan representing at least 30 percent of all unsecured claims [LCM 159].

iv. Acceptance

To become effective, a restructuring plan must be accepted (i.e., signed) by the debtor and creditors representing more than 50 percent of the sum of (1) all the debtor's unsecured claims (regardless of whether the holders of such claims have accepted the reorganization plan) plus (2) all the claims of the debtor's secured or priority creditors accepting the reorganization plan.

The plan shall be deemed accepted (conclusive presumption) by all those unsecured creditors whose claims are stated to be paid in full, subject to certain legal rules concerning quantification [LCM 158].

v. Court Approval and Veto

After receiving approval of a reorganization plan from the debtor and the required number of creditors, the conciliator must then submit the reorganization plan to the court for its own review and approval. Unsecured creditors are entitled to file objections or "veto" the reorganization plan for a set period of time. Following such period, the court would then approve the reorganization plan if it finds that the proposed plan meets all the statutory requirements and is not inconsistent with any public policy provision. The courts will not review the substance of the reorganization plan [LCM 161-164].

vi. Binding Effects

The reorganization plan, with the validation of the court, would become binding on (1) the debtor; (2) all unsecured creditors (regardless of whether or not they signed

the reorganization plan); (3) all signing secured and priority creditors; and (4) all secured and priority creditors whose claims are stated to be paid in full, subject to certain legal rules concerning quantification [LCM 165].

The fact that the reorganization plan can be imposed on non-signing parties is arguably the single most important aspect in favor of restructuring a debtor's debts through court-assisted reorganization procedures. Should the reorganization plan be binding only on signing parties, it would have been sufficient to do so out of court, without having to incur the delays and expenses of a judicial procedure. Of course, the benefits of a debtor declared *en concurso*, consisting of the stay of execution, suspension of payments, rejection of cumbersome contracts, etc., would not be afforded out of court during the restructuring negotiations.

s. Expedited Proceedings

One of the novelties of the 2007 amendments to the Insolvency Law was the introduction of expedited proceedings.

Reaching agreement through voluntary restructuring negotiations is often impeded by the ability of individual creditors to take enforcement action and by the need for unanimous creditor consent to alter the repayment terms of certain existing classes of debt. These problems are magnified in the context of complex, multinational businesses, where it is especially difficult to obtain consent from all relevant parties.... Voluntary restructuring negotiations can also be impeded by a minority of affected creditors who may refuse to agree to a solution that is in the best interests of most creditors in order to take advantage of their position to extract better terms for themselves at the expense of other parties (often referred to as "holding out"). Where these hold-outs occur, the voluntary agreement can only be implemented if the contractual rights of these dissenting creditors can be modified without their consent. Under most existing legal systems, such a modification of contractual rights requires the commencement of full reorganization proceedings under the insolvency law, involving all creditors and requiring satisfaction of the provisions of the insolvency law governing the conduct of such proceedings.... These difficulties, as well as some of the costs, delays and procedural and legal requirements often associated with full reorganization proceedings, can be avoided where

*voluntary restructuring negotiations and expedited reorganization proceedings are used. These proceedings can provide a cost-efficient means of resolving a debtor's financial difficulties....*⁵³

Prepackaged *concurso* proceedings avoid the visit stage and allow the debtor to request that the judge implement injunctive relief upon accepting the petition [LCM 340, 341].

The debtor may file for prepackaged *concurso* proceedings, *inter alia*, if the petition is signed by the debtor and creditors representing at least 40 percent of its outstanding debt, and if the petition is accompanied by a proposed plan, also signed by the debtor and creditors representing at least 40 percent of its outstanding debt [LCM 339].

If a debtor files a prepackaged *concurso* proceeding, it will not need to establish that it is insolvent (but will need to declare that its insolvency is imminent) and there is no need for the appointment of a visitor [LCM 339-III, 341].

The conciliator must take into consideration the proposed plan when preparing the restructuring plan [LCM 342].

16. Liquidation

*The type of proceeding referred to as "liquidation" is regulated by the insolvency law and generally provides for a public authority (typically, although not necessarily, a judicial court acting through a person appointed for the purpose) to take charge of the debtor's assets, with a view to terminating the commercial activity of the debtor, transforming non-monetary assets into monetary form and subsequently distributing the proceeds of sale or realization of the assets proportionately to creditors. Although generally requiring the sale or realization of assets to occur in a piecemeal manner as quickly as possible, some insolvency laws permit liquidation to involve the sale of the business in productive units or as a going concern....*⁵⁴

53 UNCITRAL (2005), pp. 238-239.

54 UNCITRAL (2005), p. 30.

If a debtor does not successfully complete the conciliation stage or, if the debtor so requests upon its voluntary petition, then it will be declared *en quiebra* and liquidated [LCM 167]. A *concurso* during conciliation can also be converted to liquidation if the conciliator considers that the debtor or the creditors are not willing to reach an agreement on a reorganization plan, or that it is impossible to reach an agreement on a reorganization plan [LCM 150].

The stated purpose of the liquidation stage is to liquidate the business, as a whole or by sale of its individual assets, to repay creditors [LCM 3].

The *quiebra* declaration results in the removal of management, and management of the debtor's enterprise would then be vested with the receiver [LCM 178]. The receiver would then proceed with the sale of the assets of the enterprise and the payment of the recognized claims pursuant to the statutory priority of payments.

a. Removal

The *quiebra* declaration will imply the outright removal of the debtor from the management of the enterprise [LCM 178].

i. Legal Nature

Theories on the legal nature of *removal* abound. Barrera (1998) provides an in-depth analysis of *removal* and is arguably the most comprehensive of Mexican treatises on the subject. Barrera (1998) distinguished between subjective, objective and other theories of *removal*.

Subjective theories include (1) the civil death theory; and (2) the civil incapacity theory. The civil death theory provides for a loss of all civil rights of a person (assumes that a debtor is, for all legal intents and purposes, deceased). The civil incapacity theory provides for a loss of all acting capacity of a debtor (treating it similar to a minor).⁵⁵

55 See Barrera (1998), pp. 44-48, and Brunetti (1945), p. 126.

Objective theories include (1) the attachment theory; (2) the pledge theory; and (3) the change in ownership theory. The attachment theory assimilates *removal* to the procedural attachment of assets. The pledge theory assumes that the creditors share a joint pledge (*communio incidens pignoratitia*) on the estate. The change in ownership theory states that the removal constitutes a change of title on the estate from the debtor to a third person (the creditors, the receiver or the government).⁵⁶

Other theories include (1) presumption of fraud theory; and (2) the devoted estate theory. The presumption of fraud theory states that all actions of the debtor with respect to the estate after the *quiebra* declaration are deemed fraudulent. The devoted estate theory considers that the estate, while still property of the debtor, is devoted to a specific purpose (i.e., payment to creditors).⁵⁷

The position that most closely resembles that adopted by the Insolvency Law has subjective and objective elements. From the debtor's point of view, upon the *quiebra* declaration, the debtor will have diminished capacity (*capitis deminutio*). While the *quiebra* declaration causes the debtor to lose its capacity to continue engaging in a commercial pursuit and to lose its capacity to manage its enterprise [CCOM 12-II, LCM 178], the debtor will continue managing its non-estate assets (*cfr.* **15.d.i-15.d.iii**) [LCM 179]. Since the debtor will not completely lose its acting capacity authority (as the civil incapacity theory suggests), but will lose some such authority, it is acceptable to state that the *quiebra* declaration will cause the debtor to suffer from diminished capacity.

From the estate point of view, the debtor will still own the estate, but the estate will be specifically devoted to the payment of claims [LCM 4-V]. The management and disposition of the estate, upon the *quiebra* declaration, is entrusted to the receiver [LCM 178]. These arguments are consistent with the devoted estate theory.

⁵⁶ See Barrera (1998), pp. 48-89, Brunetti (1945), pp. 126-127, and Rodríguez (1991), Book II, p. 298.

⁵⁷ See Barrera (1998), pp. 89, 91-92, Brunetti (1945), pp. 126-127, and Barrera (1958), pp. 324-330.

ii. Timing

Removal takes effect legally at the moment of the *quiebra* declaration [LCM 169-II, 178]. Once appointed, the receiver shall begin all occupation procedures, taking possession of all the debtor's assets and premises, books and records, and any other asset in the debtor's possession [LCM 180].

iii. Preservation Measures

Upon removal, all actions carried out by the debtor with respect to the estate without the receiver's written authorization shall be null and void, except to the extent that any such actions result in the benefit of the estate [LCM 192].

Payments made to the debtor after the *quiebra* declaration shall not release the payor if the payor knew of the *quiebra* declaration. It is conclusively presumed that the payor knew of the *quiebra* declaration if payment is made after the publication of the *quiebra* declaration in the *Federal Official Gazette*, or after the payor has participated in the *concurso* judicial file [LCM 193].

The Insolvency Law rebuttably presumes that all mail arriving at the domicile of the debtor's enterprise corresponds to the operations of the enterprise, so the receiver is authorized to receive and open such mail with no further need of authorization from the debtor [LCM 194]. This is a statutory exception to allow the receiver to open the debtor's mail without incurring a criminal offense [CPF 173-I].

The debtor has a duty to cooperate with the receiver, either by delivering possession and management of all assets of the estate or by presenting himself before the receiver [LCM 169-II, 195]. The conciliator shall also cooperate with the receiver in allowing him to take office and will deliver all the debtor's information that is in the conciliator's possession [LCM 173].

The judge has broad authority to take any and all judicial action required for the immediate occupation of assets [LCM 180].

iv. Procedure

The removal shall be conducted as per the following rules:

- Until the receiver takes office, the conciliator will continue performing his supervision and surveillance duties [LCM 181-I].
- As soon as the receiver takes office, he will immediately be provided with the debtor's inventories, properties, cash on hand, books, securities and other documents [LCM 181-II]. While the Insolvency Law is not clear, arguably, this duty corresponds to the debtor, the conciliator and any third party in possession of the debtor's assets.
- Any depositaries of the debtor's property will be ordered to immediately deliver such property to the receiver [LCM 181-III].
- Upon taking possession of the property, the receiver will immediately take the steps necessary to protect and preserve such property [LCM 183].
- Any sales of goods or services shall be made in the ordinary course of business [LCM 184].
- Any perishable goods and any instruments, the rights of which require an expeditious exercise, will be included in a list and delivered to the receiver, and any proceeds therefrom shall be delivered to the receiver in deposit [LCM 185]. It is completely unclear who is bound by this rule.
- The conservators and the debtor may participate in the removal procedures [LCM 182].
- Within 60 business days from the removal, the receiver must present to the judge (1) a report on the status of the debtor's accounting; (2) an inventory of the estate; and (3) a balance sheet as of the date of removal [LCM 190].

b. Recognition

The Insolvency Law provides for the allowance and prioritization of creditor claims and for the distribution of estate assets to be made in accordance with such priority.

Claims by creditors operate at two levels in insolvency proceedings—firstly, for purposes of determining which creditors may vote in the proceedings and how they may vote (according to the class into which they fall and the value of their claim, where that is a relevant factor) and, secondly, for purposes of distribution. The procedure for submission of claims and their admission is therefore a key part of the insolvency proceedings. Consideration should be given to determining which creditors should be required to submit claims and the types of claim that should be submitted. Those claims might include, for example, all rights to payment that arise from acts of omissions of the debtor prior to commencement of the insolvency proceedings, whether or not they are mature, liquidated or unliquidated, fixed or contingent. Consideration should also be given to the procedures applicable to the submission, verification and admission of claims, the consequences of failure to submit a claim and review of decisions concerning the admission of claims.⁵⁸

While creditor recognition is most relevant for liquidation, the process begins during the conciliatory stage and, if required, will continue through the liquidation stage [LCM 120, 177].

i. Allowable Claims

The Insolvency Law does not make a distinction and therefore it is generally accepted that all valid claims are subject to recognition. This means that recognition would include claims that are secured or unsecured, as well as claims of a civil (e.g., tort), commercial, administrative (e.g., taxes, fines), or labor nature. It would also include present claims as well as future claims originated pre-petition.

While the Insolvency Law is silent in this respect, arguably, unenforceable claims (e.g., gambling debts, claims for which the statute of limitations has lapsed, etc.) would not be recognized.

⁵⁸ UNCITRAL (2005), p. 249.

In connection with a natural person debtor, a claim arising from a non-gratuitous contract or from the payment of debts of the debtor held by his/her spouse or concubine shall not be recognized, as it is rebuttably presumed that the claim was assumed with, or the debt was paid from, assets of the debtor [LCM 126]. This principle is intimately related to the *musiana* presumption (*cf.* **15.k**).

There is no similar provision in the Insolvency Law disallowing related-party claims of an entity debtor. The only case in which the author knows such a disallowance was enforced is a recent case⁵⁹ involving a debtor applying for a prepackaged *concurso* claiming to have secured more than the required 40 percent of creditor consent (*cf.* **15.s**). In that case, the judge dismissed the petition, arguing that claims held by the debtor's subsidiaries should be disallowed. The debtor successfully appealed and reversed the dismissal. Those claims were disallowed only in the context of determining whether the debtor had access to a prepackaged *concurso* and not whether such claims are allowed or disallowed during the recognition process.

ii. Recognition Process

It is not mandatory for a creditor to submit a proof of claim for its claim to be recognized. However, any creditor that wishes to do so, may file a proof of claim with the conciliator (1) within 20 days (or 45 days, in the case of foreign creditors [LCM 291-I]) from the date of publication of the *concurso* judgment in the Federal Official Gazette; (2) within the term to object to the preliminary list of claims (see *infra*); and (3) within the term to appeal the judgment for allowance, categorization and ranking of credits (see *infra*) [LCM 122, 125].

Proofs of claim are to be made in the preprinted formats established by Ifecom, are to be filed with the conciliator and shall contain [LCM 125]:

⁵⁹ The prepackaged *concurso* of Vitro.

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- Creditor's complete name and domicile.
 - The amount of the claim against, and in favor of, the debtor.
 - The guaranties, terms and conditions and other characteristics, such as the type of documentary evidence of the claim.
 - The proposed ranking of the claim.
 - Sufficient data to identify any administrative, labor, judicial or arbitral procedure in connection with the claim.
 - Original or certified copies of the documentary evidence of the claim.

The recognition process involves the elaboration of two successive lists: a preliminary list, and a definitive list, both prepared by the conciliator [LCM 121, 130].

The conciliator will prepare the preliminary list of claims based on the debtor's accounting, the visitor's report, the proofs of claim filed by creditors and other information made available to the conciliator [LCM 121].

The preliminary list of claims must contain:

- A list of all tax and labor claims [LCM 124].
- The complete name and domicile of each creditor [LCM 128-I].
- The amount of each claim [LCM 128-II].
- The guaranties, terms and conditions and other characteristics, such as the type of documentary evidence of each claim [LCM 128-III].
- The proposed ranking of each claim [LCM 128-IV].

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- The reasons for the conciliator's proposal and justification of the differences between the preliminary list and the debtor's books and records or the creditors' proofs of claim [LCM 128].
 - A reasoned list of disallowed claims [LCM 128].
 - A list of documents that are the basis for the conciliator's proposal and a copy of such documents or indication of where they can be found [LCM 128].

The conciliator must present the preliminary list to the judge within 30 days of the date of publication of the *concurso* judgment in the Federal Official Gazette [LCM 121]. The judge will then make the preliminary list available to the debtor and the creditors for a five-day period, giving them the opportunity to object [LCM 129].

Within ten business days thereafter, the conciliator must prepare the definitive list of claims based on the preliminary list, the additional proofs of claim and the objections presented by the debtor and the creditors [LCM 130].

Within five business days thereafter, the judge shall enter judgment for the allowance, categorization and ranking of credits, as set forth on the definitive list [LCM 132].

The judgment for allowance, categorization and ranking of credits can be appealed by the debtor, any creditor, any conservator, the conciliator or the receiver and the Office of the Attorney General (only in the cases of *concursons* initiated by such Office) [LCM 136].

c. Ranking

While many creditors will be similarly situated with respect to the kinds of claims they hold based on similar legal or contractual rights, others will have superior claims or hold superior rights. For these reasons, insolvency laws generally rank creditors for the purposes of distribution of the proceeds of the estate in liquidation by reference to their claims, an approach not inconsistent with the objective of equitable treatment. To the extent that different creditors have struck different commercial bargains with the debtor, the ranking of creditors may be justified by the desirability for the insolvency system to recognize and respect the different bargains, preserve legitimate commercial expectations, foster

predictability in commercial relationships and promote the equal treatment of similarly situated creditors. Establishing a clear and predictable ranking system for distribution can help to ensure that creditors are certain of their rights at the time of entering into commercial arrangements with the debtor and, in the case of secured credit, facilitate its provision.⁶⁰

A clear ranking is important because no creditor from a lower ranking can be paid until all creditors of a higher ranking are paid in full [LCM 223]. The ranking of claims is not completely clear under the Insolvency Law. This is a possible interpretation of the full ranking:

1. Privileged labor claims [LCM 224-I].
2. Administrative claims [LCM 224-II].
3. Claims incurred to attend to the regular expenses in connection with the security, repair, conservation and management of the estate assets [LCM 224-III].
4. Claims for judicial or extrajudicial procedures for the benefit of the estate [LCM 224-IV].
5. Burial expenses [LCM 217-I, 218-I].
6. Terminal illness expenses [LCM 217-I, 218-II].
7. Secured claims [LCM 217-II, 219].
8. Labor and unsecured tax claims [LCM 221].
9. Priority claims [LCM 217-III, 220].
10. Unsecured claims [LCM 217-IV, 222].
11. Creditors of unlimited partners of the debtor, if their claims arose after the partner became an unlimited partner⁶¹ [LCM 228].

⁶⁰ UNCITRAL (2005), p. 267.

⁶¹ Claims of creditors of unlimited partners of the debtor, whose claims precede the date when the partner became an unlimited partner, shall be treated as other claims, depending on the respective ranking [LCM 228].

Some clarifications are in order:

- Claims described in Items 1, 2, 3 and 4 are referred to in the Insolvency Law as *claims against the estate* [LCM 224].
- Claims described in Items 5 and 6 are referred to in the Insolvency Law as *singularly privileged claims* [LCM 218].
- *Secured claims* referred to in Item 7 are those that are secured by a mortgage or a pledge. These claims are paid out of the proceeds of the property that have been collateralized against the mortgage or pledge, and generally in the order that the pledges or mortgages have been registered in accordance with applicable law [LCM 219].
- *Priority claims* referred to in Item 9 are those from creditors with a privilege or a retention right (e.g., a mechanics lien). These claims are paid out of the proceeds of the retained property and are generally paid in the order of privilege that has been registered in accordance with applicable law or by the date of the claims [LCM 220].
- *Unsecured claims* referred to in Item 10 are all others not otherwise specified. These claims collect proceeds of the estate on a *pro rata* basis [LCM 222].

d. Asset Liquidation

Value maximization and the preservation of a going concern are the overriding principles underlying asset liquidation [LCM 197].

Upon the *quiebra* declaration, the receiver will sell off the assets of the estate, and shall attempt to receive the highest return on the sale. If the sale of productive units allows for receiving the highest proceeds from the sale, the receiver must consider the advisability of keeping the enterprise as a going concern [LCM 197].

In principle, the sale must be carried out through public auction [LCM 198]. The receiver may employ different means of sale in the case of perishable goods [LCM 208] or, prior judicial authorization, if such alternative means of sale would yield a higher value for the asset in question [LCM 205].

The receiver may oppose the foreclosure on estate assets if he deems it is beneficial to the estate to sell those assets together with other unencumbered assets. To oppose foreclosure, the receiver must adequately compensate the secured creditor in question [LCM 214].

17. Termination, Rehabilitation and Discharge

Insolvency proceedings terminate (1) once a reorganization plan is entered into; (2) once all recognized creditors are paid in full; (3) once all creditors are paid with bankruptcy currency and there are no further assets in the estate; (4) if the estate is insufficient to cover the claims against the estate; and (5) at any time the debtor and all creditors agree to such termination or sign a reorganization plan [LCM 262].

Rehabilitation and *discharge* are two fundamental tools to guarantee individual debtors a “fresh start.” Unfortunately, the Insolvency Law does not specifically address the issue of *rehabilitation*. A debtor who is declared *en quiebra* loses its capacity to continue engaging in a commercial pursuit until it has been rehabilitated [CCOM 12-II]. Since the Insolvency Law does not contemplate the concept of *rehabilitation*, it is unclear whether a debtor will be able to engage in commerce after termination of the *concurso* proceedings.

Discharge is not only not contemplated in the Insolvency Law, it is rather disallowed: The Insolvency Law provides that once a *concurso* terminates, if not all recognized creditors have been paid in full, they will maintain a valid claim for the shortfall and, if the debtor assets are subsequently found, the *concurso* will be reopened to distribute those after-acquired assets [LCM 235, 264].

18. Cross-Border Cooperation

The stated purpose of the Model Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote, among others, the objective of cooperation between the courts and other competent authorities of the enacting state and a foreign state

involved in cases of cross-border insolvency.⁶² Berends (1998) provides a comprehensive and detailed analysis of the Model Law, to which the reader is encouraged to refer.

Mexico was one of the first countries to incorporate the Model Law, which became a specific chapter of the Insolvency Law.

a. Scope of Application

The cross-border cooperation provisions of the Insolvency Law shall apply to cases in which (1) assistance is sought in Mexico by a foreign court or a foreign representative in connection with a foreign proceeding; (2) assistance is sought in a foreign state in connection with a Mexican *concurso*; (3) a foreign proceeding and a Mexican *concurso* with respect to the same debtor are taking place concurrently; and (4) creditors or other interested persons in a foreign state have an interest in requesting the commencement of, or participation in, a Mexican *concurso* [LCM 278].

b. Interpretation

The Insolvency Law recognizes the international origin of the cross-border cooperation provisions and the need to promote uniformity in its application and the observance of good faith [LCM 285].

c. Definitions

The Insolvency Law assigns to the terms *foreign proceeding*, *foreign main proceeding*, *foreign non-main proceeding*, *foreign representative*, *foreign court*, and *establishment* substantially the same meanings afforded to the same concepts in the Model Law [LCM 279, UML 2]:

⁶² Preamble of the Model Law.

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- A *foreign proceeding* is a collective judicial or administrative proceeding in a foreign state, including an interim proceeding, pursuant to a law relating to insolvency, in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation [LCM 279-I].
 - A *foreign main proceeding* is a foreign proceeding taking place in the state where the debtor has its center of main interests [LCM 279-II]. Mexico provides substantially the same rebuttable presumption as the Model Law, that the debtor's registered office, or habitual residence in the case of an individual debtor, is the center of the debtor's main interests [LCM 295, UML 16.3].
 - A *foreign non-main proceeding* is a foreign proceeding taking place in a state where the debtor has an establishment [LCM 279-III].
 - A *foreign representative* is a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding [LCM 279-IV]. It is worthy of note that the Insolvency Law implicitly assumes that a foreign representative and a debtor have conflicting interests. In contrast, in known US Chapter 15 cases,⁶³ the foreign representative was affiliated with the Mexican debtor.
 - A *foreign court* is a judicial or other authority competent to control or supervise a foreign proceeding [LCM 279-V].
 - An *establishment* is any place of operation where the debtor carries out a non-transitory economic activity with human means and goods or services [LCM 279-VI].

63 *E.g.*, the Chapter 15 cases of *Corporación Durango*, *Metrofinanciera*, *Controladora Comercial Mexicana*, *Compañía Mexicana de Aviación* and *Vitro*.

d. Limits

The application of the cross-border cooperation provisions (1) are subordinate to (x) the principles of public policy of Mexico [LCM 283], and (y) the provisions in international treaties; and (2) are subject to international reciprocity [LCM 280, 283].

The Model Law also contemplates a public policy exception to its application [UML 6]; however, it is expressed as being *manifestly contrary to the public policy of this* [enacting] *State*. The Insolvency Law's exception is broader, as it covers anything contrary to the other provisions of the Insolvency Law or, in any manner (not *manifestly*), to the fundamental principles of law prevailing in Mexico.

The supremacy of international treaties is consistent with the current regime in Mexico. Recent binding court precedents confirm the supremacy of treaties. For example:

INTERNATIONAL TREATIES. THEY CONSTITUTE AN INTEGRAL PART OF THE SUPREME LAW OF THE UNION AND ARE HIERARCHICALLY LOCATED ABOVE THE GENERAL LAWS, FEDERAL AND LOCAL. INTERPRETATION OF ARTICLE 133 OF THE CONSTITUTION.

*The systemic interpretation of Article 133 of the Political Constitution of the United Mexican States allows the identification of the existence of a superior legal order, of national character, integrated by the Federal Constitution, the international treaties and the general laws. As well, derived from such interpretation, harmonized with the principles of international law contained in the constitutional text, as well as the fundamental rules and premises of this branch of law, it is concluded that the international treaties are hierarchically located below the Federal Constitution and above the general laws, federal and local, to the extent to which the Mexican State, upon subscribing them, becomes bound before the international community, pursuant to the provisions of the Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations and, as well, taking into consideration the fundamental principle of consuetudinary international law *pacta sunt servanda*. These obligations cannot be ignored, invoking rules of internal law, which, if breached, entail a liability of international nature.*

Conditioning the application of cross-border cooperation provisions to international reciprocity is a novelty of the Insolvency Law, as it is not found in the Model Law. Reciprocity can be defined as *the term attributed to the custom of a state granting another state a like treatment to the one the former receives from the latter, in a specific issue of international cooperation*.⁶⁴ The reciprocity requirement can be seen from two different angles: (1) positive (or specific) reciprocity; or (2) negative (or diffuse) reciprocity. Positive (or specific) reciprocity would require an enacting state to have affirmative evidence of reciprocity from another state; while negative (or diffuse) reciprocity would require absence of evidence that another state would refuse reciprocity.

Given Mexico's international cooperation tradition in other areas, it is reasonable to conclude that the position Mexico has taken adheres to the negative (or diffuse) reciprocity test. That is, the cross-border cooperation provisions would apply and Mexico would recognize a foreign proceeding and grant a foreign representative access to Mexican courts and proceedings, etc., unless there is evidence that another state would not recognize a Mexican *concurso* and grant a Mexican representative access to its courts and proceedings, etc. ALI Mexico (2003) considers that reciprocity would exist regarding states that incorporate the Model Law into their legal systems.⁶⁵ An unrelated precedent illustrates Mexico's position in connection with reciprocity, taking a negative (or diffuse) reciprocity position:

INHERITANCE. WHOEVER INTENDS TO EXCLUDE A FOREIGN-BORN INDIVIDUAL SUCCESSOR HAS THE BURDEN TO PROVE FOREIGN LAW AND LACK OF RECIPROCITY.

According to Article 86 bis of the Federal Code of Civil Procedures and 284 bis of the Code of Civil Procedures for the Federal District, the party invoking the application of foreign law must invoke it. Lack of international reciprocity cannot derive from scattered provisions of foreign law, therefore it is insufficient to simply gather a partial copy of a foreign civil code; likewise,

64 IIJ (2002), p. 53, Book VI.

65 P. 309.

[plaintiff] must submit a certification from the Mexican Ministry of Foreign Affairs showing the lack of reciprocity amongst the governments of Mexico and of the other country [with respect to the laws] that determine that the possibility that Mexican nationals may inherit from a foreign national and vice versa, according to the relevant laws in force on both states, in terms of the provisions of Article 1313-IV of the Civil Code for the Federal District; [plaintiff] must also submit expert testimony from licensed legal experts from the place where such foreign law governs to the effect of establishing the form of application of extranational laws and, since that evidentiary burden was not met, the foreign national shall not be excluded as a successor.

e. National Treatment

Foreign creditors are afforded the same treatment as Mexican creditors regarding the commencement of, and participation in, *concurso* proceedings, and their claims will not be ranked in a manner different than the claims of a Mexican creditor, except that the claims of a foreign creditor will not be ranked lower than unsecured claims (*cf.* **16.c.10**) [LCM 290]. It is worth noting that the Model Law provides alternative language permitting an enacting state to disallow the recognition of foreign tax and social security claims [UML 13(2) fn 2]. The Insolvency Law adopts the default provision and therefore does not automatically disallow the recognition of foreign tax and social security claims.

Under the Insolvency Law, whenever notification is to be given to creditors in Mexico, such notification shall also be given to the known creditors that do not have addresses in Mexico. The judge may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known. Such notification shall be made to the foreign creditors individually, unless the judge considers that, under the circumstances, some other form of notification would be more appropriate. No letters rogatory or other similar formality is required [LCM 291].

f. Enabling and Access

The rules of enabling and access relate to (1) what a “domestic representative”⁶⁶ is entitled to perform abroad (for “outbound” cases); and (2) what a foreign representative is entitled to perform in the enacting state (for “inbound” cases).

The Insolvency Law enables the visitor, conciliator and receiver to act in a foreign state on behalf of a Mexican *concurso*, as permitted by applicable foreign law [LCM 282].

Any foreign representative is entitled to apply directly to the courts in Mexico, subject to the other provisions of the Insolvency Law [LCM 286].

A foreign representative is entitled to apply to commence a *concurso* in Mexico pursuant to the Insolvency Law if the conditions to commence such *concurso* are otherwise met [LCM 288]. Upon recognition of a foreign proceeding, the foreign representative is entitled to participate in any Mexican *concurso* pertaining to the debtor [LCM 289].

The sole fact that an application pursuant to the cross-border cooperation provisions of the Insolvency Law is filed with a Mexican court by a foreign representative does not subject the foreign representative or the foreign assets and affairs of the debtor to the jurisdiction of Mexican courts for any purpose other than the application [LCM 287].

g. Recognition

i. Application

A foreign representative may apply to the Mexican court for recognition of the foreign proceeding in which the foreign representative has been appointed. An application

⁶⁶ The term *domestic representative* is not contained in either the Model Law or the Insolvency Law. It is used here for convenience when referring to the person or body administering a reorganization or liquidation under the law of the enacting state.

for recognition shall be accompanied by (1) a copy certified by the foreign court of the decision commencing the foreign proceeding and appointing the foreign representative; (2) a certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative; or (3) in the absence of the foregoing, any other evidence acceptable to the judge of the existence of the foreign proceeding and of the appointment of the foreign representative. In addition, the application shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative and must identify the debtor's domicile for service of process [LCM 292].

The judge shall require a Spanish translation of documents supplied in support of the application for recognition that are in a language other than Spanish [LCM 292].

ii. Procedure

The recognition procedure will be carried out as an ancillary procedure between the foreign representative and the debtor, together with the visitor, conciliator or receiver, as the case may be [LCM 292, 294]. It is unlikely that at the point in time when recognition of a foreign proceeding is being sought, a visitor, conciliator or receiver has been appointed. This would only occur in the case when a Mexican *concurso* of the same debtor is already under way.

If the debtor has an establishment in Mexico, the recognition procedure shall be carried out in the same manner in which a demand for *concurso* would be sought with respect to a debtor in Mexico. That is, once admitted, the process would begin with the visit to determine that the commencement standards were met, etc. [LCM 293]. A recent binding precedent confirms this position:

INSOLVENCY LAW. CONDITIONS FOR THE RECOGNITION OF A FOREIGN PROCEEDING IN MEXICO.

From a systematic and harmonic interpretation of Articles 293 and 294 of Title Second of the Insolvency Law, relative to international cooperation, in accordance with Articles 29,

30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40 and 41 contained in Chapter IV of Title First of such [Insolvency] Law, it is inevitably concluded that the legislator foresaw two cases for recognition of foreign proceedings: the first, when the foreign proceeding to be recognized refers to a debtor that has an establishment in Mexico, a case in which it is effectively required that the concurso of such debtor begins in accordance with the Insolvency Law and, once the confirmatory visit provided in such [Insolvency] Law is carried out, the concurso judgment is passed and at that same time the foreign proceeding is recognized. That is, the recognition of a foreign proceeding of a debtor that has an establishment in Mexico assumes the need to open the concurso of such debtor under which the verification visit must be carried out, judgment is passed declaring the debtor *en concurso*, and then the foreign proceeding is recognized....

This is probably the main obstacle presented by the Insolvency Law, which completely neutralizes all benefits of the Model Law for expedited recognition. Basically, a recognition procedure is converted into a main proceeding with all the costs and delays associated with it. It is hard to understand why Mexico took this position when drafting the cross-border cooperation provisions.

iii. Recognition

A foreign proceeding will be recognized (1) as a foreign main proceeding, if it is taking place in a state where the debtor has the center of its main interests; or (2) as a foreign non-main proceeding, if the debtor has an establishment in the foreign state [LCM 296].

It is worth noting that the Insolvency Law failed to incorporate UML 17(3), which states that *[a]n application for recognition of a foreign proceeding shall be decided upon at the earliest possible time*. This omission reinforces the argument that the Insolvency Law has completely neutralized the benefits of the Model Law for expedited recognition (*cf.* 18.g.ii).

h. Relief

Relief is available (1) upon application for recognition of a foreign proceeding and (2) once recognition is granted.

i. Upon Application for Recognition

Upon application for recognition, the foreign representative may request that the judge grant temporary relief [LCM 298]. The main characteristics of this type of relief are that:

- Relief is subject to request from the visitor, conciliator or receiver at the request of the foreign representative. The Model Law allows the foreign representative to request relief directly from the judge. This is another flaw in the cross-border cooperation provisions of the Insolvency Law.
- The judge may grant or deny relief.
- Relief is temporary.

The types of relief that may be granted include:

- Staying execution against the debtor's assets.
- Entrusting the administration of all or part of the debtor's assets located in Mexico to the person designated by Ifecom (including the foreign representative), to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy.
- Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities.
- Entrusting the administration or realization of all or part of the debtor's assets located in Mexico to the foreign representative or the visitor, conciliator or receiver.
- Granting any additional relief that may be available to the visitor, conciliator or receiver under the laws of Mexico.

ii. Once Recognition Is Granted

Once recognition of a foreign proceeding is granted, there are two types of relief: automatic, and non-automatic.

Automatic relief is available only if the foreign proceeding is recognized as a foreign main proceeding. Automatic relief includes [LCM 299]:

- Staying execution against the debtor's assets.
- Suspending the right to transfer, encumber or otherwise dispose of any of the debtor's assets.

The Model Law also provides that automatic relief shall include a stay in the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities [UML 20(1)(a)]. The Insolvency Law does not grant this measure, which is consistent with the fact that individual proceedings are not stayed as a result of a *concurso* declaration (*cf.* **15.h**).

Non-automatic relief can be granted upon recognition, regardless of whether the foreign proceeding was recognized as a foreign main proceeding or a foreign non-main proceeding. Non-automatic relief is subject to request from the visitor, conciliator or receiver at the request of the foreign representative. The Model Law allows the foreign representative to request relief directly from the judge. Non-automatic relief includes [LCM 300]:

- Staying execution against the debtor's assets.
- Suspending the right to transfer, encumber or otherwise dispose of any of the debtor's assets.
- Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities.
- Entrusting the administration or realization of all or part of the debtor's assets located in Mexico to the foreign representative or the visitor, conciliator or receiver.

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- Extending any previously granted relief.
 - Granting any additional relief that may be available to the visitor, conciliator or receiver under the laws of Mexico.

Upon recognition of a foreign proceeding, whether main or non-main, the judge may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in Mexico to the foreign representative or another person designated by Ifecom, provided that the judge is satisfied that the interests of creditors in Mexico are adequately protected [LCM 300].

Upon recognition of a foreign proceeding, the foreign representative has standing to request that the visitor, conciliator or receiver initiate asset recovery or avoidance actions [LCM 302]. The Model Law provides that the foreign representative has standing to initiate these actions directly [UML 23(1)], and not through a "domestic representative."

The cross-border cooperation provisions will not limit the Mexican judge, Ifecom, or the visitor, conciliator or receiver from providing additional assistance to a foreign representative under other laws of Mexico [LCM 284].

i. Cooperation and Coordination

The judge, visitor, conciliator and receiver shall cooperate to the maximum extent possible with foreign courts or foreign representatives in matters of cross-border insolvencies. The judge, visitor, conciliator and receiver are entitled to communicate directly with foreign courts or foreign representatives, with no need of letters rogatory or other formalities [LCM 304].

Cooperation may be implemented by any appropriate means, including: (1) appointment of a person or body to act at the direction of the judge, visitor, conciliator or receiver; (2) communication of information by any means considered appropriate by the judge, visitor, conciliator or receiver; (3) coordination of the administration and supervision of the debtor's assets and affairs; (4) approval or implementation by courts of agreements

concerning the coordination of proceedings; and (5) coordination of concurrent proceedings regarding the same debtor [LCM 305].

In the case of concurrent proceedings, the Insolvency Law has adopted the principles of Articles 29 and 30 of the Model Law [LCM 306-308]. Berends (1998) summarizes these principles with the following three rules:⁶⁷

- (1) Effects of a foreign proceeding must always be adjusted to the effects of a local proceeding.
- (2) Effects of a foreign non-main proceeding must always be adjusted to the effects of a foreign main proceeding.
- (3) Effects of more than one non-main proceeding must be adjusted to each other.

Finally, the Insolvency Law has adopted the Model Law's *hotchpot rule*:

Article 310. Without prejudice to secured claims or rights in rem, a creditor who has received part payment in respect of its claim in a proceeding pursuant to a law relating to insolvency in a foreign state may not receive a payment for the same claim in a proceeding under this [Insolvency] Law regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received.

To summarize, while Mexico has made an attempt to incorporate the Model Law with minor modifications, some of the adjustments substantially impair the benefits intended by the Model Law. These impairing modifications include: (1) Mexico demands reciprocity in the granting of international cooperation; (2) the foreign representative is not entitled to directly initiate avoidance actions; (3) the recognition of a foreign proceeding of a foreign debtor having an establishment in Mexico, rather than resulting in an expeditious process, is subject to the meeting of commencement standards and the visit stage; and (4) the foreign representative is not entitled to request provisional relief directly from the Mexican courts.

⁶⁷ Berends (1998), p. 387.

PART III

Special Insolvencies

The Insolvency Law provides for three special cases of insolvency: (1) public service concessionaires; (2) banks; and (3) non-bank financial sector firms. Only the insolvency of concessionaires and non-bank financial sector firms is addressed in this part of the book. Bank insolvency is addressed in **Part IV**.

19. Public Service Concessionaires

A concession is an *[administrative] act through which a private individual [or entity] is granted [1] the management and exploitation of a public service or [2] the exploitation and benefit of property of the state.*⁶⁸ Concessionaires subject to differentiated treatment under the Insolvency Law include only those with a concession of the first kind (i.e., a concession for the management and exploitation of a public service).

The insolvency of a debtor providing a federal, state or municipal public service under a concession is regulated by (1) its concession title; (2) the special laws and regulations governing the public service in question; and (3) the Insolvency Law to the extent that it does not oppose the concession title or the special laws and regulations [LCM 238].

The governmental entity that granted the respective concession can give suggestions to the judge in all matters relating to the appointment, removal and replacement of the conciliator and the receiver, and can appoint a manager of the enterprise [LCM 240, 241]. The appointment of an enterprise manager is different from the removal of the debtor (*cfr.* **16.a**); however, the practical difference is not evident in the Insolvency Law.

Any proposed reorganization plan to be executed by the debtor and its creditors must be made known to the concession grantor, who shall have the authority to veto the proposed plan [LCM 242].

⁶⁸ Fraga (1991), p. 242.

20. Non-bank Financial Sector Firms

Due to recent amendments to the Mexican financial laws, it is not completely clear which entities qualify for differentiated treatment under the Insolvency Law afforded to non-bank financial sector firms. One line of interpretation suggests that the concept only includes bonded warehouses,⁶⁹ but it can be further expanded to include most entities subject to the supervision of the National Banking and Securities Commission, or CNBV. This broader concept would also include credit unions, foreign exchange houses, limited-scope financial companies (or sofoles), and regulated (and even unregulated) multiple-scope financial companies (or sofomes).

CNBV is entitled to demand the *concurso* of a non-bank financial sector firm and shall have an active role in the process [LCM 255]. CNBV can give suggestions to the judge in all matters relating to the appointment, removal and replacement of the conciliator and the receiver [LCM 259].

CNBV may also request that the proceeding commence in the liquidation stage, or that the process is converted to liquidation at any point during the conciliatory stage [LCM 258].

CNBV shall intervene in the asset sales program proposed by the receiver [LCM 261].

⁶⁹ And, until the passing of a transition period ending in 2013, the concept would also include certain financial lessors and factoring companies that do not opt out of a regulatory regime. Thereafter, all these financial lessors and factoring companies will not be included.

PART IV

Administrative Resolution of Banks⁷⁰

As a result of the 2008 – 2010 worldwide financial crisis, the issues surrounding bank insolvency have taken on new speed. The situation is fluid and the legal framework can change at any moment. For example, the Basel Committee on Banking Supervision recently published many of the “Basel III” rules for the new global capital and liquidity standards for banks, the United States recently passed the Dodd-Frank Wall Street Reform and Consumer Protection Act and Mexico is discussing a new bill of law to regulate the insolvency of banks and other financial system firms.

21. Introduction

Bank insolvency merits a specifically devoted portion of this book due to the complexity of its regulation. There is ample discussion on the importance of banks having a special insolvency treatment. One of the exponents, Hüpkes (2003), devotes a whole paper to the subject and sets forth the following reasons why banks should have a special insolvency treatment:⁷¹

Why should banks be accorded special treatment in insolvency? The common answer is that banks play a special role in a country's economy in that, collectively, their functions are so important as to constitute a sort of public service. In order to justify this special attention, reference is commonly made to three characteristic functions of banks:

- *First, banks typically hold highly liquid liabilities in the form of deposits that are repayable at par on demand. On the asset side, they generally hold long-term loans that may be difficult to sell or borrow against on short notice. Under normal circumstances, this mismatch of maturity does not pose a major problem: Whereas withdrawals are subject to the law of large numbers, loans will be held until maturity and repaid at face value. A bank's required capitalization covers the risk of loan loss, and a cushion of liquid assets ensures its ability to cover withdrawals in normal times.*

70 Mexican banks are either (1) commercial banks or (2) state-owned national development institutions [LIC 2]. Unless the context requires otherwise, reference herein to “banks” shall be deemed to be made to commercial banks only. State-owned national development institutions are governed by the Banking Law and their respective organic laws [LIC 30], and the resolution regime applicable thereunder could defer from the one applicable under the Banking Law.

71 Hüpkes (2003), pp. 2-3 (footnotes omitted).

If, however, something happens to disturb confidence in the bank's ability to meet its payment obligations, massive withdrawals of deposits risk causing liquidity problems and may threaten the bank's solvency.

- *Second, banks perform financial services that are fundamental to the functioning of an economy, such as the extension of credit, the taking of deposits and the processing of payments. Despite the complementary role of capital markets in the credit intermediation process and their capacity to mobilize capital, banks remain the primary source of liquidity for most financial and non-financial institutions. They provide direct and standby sources of credit and liquidity to the economy of a country, either by supplying money in the form of loans or by providing guarantees in the form of loan commitments.*
- *Third, banks constitute the transmission belt for monetary policy, that is, the linkage between the monetary policy process and the economy.*

22. Three Pillars

There are three pillars in a bank insolvency: (1) protection of interests of depositors; (2) soundness of the payment system; and (3) prevention of systemic risk. Oftentimes these three pillars are in conflict with each other and require compromises from lawmakers and regulators.

The legal framework for bank insolvency goes beyond the rules of administrative resolution and includes preventive and remedial tools. Preventive tools are directed to prevent a bank from insolvency and include capitalization requirements (*cf.* **24**), asset allocation and risk management rules, deposit insurance and payment systems rules (*cf.* **15.p**). It is beyond the scope of this book to address these measures. Remedial tools are those directed to resolving the case of a bank that encounters insolvency, and these are addressed in this part of the book.

23. Commencement Standards for Banks

Administrative measures are subject to both the balance sheet test and the liquidity test (*cf.* **11.a**). These are triggered when (1) a bank's capitalization index (*cf.* **24**) falls below 8 percent [LIC 28-V]; (2) the bank defaults under one minimum corrective measure, defaults under more than one special additional corrective measure or repeatedly defaults under one special additional corrective measure (*cf.* **25**) [LIC 28-IV]; or (3) the bank [x] defaults under obligations worth more than 20 million UDIs [A] deriving from loans from another bank, a foreign financial institution or Banco de México or [B] deriving from securities deposited with a securities clearing system; or [y] for two business days or more, with respect to obligations worth more than 2 million UDIs, [A] fails to pay balances resulting from compensation processes or fails to honor three or more checks or [B] fails to pay at two or more bank branches deposit withdrawals from 100 or more depositants [LIC 28-VI].

Administrative measures include (1) subjecting the bank to operation under a conditioned operation regime; or (2) resolving the bank. The type of bank resolution technique would depend on whether the bank in question is systemically important. Systemically important banks would be subject to healing or purchase-and-assumption techniques. Non-systemically important banks are subject to liquidation.

24. Capitalization Index

Banks must have certain minimum levels of capital [LIC 50]. Capital requirements concern both the minimum equity capital and the net capital a bank must have. Equity capital is an absolute number, and its level depends on the scope of activities of the bank. Net capital is divided between basic capital and additional capital (similar to Tier I and Tier II under Basel I), and its required level depends on the level of risk-adjusted assets of the bank.⁷² The level of net capital relative to risk-adjusted assets is referred to as the capitalization index, or ICAP [LIC 134 bis].

⁷² Rules on capital requirements for banks, issued by the Ministry of Finance.

Capitalization is an important indicator of a bank's financial health, a reduction of which, depending on its level, could (1) trigger "early warnings"; (2) entitle the bank to apply for a conditioned operation regime; or (3) subject the bank to a resolution process.

25. Early Warning

Once a bank's ICAP falls below 10 percent, such bank will be subject to minimum corrective measures or special additional corrective measures, depending on the bank's actual level of ICAP.

Minimum corrective measures include notifying the board of directors; submitting to CNBV a recapitalization program; suspending payment of dividends, interests of hybrid instruments and bonuses; and refraining from making capital investments.

Special additional corrective measures include hiring external auditors; refraining from increasing compensation and entering into certain types of transactions; substituting officers, directors and auditors; carrying out transactions to reduce exposure to risk; and amending deposit-taking policies.⁷³

26. Conditioned Operation

A bank with an ICAP below 8 percent (but higher than 4 percent) may apply to operate under a conditioned operation regime. To have access to the conditioned operation regime, the bank shall (1) request so to CNBV; (2) cause at least 75 percent of its shares to be placed in a trust; and (3) present a recapitalization plan [LIC 29 bis 2, 29 bis 3].

The trust referred to in (2) above shall allow the Institute for the Protection of Bank Savings, or IPAB, to exercise economic and corporate rights of those shares if (1) CNBV disapproves the recapitalization plan; (2) CNBV determines that the bank has defaulted under the approved recapitalization plan; (3) the bank's ICAP falls to or below 4 percent; or (4) the bank meets any of the commencement standards mentioned in subparagraphs (2) or (3) of **Section 23** above [LIC 29 bis 4].

⁷³ Rules on Article 134 bis of the Banking Law.

27. Resolution Alternatives and Systemic Importance

The Financial Stability Committee, or CEF, formed by high-ranking officers from the Ministry of Finance, or SHCP, along with Banco de México, CNBV and IPAB, is entrusted with determining whether a bank is systemically important and what percentage of the bank's non-IPAB-insured liabilities are susceptible to systemic repercussions. A bank shall be systemically important if failure of such bank to meet its obligations would (1) generate serious negative effects in other banks or other financial system firms in such a manner that it puts their stability or solvency in peril, if such an event would affect the stability or solvency of the financial system; or (2) jeopardize the functioning of the payment system [LIC 29 bis 6, 29 bis 8].

A bank that meets the commencement standards (*cf.* **23**) would be subject to resolution. The type of bank resolution technique would depend on whether the bank in question is systemically important. Non-systemically important banks are subject to winding up and, if applicable, liquidation. Systemically important banks would be subject to bank restructuring or purchase-and-assumption techniques. Bank restructuring is available if the CEF determines that 100 percent of the bank's non-IPAB-insured liabilities are susceptible to systemic repercussions, and purchase-and-assumption techniques are available if the CEF determines that less than 100 percent of the bank's non-IPAB-insured liabilities are susceptible to systemic repercussions [LIC 122 bis].

28. Winding Up and Liquidation

A bank would be wound up if (1) the bank meets any commencement standard; and (2) the CEF does not make a determination that the bank is systemically important [LIC 122 bis-I]. Winding up is also available in the case of voluntary winding up and in the case of revocation of the bank's license for reasons unrelated to insolvency, which are not addressed herein.

A bank would be declared *en concurso* if it meets the commencement standards otherwise applicable to non-bank debtors (*cf.* **11**).

The winding up of a bank and its *concurso* shall be carried out pursuant to the following special rules, in addition to the general rules applicable to non-bank debtors:

- Only IPAB or CNBV are entitled to demand the *concurso* [LIC 122 bis 16-II; LCM 246].⁷⁴
- IPAB shall be named as the liquidator or receiver [LIC 122 bis 16-I].
- The *concurso* of a bank shall begin in the liquidation stage [LCM 249].
- In the case of the *concurso* of a bank, the bank shall close all of its branches and suspend entering into new transactions [LCM 246].
- IPAB shall pay all IPAB-insured obligations of the bank [LIC 122 bis 17].
- The bank's non-IPAB-insured obligations:
 - Shall be stayed [LIC 122 bis 16-III].
 - Shall become due [LIC 122 bis 21-I].
 - If unsecured, shall be converted into pesos⁷⁵ and shall cease accruing interest [LIC 122 bis 21-II-III].
 - If secured, shall be maintained in their original currency or unit of account and shall continue accruing interest to the extent covered by the collateral [LIC 122 bis 21-IV].

⁷⁴ It is unclear whether the *concurso* of a bank can be initiated through the bank's petition or only as a result of demand from IPAB or CNBV.

⁷⁵ It is unclear whether, as a result of a bank's *concurso*, its non-IPAB-insured obligations are converted into pesos (as a result of the application of the LIC) or into UDIs (as a result of the application of the LCM).

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- If subject to a condition precedent, the condition shall be deemed as never occurred [LIC 122 bis 21-V]. Therefore, the claim shall be deemed not to exist.⁷⁶
 - If subject to a condition subsequent, the condition shall be deemed as occurred, that is, the claim shall be extinguished [CCF 1940]; however, the parties shall not be entitled to a refund of any consideration paid during the pendency of the condition [LIC 122 bis 21-VI].
 - IPAB is entitled to carry out purchase-and-assumption (*cf.* **30**) or other transactions it considers to be the best alternative to the interests of the depositors in light of the circumstances [LIC 122 bis 25], subject to the *lesser cost* rule [LIC 122 bis 26]. The *lesser cost* rule implies that the cost of implementing an alternative should be lower than the cost of paying IPAB-insured liabilities [LIC 122 bis 26].

29. Bank Restructuring

A bank would be subject to bank restructuring if (1) the bank meets any commencement standard (*cf.* **23**); and (2) the CEF determines that [x] the bank is systemically important and [y] 100 percent of the bank's non-IPAB-insured liabilities are susceptible to systemic repercussions [LIC 122 bis-II].

The type of bank restructuring would depend on whether the bank elected to be subject to the conditioned operation regime (*cf.* **26**). A bank that elected to be subject to the conditioned operation regime would be subject to bank restructuring through support, whereas a bank that did not elect to be subject to the conditioned operation regime would be subject to bank restructuring through loans [LIC 122 bis II-a].

a. Bank Restructuring Through Support

Bank restructuring through support is available if (1) the bank [x] meets any commencement standard, and [y] is subject to the conditioned operation regime; and (2) the CEF determines that [x] the bank is systemically important and [y] 100 percent of the bank's non-IPAB-insured liabilities are susceptible to systemic repercussions [LIC 122 bis 2].

⁷⁶ Borja (1991), pp. 395-399.

Bank restructuring through support is carried out in the following fashion:

- The bank shall offset all positive shareholders' equity accounts (other than corporate capital) against all negative shareholders' equity accounts [LIC 122 bis 3-I].
- The bank shall then apply losses against the corporate capital [LIC 122 bis 3-II].
- The bank shall increase its corporate capital to the extent required for its ICAP to reach 8 percent [LIC 122 bis 3-II].
- IPAB shall subscribe and pay for such capital increase [LIC 122 bis 3-III].
- IPAB shall offer those shares to the shareholders of the bank that placed their shares in trust (*cf.* **26(2)**) [LIC 122 bis 3-III].
- Thereafter, if any shares remain unsold, IPAB shall sell (and cause the trust referred to in **26** to sell) all of the shares of the bank [LIC 122 bis 4, 122 bis 5].

b. Bank Restructuring Through Loans

Bank restructuring through loans is available if (1) the bank [x] meets any commencement standard, and [y] is not subject to the conditioned operation regime; and (2) the CEF determines that [x] the bank is systemically important and [y] 100 percent of the bank's non-IPAB-insured liabilities are susceptible to systemic repercussions [LIC 122 bis 7].

Bank restructuring through loans is carried out in the following fashion:

- CNBV shall cause the intervention of the bank, through an intervenor appointed by IPAB [LIC 138, 139].
- IPAB shall make a 15-day loan to the bank in the amount required for the bank's ICAP to reach 8 percent [LIC 122 bis 7]. The loan (1) shall be secured by all the bank's shares; and (2) may be repaid only out of proceeds from an increase of the bank's corporate capital [LIC 122 bis 8].

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- The bank shall increase its corporate capital to the extent required to repay the loan and allow its ICAP to remain at 8 percent [LIC 122 bis 9]. Only then-current shareholders of the bank shall be allowed to subscribe for the capital increase [LIC 122 bis 10].
 - If insufficient corporate capital is subscribed and paid so that the IPAB loan remains outstanding, IPAB shall adjudicate the shares at book value [LIC 122 bis 12].
 - If, after the adjudication of shares, the IPAB loan is not repaid in full, the bank shall repay it [LIC 122 bis 12].
 - Thereafter, the bank shall offset all positive shareholders' equity accounts (other than corporate capital) against all negative shareholders' equity accounts [LIC 122 bis 13-I].
 - The bank shall then apply losses against the corporate capital [LIC 122 bis 33-II].
 - The bank shall increase its corporate capital to the extent required for its ICAP to remain at 8 percent [LIC 122 bis 13-II].
 - IPAB shall subscribe and pay for such capital increase, including by capitalizing the outstanding balance of its loan [LIC 122 bis 13-II].
 - IPAB shall offer to sell all the shares of the bank [LIC 122 bis 14].

30. Purchase-and-Assumption

A bank would be subject to purchase-and-assumption if (1) the bank meets any commencement standard; and (2) the CEF determines that [x] the bank is systemically important and [y] less than 100 percent of the bank's non-IPAB-insured liabilities are susceptible to systemic repercussions [LIC 122 bis II-b].

The purchase-and-assumption technique is carried out in the following fashion:

- The bank shall be wound up [LIC 28].
- IPAB shall carry out the payment of those non-IPAB-insured obligations determined by the CEF to be payable by IPAB [LIC 122 bis 20].
- The liquidator shall transfer assets and liabilities to a bridge bank created by IPAB for such purpose or to another bank [LIC 122 bis 27, 122 bis 29].
- IPAB can create a bridge bank with a life of up to six months, just to carry out the purchase-and-assumption transaction of a bank [LIC 27 bis 1-27 bis 6].

PART V

Sundry Corporate and Other Law Issues

This part of the book addresses in a general manner specific topics relating to sundry corporate and other legal issues arising in the context of insolvency.

31. Director Liability⁷⁷

There are two time frames relevant to the analysis of director liability in the context of insolvency: (1) in the vicinity of insolvency; and (2) during insolvency.

a. In the Vicinity of Insolvency

In the absence of an illicit action, directors of a debtor are not liable to creditors outside of insolvency.⁷⁸ Mexico does not recognize the concept of the vicinity of insolvency (the “twilight zone” or the “zone of insolvency”), so doctrines of wrongful trading are also not recognized.

The only case remotely connected with wrongful trading consists of a concept in the General Law of Commercial Companies under which, among other cases, the loss of two-thirds of the equity capital of a commercial company gives grounds for dissolution of the company. Should the company enter into new transactions once a case of dissolution has been recognized, the directors of the company shall be jointly and severally liable for the obligations of a company under those post-recognition transactions [LGSM 229-V, 233].

Only the shareholders’ meeting of the company in question is entitled to “recognize” that the case of dissolution has occurred. The rationale behind this is expressed in the LGSM Bill, which provides:

The dissolution of companies, according to guidance from treatises, is regulated in a different manner when it is produced ipso facto by the expiration of its term, and when it is the result of a partner decision or the recognition by the company’s corporate bodies that another of the

⁷⁷ This section does not address issues concerning director liability (1) with the debtor; (2) with creditors for matters unrelated to insolvency; or (3) for criminal actions.

⁷⁸ *Cfr.* Galindo (1957), pp. 170-203.

causes for dissolution has occurred....Once another cause for dissolution exists, the partners are entitled to change the corporate purpose, admit new partners or reconstitute the equity capital....

A court precedent confirms this position:

DISSOLUTION OF A COMMERCIAL COMPANY. FOR ANY INTERESTED PERSON TO APPLY FOR ITS REGISTRATION WITH THE PUBLIC REGISTRY OF COMMERCE, IT IS PROCEDURALLY NECESSARY TO PROVE THAT THE SHAREHOLDERS' MEETING HAS RECOGNIZED THE CAUSE FOR DISSOLUTION.

Within the causes of total dissolution of a company foreseen in Article 229 of the LGSM, the one provided in Section I [passing of its term] does not require any type of recognition, since it becomes effective the moment the term for which the company was created expires. On the other hand, all other causes of dissolution foreseen in such Article [229 of the LGSM], except for the voluntary dissolution foreseen in Section III, which provides that the company may dissolve as a result of a partner resolution to that effect, do require a declaration [of recognition], which declaration is not voluntary but rather necessary due to the multiplicity of legal engagements the company acquired during its corporate life. Now, a literal interpretation of the second paragraph of Article 232 of the LGSM infers that prior to requesting the registration of the dissolution of a company, a declaration from the company recognizing the cause for dissolution is required. In this context, any interested person must satisfy the procedural requisite of [proving] the company's prior recognition of the cause for dissolution, to request the registration of the dissolution of such company.

Unfortunately, the issue of what constitutes losing two-thirds of the equity capital is unclear. There are two main approaches to interpret this case: (1) a company having accumulated losses which, in the aggregate are equal to or higher than, an amount equal to two-thirds of the equity capital; or (2) the net worth of the company falling to an amount that is below one-third (implies "losing" two-thirds) of the amount of the equity capital. Arguably, the second alternative is the correct line of interpretation; however, no precedent resolving this issue has been found.

b. During Insolvency

Aside from the duties to cooperate with the visitor, conciliator and receiver to enable them to perform their duties, directors have no liability with creditors during insolvency proceedings.

During the course of insolvency proceedings, even during conciliation where management remains in possession of the enterprise, the duties of directors do not change or expand in favor of creditors. The conciliator and the conservators, if appointed, have oversight of the transactions carried out during the conciliatory stage, and the conciliator even has the remedy of demanding removal (*cfr.* **16.a**) in cases where the conciliator considers it to be for the benefit of the estate [LCM 81].

32. Mergers & Acquisitions⁷⁹

There are three time frames relevant to discussing issues surrounding mergers and acquisitions (M&A) in the context of insolvency: (1) in the vicinity of insolvency; (2) during the conciliatory stage; and (3) during the liquidation stage.

a. In the Vicinity of Insolvency

Except for the application of avoidance powers, the Insolvency Law is unconcerned with M&A transactions in the vicinity of insolvency. Please refer to **Section 15.j** for an analysis of the avoidance powers rules.

b. During the Conciliatory Stage

There are two levels of authority for disposing of assets during conciliation: (1) in the ordinary course of business; and (2) out of the ordinary course of business. The debtor is entitled to dispose of assets in the ordinary course of business, but will require the conciliator's consent to dispose of assets out of the ordinary course of business

⁷⁹ Reiss (2009) provides an in-depth analysis of distressed M&A transactions, which the reader is encouraged to consult.

[LCM 75]. The determination as to what constitutes a transaction in the ordinary course of business is fact-specific and must be made on a case-by-case basis.

Distressed M&A is an underdeveloped area of legal practice in Mexico. Aside from the overriding principles of value maximization and the preservation of a going concern, there are no clear rules on the permitted strategies for disposing of assets.

Arguably, any “363 Sale” (i.e., a sale during the pendency of the conciliation stage) would only require the conciliator’s consent (with the approval from the conservators), which is a more expedient procedure than seeking court approval, and no exceptions to the general principles of law would be available in a disposition of assets during conciliation.

Mexico does not recognize theories of *de facto* merger, so the risk of successor liability in distressed M&A transactions is basically nonexistent.⁸⁰

c. During the Liquidation Stage

The rules pertaining to M&A transactions during liquidation are addressed in **Section 16.d** above.

The Federal Competition Commission, or Cofeco, the Mexican antitrust regulator, is empowered to contest and penalize those transactions such as mergers, acquisitions of control or any other act whereby companies, partnerships, shares, equity, trusts or assets in general are concentrated by competitors, suppliers, or customers or by any economic agent, with the purpose or effect of reducing, impairing or hindering competition and free access to market in connection with equal, similar or substantially related goods or services [LFCE 16]. As a preventive measure, prior to closing, for the purpose of clearance, Cofeco must be notified of any transaction that meets or exceeds certain statutory thresholds [LFCE 20].

⁸⁰ There are some tax, labor and social security obligations that could follow the transfer of an enterprise as a going concern.

Until recently, Cofeco had not taken an official position regarding horizontal mergers involving failing firms.⁸¹ Since 2004, Cofeco has sustained the non-binding criterion that it may be more efficient for a failing firm to be acquired by a competitor than to let it fail.⁸²

3.10. Enterprises in Financial Distress

In connection with market efficiencies, there is the case where an agent in the relevant market acquires another agent in the same market, and the latter risks disappearing. If the bankruptcy of that [latter] agent is highly probable and a real possibility, then its ceasing operations would be more inefficient than if it were acquired by another [agent], even if the acquiring agent has substantial power [in the relevant market].

In March 2011, Cofeco issued a new criterion in that respect. While stating that the failing firm exception is not expressly available in an antitrust framework, Cofeco cites a 2001 case where it did take such argument into account in its pre-merger authorization process:⁸³

Enterprises in Economic Distress.

Neither does the [Antitrust] Law nor Cofeco's practice foresee a specific mechanism to notify transactions in which the target is found in financial distress, where the transaction could give place to a significant market concentration. [Footnote 27: In the file CNT-149-2001, Cofeco analyzed the acquisition of Promotora de Marcas Nacionales, SA de CV, which was the holder of trademarks relating to Mundet products, by subsidiaries of Fomento Económico Mexicano, SA de CV (Femsa). This is one of the few cases which Cofeco has analyzed from the failing firm perspective. Cofeco determined that the target was in such a state of decay that its prospects were compromised, and [whose failure] would have reduced the consumers' selection opportunities. Cofeco authorized the transaction subject to a [certain specified] condition...].

81 *Cfr.* Chapter 11 of the US DOJ/FTC 2010 Horizontal Merger Guidelines.

82 Cofeco (2004).

83 Cofeco (2011).

33. Securities Market⁸⁴

Holders of publicly traded debt securities are generally represented through indenture trustees. The indenture trustee has broad authority to exercise all actions and rights on behalf of the debt holders, carry out all corresponding conservatory actions, and enter into documents and agreements with the debtor on behalf of the security holders [LGTC 217-VIII, XII].

The level of authority of the indenture trustee raises two important issues. The first issue is whether the indenture trustee has sufficient authority to enter into a standstill agreement in a private workout. An argument can be made that the standstill agreement constitutes a conservatory act (lack of cooperation in the private workout could frustrate attempts to reorganize) and therefore, within its scope of authority; however, there are compelling arguments to the contrary (the indenture trustee must seek repayment and has no duty with the other creditors). Since there is no specific authority to enter into a standstill agreement and carry out interim actions, in practice, indenture trustees will call a meeting of security holders to resolve whether to enter into standstill agreements. This practice causes delays and multiplies the opportunities for miscommunication and opposition to the reorganization process. In practice, some security holders choose to allow their custodians to represent them in the holders' meetings, which mitigates (but does not eliminate) the problem.

The second issue is whether the indenture trustee will be able to accept a rescheduling agreement or a reorganization plan on behalf of security holders. A statutory provision requires the approval of the security holders' meeting to consent to extensions or carry out "any other amendment" to the debt instrument ("any other amendment" is considered to include a change in the covenants in general but does not include a change in the financial conditions, which shall be a decision of the individual holders and not the subject matter of

⁸⁴ This section does not address securities market issues from jurisdictions other than Mexico. Mendales (1993) provides an in-depth analysis of restructuring public debt, which the reader is encouraged to consult.

a security holders' meeting⁸⁵) [LGTOC 220-III]. Consenting to extensions or carrying out "any other amendment" to the securities is considered a major event and requires a qualified majority (holders representing a 75 percent interest) for the meeting to be validly convened. This quorum requisite is relaxed in the second or subsequent call, in which a meeting will be legally convened with the presence of any number of security holders. The note or the indenture may impose higher majorities.

The issue is further complicated if the rescheduling agreement or the reorganization plan requires creditors to accept haircuts or otherwise change the financial conditions of the debt instrument (e.g., converting principal to a different unit of account, reducing the rate of interest, etc.), or to convert the original debt instrument into another type of debt or equity instrument. In these cases, agreement from the ultimate security holder of record (not the indenture trustee or even the custodian) will be required. Depending on the level of dispersity of the debt instrument in question, the practical hurdle of seeking the consent of each ultimate holder of record can delay or even frustrate the process.

Oftentimes, a rescheduling agreement is implemented through an exchange offer. An exchange offer also poses registration costs and delays, and participation is individually voluntary. Some additional obstacles imposed by Mexican securities laws prevent broad acceptance of the exchange offer. For example, consideration has to be the same for all participants (staggered pricing to incentivize early tender or acceptance is theoretically allowed but the author does not know of any case where it has ever been used), and exit-consent mechanisms are not a permitted means for changing the terms of holdouts unless carried out in the context of a security holders' meeting. For these reasons, the existence of publicly traded debt securities often makes court assistance necessary to achieve a successful reorganization.

⁸⁵ This is not a settled matter. As a matter of practice, indenture trustees have been reluctant to accept executing orders from a security holders' meeting that decides to accept a haircut or change other financial conditions of the securities, under the claim that those matters are individual decisions of the security holders that cannot be imposed on holdouts.

A reorganization plan would be enforced on public debt holders without the need to carry out an exchange or similar registered offer.

34. Tax Issues

Some of the most relevant tax aspects in light of insolvency concern the treatment for reserves for uncollectible claims, income recognition from haircuts and capital gains and transfer taxes arising from the disposition of assets.

A creditor may obtain a deduction for losses arising from uncollectible claims if, among other cases, the debtor has been declared *en concurso* [LISR 31-XVI-c].

Generally, a taxpayer would have to recognize a haircut as taxable income [LISR 167-I, 168-II]; however, in the case of a debtor declared *en concurso*, the gain would offset a tax-loss carryforward, and the debtor would not have to accrue the difference resulting from the gains exceeding the loss carryforward [LISR 16 bis, 121 bis].

There are no exemptions or special tax treatments on the sale of assets of a debtor declared *en concurso*. Local transfer taxes could also apply to the sale of realty. There are, however, some benefits concerning the recognition of interest income to asset management companies that acquire loan portfolios and comply with certain regulatory requirements.⁸⁶

35. Criminal Aspects

The Insolvency Law provides for certain criminal activities and their sanctions in connection with an insolvency procedure. The criminal actions generally imply bad faith on the part of the debtor, including carrying out deliberate actions to cause or aggravate its cessation of payments and the destruction, alteration or hiding of books and records [LCM 271-277].

⁸⁶ See Rule I.13.6 of the *Resolución Miscelánea Fiscal para 2011*.

Appendix

Real and Chattel Property

The definition of what constitutes realty and chattel is a matter of local law [CPM 121-II]. In Mexico, most civil codes have similar definitions to those contained in the Federal Civil Code; however, differences may exist. At the federal level, as a general rule, any asset not specifically stated to be realty, shall constitute chattel property [CCF 759]. Realty includes [CCF 750]:

- The ground and the constructions attached to it.
- The plants and trees, as well as the fruits on the trees, while they are naturally joined to the earth and have not been cut as crop or otherwise severed.
- Anything attached to realty in a permanent manner, so that upon separation, deterioration is caused to the realty or to the attached object.
- Statues, reliefs, paintings or other ornamental objects placed on buildings or placed by the owner of the realty in such a way as to reveal intent to unite them permanently to the realty.
- Dovecotes, beehives, fish tanks or analogous breeding tanks, if the owner keeps them for the purpose of being integrated to the realty, and they form part of it in a permanent way.
- Machines, containers, equipment and tooling that the owner of the realty has destined for direct and exclusive industrial use or other exploitation of the realty.
- All fertilizers for agricultural crops of realty, which are on the fields where they are to be used, as well as the necessary seeds for planting.
- Electrical equipment and appliances and their accessories that are fixed to the ground or to a building by the owner, unless an agreement provides otherwise.
- All wells, pools, reservoirs and waterways, as well as aqueducts and piping ducts of any type used for carrying liquids or gases to realty or for their extraction therefrom.

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- All kinds of animals used for breeding on rustic land totally or partially devoted to the raising of cattle, as well as those used for the performance of farm work, as long as they are employed for that purpose.
 - Dry docks and similar constructions which, even if movable by floating, are kept stationary at a specific location on a river, lake or coast by reason of their use and purpose.
 - All *in rem* rights on realty.
 - Telephone and telegraph lines and permanently based radio-telegraph stations.

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