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"HIGHLIGHTS OF MEXICO'S INSOLVENCY LAW"

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"HIGHLIGHTS OF MEXICO'S INSOLVENCY LAW"

I. BACKGROUND

In Mexico, the subject of insolvency and bankruptcy was governed by the Suspension of Payments Law (Ley de Quiebras y Suspensión de Pagos) ("LQSP") from 1943 to 2000, a pro-debtor statute. The current Commercial Insolvency Law (Ley de Concursos Mercantiles) ("LCM") became effective in May 2000 and gives a greater say to creditors.

The LCM was amended on December 28, 2007 to, inter alia, contemplate pre-packaged reorganization plans, to treat insolvency experts' fees as ordinary operating expenses and to clarify some of its provisions.

The LCM is a "public interest" statute.^{1/} An insolvency proceeding may take place when a merchant incurs in a general default of its obligations. A general default of a merchant's obligations takes place when (i) its due and payable debts represent at least 35% (thirty-five percent) of all of its outstanding debts at the time of the filing for insolvency; or (ii) the value of its assets is not enough to cover at least 80% (eighty percent) of all its due and payable debts.^{2/} When 2 (two) or more creditors or the district attorney (ministerio público) file for the reorganization (involuntary petition), (i) and (ii) must be proven.

In Mexico, there are no special bankruptcy courts. The district courts have exclusive jurisdiction over the subject matter.^{3/}

Insolvency proceedings are handled in three stages:

^{1/} See article 1 of the LCM.

^{2/} Id. articles 9 and 10.

^{3/} Id. article 17.

1) Initial stage. Its purpose is to determine whether or not a merchant has incurred in a general default of its obligations and thus it qualifies for a proceeding.

2) Reorganization. Its purpose is to try to achieve an agreement between the debtor, known as the "Merchant" under the LCM, and its creditors. Generally, the debtor continues to operate the business, with the supervision of a mediator. Should the mediator deem it appropriate for the protection of the estate, it may ask the judge to remove the Merchant from the management of its company. In admitting the request, the judge shall be authorized to take all measures as it shall deem appropriate to preserve the integrity of the estate. The removal of the Merchant shall be decided by the judge via an incidental proceeding.^{4/}

3) Bankruptcy. Its purpose is to sell (liquidate) the assets and rights of the estate and pay off the creditors.

Certain developments are worth mentioning regarding the LCM.

I.1 IFECOM

IFECOM (Instituto Federal de Especialistas de Concursos Mercantiles), known as the "Institute" under the LCM, is an auxiliary body of the Federal Judiciary Council (Consejo de la Judicatura Federal) with technical and operative autonomy.^{5/} Its main role is to manage insolvencies and insolvency specialists, like examiners (visitadores), mediators (conciliadores) and bankruptcy trustees (síndicos). It randomly designates the specialists who will participate in every insolvency proceeding, determine their fees and overview their performance.

I.2 Duration of Proceedings

In principle, "conciliation" (reorganization) proceedings cannot last for more than 185 (one hundred and eighty-

^{4/} Id. article 81.

^{5/} Id. article 311.

five) days from the date of the final reorganization judgment publication in the Federal Register (Diario Oficial de la Federación) ("D.O.").^{6/}

The mediator or Recognized Creditors (representing at least 2/3's of the total amount of the recognized credits), may apply for a 90 (ninety)-day extension if they deem that a reorganization agreement is "about to be entered into".^{7/} The Merchant and 90% (ninety percent) of the Recognized Creditors may apply for an additional (and final) 90 (ninety)-day extension term.^{8/}

Under no circumstances can the term of a reorganization exceed 365 (three hundred and sixty-five) days from the final publication of the reorganization judgment.^{9/}

I.3 Foreign Currency-Denominated Obligations; Investment Units in Mexico

- (i) Peso-denominated obligations must be converted into UDI's (investment units) and cease to accrue interest;
- (ii) UDI-pegged credits must also cease to accrue interest;
- (iii) Foreign currency-denominated obligations shall be converted into pesos, shall stop accruing interest and be converted into UDI's; and,
- (iv) Secured credits, whether denominated in pesos or in another currency, can only accrue ordinary interest up to the value of the collateral. (Interest accrued does not increase creditors'

^{6/} Id. article 145.

^{7/} Id.

^{8/} Id.

^{9/} Id.

decision making rights).^{10/}

I.4 Contractual Provisions that May Not be Enforceable in an Insolvency Proceeding

The LCM provides that "unless otherwise expressly permitted in the law, any contractual provision which as a result of a filing or demand for insolvency proceedings may modify a contract to make its terms harsher for a Merchant, shall be deemed null and void".^{11/}

Query: could a provision that enables the other party to a contract to terminate it upon commencement or continuation of insolvency proceedings be considered as imposing "harsher terms on the Merchant"?

II. ANCILLARY PROCEEDINGS-INTERNATIONAL COOPERATION

The LCM contains a whole section regarding "cooperation in international proceedings" which is modeled after the UNCITRAL Model Law on Cross-Border Insolvency: Title Twelfth. Title Twelfth is divided in 5 (five) Chapters, with a total of 34 (thirty four) detailed provisions.

The goal of Title Twelfth is to integrate Mexico in the world of multinational insolvency proceedings. The Mexican judiciary needs more preparation and experience to live up to this sudden challenge. However, the tools are provided in the LCM for this effort of integration to proceed in a semi-smooth fashion.

The LCM refers to the need to "take into account its international origin and the need to promote uniformity in its application and good faith observance".^{12/} In addition, Mexican court precedents recognize the importance of the Model Law on Cross-Border Insolvency in interpreting its provisions. The LCM cannot be applied in any manner "contrary to fundamental

^{10/} Id. article 87.

^{11/} Id.

^{12/} Id. article 285.

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principles of Mexican law", usually referred to as "public order".^{13/}

Title Twelfth applies where, inter alia, assistance is sought in the United States by a foreign court or foreign representative in connection with a foreign proceeding, or assistance is sought in a foreign country.^{14/}

A foreign proceeding must be recognized as a foreign main proceeding or foreign non-main proceeding. The LCM defines "foreign main proceeding" as "a foreign proceeding pending in the country where the debtor has the center of its main interests" (centro de sus principales intereses), known as "COMI".

The LCM defines "establishment" as "any place of operations where the debtor carries out a nontransitory economic activity".^{15/}

The recognition procedure is the sole entry point for access by a foreign representative to the state and federal court systems in Mexico, except for the limited purpose of collecting accounts receivable of the debtor. With recognition, a foreign representative obtains standing to act before the state and federal courts of Mexico. Without recognition, the foreign representative cannot seek relief from the Mexican courts.^{16/}

The LCM covers court-to-court communications, an area that is key to the efficiency of the cross-border insolvency process. The Mexican statute contemplates that "the mediator or the trustee shall be authorized, to the extent consistent with their position, to communicate directly and without using letters rogatory or other formalities, with foreign courts or representatives".^{17/}

^{13/} Id. article 283.

^{14/} Id. article 278.

^{15/} Id. article 279-VI.

^{16/} Id. article 292-299.

^{17/} Id. article 304.

The Mexican courts could take better advantage of this opportunity, both in the context of specific proceedings and to participate more actively in cross-border academic programs.

III. COURT PRECEDENTS

Title Twelfth of the LCM has been challenged before Mexico's Supreme Court of Justice (Suprema Corte de Justicia de la Nación) ("SCJ") and Circuit Courts (Tribunales Colegiados de Circuito) on various grounds. The courts' decisions relate to the string of Xacur cases.

The SCJ has confirmed the constitutionality of Title Twelfth, among other reasons, because "article 283 thereof clearly establishes that its provisions cannot be interpreted in violation of the Statute itself or the legal principles that apply in the Mexican Republic"; "the legislator safeguards such fundamental principles as well as the national juridical order"; and "it affords equal treatment to Mexican and foreign creditors".^{18/}

Please feel free to bring to the attention of Agustín Berdeja (aberdeja@berdelaw.com) or Luis Rodrigo Morales (lmorales@berdelaw.com) any question or concern that you may have in connection with the above information.

^{18/} See Tesis Aislada 1a. CLXIII/2006. Novena Época. Suprema Corte de Justicia. Primera Sala. Fuente: Semanario Judicial de la Federación y su Gaceta XXIV, Octubre de 2006, pág. 276.

See also, Tesis Aislada I.12o.C.15 C. Novena Época. Tribunales Colegiados de Circuito. Fuente: Semanario Judicial de la Federación y su Gaceta XXII, Agosto de 2005, pág. 1973. Materia(s): Civil; Tesis Aislada I.11o.C.176 C. Novena Época. Tribunales Colegiados de Circuito. Fuente: Semanario Judicial de la Federación y su Gaceta XXVI, Octubre de 2007, pág. 3210. Materia(s): Civil; and, Tesis Aislada I.12o.C.14 C. Novena Época. Tribunales Colegiados de Circuito. Fuente: Semanario Judicial de la Federación y su Gaceta XXII, Agosto de 2005, pág. 1974. Materia(s): Civil.

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