

3-1-2005

Current Techniques for Secured Financing of Negotiated Acquisitions in Mexico, including Analysis of Effective Use of Guarantee Trusts and Pledges without Possession

Hans P. Goebel Caviedes

Follow this and additional works at: <http://digitalrepository.unm.edu/usmexlj>

Recommended Citation

Hans P. Goebel Caviedes, *Current Techniques for Secured Financing of Negotiated Acquisitions in Mexico, including Analysis of Effective Use of Guarantee Trusts and Pledges without Possession*, 13 U.S.-Mex. L.J. 71 (2005).
Available at: <http://digitalrepository.unm.edu/usmexlj/vol13/iss1/10>

This Article is brought to you for free and open access by the Law Journals at UNM Digital Repository. It has been accepted for inclusion in United States - Mexico Law Journal by an authorized editor of UNM Digital Repository. For more information, please contact disc@unm.edu.

CURRENT TECHNIQUES FOR SECURED FINANCING OF NEGOTIATED ACQUISITIONS IN MEXICO, INCLUDING ANALYSIS OF EFFECTIVE USE OF GUARANTEE TRUSTS AND PLEDGES WITHOUT POSSESSION

LIC. HANS P. GOEBEL CAVIEDES*

INTRODUCTION

This article examines secured transactions in Mexico, including guarantee trusts and pledges without possession. I will discuss the common security mechanisms available in Mexico, the status of blanket liens in Mexico before and after 2000, and the 2003 amendments to trusts. The final section describes guarantee trusts and pledges without possession after the 2003 amendments.

United States and foreign lenders providing loans to Mexican companies that are secured by Mexican assets first need to be aware of how Mexican law enforces judgments. A foreign lawsuit judgment will be recognized by the courts of Mexico only if, among other criteria, the judgment is strictly for the payment of a certain sum of money. Jurisdiction of the suit must be based on an *in personam* action as opposed to an *in rem* action. This means that any security device with respect to Mexican assets located in Mexico must be available under Mexican law. U.S. lenders cannot create a lien on a Mexican asset by initiating a Uniform Commercial Code (UCC) filing in the United States, and subsequently attempting to enforce a U.S. judgment with respect to such lien in Mexico.

SECURITY MECHANISMS

The most common security devices available in Mexico are mortgages and pledges. Ordinary mortgages are available in general terms for real estate and for other assets if a public registry exists. The mortgagor retains possession of the mortgage assets, and registration is required for legal protection against third parties. This is a very important feature of registration in Mexican law. What happens if a mortgagor does not register its lien when registration is required and a third party later registers a mortgage on the same property? The mortgagor would lose its preference in a bankruptcy proceeding. Registration is also required when a sale of real estate takes place. If an initial sale of real estate is not registered and the former owner sells the property again to another purchaser, the initial purchaser can ask for damages, but cannot make that transaction null and void because the second purchaser is deemed a *bona fide* purchaser.

In the mortgage there is also a preventive notice feature. Once a lender is ready to lend and secures a debt with a mortgage, the lender files a preventive notice with

* Lic. Hans P. Goebel C. is a partner in the firm of Jáuregui, Navarrete y Nader, S.C., Torre Arcos, Paseo de los Tamarindos 400-B, Pisos 7, 8 y 9, Col. Bosque de las Lomas, 05120 Mexico, D.F. Telephone: 52-55-5267-4554. Fax: 52-55-5258-0595. E-mail: hpg@jnnr.com.mx. Lic. Goebel's main areas of practice are corporate finance, banking, securitization, project finance, consumer finance, mergers and acquisitions, foreign investment, and general corporate and commercial law. He worked as a foreign associate at the law firm of Mayer, Brown, Rowe & Maw LLP in Chicago. Lic. Goebel has taught Financial Contracts at the *Universidad Iberoamericana* in Mexico City. He received a *Licenciatura en Derecho* from the *Instituto Tecnológico Autónomo de México* (ITAM), Mexico City and an L.L.M. degree with honors from Northwestern University School of Law, Chicago, IL.

the Public Registry of Property. Once the mortgage is executed, the effective date of the registration will be retroactive to the date of the preventive notice. Another security device is an industrial mortgage. This type of mortgage extends to all present and future assets of a business unit. A business unit includes not only real estate, but also tangible and intangible assets. However, this type of security is available only to Mexican banks. Registration is also necessary. This was one of the few mechanisms available for blanket liens before the guarantee trust and the “pledgor-in-possession” pledge.

The communications mortgage is a very similar mechanism to the industrial mortgage. It extends to all the assets of communication companies, including telecommunication companies. The assets are related to a concession title and all the proceeds thereof. The pitfall is that the communications mortgage is available only to assets of communication companies. Registration is necessary in a communications mortgage as well.

The ordinary pledge is another security device available in Mexico for tangible movables and negotiable instruments, including shares of stock and promissory notes. There has been a discussion as to whether it is also available for intangible assets, such as receivables. My opinion is that perfection of an ordinary pledge for intangible assets is questionable.

There are two general means to perfect an ordinary pledge. The first is to deliver a document where the rights arising from that document are contained therein, such as negotiable instruments. If the negotiable instrument is lost there are no rights unless they are contained in another document. The pledgor generally retains possession of the pledged assets. The second is to deposit the assets with a third party. If a pledge is perfected through deposit of the pledged assets with a depository, the depository could be subject to criminal liability if the depository does not comply with its obligations. Except for registration in the registry book of a company, which is necessary for a pledge on stock, no registration is necessary under the ordinary pledge.

Crédito de habilitación y avío (financing credit agreement), and *crédito refaccionario* (equipment operating credit) pledges are available generally for raw materials and equipment acquired with the proceeds of a loan. Here the pledgor retains possession of the pledged assets, and registration is necessary. Another kind of pledge also available only to Mexican banks is the pledge by endorsement of invoices.

Other devices may work as security interests, but technically are not security interests. One very effective mechanism is the administration or source of payment trust. For receivables, the settlor would transfer its rights to receivables into a trust, and with the proceeds of those receivables the lender gets re-paid. Another mechanism that may work as a security interest is a contingent assignment. That is an option for a lender to buy certain assets from a third party if the debtor does not comply with its payment obligations with the lender. Finally, personal guarantees of third parties may be used to secure repayment of a loan.

BLANKET LIENS BEFORE AND AFTER 2000

Before 2000, it was very difficult to obtain a blanket lien. The only way to get one was basically through an industrial or a communications mortgage. However,

industrial mortgages are available only to Mexican banks acting as lenders, and communications mortgages are available only to communications companies acting as borrowers. Blanket liens were created through a combination of security devices and security-interest-like mechanisms where lenders could obtain a security interest in fixed assets and establish an administration trust with respect to the receivables or other intangible assets. All the collections passing through the trust could serve the debt. As mentioned before, those do not constitute a security interest. After 2000, the pledge without possession and the guarantee trust allowed present and future assets to be subject to a security interest. In pledges without possession intangible and tangible movables can be included. In guarantee trusts real estate also can be included. Registration for both of these mechanisms was necessary before the 2003 amendments discussed below.

The “Barzón clause” is a statutory waiver by the secured party to recover any amount beyond the foreclosure proceeds.¹ A lobbying group pushed very hard for the Barzón clause because of an increase in interest rates. Before the clause, a borrower could take out a home loan for \$100,000, purchase a house, and two years later the principal and interest could be 40% more. The borrower could agree to foreclosure, but would still owe the \$40,000 difference. The Barzón clause remedied this situation, but disfavored lenders’ use of guarantee trusts and pledges without possession. The 2000 amendments introducing the guarantee trust and the pledgor-in-possession pledge were useful. However, because of the Barzón clause, lenders tried to avoid these mechanisms and still use the ordinary pledge and the ordinary mortgage. Through intense lobbying, the additional amendments were enacted in 2003.

2003 AMENDMENTS TO TRUSTS

I will first address the amendment to trusts in general. Before 2003, the trust was defined as a mechanism whereby a settlor could affect certain assets to carry out a legal purpose by means of the trust, and would order a trustee to carry out such purpose. The term of the trust was limited to 30 years. After the 2003 amendments, by means of the trust, a settlor transfers to a trustee title to one or more assets or rights to be used to carry out a legal purpose, and orders the trustee to carry out such purpose. Due to the inclusion of the word “transfer” in the trust definition, equal to a “true sale,” the 2003 amendments further strengthened the bankruptcy-remote status of the trust estate. In addition to the trust definition, the 2003 amendments also extended the term of the trusts up to 50 years and allowed for tailor-made foreclosure mechanisms.

1. El Barzón is a lobby group representing debtors. The group was created as debtors could not pay the dramatic increases in interest rates on loans that occurred as a result of the value of the peso falling. See *The Peso Crisis, A Monetary Crisis?*, available at <http://www.eco.utexas.edu/facstaff/Cleaver/304 Lpesocrisis.ppt> (last visited April 6, 2005).

ANALYSIS OF PLEDGES WITHOUT POSSESSION AND GUARANTEE TRUSTS AFTER
THE 2003 AMENDMENTS

The purpose of the 2003 amendments was to encourage granting of credit in Mexico by removing the statutory deficiency waiver provision or “Barzón clause.” The amendments are not applicable to debt existing before they took effect on June 14, 2003.

Under a pledge without possession, the pledgor retains possession of the pledged assets, unlike the ordinary pledge. Registration at the public registry of commerce of the debtor’s domicile is required, and a security interest on receivables and other intangible assets is clearly attainable. The pledge may extend to the proceeds of a sale of pledged assets. For example, if the raw materials are transformed into inventory, the inventory is also included in the pledge.

The assets subject to the pledge must be specifically identified, unless all movables used in the pledgor’s ordinary course of business are pledged, in which case the assets may be identified in a generic manner. To be effective *vis-à-vis* third parties, registration of the pledge is necessary.

In guarantee trusts, the settlor may retain possession of the pledged assets and any kind of assets may be conveyed to the trustee. Except for real estate transferred to the trustee, the 2003 amendments eliminated the registration requirement for guarantee trusts. Such amendments also allowed for the beneficiary of the trust to request out-of-court sale of the assets and for tailor-made foreclosure rules to be contained in the trust agreement.

I will now address any questions the audience may have.

QUESTIONS AND ANSWERS

JOHN ROGERS: Given the bankruptcy-remoteness advantage of the guarantee trust, is there any good reason to use the other devices except for the costs of trustee fees and transactional costs?

HANS GOEBEL: Depending on the size of the transaction, trustee fees may be an important obstacle for use of guarantee trusts. Also, for straightforward transactions, courts have more experience dealing with other traditional security devices such as the mortgage and the ordinary pledge.

JOHN STEPHENSON: If I represent a U.S. company trying to acquire a company in Mexico, can the assets of the target company be put in a guarantee trust that guarantees performance of payment of a debt? Can the assets secure the financing made to the acquiring company?

GOEBEL: From the pure secured lending perspective, they can. The problem is that you may end up having consideration issues in case of bankruptcy of the Mexican company.

STEPHENSON: Because the transfer could be attacked by other creditors?

GOEBEL: Exactly.

VALERIE PREST: I find this discussion about the *fideicomiso* (trust) very interesting. I structured a transaction like this in Colombia with a *fideicomiso*, and I am wondering if it is similar. In that case I found the purpose of the *fideicomiso* was to hold all the assets of a company borrowing a large sum of money to do a project. The duration of the *fideicomiso* was only so long as debt money was outstanding. Therefore, it really was a secured financing mechanism that held all the assets of the project within. This is as opposed to buying a piece of real estate or equipment, in which case an *hipoteca* (mortgage) makes more sense perhaps. Would that be a fair assessment of what you are talking about, Mr. Goebel?

GOEBEL: That is a fair assessment. The structure that you mentioned could be implemented in Mexico either through a guarantee trust or through a source of payment or administration trust.

PREST: Just to follow up, would the new *prenda sin posesión* (pledge without possession) be similar to a UCC filing that you would do when you register?

GOEBEL: That is correct, it would be very similar to a UCC filing.

PREST: I did a deal once in Argentina, and I had to actually put a sticker on every single cable and box and piece of equipment that went in a project. Does Mexico have that level of identification security?

GOEBEL: That is one of the good things about pledges without possession. It is very clear that the pledgor may retain possession of the assets. Before, when pledging machinery for example, the pledgee could require the machinery to be labeled, basically stating that the machinery was pledged to "X" lender, so that a *bona fide* acquirer or lender would know that someone else had already taken the machinery in pledge. Under a pledge without possession, that is not necessary because you register the pledge itself in a public registry. Every person is deemed to have knowledge about the pledge because it is already recorded in the Registry.

CHRIS BAUMAN: In terms of the registration, how specific do you have to be in describing whatever it is that the pledge is covering?

GOEBEL: It depends. You can do a general description if the pledge extends to all the pledgor's assets. If not, you need to specify the type of assets pledged and provide for a mechanism to update that description from time to time.

ROGERS: On the registration issue, suppose you have a guarantee trust that has not been registered, and then the debtor turns around and tries to transfer the assets again to another guarantee trust which is registered? Given the fuzziness of the registration requirement, who wins in a dispute between the two?

GOEBEL: It works as in any other transfer of property. If the first sale is not registered and the second sale is registered, then the first buyer would have a right against the seller, but could ask for damages only.

ROLAN PELLETIER: The pledge with possession was real security because one held the property. The question at issue of the pledge without possession is whether it would be readily executable. Do you know of some case law of the Mexican courts regarding enforcement of a pledge without possession?

GOEBEL: In addition to the changes to the substantive law, there were also procedural changes. The procedural change applying to a pledge created two different ways for foreclosure to be made. One is an out-of-court proceeding, and the other is a very expedited new in-court mechanism. I am not aware of any precedent regarding the out-of-court proceeding.

MANUEL RAJUNOV: Has anybody challenged the constitutionality of the non-judicial foreclosure proceedings?

GOEBEL: I am not aware of any such challenge yet.