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A Panel Discussion

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FINANCING COMMERCIAL TRANSACTIONS IN MEXICO AND THE UNITED STATES: PANEL DISCUSSIONS ON PERSONAL AND REAL PROPERTY

SECURED FINANCING OF PERSONAL PROPERTY IN MEXICO: A PANEL DISCUSSION

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INTRODUCTION

Mr. Michael I. Owen: As we are all aware, Mexico has done a remarkable job in the two most recent decennials of tackling many difficult tasks and as well as difficult changes in its legal system. Mexico has achieved results which we in the United States can only dream about achieving in regards to similar problems. Yet, one problem that Mexico has yet to tackle is the development of a modern system for financing its sale of goods.

HYPOTHETICAL CASE STUDY

The following is a hypothetical case that our panelists will discuss. Synthetica de Mexico, S.A. de C.V. is a Mexican company representing a 50-50 joint venture between Synthetica, Inc., a corporation organized under the laws of the State of California, and Grupo Sustencial, S.A. de C.V., a Mexican company. Grupo Sustencial desires to obtain a working capital line of credit for $3,000,000 (U.S.) (or its new peso equivalent) to assist the company in its development of a newly-established business in Mexico.

Synthetica USA is the inventor and holder of the United States and Mexican patents on the “Waste Vaporizer.” The Waste Vaporizer is a compact unit which, through a combination of heat and steam, breaks

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down and neutralizes nearly all types of toxic wastes. In addition, Synthetica USA has registered the tradename "Synthetica" in Mexico. Synthetica de Mexico has been licensed by Synthetica USA to market, and ultimately to manufacture, the Waste Vaporizer in Mexico. Also, Synthetica de Mexico has been licensed to market a toxic waste disposal service at a site owned and operated by Synthetica de Mexico. Finally, Synthetica de Mexico has been licensed by Synthetica USA to use the tradename "Synthetica."

All necessary permits have been obtained for Synthetica de Mexico to operate its Waste Vaporizer, and purchasers of the Waste Vaporizer are readily obtaining their necessary permits.

Synthetica de Mexico does not own any real property in Mexico; it rents its facilities in Mexico. Synthetica de Mexico has been in existence for only one year, and a one-year track record is normally not enough time to create a track record and establish credit from a bank.

Synthetica de Mexico sells Waste Vaporizers in Mexico for a sales price of $6,500,000 (new pesos). During its first year of operation, Synthetica de Mexico sold and delivered three Waste Vaporizers. It is projecting the sale of five Waste Vaporizers in its second year of operation. Also, Synthetica de Mexico maintains a Waste Vaporizer on its premises and will dispose of its customer-delivered toxic wastes for a fee. During the first year of operation, Synthetica de Mexico earned $4,500,000 (new pesos) from neutralizing toxic wastes. Finally, Synthetica de Mexico leased two Waste Vaporizers in the past year and receives $650,000 (new pesos) a month from the leased vaporizers. The company expects to lease two additional Waste Vaporizers during its second year of operation.

In connection with its sale of Waste Vaporizers, Synthetica de Mexico has committed to maintain an inventory of parts for the Waste Vaporizers. The value of the inventory is approximately $3,500,000 (new pesos). Additionally, the end product of certain neutralized toxic wastes is reusable in certain manufacturing operations. The average value of this reusable substance on hand is approximately $1,000,000 (new pesos). Synthetica de Mexico has an average of $1,000,000 (new pesos) in time deposits with Mexican banks or invested in Mexican treasury bills, or cetes.

Synthetica de Mexico has approached both Mexican and United States banks with a request for extending a working capital line of credit. One Mexican bank and one United States bank have independently expressed a willingness to consider extension of the credit, but they both indicated that the loan would have to be fully-secured. The investors (the parent companies) are willing to have Synthetica de Mexico provide security, but neither company is prepared to guarantee the indebtedness.

**ISSUES RAISED BY THE HYPOTHETICAL CASE STUDY**

1. What types of security does Synthetica de Mexico have to offer its lenders?
2. How should the credit be documented?
   a. What additional rights are available depending on the nature of the credit documentation?
b. What are the attendant costs depending on the nature of the credit documentation?

3. How would the different types of security be documented?

4. Should a default occur under the credit documentation, how would the lender realize on its collateral?

5. What are the practical difficulties a United States or a Mexican lender could expect to encounter in attempting to realize on its collateral for this loan?

THE DISCUSSION

Mr. John E. Rogers: Note that the $3,000,000 (U.S.) credit sought by Synthetica de Mexico would be worth, in peso terms, about $9,000,000 (new pesos).

Mr. Michael I. Owen: Also, note that we are discussing a financing that is secured by inventory or by accounts receivable. These two types of property can fluctuate in value greatly from one day to the next. When a bank is lending against the value of accounts receivable or inventory, it often ties the amount of the loan that can be granted or outstanding at any one point in time, to the amount of the value of the inventory or accounts receivable. The formula determining the amount of the loan is referred to as a "borrowing base," and it has to be monitored on a daily or a weekly basis.

Assume, for example, that Synthetica de Mexico is based in California and has the same property that I just described. Applying the principles summarized by Professor Hart on Article 9 of the Uniform Commercial Code,1 how would you go about obtaining a perfected security interest in all of that collateral? The types of collateral that the case study presents for us are: patent rights, licenses, inventory, equipment, time deposits, chattel paper (the lease receivables would probably be classified as such), and treasury bills. Under Article 9 of the Uniform Commercial Code, a creation of a security interest in all of these collateral interests would be by means of a standard security agreement; it could be one agreement that covers all types of property. For nearly all of the above types of property, the security interest is perfected by filing a Form U.C.C.-1 with the Secretary of State in California, or any other state in which the collateral is located. Of course, a loan must first be made to provide value before the security interest can be perfected. The perfection is accomplished by filing the security agreement. The filing fee varies from state to state but, usually, it costs about $15.00 (U.S.). A security interest is then perfected in all of these different types of property.

There are some exceptions, however. With respect to patents, there is a federal statute that is an overlay: a summary of the patent assignment agreement must be recorded with the United States Patent and Trademark

Office in order to perfect and provide notice to third parties of a security interest in the patents. In addition, the time deposits are handled differently by states under Article 9 of the Uniform Commercial Code. In California, Article 9 governs perfection of a security interest in deposits, but the manner in which it is perfected varies. If the deposit is with a secured party, a security agreement that is signed and delivered to the secured party is considered perfected. If the deposit is with a third-party bank or institution which is not the secured party, the security interest is perfected by giving notice of the security agreement to that bank or institution. The perfection of security interests in the treasury bills is a somewhat complicated area, which is beyond the scope of this article. They are considered uncertificated securities in the United States.

The manner in which a security interest in uncertificated securities is perfected is governed by Article 8 of the Uniform Commercial Code. The best way to perfect a security interest in uncertificated securities is to pledge them as collateral. After a security agreement describing the collateral has been filed, the secured party should become a registered pledgee of the securities, meaning that it should have the pledge registered on the books of the issuer of the securities. This is a very brief summary, but it underlines the simplicity of the United States system in creating a security interest in a broad variety of property interests. Licenciado Agustín Berdeja-Prieto, an expert on how to obtain a security interest in all of these types of collateral in Mexico, will address the formalities of this issue.

Lic. Agustín Berdeja-Prieto: The main statute in Mexico regarding commercial transactions is the Commercial Code (the Code). The Code, enacted as legislation in 1889, has been tested and proven credible over and over. However, the United States lawyer who attempts to find a statement of what is required by the Code for each type of security device is bound to go crazy. Yet, at the same time, the Code is very flexible and full of principles. One of the principles embodied in the Code is that commercial contracts are valid without a need for any formality, except as otherwise expressly required by an applicable law.

Next, one of the reasons why past due obligations of Mexican banks have recently increased so dramatically is because the banks have concentrated on perfecting security interests and have neglected the basic wisdom of the underlying transaction. Before reaching the point of perfecting a security interest in Mexico, the banks should ensure that the underlying deal is a good one. The hypothetical case presented here is designed to illuminate these legal issues.

The time deposit under Mexican law could very well be assigned or pledged. In this case, because it is used to guarantee an obligation, it could be a pledge that would affect the credit rights under the time deposit. The creation of the pledge, of course, should be written into a contract. The bank should be notified of the existence of the pledge and

2. See Código de Comercio [Código Com. - Commercial Code], art. 75 (Mex.).
the place of its location. The pledge contract in Mexico is regulated by the *Ley General de Titulos y Operaciones de Crédito* (L.T.O.C., General Law of Negotiable Instruments and Credit Transactions)\(^3\) which was enacted in 1932. Everyone conducts business under this law, and they enjoy it.

One important issue that this hypothetical case does not mention is the location where the transaction occurs. Assume that the transaction occurs in Mexico City because the Federal District of Mexico City has the most popular civil code in the country and most states follow it. As in the case of a time deposit, once the bank is notified of the existence of the pledge, constructive or actual delivery of the pledge contract must exist. Hopefully, the time deposit certificate will be issued in favor of the lender. To make the pledge valid vis-à-vis third parties, the pledge agreement is registered or recorded in the Public Registry of the place where the funds are located, in this case, in Mexico City. As to enforcement, because of Article 14 of the Mexican Constitution,\(^4\) a judge would have to authorize the pledge to realize the collateral. This is an unsolved problem. Mexican courts have refused to allow private parties, under pledge agreements, to settle their disputes, except with the express authorization of the pledgor.

The time deposit can also be converted into money to create cash collateral. In that case, the perfection requirements would change slightly in that the depository (the bank in this case) would not have to be notified of the existence of the collateral. There is a provision in the L.T.O.C. that has created much confusion\(^5\) even in the purely domestic transactions of the Mexican market. The provision states that cash collateral is supposed to be transferable as property or money, unless otherwise agreed upon by the parties. The common interpretation is that if a pledge of cash collateral is received, the money is available and possession can be maintained indefinitely. It is assumed that the pledgee automatically becomes the proprietor in case of a default under the contract. Mexican courts, however, do not interpret the provision in that way. The only advantage of cash collateral, as opposed to time deposits in this case, is that when you are the creditor under a cash collateral pledge agreement, the money is available for use while the legal proceedings are taking place. This is known as a fungible asset: one that is not easily identifiable or distinguishable from other assets. As a result, while the legal proceedings are underway, for the creditor to realize his cash collateral, he can dispose of the money or use it for any purpose, except that he cannot yet treat the transaction as final on his books. These are the essential elements involved in the pledge of a time deposit or cash collateral.

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4. Article 14 includes Mexican principles on the due process of law.
Regarding the use of *cetes*, or Mexican treasury bonds, there is some good news from Mexico. The new securities bond, or *caución bursátil*, was recently created through an amendment to the Securities Market Law\(^6\) that was published in the Federal Register, the *Diario Oficial de la Federación* (D.O.) on July 23, 1993. Under this new concept of *caución bursátil*, a bank can accept Mexican *cetes* as a guaranty and deposit them with a third party, another *casa de bolsa*, a brokerage house, or another bank. It is essential that the depository be separate from the same financial group in order for this new structure to work. When the time arrives for the underlying debt to be paid, the creditor has a right to demand payment of the obligation and, if the guarantor does not pay pursuant to the securities bond contract, the third-party is entitled to immediately liquidate the securities and deliver the money to the creditor. The third-party is known as an *executor*, or trustee, under the Securities Market Law.\(^7\) This is a new concept in Mexico and is the result of a lot of lobbying by creditors in Mexico who wanted an easier form of realizing collateral. The Mexican Supreme Court might determine that the Securities Market Law violates due process under the Constitution. To the best of my knowledge, the question has not been presented to the supreme court. In the meantime, many attorneys in Mexico are utilizing this new security vehicle. It is possible that, before long, we will have a case confirming the constitutionality of this new structure.

Synthetica de Mexico sells Waste Vaporizers and it would prefer immediate liquidity out of the sale. Business enterprises are usually part of a financial group under this universal banking system that is in place. The bank analyzes the risk and opens a line of credit to the purchaser of the machine, and Synthetica would obtain immediate liquidity out of the sale and leave the factoring company in charge of collecting the money on the Waste Vaporizer.

One feature of a factoring contract is that, by express provision of the General Law on Auxiliary Credit Organizations and Institutions,\(^8\) it is not necessary to record the contract with any public registry. The factoring contract must be signed and the debtor under the underlying purchase and sale agreement must be notified that the rights of the seller have been assigned to a factoring company. Thus, the interest is perfected. Factoring companies are supposed to maintain foreign currency reserves for foreign denominated factoring agreements. If there are transaction costs in dollars, then the seller is required to make the foreign reserves available.

Moreover, there is a possibility of a purchase financing agreement. If a United States lender could finance the purchase of the Waste Vaporizer directly, through a *crédito de habilitación o avío*, it would have a security

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6. See *Ley del Mercado de Valores* [Securities Market Law], arts. 27, 99, D.O. (July 14, 1993) (Mex.).

7. See L.T.O.C., art. 99(l).

8. See *Ley General de Organizaciones y Actividades Auxiliares del Crédito* [General Law on Auxiliary Credit Organizations and Institutions], arts. 45(l), 48, D.O. (Jan. 14, 1985) (Mex.).
interest in the Waste Vaporizer and in the proceeds of the exploitation of the Waste Vaporizer. It is essential to execute such a purchase agreement before a notary or a public broker, *corredores publicos*. Mexico enacted a new law on *corredores publicos* that makes their participation in these transactions very desirable. Through the *crédito de habilitación o avío*, a security interest is obtained. It is essential to not only notarize, or otherwise formalize the security interest, but also to register the security interest at the public registry. If there is a bankruptcy of the debtor, a secured creditor would have the same priority as any mortgage creditor under this type of arrangement.

Finally, I will comment on the problem of foreign denominated currency transactions in Mexico. In the *Banco de Brasil* case, one smart and aggressive trustee stated that if all debts need to be liquidated and no debt is going to accrue interest after a company has been declared bankrupt, then no foreign currency-denominated debt should continue to shift or float throughout the proceedings. The circuit court accepted this rationale which resulted in the dollar amount being frozen in pesos as of the date of declaration of the bankruptcy.

*Mr. Owen*: Is this wonderful new vehicle of Mexico, the *caución bursátil*, similarly available to a United States lender in the United States if he wants to proceed with the transaction?

*Lic. Berdeja-Prieto*: Yes, although one must ascertain the nature of the securities that are being pledged. Certain securities have restrictions as to who can and cannot own them.

*Mr. Owen*: Originally, of course, the trust concept was created to deal with the problem of real estate in the forbidden zones in Mexico. The reason it worked was that Mexican banks had to be 100% owned by Mexicans and, therefore, when they acted as trustee, the real property was deemed to be owned by companies that were 100% owned by Mexicans. In this new development, as I understand it, insurance and bonding companies can now be partially-owned by foreigners. Could they then still serve as trustees for real property in the forbidden zone?

*Lic. Berdeja-Prieto*: Yes. There is an ongoing battle between the Ministry of Commerce and the Ministry of Foreign Relations regarding this matter. The Ministry of Commerce wants to eliminate most of the restrictions for foreigners to own property inside the restricted zone. There is a recent decision by a Mexican court involving the validity of a trust guarantee where a third party wanted to take the assets that were subject to a trust arrangement with a bank. The court said, "[t]he assets are

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11. Future rate coverage contracts and their management may be employed as a solution.

out of the realm of the debtor and they are under the realm of the assets of the trustee, which is a bank, and they are fiduciary property, so they cannot be subject to these proceedings.\textsuperscript{13} This statement is a breakthrough and a clear and fortunate interpretation of the use of the trust arrangement in cases that do not concern the ownership of property in restricted areas. Now, keep in mind that banks are authorized to act as trustees in all transactions, while insurance companies, bonding companies, and brokerage firms are authorized to act as trustees only in transactions that are directly related to their activities.

\textit{Mr. Rogers}: Our Synthetica hypothetical case has a couple of categories of receivables. Could you address the types of security interests that might be created in those receivables that are rental contracts and, possibly, receivables for servicing toxic waste?

\textit{Lic. Berdeja-Prieto}: We are talking about a new product in Mexico. I would not feel comfortable relying on the receivables because the market might not be ready for it. Nevertheless, if we were to use the receivables under a trust arrangement in which the trustee would be responsible for obtaining all the money, the lessees would be obliged under the lease contract to make the payments to a certain account controlled by the trustee. One of the nice features about the trust arrangement is that, pursuant to the L.T.O.C.,\textsuperscript{14} the trustee must observe the instructions of the settlor, the \textit{fideicomitente}. If there is a default under the loan, or under the lease contract for any underlying obligation, the trustee could immediately make the funds available to the lender or to Synthetica without the need for any further court proceedings.

\textit{Mr. Rogers}: Apart from the trust, are there other means to use to perfect a security interest in receivables?

\textit{Lic. Berdeja-Prieto}: Yes. The rights to the security interest can be assigned. This may generate issues under the tax law on the transfer of property or, perhaps, trigger tax obligations that one may not want to trigger.

\textit{Mr. Rogers}: What about inventory? Can you envisage inventory being subjected to these same types of trust arrangements?

\textit{Lic. Berdeja-Prieto}: I would not envision floating inventory being subject to such trust arrangements; Mexico does not have the concept of a floating lien.

\textit{Mr. Rogers}: You mentioned the \textit{crédito de habilitación o de avío}, and there is also the \textit{crédito refaccionario}. Could you tell us a little more about the procedures that are used for perfecting the security interest?

\textit{Lic. Berdeja-Prieto}: A \textit{crédito refaccionario} is basically the same as a \textit{crédito de habilitación de avío}, except that \textit{crédito refaccionario} is used to create or promote a business, and the \textit{crédito de habilitación o avío} is used for working capital purposes. The \textit{crédito de habilitación o avío} must be in writing and signed. You have to be very specific as to which

\begin{itemize}
\item \textsuperscript{13} Id.
\item \textsuperscript{14} See art. 356.
\end{itemize}
property is being covered. You have the right to include all accounts receivable that will be derived from the exploitation of the goods that are being purchased by means of this money. You must register at the public registry where the goods will be located. In that way, you gain preference in case of bankruptcy; the same preference a mortgage creditor would have.

_Mr. Rogers:_ Every time a new item of inventory appears in the stock of the company does it have to be treated the same way?

_Lic. Berdeja-Prieto:_ This issue would be addressed in your agreement, which ensures adequate protection.

_Mr. Rogers:_ When it comes time to sell the item of inventory, what happens? Assume that a customer wants to buy the inventory, but it is subject to this security interest.

_Lic. Berdeja-Prieto:_ Well, you can provide for that in the _crédito de habilitación o avío_. You can state that the money will be used to continue operating the business or that it will be deposited in a particular account for the benefit of the creditor.

_Mr. Owen:_ Is there any formal release that needs to be made if the merchant wants to go ahead and sell the inventory that is the subject of the security interest under the _crédito de habilitación o avío_?

_Lic. Berdeja-Prieto:_ Article 327 of the L.T.O.C. states that one cannot sell property that is the subject of the _crédito de habilitación o avío_ without the consent of the lender. If the property is sold without the lender’s consent then the lender has the right to rescind the contract.

_Professor Frederick M. Hart:_ Because the debtor usually pays for these things, what is the cost to the debtor of perfecting a security interest on a $2,000,000 item of equipment in the Federal District of Mexico?

_Lic. Berdeja-Prieto:_ I think that it would be approximately one-half of one percent for perfecting a security interest before a notary public or a public registrar. In addition, we would have to review the treasury law for Mexico City to see what type of duties would be payable for the recordation in the public registry. For several years, the fee was a percentage of the amount of each transaction as recorded in the public registry. However, there have been three or four decisions by Mexico’s Supreme Court providing that the authorities should charge only an amount proportionate to the cost of rendering the respective services, not to the amount of the transaction. Thus, if I were perfecting a _crédito de habilitación_ for $100,000, and the amount of work was the same for a $10,000 transaction, there would be no reason why the authorities should charge more. They are no longer permitted to do so.

_Mr. Owen:_ Is the percentage usually tied to the amount of the credit being secured, or the value of the inventory being given as security?

_Lic. Berdeja-Prieto:_ The percentage is tied to the credit being secured. When you deal with _notarios publicos_ in Mexico, they have an _arancel_, a schedule of fees, that is tied to the amount of the credit. It does not seem that the government intends to do anything about this situation.

_Mr. Rogers:_ You mentioned that in the case of a pledge agreement covering time deposits, the perfection involves a recordation. Do we have the same issue as in the case of time deposits?
Lic. Berdeja-Prieto: You would want to register the pledge on the movables section at the public registry where the company is located. Synthetica de Mexico, for example, would be registered in Mexico. The public registry has three sections: one section for company and corporate documents; a second section for immovable transactions; and a third section for movable transactions. You can certainly make an entry in the applicable folio to make sure the pledge will be enforceable vis-à-vis third parties.

Mr. Owen: Is there a recordation fee that is tied to the amount of the credit being secured?

Lic. Berdeja-Prieto: In the past, yes. However, there have been changes in the law of the Mexican Federal District, but not in many of the states. This can be challenged in court, but recall that the *amparo* suit benefits only the party who is seeking the *amparo*.

Mr. Rogers: We are going to turn now to a different approach regarding this type of problem. We will now look at this issue from a creditor’s point of view. Jim Mayer is President and Chief Executive Officer of Diversicorp, Inc., a company based in Dallas which monitors, controls and warrants pledged current assets, such as inventory and receivables. He is also director of Credit Support International based in Brussels. Mr. Mayer has a great deal of experience in developing a different approach to collateral.

Mr. Jim Mayer: This discussion is about mechanisms for controlling the security interest of United States companies with assets in Mexico and Mexican companies with assets in the United States. Having such mechanisms are fine, but having mechanisms on fungible collateral does not ensure that what you pledged today is what you will have tomorrow. Certainly, in the United States there have been notable occurrences, not only with small and middle market companies, but even big companies which, it would not seem, would require being subjected to any type of continuing control. Recent examples are: Leslie Fay; Crazy Eddie; and Web Tech. The fact of the matter is that size does not prevent fraudulent pledging. I do not want to lead people to believe that the only reason that you should provide a continuing information system outside of the pledge, or other security interest, is because of troubled situations. There are normal occurrences, where inventory problems exist, frequently in the case of a new company. In our case study, Synthetica, instead of being over-collateralized, may not be adequately collateralized. Vendors may be taking specialized liens, such as “purchase money security interests.” When there are competing interests, it may be difficult to prove that you had the security interest you thought you had.

The collateral management industry began before Article 9 of the Uniform Commercial Code was adopted. This code was developed in the era when, in fact, possession was demonstrated by devices like warehouse receipts. Accounts receivable were simply sold in a factoring arrangement; whereas now accounts receivable can be pledged, and the owner of those receivables can retain ownership. Today the collateral management industry is primarily employed for the growing middle-market companies,
whom creditors want to remain in touch with the assets on which they are relying.

In Mexico, there is good news and there is bad news. Most of the applicable Mexican laws emanated from the old Napoleonic Codes. American creditors attempting to realize on pledges in Mexico will quickly find that there is a basic dysfunction between receivables and inventories. In the United States, on the other hand, there is recognition of the interrelationship of the two; inventory is really accounts receivable waiting to happen. In Mexico, however, a company like Synthetica has the task of finding a way to stay in touch with the assets that are being pledged.

The good news is that Mexico is developing improved laws. Companies like Synthetica have to deal with financial institutions which control factoring companies. The factoring companies provide the necessary notification and control of receivables. Next, we have to deal with companies, also authorized under the banking laws, which take control of the inventories. We must strive to create systems integrators like those in the computer industry. These systems are currently being developed.

The bad news is that this process will be expensive. It will be particularly difficult for the lenders because, when a lender is charging the prime rate in the United States, the idea of charging equivalent amounts to control his collateral in Mexico is something that has never been dealt with before. An exporter from the United States and an exporter from Mexico should anticipate that the costs will be higher.

Mr. Rogers: Could you describe a typical situation in the United States for which you structure the control relationship?

Mr. Mayer: There are three different mechanisms that are used in the United States: (1) the examination; (2) the information reporting system that people generally refer to as collateral monitoring; and (3) control.

Examinations are just examinations. If the borrower is worthy of credit and has a long-term relationship with the lender, one only needs to quantify the assets as accounts receivable or inventory. In some cases, it is necessary to check the periodic cut-offs of the financial reporting to see that the numbers coincide with what is being reported to the bank.

The third party who controls the borrowing base periodically reviews the information. The controls are a throw-back to both the factoring industry and to the field warehousing industry. The controls employ bailment and segregation. The person controlling the borrowing base takes instructions from the creditor involved and conditionally has the capability of taking control of the assets.

Mr. Rogers: Is this accomplished by an agent of the creditor located on the debtor’s premises?

Mr. Mayer: It can be done by an agent or one of the creditor’s own employees. We may conduct bonding checks on employees of the company, which is the debtor, and effectively bring them under our professional liability. In very troubled situations, we may put in an independent agent, which is nothing more than our own employee. The control element involves continuous control and reporting of what is in stock. This may
require dominion over the assets, continuing reports of information about the assets, and periodic examinations as part of the same service.

Lic. Berdeja-Prieto: Mexico provides fertile ground for your services. Under a crédito de habilitación o avío the creditor has a right to appoint an agent by law, an intervenor under Mexican law. In cases of default, the creditor has the right to accelerate the loan where the debtor may be paying its obligation but is not using the goods for the purpose which was represented. Having an agent with the debtor who can report to the creditor on a timely basis what is going on at the company can give the creditor the right to accelerate the loan and prevent further damage. Also, under the law in Mexico, if the goods were not being used properly and the creditor knew or should have known, but did nothing, then the creditor will lose his preference in bankruptcy. This agency relationship through the intervenor, of course, is statutorily accepted for the crédito de habilitación o avío, but I see no reason why it could not be implemented to control other types of collateral in Mexico.

Mr. Owen: The crédito de habilitación o avío is one of the most important credit devices available. However, it is my understanding that it is generally not available nor is it a satisfactory approach towards obtaining a security interest for a working capital line of the type in our case study. To perfect a security interest under a crédito de habilitación o avío, the secured party has to be certain that the monies advanced are actually used to purchase the equipment that is being secured under the crédito de habilitación o avío. The monies advanced under Mexican law cannot be just a working capital advance to be used for any purpose in operating the company. Is that correct?

Lic. Berdeja-Prieto: Yes. However, other types of collateral may be available. Again, I emphasize that even if you do not locate the type of collateral you desire for your transaction as specifically regulated in any code in Mexico, you should talk to your lawyer. For example, you may be able to create the desired type of collateral based on a principle in the Code of Commerce which provides that commercial transactions can be entered into without the need for any formalities or restrictions, except as otherwise provided in the law. Customization, or tailor-making of collateral for a transaction is available in Mexico, and the crédito de habilitación o avío is not the only way to collateralize a working capital line.

Mr. Mayer: I would like to give another word of caution, primarily for Mexican lawyers looking at financing in the United States. As we have seen in the last three years courts have been difficult with regard to the number of bankruptcies in Mexico that have been devastating times. I am a lay person, but I have been involved with enough problems under section 547 of the United States Bankruptcy Code, particularly in the area of over-collateralization. The tendency is to believe that I will obtain the assets, the receivables, and the inventory, but before you know

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15. Código de Comercio [Cód.Com.], art. 78 (Mex.).
it, you have a preponderance of all the collateral that is available and it becomes disproportionate to the loan advanced. Remaining in close touch with the collateral is preferable to over-controlling the situation.

Mr. Owen: We are aware of the serious problem that Mexico faces because of the lack of credit that is available, especially to small and medium-sized companies. The source of the credit in the United States has come from asset-based lenders. The asset-based lenders, as a group, mushroomed as a result of the adoption of Article 9 of the Uniform Commercial Code (U.C.C.). Article 9 is truly a revolution in this country. The implementation of Article 9 facilitated an entire industry and a new source of credit for people in our country who, at the time of its inception, desperately needed credit, just as people today need this type of credit in Mexico.

We have heard rumblings that Mexico is occasionally glancing our way to consider whether elements of United States law are worthy to assist the Mexican government as it modifies its laws in the area of economic development. Mexico is considering laws similar to the United States antitrust law and securities law (heaven forbid!). Mexico is even looking to our tax law for guidance, but I think no one would be so masochistic as to adopt any elements of our tax law. Yet, one area of United States law that could benefit Mexico is Article 9 of the U.C.C. Today, we have presented a good perspective on the types of facilities and credits that are available in Mexico, and I certainly do not want to minimize that discussion. Indeed, one of the most important recent developments in Mexico is the use of the trust, the fideicomiso, which has evolved as a recognition within Mexico of the limitations of the traditional forms of obtaining security interests within the country. Nevertheless, it is apparent from this review that the situation in Mexico is very similar to that which Professor Hart described as being the situation in the United States in the 1940s and the 1950s. If you wanted to obtain security interests, you had to determine whether a law existed that could be applied to obtain a certain type of security interest. It was a very inefficient system.

In Mexico, no mechanism exists for the creation of various types of personal property security interests. For example, a security interest in equipment where the proceeds of the loan are used for a purpose other than financing the purchase of that equipment. As important, there is no inexpensive and certain mechanism for a potential lender to determine whether specific personal property has already been given as collateral for pre-existing credit. In the United States, this situation happens thousands of times daily all across the country. A potential lender will conduct a search at the Office of the Secretary of State in the locale where the debtor is located and, very quickly, he can determine what security interests, if any, have been granted in property of that debtor. He can then know whether he will be able to obtain security interests in the type of collateral he wants. In Mexico, there is no efficient and complete way of conducting this type of search. Even in situations where there is recordation, sometimes the recordation is with one registrar in one state and sometimes it may be with another registrar in a different state.
Furthermore, enforcement by a lender of its security interest normally requires resort to the courts. A court proceeding results in extended delays and costly legal fees to realize the collateral. The recording fees mentioned impede this type of financing; for instance, in a work-out situation, where there is security available that the lenders would like to obtain as a part of a compromise to "work out" a situation, or "work out the debt" in order to sustain the borrower. Yet, the very cost of simply notarizing or recording the security interest in that collateral is so expensive that the lenders, ultimately, forego doing so. The liquidity of the borrower is also very limited. The creditors simply cannot afford to use up that liquidity to pay the recording fees. In the United States, the recording fees tend to cost about $15. In Mexico, the recording fees vary from state to state. I have been told that a fee can average one and one-quarter to one and one-half percent of the total debt secured. Thus, if you have a financing for $5,000,000 (U.S.), even if the recording fees were only one-fourth of one percent, those fees alone would cost $12,500 (U.S.). This price does not take into consideration lawyers' fees and all other costs.

There are a number of recommendations that I suggest. Many of the recommendations, if implemented, would be as revolutionary in Mexico as was Article 9 in the United States when it was adopted. Mexico should consider permitting the creation of security interests by contract without requiring possession and covering inventory, equipment, accounts receivable and contract rights in general, and permitting the security interest to be on a generic basis. The law should also provide for notice requirements to parties by agreeing on a registry where summaries of the grant of security interests could be recorded. One problem in Mexico is that when you have to record something, you normally have to record the entire instrument by which the pledge is given. Thus, if a crédito de habilitación o avío is involved, the entire loan agreement must be recorded. For the creditor and the debtor, there may be some dirty laundry in that they would rather the public not be aware of information which is not necessary for third-party creditors to know.

The enforcement of security interests is one area that we have not been able to review thoroughly. There are certain types of enforcement of security interests available to Mexican banks where it is not necessary to go to court. That is, Mexican banks are permitted, on occasion, to sell security interests, or to enforce their security interest by sale through a public broker. However, this enforcement mechanism is not available to foreign lenders because it is contained in the Ley de Instituciones de Crédito, which only deals with Mexican credit institutions.

There are numerous lenders in the United States and elsewhere who would like to come into Mexico to do business if the Mexican laws were more supportive to the lenders. Furthermore, such laws would also encourage the creation of very strong, asset-based lenders in Mexico.

Lic. Berdeja-Prieto: The trend in Mexico is towards facilitating these transactions and towards making the fees more hospitable to asset-based
lending. It is clear that recording a mortgage in Mexico City will only cost $300. Mexico City has the leading public registry.

A few years ago, Canada enacted the concept of a floating lien. And, France and Germany already have special laws on securitization of assets. In Mexico, the real question is not whether we can change the federal laws and facilitate this type of transaction, as in the United States, but rather, whether the Mexican Supreme Court will change its interpretation of the due process clauses in the Mexican Constitution, specifically Articles 14 and 16, to enable a law like Article 9 of the U.C.C. to be valuable. Even if Mexico changes its law, as we did with the securities bond contract, I still have doubts that the Mexican Supreme Court, or any federal court, would find this issue constitutional. The resolution of this issue is urgent.

QUESTIONS AND COMMENTS

QUESTION, Mr. Michael Mandig, Tucson, Arizona: The National Law Center in Tucson hosted a group of attorneys, law professors, notarios publicos, and a professor by the name of Ronald Cumming, from Canada, in 1993. The topic of the discussion was the recent creation in Canada of a centralized, readily-accessible commercial registry. Should this lead be followed in Mexico and, possibly, in the United States?

Representatives of the notarial bar in Mexico expressed great interest in a central federal registry in Mexico. The Instituto de Estudios Políticos in Mexico City will participate in a study with an organization from Canada to determine if Mexico should create a registry. At a recent meeting, the house counsel for ITT Commercial Finance Corporation made it clear that they have been looking at trying to do business in Mexico, but unless and until mechanisms are provided whereby the company has better assurances of being paid or being able to enforce security rights if the company is not paid, it is not considering doing business in Mexico. ITT has concluded that there is no adequate mechanism available in Mexico for secured lending to finance inventory.

As an example of one of the changes that is occurring in Mexico, the State of Sonora recently enacted a new code regarding public registries. The Sonoran government is putting all of its future public registry information on computers and, apparently, there is talk about having a centralized registry in Mexico City that would be tied into the registries in the states.

I represent GMAC de Mexico (General Motors Acceptance Corporation of Mexico). GMAC has one case in Tucson and three cases in Sonora. Although GMAC purports to finance car dealer inventories, it is not entitled to do so in the same manner as a Mexican bank. GMAC uses contratos de consignacion, consignment agreements, under which GM de Mexico manufactures automobiles, sells them to GMAC de Mexico, and then ships them to the automobile dealer’s place of business where the automobiles are placed on display. GMAC tries to keep track of activities by having field representatives go to the dealerships on a monthly basis.
to count cars and check serial numbers. Last year, GMAC realized that one of their customers, a fellow who had about five car dealerships in the State of Sonora, had sold approximately 750 cars but had not bothered to pay GMAC for the cars. He allegedly used the money to service bank debt. When this was discovered, GMAC’s representatives went to one of the dealer’s businesses in Hermosillo, and under a written agreement with the consignator, the GMAC representative began to take possession of the vehicles that were still on the lot and shipped them to another location. Thereupon, the dealer’s Mexican attorney went to court, or to the procurador, I am not sure which, but, in any event, the dealer obtained a warrant to have the GMAC representative arrested for robbery. In fact, under the technical definition of robbery in Mexico, the GMAC representative had, indeed, committed robbery, notwithstanding the fact that GMAC was technically the owner of the vehicles that were being repossessed. Could the relationship between GMAC, General Motors, and the car dealer have been structured differently from a consignment arrangement to prevent this type of situation?

ANSWER, Lic. Berdeja-Prieto: This problem raises several issues. First, it is not entirely true that Mexican banks have advantages over foreign lenders. In fact, in this situation the Mexican banks do not have the type of advantage you referred to. Do you think your client would have been better off if it had financed the cars through a Mexican bank? My firm was recently hired to review the guaranties under foreign exchange contracts for a Mexican bank. The bank told us that it had approximately 2,400 cars that it had recovered from people who stopped making payments, but the bank could not use or sell the cars without facing the same threat of arrest as was the case with your clients. In general, under Mexican law, even if you are a good-faith proprietor, you do not have confirmed property rights over cars in the hands of a good-faith possessor unless a court will confirm that the debtor no longer has ownership or has a better right. Therefore, if your clients thought that they could repossess the cars because they had the right to do it under the contract, they were wrong and they committed a crime. The GMAC representative should have gone to court, but this, too, raises the due process problem that I discussed earlier which permeates every aspect of our car dealer system. You have to go to court for the court to proclaim that the debtor did not meet his payment obligations and the creditor is entitled, under the contract, to repossess the automobiles. Basically, in Mexico your client can do very little without court intervention.

QUESTION, Mr. Ed Einstein, San Antonio, Texas: Are any of the panel members aware of a civil law country, perhaps in Western Europe, that has mechanisms like Article 9 of the Uniform Commercial Code?

ANSWER, Mr. Owen: I am not aware of any country that has adopted a law what extends as far as Article 9.

ANSWER, Mr. Mayer: France has a similar type of mechanism. The United States has a transactional-type mechanism, whereas France recently adopted a bulk pledge system.
QUESTION, Mr. Rogers: Is France’s system more or less equivalent to a floating lien?
ANSWER, Mr. Mayer: It accomplishes the same objective as a floating lien but it is still slightly different.

QUESTION, Mr. Chris Bauman, Albuquerque, New Mexico: I have three questions for Licenciado Berdeja-Prieto. First, what remedies does a creditor have if the bank or ejecutor holding the pledged accounts, or security bonds, innocently releases the pledge due to fraud? Second, does the security received through a crédito de habilitación o avío extend to proceeds from the sale of that collateral? And third, would there be a viable and less expensive alternative by requiring the purchaser of equipment to purchase a bond for his performance under the purchase agreement?

ANSWER, Lic. Berdeja-Prieto: First, if the ejecutor, or trustee, releases the guaranty improperly, then the lender has improved the quality of your risk because, now, the lender can go after the brokerage house instead of your purchaser of merchandise. There are, of course, civil actions to recover the value of the guaranty and, perhaps also, criminal actions which are as effective in settling cases.

QUESTION, Mr. Bauman: The situation I described was, one in which there is an innocent release due to the fraud of the pledgor. Do you as a creditor have any remedies against the ejecutor? Is it possible, instead of trying to secure the collateral upon the sale of equipment, to ask the purchaser of that equipment to purchase a bond on his performance under the purchase agreement and, thereby, avoid having to worry about enforcing their security interest?

ANSWER, Lic. Berdeja-Prieto: It is not something that we have seen very often, but you can certainly purchase a bond, a fianza, that will guarantee fulfillment of the purchaser’s obligations. It would be a matter of (1) the cost for the purchaser, and (2) the type of bonding institution that is acceptable to you.

QUESTION, Mr. David Spencer, Seattle, Washington: It seems to me, in reading the hypothetical case, that the Waste Vaporizer that is going to provide the services for processing hazardous waste could be financed through a crédito refaccionario. Is that correct?

ANSWER, Lic. Berdeja-Prieto: Yes. The crédito refaccionario is the same as the crédito de habilitación o avío, except the crédito refaccionario is used primarily to commence business operations. The regulations are ninety-five percent the same for a crédito refaccionario as for a crédito de habilitación o avío.

QUESTION, Mr. Spencer: Therefore, is it correct to state that a financing agency could use crédito de habilitación o avío to finance the purchase of the Waste Vaporizer that Synthetica de México has on its premises, and also the Waste Vaporizers that Synthetica de México leases, because those are still considered inventory or equipment of Synthetica de México?

ANSWER, Lic. Berdeja-Prieto: Yes.