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Jaime Rene Guerra

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MEXICAN INSOLVENCY LAW: ¿QUÉ PASARÁ?
JAIME RENE GUERRA*

INTRODUCTION

This article will provide a treatment of the federal Ley de Quiebras y la Suspensión de Pagos [Bankruptcy and Suspension of Payments Law] procedure of the Mexican judicial system. Both have been in force since 1943 and although they have withstood revision, some of the provisions within the insolvency law still generate heavy discussion. This is due to the perceived inadequacy of those laws to provide a prompt and efficient system necessary for creditors to realize their rights. Therefore, within the text are included some suggestions to help improve and accelerate the judicial procedure for those of you considering reform. Although there are studies currently being conducted by La Barra Mexicana [the Mexican Bar Association] into the merits of the bankruptcy law and reform legislation has in fact been proposed, what follows is strictly the opinion of the author.

OVERVIEW

As the disappearance of a corporation is often considered a grave economic loss for a local economy, the interest to preserve and maintain the work of the employees generally becomes the fundamental spirit of bankruptcy proceedings. Hence, bankruptcy law commonly facilitates a means for the merchant to avoid complete liquidation while it simultaneously attempts to conclude any debt proceedings with a final payment agreement. Where possible, it fosters a successful reorganization of the corporate entity.

Now although there are three types of insolvency procedures in Mexico, only two are specifically of concern in this article since the third variation generally applies to non-merchants. The first insolvency procedure results in an attempt to suspend payments on existing delinquent accounts. Full suspension manifests the intent to preserve and maintain the corporation in its functioning capacity as opposed to the alternative of complete dissolution. Therefore, the debtor is relieved of payments on principal and interest while he negotiates a reorganization and restructuring plan with his creditors. If the majority of creditors do not approve, or if the court rejects the plan, then bankruptcy proceedings are initiated by default. The second procedure is absolute bankruptcy, in which the corporation’s assets are completely or partially liquidated in order to fully satisfy claims by all outstanding creditors.

Thus the former procedure, the suspension of payments, is frequently employed in order to avoid a full-blown bankruptcy proceeding that might result in the

* A partner of Guerra, Gonzalez y Abogados, S.C., Guerra received his Licenciatura en Derecho in 1970 from the Universidad Nacional Autónoma de México and a Master’s in Comparative Law from Southern Methodist University in 1972.

1. Ley de Quiebras y Suspensión de Pagos,” [L.Q.S.P.], Diario Oficial, 20 de abril de 1943.
5. L.Q.S.P. art. 419.
termination of a local corporation. It is a self-initiated procedure by which the merchant travels to the court to obtain a judicial order to suspend outstanding debt payments. The merchant at this time may also offer the judge a reorganization plan and a timetable for repayment to creditors according to a preventive agreement as outlined in the law.6

Under Mexican law, as soon as the court delivers a bankruptcy or suspension of payments decree, the court retains the power to oversee all the acts of the merchant. The principal difference between the two insolvency procedures is owed to the role of the sindico [administrator or trustee] appointed by the presiding court. In bankruptcy proceedings, the trustee oversees corporate operations throughout the process and has the power to sell off all any assets necessary for liquidation.7 In the suspension of payments procedure, the trustee only serves as a liaison between the creditors and the debtor and oversees certain acts undertaken by the debtor.8 Nonetheless, in both processes, the court appoints an insolvency representative, who is bound to perform the duties of trusteeship with impunity as he potentially can incur all damages of the bankruptcy by his failure to do so.9

Both the bankruptcy and suspension of payments are divided primarily into three procedural steps. The first step is an actual petition to the juez de primera instancia or juez de distrito [a state court of first instance or a federal district court] where the merchant asks for the bankruptcy or suspension of payments relief. Both forums share jurisdiction over bankruptcy matters since historically there was no specific bankruptcy court created by the Constitution, although special courts were instituted as late as 1988 to hear insolvency matters in the Federal District only.10 In order to ask the court to declare bankruptcy or to order for the suspension of outstanding payments, the merchant has to first exhibit all of the following:11 1) the corporation’s accounting books; 2) the corporation’s financial statements for the past five years; 3) a list of all creditors; 4) a list of the corporation’s debts; and 5) an appraisal of all the assets in order to determine whether the debtor is truly insolvent or not.

The second step in this petition for relief is the acknowledgement of the creditors. This procedural step is actually a series of mini-lawsuits within the insolvency procedure whereby all known creditors step forward, understandably demanding payment. Meanwhile, the debtor attempts to oppose or negate the pressing claims of each creditor, as it obviously is in the best interest of the debtor to minimize the number of outside claims in order to have fewer financial obligations to fulfill. Thus, what ensues is a very lengthy and laborious process because painstaking efforts are made to ensure that 1) no creditor is wrongfully denied a true claim to the debtor’s assets or 2) that no debtor is obligated to pay more than the amount that was originally contracted. During this aspect of the process, which unfortunately accounts for a majority of the time spent during the

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6. L.Q.S.P. art. 400.
7. Conversely, an intervenor is appointed by the court to represent and safeguard the interests of creditors "in the vigilance of the actions of the trustee." L.Q.S.P. art. 58.
9. L.Q.S.P. art. 41.
11. L.Q.S.P. art. 6
insolvency procedure, the insolvency representative is not allowed to sell any of the current assets, essentially rendering the corporation obsolete throughout the prevailing interim.

The third step actually consists of an assessment stage that determines final action. In the case of the suspension of payments procedure, *la reunión de acreedores* [the creditors’ meeting] commences after it is fully decided by the court which creditors indeed possess legitimate claims and therefore who is entitled to vote in the creditors’ meeting.12 The purpose of the assembly is to decide on a strategy of reorganization, or a preventive agreement, for the struggling enterprise. Hence, the insolvency representative appointed by the court offers a payment agreement, to which terms the creditors must agree by majority vote. If no resolution is achieved, then the bankruptcy process is automatically enacted by default by mandate of statute.13

During the bankruptcy proceeding, an assessment is made by the presiding court for the purpose of classifying the controlling category it fits, whether accidental, culpable or fraudulent.14 The proceeding also sets a retroactive date. Any financial transaction or conveyance made subsequent to the retroactive date are deemed fraudulent or void.15 The court thereby imposes additional fines and punishment as required by law.16

It is important to note that when the court grants a bankruptcy or suspension of payments relief, no additional interest can be charged and added to the existing debt by any creditor. Thus, in the interest of fairness, a hierarchy has been established in order to ensure orderly, efficient, and equitable results. Hence, Mexican law has identified and classified five different classes of creditors.17

Parties who are entitled to redeem their claims first, above all others, are known as *acreedores singularmente privilegiados* [exclusively privileged creditors]. Exclusively privileged creditors include employees who are owed salaries for services rendered within twelve months prior to the bankruptcy declaration or initiation of procedure. Also included are creditors to whom medical and related expenses are owed, but only if the illness caused the death of the debtor and bankruptcy was declared after his death. Foreign creditors are eligible to collect as well, since there are no specific limitations placed on the right to appear in this stage of the capital recovery process.

The group of creditors who receive second priority are the *acreedores hipotecarios* [mortgage creditors and pledge creditors], which are the only secured creditors in the bankruptcy and suspension of payments law that are privileged to collect before others. Following the secured creditors are the *acreedores con privilegio especial* [specially privileged creditors] which take on the form of building contractors or commission agents. Fourthly are *acreedores comunes por operaciones mercantiles* [common creditors] whose claims arose in “the normal course of business.” These parties are allowed to collect pro-rata shares in

12. L.Q.S.P. arts. 80, 220, 224.
13. L.Q.S.P. art. 419.
15. L.Q.S.P. art. 121.
16. L.Q.S.P. arts. 95, 99.
17. L.Q.S.P. art. 261.
proportion to their original investment without regard to the particular date when their respective claims arose. Lastly, are those common creditors whose claims arose from acreedores comunes por derecho civil [civil law obligations].

SUGGESTED MODIFICATIONS

Nonetheless, in spite of all the provisions set forth in meticulous detail by the code, Mexican insolvency law has become the target of very strong criticism. Although current bankruptcy law has been in effect for over fifty years, creditors still complain about their unsafe exposure to the risk of not being able to collect their assets in full. Hence, the author suggests the following amendments:

A. **Impose definite and specific time constraints.** In a bankruptcy proceeding, all the assets of the corporation should be sold by the insolvency representative within six months after the court has declared bankruptcy. Within this finite window, all relevant parties involved should know how much they are going to be entitled to collect, and how much they will have to write off as a loss. Even though the insolvency representative normally attempts to sell all remaining assets as quickly as possible, there are no concrete time-lines in place which thereby allows for a wide range of fluctuation, detracting from any efforts of the courts to develop and attain consistency. Consequently, sometimes the assets are not sold at their proper value due to changes in the market over time. Also, in a bankruptcy proceeding, the assets of the corporation should be sold only after a complete and thorough appraisal of all existing claims. This will ensure the absence of glaring disparities between payments to certain creditors and preferentially treated interests.

B. **Abolish the acknowledgment of creditors phase.** In both proceedings, a significant amount of time could be saved with the exclusion of the second step of the proceeding, the acknowledgement of creditors. First of all, the debtor is obliged, according to Mexican law, to keep a record of all outstanding debts and current assets. Thus, if the debtor had previously registered existing financial obligations in the public ledger and accurate and reliable records have been maintained, then it is actually redundant and inefficient to reopen discussions of rightful creditors and the exact amounts owed them. Mexican law could impose strict financial penalties on those corporations that do not adhere to their filing requirements. Since acknowledgment of all rightful creditors may be obtained through the account ledger of the debtor, the precious and valued time of the court is not expended in such a protracted process. This step, if properly implemented, will undoubtedly save judicial resources and promote overall efficiency.

C. **Perform feasibility assessments of practical reorganizations (within the suspension of payments procedure).** It is important to note that in the last twenty years no more than thirty companies have successfully restructured and reorganized under the suspension of payments relief. The lack of available credit for an insolvent business makes a reorganization bid very difficult to

Therefore, in order to know if the merchant in a suspension of payments will rehabilitate its business, it is first necessary to determine if the merchant realistically can perform strongly in the market before engaging in a long and overdrawn procedure.

The insolvency representative could present to the court a report outlining the strengths and weaknesses of the respective corporation within six months of a suspension of payments decree. A final assessment and recommendation would then be made as to whether the merchant is financially solvent enough to avoid complete bankruptcy and possibly undergo rehabilitation. Otherwise, if the specially appointed master finds that a rejuvenation is not entirely possible, the court may directly declare bankruptcy in order to liquidate the merchant's assets.

D. Streamline the process. In the United States, there is already in place a "pre-packaged plan" designed to simplify and streamline the bankruptcy process.\(^2\)

It would therefore be convenient to make an amendment to the Mexican bankruptcy and suspension of payments laws in order to try offering a similar pre-packaged plan. The court would then only be permitted to authorize or reject the agreement reached between the creditors and the corporation, effectively minimizing its role significantly. This improvement on the current proceeding would avoid the long suspension of payments procedure and liberate the court to allocate its precious time and limited resources on other needed matters.

QUESTIONS AND COMMENTS

AIZA HADDAD: When assets are transferred into a security trust, does the court typically respect the transfer of those assets, separating them from the bankruptcy proceeding? Or do they question those transfers and try to consolidate the assets that are in the proceeding?

AUTHOR: Right now the courts are making a distinction between a fideicomiso administrativo y un fideicomiso garantizado [an administration trust and a warranty trust]. In the administration trust, the court considers the transfer legitimate because the interest of the trust is to create another unit different from the merchant. However, they may stop the bankruptcy sale procedure in order to pay the creditor because the trust is listed in the suspension of payments. Nobody can transfer or collect assets aside or independent from the suspension of payments procedure. This is the criteria that the court has been able to determine until now.

NADER SCHEKAIBAN: With so-called trusts, that presumably transfer ownership to the trustee but the asset is only used as collateral, we really have in fact a guarantee. At the end of the life of the trust, if the borrower has paid his loan, the assets return back to the borrower. Do you agree or disagree that when the dust

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19. Id. at 436.

20. A pre-packaged plan is a consensual restructuring negotiated and accepted by creditors and stockholders before a proceeding is commenced. "In theory, the Prepackaged Bankruptcy can be quick (30 to 180 days) and non-contentious, and, therefore, less costly and disruptive to the restructuring company." Steven R. Gross & George E.B. Maguire. Prepackaged Chapter 11 Plans 682 PLJ/Comm 433, 435 (1994); see also 11 U.S.C. § 1126(3), § 1123(a)(1), § 1123 (a)(2).
finally settles, it is only a guarantee that need not be specifically listed in the list of items that would provide someone special treatment as a secured creditor?

**AUTHOR:** Yes, I agree with you. Also, I think in the bankruptcy or suspension of payments proceeding, if you want to make a public sale of the trust, the debtors may ask the court to exclude from the assets the ones that are in the trust agreement. That gives the right to the borrower to perform that public sale. However, the courts will not allow public sales on those types of trust agreements because they are trying to collect independently from the bankruptcy.

**NADER:** One of the major concerns of foreign lenders of dollars concerns the repayment in pesos. Although not expressly written out in the code, a judicial practice has evolved over the fact that dollar-denominated claims are converted into pesos to assure the same treatment to all creditors. Do you think that without changing the bankruptcy law there is any possibility that bankruptcy courts could start reversing that trend, and shift towards a more favorable treatment for dollar-denominated loans?

**AUTHOR:** Yes, I do. Roughly ten years ago, the court established a very, very strong precedent in which all the claims in dollars had to be converted at the rate of the date of the bankruptcy or suspension of payments.\(^2\) So in case, for example, a bankruptcy was filed in 1993 and then the devaluation occurs in 1994, that devaluation would not affect the claim and payment would be made at the applicable rate for the time period in which the court issued a suspension of payments or bankruptcy decree. However, the courts have modified this requirement in some circumstances. I have won cases representing foreign creditors in which the claims were in dollars and they have been paid as of the date of the creditors' committee and not to the date when the bankruptcy or suspension of payments decree was issued, which is very far from one stage to the other.

**NADER:** I think that is a major breakthrough because practice has been very detrimental to foreign lenders for the reason that you mentioned. Thank you very much.

**AUTHOR:** I agree with you, however, let me say that the intent of the courts at the beginning is not to punish lenders for dollar-pesos, it is to establish the same situation for everybody at a certain moment. Now, as I said, they are making the progression that the dollar must be paid when the creditors' committee has taken place.

**LIEBMAN:** Equipment lessors from outside of Mexico have experienced, at least in our practice, difficulty in regaining their equipment in default cases. This is due to the absence of any remedy which would be equivalent to a writ of possession, which is a common practice in the United States. The lessee is not in suspension of payments, not in bankruptcy, nor is he paying the designated rent; he is simply using the equipment. Civil proceedings in the state courts of Mexico to recover the equipment are in fact possible; however, it is not uncommon for these proceedings to endure for a very, very long time. Short of being able to repossess the equipment, would you recommend that the lessor in this case perhaps undertake to file an involuntary bankruptcy proceeding against the lessee in order to catalyze the

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Mexican lessee into resolving the situation? I pose this inquiry due to the fact that civil litigation itself does not appear as a viable response.

AUTHOR: That could be a remedy, yes.

LIEBMAN: Approximately how long would it take to perfect?

AUTHOR: As it is established right now, I think six months and no more, my good man.