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The Basis for Proposed Legislation to Modernize Secured Financing in Mexico

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THE BASIS FOR PROPOSED LEGISLATION TO MODERNIZE SECURED FINANCING IN MEXICO

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I. INTRODUCTION

This article will describe important shortcomings of secured financing in Mexico and their resulting economic impact. It will also outline impending Mexican legislative reform of secured financing. However, it is important to first establish the foundations of commercial credit and its key regulatory principles. This examination highlights that while Mexico's public law of banking assumes the presence of secured commercial credit, its private law has failed to follow this and other key principles, thereby failing to implement a recognized normative goal.

First, although commercial credit is as old as trade itself, it was not until early in the eighteenth century that the Bank of England formulated the regulatory principle that has come to characterize commercial lending. Specifically, a commercial loan is special in the sense that it is of short duration and self liquidating. Unlike its real estate counterpart, a commercial credit loan is repaid with the proceeds generated by the financed transaction. A corollary of this principle is that the collateral most compatible with commercial lending is the borrower's own commercial assets. Thus, if everything else fails, the creditor or a third party can resell the borrower's collateral quickly and cheaply, thereby recovering the whole or a significant amount of the debt. Accordingly, a question that a commercial banker must ask themselves prior to extending credit, is whether or not their borrower has the ability to repay and can provide a reliable source of repayment if they cannot. In this light, collateral can be any commercial asset with discernible value in the marketplace, or any asset for which other participants in the marketplace are willing to pay money or give value for. Unlike real estate, such an asset can be tangible or intangible, conditional or unconditional, paper-based or electronic, present or future, or fixed at a given location rather than moveable.

Although the Mexican Ley de Títulos y Operaciones de Crédito[1] [credit law of titles and operations], assumes the presence of self liquidating

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1. D.O., 18 de julio de 1990. Reformas: D.O., 9 de junio de 1992, 23 de julio de 1993, 23 de diciembre de 1993, 22 de julio de 1994, 15 de febrero de 1995, 28 de abril de 1995, 17 de noviembre de 1995, 30 de abril de 1996, and 23 de mayo de 1996.

commercial loans, self liquidation has not been fully implemented in Mexico's lending business. Hence, a very significant gap exists between the Mexican goal of facilitating self liquidating commercial credit and the availability of commercial credit at reasonable rates. In comparison with commercial credit available to its North American Free Trade Agreement[2] (NAFTA) partners, commercial credit in Mexico continues to be extraordinarily expensive and difficult to obtain. Moreover, when commercial credit is available, it often relies on possessory secured transactions which generally immobilize the collateral. Such possessory secured transactions prevent the resale or repledge of collateral and hinder self liquidation.[3]

II. THE UNRESPONSIVENESS OF MEXICO'S CURRENT COMMERCIAL LENDING LAWS

Although Mexican law has provided at least six methods to secure commercial and agricultural loans, none are truly responsive to the needs of the Mexican commercial marketplace. For instance, some methods require the debtor's dispossession and others require that each item of collateral be carefully and minutely described thereby making the description of inventory and accounts receivable both unworkable and prohibitively expensive. Several methods are available only to banks or are inherently subordinated to real estate security interests. In short, no current security interest in Mexico covers such market demands as unlimited generations of proceeds, super priority for purchase money security interests, or notice filing.

A responsive system of commercial lending which includes the aforementioned attributes provides credit at a reasonable rate of interest as often as it is needed and for any kind of lawful commercial transaction. Unless such commercial lending is made available in Mexico, small and medium-sized Mexican enterprises will not be able to compete with their Canadian and U.S. counterparts who pay considerably less for credit. Consequently, Mexican enterprises will continue to fail in massive numbers and NAFTA will not succeed. Mexico and the United States will suffer from the serious economic and political dislocations that will follow such a failure. Moreover, the current status of Mexico's commercial lending system stifles Mexican enterprises from obtaining global financing as well. That is, short term capital flows from global sources available only to markets with reliable streams of income. Unless the Mexican commercial lending system can produce such streams backed up by reliable self-liquidating mechanisms, its real or personal property secured loans will

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2. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex. (effective Jan. 1, 1994), 32 I.L.M. 605 (1993).

3. TODD C. NELSON AND RONALD C.C. CUMING, *Harmonization of the Secured Financing Laws of the NAFTA Partners: Focus on Mexico*, 3 NAT'L L. CENTER FOR INTER-AM. FREE TRADE (1997); JOHN M. WILSON-MOLINA, *Mexico's Current Secured Financing System: the Law, the Registries and the Need for Reform* (Sept. 1996) (unpublished manuscript, on file with NLCIFT).

not be of interest to global buyers, lenders, or exchangers of capital flows.

The absence of a responsive system of secured commercial lending also discourages foreign investment. Many potential Canadian and U.S. investors in Mexico's industrial sector are presently unable to participate, or to increase their current investments, because they cannot convince their banks to extend credit lines to Mexican operations.[4] Specifically, Canadian and U.S. banks feel insecure with respect to the collateral value of Mexican based assets such as equipment, inventory, accounts receivable, proceeds, and intellectual property. Industrial investment in *maquila* type of industries could have expanded to other sectors and become much more significant had secured commercial credit been available in Mexico.[5] In sum, Mexico needs a more comprehensive and up-to-date collateral scheme based on market value for it to take full advantage of NAFTA and the global financial marketplace.

III. ESSENTIAL PRINCIPLES OF SECURED COMMERCIAL LENDING

Asset-based or secured commercial lending requires support from a legal regime inspired by eight basic principles.[6] First, any asset can become the collateral of a secured transaction as long as buyers or lenders are willing to give money in exchange for acquiring it or a security interest in it. Therefore, the definition of collateral must be open ended. A *numerus clausus,* or closed number of collateral, is consistent with the recordation of rights associated with real property transactions but is inconsistent with personal property secured transactions. For this reason, the first principle of secured commercial lending is at odds with the Spanish-colonial "asset culture." In this culture the most valuable and principal collateral is real property. The rights to, or in, such property are usually minimal and are listed by the law for transactional and recording purposes. In such a *numerus clausus* and minimal rights in rem culture, *res mobilis*, or personal property, is generally regarded by lenders as *res vilis*, or vile property.[7] This mentality must continue to change if commercial credit is to flourish in Mexico.

Second, a debtor may convey to a potential creditor a right to the possession of some collateral that has yet to come into being. Simply,

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4. David W. Eaton, *Study Finds Flaws in Lending Laws*, 7 BUS. MEXICO 27 n. 3 (1997).

5. *Id.* at 29.

6. *See* Boris Kozolchyk, *What to do about Mexico's Antiquated Secured Financing Law*, 12 ARIZ. J. OF INT'L & COMP. L. 1, 4-5 (1995).

7. It will be remembered that the Spanish, until not long ago, viewed commerce and particularly commercial lending as a sinful occupation. As a result, commercial lending did not flourish either in Spain or in its colonies until much later than in the European continent and in the Western Hemisphere. Paradoxically, the most detailed descriptions of commercial lending in Mexico were written in the seventeenth century by Spanish priests, some of whom spent a considerable part of their lives observing and describing credit transactions in Mexican ports. Since many of these transactions required the payment of interest these priests concluded that they were usurious and sinful.

the collateral need not exist at the time of the loan and the secured debtor need not be the owner of the collateral. All the debtor needs to have is rights to the present or future possession of that collateral. The notion derived from real property law that ownership of the collateral is required to borrow on it is contrary to the second principle of secured commercial lending. Indeed, with the onset of mass marketing of industrial products at the turn of the twentieth century, the ownership of personal property was fragmented into multiple and virtually unlimited possessory rights. Some of these rights could be sold by means of documents of title such as negotiable bills of lading or warehouse receipts. Others could be conveyed in security agreements such as conditional sales, chattel mortgages, pledges without dispossession, factors' liens, and trust receipts. Another set of possessory rights could be leased through ordinary and "financial" leases. Thus, in the burgeoning commercial credit markets following the Second World War, it was not unusual for multiple creditors to enjoy their respective possessory rights in the same collateral at the same time. Many of these rights were also transferable and some were even negotiable.

Consider, for example, goods manufactured and shipped from the United States to Great Britain subject to a purchase money security interest in favor of either the seller's or the buyer's bank. The same goods could also be subject to a floating lien or charge against all the commercial assets of an English importer. At the same time, they could be subject to a carrier's lien for the payment of unpaid freight and to the right of possession incorporated in the negotiable ocean bill of lading in the hands of an endorser or endorsee of that bill. Upon sale of the goods shipped, the accounts receivable generated by these sales and the proceeds of these accounts could also become the subject of a security interest. Transactions involving a multiplicity of possessory rights and claims to the same collateral or to their proceeds, necessarily require that the legal protection of secured creditors and bona fide purchasers does not depend upon a determination of the historical ownership of the collateral. This historical ownership approach is commonly included in the law of real property and real property security interests. Unlike the real property approach, in the world of asset-based lending, no one knows or cares about who is the historical owner of the collateral because anyone with a right to possession of the collateral can grant a security interest in it. Indeed, according to the Uniform Commercial Code[8] (U.C.C.), all that is required in asset-based lending is that the debtor-grantor of the security interest have "rights in the collateral." In sum, adherence to the second basic principle of secured commercial lending in Mexico requires a change in the attitude associated with real property security interests. The debtors in personal property secured transactions need not be the present or future owners of the collateral; all they need to have is possessory rights in the collateral.

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8. U.C.C. §§ 9-202, 9-203(1)(c) (1996).

As codified in the U.C.C., the third principle evinces that if collateral is, for example, sold fraudulently, re-pledged without authorization, consumed by the debtor, consumed by a third party, or simply disappears, a creditor's secured right can continue to be enforceable against the original collateral's replacement or its proceeds.[9] Simply, the right secured by proceeds is a right to the economic value of the original collateral and not to the original collateral itself. Continuing, the fourth principle is a corollary of the third. That is, secured rights in the same collateral may be held by different creditors concurrently or at different times as long as these rights are assigned different priorities.

The fifth principle posits that a system of secured lending based upon open ended collateralization and multiple concurrent rights, requires a comprehensive, efficient, cost effective, and easily accessible system of registration for security interests. This is especially true for actual or potential secured creditors and bona fide purchasers. Secret liens are the worst enemies of such a system and of widespread secured credit. No potential secured creditor who relies on a given collateral to grant credit would be willing to lend if they cannot determine in advance whether someone else has better rights to that collateral. The same is true for potential purchasers in good faith.

The sixth principle dictates the creation of a unitary security interest that includes all the pre-existing types of security devices, as well as those yet to be created. Efficient notice cannot be provided unless all actual and potential security interests are reduced to one common legal denominator. Without such a denominator, a sale of goods on the basis of a conditional or reservation of title claim can lead to non-recordation because, until full payment is rendered, the seller remains the owner of the goods. A similar claim could be made by, among others, a financial lessor and a trustee of a *fideicomiso de garantía*, or security trust. Without a unitary security interest, recordings will be meaningless. Thus, a public notice system will flourish only if all security interests are reduced to one common denominator and a uniform criterion for the perfection of security interests of various creditors based on priority is established. This does not mean that exceptions cannot be made to the criteria of perfection or priority. However, these exceptions will only be accepted by other creditors if the contribution of value given by the beneficiary of the exception enhances the market value of the debtor's collateral.

The seventh principle addresses the type of registry required by modern secured lending. This registry is not a registry of collateral, but of debtors. Only when the individual item is highly valuable and subject to serial number identification does a registry of collateral make sense. Lastly, the eighth principle highlights the importance of quick and inexpensive enforcement of secured rights. Enforcement must include a peaceful use of the creditor's right to repossess the collateral by himself.

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9. U.C.C. § 9-306 (1996).

Since Mexico's commercial credit system is not currently governed by these principles, it is not surprising that the six different types of secured transactions presently available under Mexican law do not satisfy marketplace needs. Often there is a question whether some parties can create a security interest at all. For instance, *fideicomisos de garantía,* or security trusts, cannot be granted to lenders other than banks. It is therefore not certain whether many valuable assets, such as inventory and proceeds, can be deemed collateral without undertaking exceedingly cumbersome and costly formal procedures to create and perfect the security interest involved. Further, as mentioned above, problems can arise in the perfection of a successfully created security interest due to the secrecy associated with security interests that are easily disguised or simulated as conveyances or retention of ownership. Once they are characterized as ownership interests, they do not require recording and therefore provide no notice to potential lenders and purchasers. Finally, and very importantly, there are serious problems with regard to the unavailability of self-help and other reasonably quick and inexpensive enforcement mechanisms. It is not unusual for a judicial or strict foreclosure in Mexico to take five years to perfect. The current difficulties with Mexico's six secured transaction types can be remedied with adherence to the aforementioned eight principles of secured commercial lending.

IV. NAFTA AND THE PROPOSED MODERNIZATION OF SECURED COMMERCIAL CREDIT IN MEXICO

The National Law Center for Inter-American Free Trade (NLCIFT) began to consult with the Mexican government in 1992, shortly prior to the approval of NAFTA, on how to harmonize Canada, Mexico, and U.S. laws of secured transactions. The Mexican government agreed that access to secured commercial credit at reasonable rates of interest and availability of computerized credit information was an integral part of NAFTA's success. It was noted that in addition to the serious impact the absence of commercial credit has upon the viability of small and medium-sized Mexican businesses, this void also undermines NAFTA's guiding principle of national treatment. In short, this principle requires that nationals from any of the NAFTA countries, as well as their products and services, be treated alike throughout the free trading region. The current practice of lowering tariffs will not bring about the desirable levels of trade or investment unless the cost of obtaining import, export, production, or distribution credit in Mexico is comparable to Canadian and U.S. standards. As noted above, Mexican and NLCIFT representatives recognize that exporters and investors in all three countries should have access to cost effective commercial credit, credit information, and filing procedures. A potential lender in any of the three NAFTA countries should be able to determine via computer what liens, if any, are recorded against a trading partner's loan applicant. If the decision to loan is made, the creditor should be able to record a security interest throughout the region. Such an access to credit and credit information will do more to encourage regional trade than tariff reductions.

With these agreements in mind, the initial meeting to plan the harmonization and modernization of secured transactions laws was held at the NLCIFT in Tucson in 1992. The participants included Mexican and U.S. lenders, the Mexican Notarial Association, representatives of Mexican small and medium-sized businesses, as well as registrars and scholars of the three countries. Professor Ronald Cuming, NLCIFT's Secured Financing Project coordinator, suggested the work of NLCIFT and its Mexican and Canadian counterparts proceed along two successive tracks. The first involves a comparative study of secured transactions law and practice in the three countries.[10] This study included a comparative description and analysis of the feasibility of eight different types of commercial loans in the NAFTA countries taking into account statutory, administrative, decisional, and doctrinal law as well as marketplace reactions and adjustments to the shortcomings of the legal system.

The second track involves a comparative analysis of commercial or secured transactions registry law and practice with an emphasis on the formulation of uniform procedures for searching and filing standardized paper based and electronic messages. The participants agreed with Cuming's suggestions and added that in light of the ongoing revision of U.C.C. Article 9, a harmonized NAFTA system of filings and searches should be one of the goals. The participants also agreed that the harmonization of the substantive law of the three countries required a unitary security interest based upon the preeminence of possessory over ownership rights. Once those substantive law principles were harmonized, a uniform registry system can be established so that notice of filings would be accessible and convenient. The ultimate goal is to develop a system that allows potential lenders in the three countries to search for relevant data on their potential borrowers and to file their security interests from remote locations in any of the designated national, state, or provincial registries. It was also agreed that Canada's western provinces, such as British Columbia and Saskatchewan, had the most advanced recording system and that they could serve as the model for the other NAFTA countries.

The NLCIFT's counterpart in Mexico, the *Instituto Nacional de Investigaciones Jurídicas*, or National Institute of Judicial Investigations, suggested that the next meeting be in Mexico at the Public Registry of Property of the Federal District. The *Secretaría de Comercio y Fomento Industrial*[11] (SECOFI) was also receptive to the idea of modernization and favored a central federal commercial registry that would store all the filings made in Mexico. The initial SECOFI-sponsored study group, however, made recommendations heavily influenced by the law of real property and by reforms to the Land Registry which assigned an electronic file to each subdivision, lot or building, a file often referred to as the *folio real*. Clearly, personal property rights, except for highly valuable

10. *See* T. NELSON AND R. CUMING, *supra* note 3.
11. Mexico's Secretariat of Commerce and Industrial Development.

and easily identifiable collateral, could not be filed in a *folio real* fashion. A commercial registry in our day is fundamentally a registry of debtors, and only exceptionally of collateral. On the other hand, SECOFI's study group initially made no recommendations on the wholesale revision of Mexico's substantive law of secured transactions.

While SECOFI was engaged in preparing its first commercial registry law draft, the Mexican Notarial Association began to prepare its own draft to modernize the substantive law related to the Federal District's Registry. It contained imaginative provisions which proved that Mexico's substantive law of secured transactions could be modernized without harm to Mexico's civil law tradition. It recognized the distinction between ownership and possessory rights. It set forth simple and inexpensive attachment, perfection, and priority procedures and carved out an exception for purchase money security interests. It carefully defined proceeds as distinguished from mere products and provided for notice filing of security interests. The Notarial draft did not create a unitary security interest that would encompass all pre-existing security devices, nor did it address the main issues of registry reform. Meanwhile, the NLCIFT had completed its comparative disparities study and forwarded it to SECOFI and to the Mexican Notarial Bar.

V. DEVELOPMENTS SINCE PRESIDENT ERNESTO ZEDILLO'S ELECTION

In one of President Zedillo's campaign speeches, he stated:

> It's about time that Mexican commercial lending terminate its reliance on real property collateral and the personal signature of the debtor and acknowledge that there is more to be gained by relying on the assets and what borrowing enterprises can produce. Hopefully, Mexico will move in that direction.[12]

Soon after President Zedillo's election, this writer met with Dr. Jaime Zabludovsky, SECOFI's under-secretary; Dr. Fernando Salas, SECOFI'S Coordinator of Advisors; and Licenciado Luis Telles, President Zedilllo's Economic Advisor. This meeting was followed by a meeting with President Zedillo himself. The purpose of these meetings was to brief these high officials on the results of the NLCIFT comparative study and to urge the need for the secured financing legislation drafted by SECOFI. Mexico's Notarial Bar had already met with President Zedillo essentially conveying the same message. Both the Zedillo administration and the Notaries were now in agreement that a modernization of the law was needed and that real property inspired legal institutions were not the advisable models. By President Zedillo's suggestion, NLCIFT's Ad Hoc Committee on

12. *Mexican Presidential Candidate Ernesto Zedillo Ponce de León's Address at a Conference for Entrepreneurs, in Gomez-Palacio, Durango, Mexico*, EL NORTE, May 25, 1994, at 1.

Secured Transactions formed with representatives from the financial, industrial, commercial, and legal sectors.[13]

The committee met with Secretary Herminio Blanco of SECOFI on March 26, 1996, to discuss the likelihood of secured financing law reform. At the end of this meeting, Secretary Blanco announced that Dr. Fernando Salas would head up a feasibility study and, if warranted, the drafting by SECOFI of a comprehensive modernizing statute. Shortly thereafter, Dr. Salas appointed Licenciado Francisco Ciscomani, SECOFI's Director of Legislation, as the Coordinator for the Draft and requested that the NLCIFT share its research and drafting experience with Licenciado. Ciscomani. Shortly thereafter, the Mexican Bankers Association, led by BANAMEX, joined the process of revision. NLCIFT appointed John Wilson Molina, a U.S. lawyer familiar with Mexican as well as U.S. secured transactions law, to help Licenciado Ciscomani with the drafting of the SECOFI proposal.

A separate process of modernization of secured transactions law had also been initiated by the Federal District of Mexico which comprises Mexico City. The Federal District decided to prepare a draft of the law that would modify the Civil Code for the Federal District and its Registry. Unlike the United States where no distinction is made between commercial and civil law, these two branches of the law are separate in Mexico. Commercial law is federal and civil law is state law. Thus, unlike the United States where each state has its own commercial code, Mexico has only one commercial code and as many civil codes as there are states. For coding purposes, the Federal District is a state. Commercial lending is governed by several supplementary statutes that are part of the commercial code.[14]

The draft of a secured transactions law proposed by the Federal District was concerned only with the civil, non-commercial or consumer secured loans and with the registry reforms that such a revision would entail. Having been strongly influenced by the Notarial Draft, the Federal District Draft adopted most of the principles enumerated earlier, including a comprehensive definition of collateral and proceeds as well as special rules on notice filing and purchase money security interests. Further, it proposed to do away with the *Registro de los Muebles* [Registry of

13. John E. Rogers, Chairman U.S. and Cross-border Legal Matters, American Chamber of Commerce; Ing. Guillermo Jimenez Sepúlveda, Senior Vice President, Banamex; Margarita de la Cabada, Legal Counsel, Banamex; Lic. José Dosal de la Vega, Mexican Bar Association; Dr. Arturo de la Cueva, Legal Counsel, Bancomer; Bob Copeland, Executive Vice President and Senior Credit Officer, Bank of America; Ron Tweedy, Executive Vice President, Bank of America; Steve Ruth, Director of Credit, Bank of America; Rand Haddock, General Counsel, Bank One; Leslie Corrigan, Vice President, Citibank; Lic. José Manuel Fernández, Director, Citibank; Dan F. Witt, Senior Vice President, Congress Financial; Luis Fernandez, General Counsel, General Motors; Paul Karon, President and General Director, MexUS and Offshore International; Boris Kozolchyk, President and Director, NLCIFT; Todd Nelson, Project Coordinator, NLCIFT; Jorge Z Mejía, Director, Department of Commerce; Dr. Herminio Blanco, Secretary of SECOFI; Dr. Raymundo Vásquez Castellanos, Head of SECOFI's Registry Office.

14. *See* John M. Wilson-Molina, *supra* note 3.

Moveables], and put a system in its place which would record liens and secured rights based upon the debtors' names.

There are some problems with this limited reform, but the fact that the Federal District decided to draft such a statute with the backing of the Notarial Association for the Federal District indicates that a major segment of secured lending can be dealt with in Mexico without violating key tenets of its legal system and of its civil law tradition. As the Federal District's draft was being submitted to the Office of the Presidency for eventual forwarding to Congress, SECOFI was proceeding with its own draft of a federal commercial statute. The principles that govern SECOFI's draft are the same eight principles set forth above, and being a federal enactment, it also offers the opportunity to create a unitary security interest for the whole of Mexico. As reported by Licenciado Ciscomani, SECOFI intended to have its draft completed by the end of April 1997 with a view to introducing it in Congress during the summer of 1997. As customary with Mexican statutory law, the statute would be implemented by regulations which would, *inter alia*, cover the registry and enforcement aspects of the amended law.

The mere fact that Mexico has started the process of modernization of its secured transactions law has begun to attract attention around the globe. The International Association of the Latin Notariat will devote a major segment of its 1998 annual meeting, to be held in Veracruz, Mexico in February 1998, to the contemplated modernization. A similar meeting, sponsored by the NLCIFT, the Organization of American States, the Office of the Legal Advisor of the United States Department of State, the United States Council on International Banking, the Council of the Americas, the *Programa Bolivar*, and the Federation of Latin American Banks is tentatively scheduled for January 1998 in Miami, Florida. This meeting will create national and regional working groups to help with the drafting of similar minded statutes and regulations by Central and South American countries. If one takes into account that the absence of secured and asset-based lending has been conservatively and responsibly estimated to mean a loss of anywhere between 5% and 10% of a nation's GDP, the economic significance of the hemispheric movement being initiated by Mexico's impending legislation cannot be overlooked. As a result of the developments described in this article, Mexico could well become one of the most important financial centers of the hemisphere.

QUESTIONS AND COMMENTS

Q: What is the advantage to the Notaries of the system that has been proposed?

Kozolchyk: I think that the Notaries, highly capable and intelligent professionals, recognized that this is the future about to become the present and they would either become an integral part of the process of modernization, or they will be left out as obsolete and expensive legal intermediaries. I do not see any immediate gains to them because the charge for the filing that is contemplated is in the same range as Canadian

and U.S. filing fees, and the forms used for searches and filings will be standardized or pre-codified. In many of these loans, the parties do not need to document their security agreement with a public or notarial deed; they can get by with an inexpensive *escritura privada*, or private contract.

Q: What about enforcement?

Kozolchyk: Of course, it is absolutely essential to have enforcement by private sale. I am aware of a recent six-to-five decision by the Mexican Supreme Court which found self- help to be unconstitutional as a violation of due process of law.[15] Justice Olga Sanchez de Cordero, who was a recent visitor to NLCIFT and a wonderful addition to Mexico's Supreme Court, issued one of the dissenting opinions in that opinion. During a discussion with Dr. Christina Moeckel, our Coordinator of the Intellectual Property Project at the Center, Dr. Moeckel noted that the very same issue was presented to the German Supreme Court as far back as 1941.[16] The German Supreme Court held that a creditor could, in pursuance of the conveyance to him by the debtor of qualified title to the collateral (inventory), repossess that collateral without violating law or public policy. Crucial in the court's analysis was the conveyance by the debtor of title to the collateral in the security agreement. On March 18, 1997, the Mexican Supreme Court handed down a decision which affirmed the

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15. *See* Pleno, *Semanario Judicial de la Federación y su Gaceta*, 9a. EPOCA, TOMO II, Diciembre de 1995, Tesis P. CXXI/95, Pág. 239.

16. RGZ, 7, 40 (82). (The Court here noted the main purpose of the security trust is to secure the creditor. The rights of the latter towards the debtor are to be determined according to the security agreement. Especially the disposal of the collateral by the creditor in case of default is subject to agreement between the parties).

Defendant was the owner of a furniture store. Plaintiff was shareholder in the company. Defendant and plaintiff concluded a security agreement according to which the title to the inventory was transferred to plaintiff to secure money he loaned to defendant to enable him to buy more furniture. To create the security agreement the title to determined pieces of inventory was transferred to plaintiff. Plaintiff consequently became the owner of these pieces of inventory. The ownership was, however, limited through the security agreement that the parties concluded. Thus, a trust was established between the parties.

The ownership of plaintiff in the inventory was established according to section 930 of the German Civil Code which permits ownership without possession. The possession in this case remained with the defendant.

According to the security agreement plaintiff is owner of the furniture in the store but defendant has the right to sell it to customers. Plaintiff subsequently receives the accounts receivables. According to the security agreement plaintiff has the right to control the inventory at any time and to demand information about the accounts.

After plaintiff realized that defendant cheated by assigning accounts receivables to a bank instead to plaintiff he demanded possession of his property according to section 985 of the German Civil Code. Defendant denied that demand by claiming that plaintiff's right is void according to section 138 of the German Civil Code because plaintiff was over secured.

The court approved plaintiff's right to demand possession of the collateral from defendant. The court held that plaintiff's right derived from the security agreement and that the agreement was not void because plaintiff's claim must be interpreted in the light of a trust relationship. Thus, he can only demand the amount of furniture he needs to satisfy his credit claim.

Consequently, plaintiff has a right to claim possession of his property according to section 985 in conjunction with the security agreement. A security agreement may give plaintiff broad rights that allow him to dispose of his collateral without prior court approval. It may, however, also limit plaintiff's rights to the narrow rights of the holder of a pledge who needs a court title in order to dispose of his collateral. Thus, the interpretation of the security agreement is crucial to determine plaintiff's rights. (Translated by C. Moeckel).

constitutionality of judicial and *pari passu* of self-help repossession. As described in a March 19, 1997 article of *El Financiero*:[17]

> By a six to five majority the Supreme Court, after a sharp debate, declared Article 341 of the *Ley General de Titulos y Operaciones de Credito* constitutional and not in violation of the due process provisions of the Mexican Constitution. Once a loan is in default, Article 341 allows the creditor - generally a bank- to appear before a civil judge and obtain authorization to sell the moveable property, automobiles being the most common. The debtor can only avoid the sale if within a period of 72 hours, he demonstrates that he paid the total amount of the debt, which obviously never takes place. The justices in the majority reasoned that the debtor does not have a right to a hearing because he agreed to give up such a hearing when he signed the security agreement. Moreover, Justice Mariano Azuela warned that if a hearing is granted to the debtor, which would delay the foreclosure sale for many months, banks would discontinue to lend using personal property as collateral and this would make credit more considerably expensive than what it is now and this would have a negative effect upon those with fewer resources. . . .Other justices in the majority, such as Genaro Gongora and Salvador Aguirre argued that there are other laws concerning other loans which do not even require a judicial presence to authorize a foreclosure-sale. For example, Article 99 of the Law of Securities and Stock Exchange allows a stock exchange operator who receives securities as collateral for a loan to sell these securities when the debtor defaults, without having to require anyone's authorization. "If a hearing is granted to the debtor (to, as a minimum, delay the foreclosure sale); the commercial nature of the pledge is denaturalized," affirmed Justice Aguirre. Accordingly, "two consequences would follow; the pledge would stop being a security for commerce and the opening of credit would lose one of its most important bases.

Q: You were talking about the expansion of the definition of collateral as anything that has value in the marketplace. Were you referring only to tangible items or intangible ones as well?

Kozolchyk: Anything and everything. Tangible and intangible. The proposed legislation by SECOFI and by the Federal District includes everything.

Q: In your discussion with the Mexican banks, did you see any objection or unwillingness to extend to foreign lending institutions the privilege of the trade laws with respect to the execution process?

Kozolchyk: The first meeting that we had included General Motors and their lawyer asked that very same question. The answer is this: At first, the position of the banks, or at least those that spoke up, was that they would like to retain restrictions on foreign banks. However, something very interesting has occurred. A significant amount of shares of certain banks were bought by a Canadian, Spanish and U.S. bank.

17. El Financiero, Miercoles 19 de Marzo de 1997, p. 6, translated by Boris Kozolchyk.

So, suddenly what looked like a provincial attitude became a much more international attitude. During the last meeting we had with the banks, the answer came back that they will insist in not including the restrictions in this new legislation, but that the right to execution should be opened up to everyone who actually lends, so it should not be a kind of class privilege. I do not know when it gets down to actually writing the rules, it is going to remain that way. Hopefully, the principle of equality of treatment that is so essential will be applied.

Q: On the issue of electronic filings and electronic searches for information, I understand that the Canadian system is fairly well along and that in the United States, the U.C.C. Article 9 system is in the process of revision. Do you see some possibility of a North American-wide system whereby information can be checked cross-border?

Kozolchyk: The Canadians are well along in the electronic process; the United States is beginning to do its revision right now and one state, Texas, seems to be the most advanced in terms of these revisions. I absolutely envisage the possibility of having electronic information being sent across the boundaries of the three NAFTA nations. Incidentally, this is an extraordinary opportunity for Mexico. I indicated first to President Zedillo and then to Secretary Blanco that Mexico stood in the position of being the financial capital for the rest of the hemisphere. That is, if Mexico becomes the first fully computerized place where creditors can reliably get that kind of information, institutions in Mexico could either generate the loans or syndicate them with Canadian, European or Middle Eastern institutions. There is no question that, despite the present problems in Mexico, it continues to be an extraordinarily attractive market for North American, European, Asian, and Middle Eastern countries. If Mexico becomes a repository of the data and the place where collateralized transactions can take place, it could mean a great deal for the growth of their and the hemispheric capital markets.

Q: I would like to inform you that Chihuahua has already started this computerization process.

Kozolchyk: I have heard that Chihuahua has direct line access to the registries right now and that it covers an area of population of more than a million people. Sonora and Nuevo Leon have also done quite a bit in terms of the availability of this information.