The Legal 500 & The In-House Lawyer

Comparative Legal Guide

Mexico: Restructuring & Insolvency

This country-specific Q&A provides an overview of the legal framework and key issues surrounding restructuring and insolvency in Mexico.

This Q&A is part of the global guide to Restructuring & Insolvency.

For a full list of jurisdictional Q&As visit **http://www.inhouselawyer.co.uk/index.php/practice-areas/restructuring-insolvency/**

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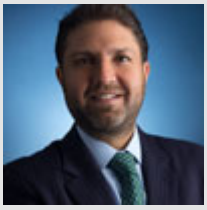
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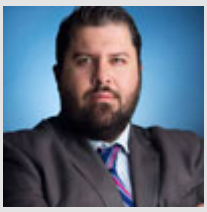
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1. **What forms of security can be granted over immovable and movable property? What formalities are required and what is the impact if such formalities are not complied with?**

   The most commonly used forms of security interest in Mexico are (a) the commercial pledge (prenda mercantil); (b) the floating lien pledge (prenda sin transmisión de

posesión); (c) the security trust (fideicomiso de garantía); (d) the mortgage (hipoteca); and (e) the industrial mortgage (hipoteca industrial). Each of these forms of security interest has specific formalities requirements which, if not complied with, would render the security interest ineffective or not enforceable vis-à-vis third parties, as applicable.

a) Commercial Pledge.
Formalities: (i) execution of a pledge agreement; and (ii) additional requirements depending on the type of assets (e.g. in case of assets or bearer negotiable instruments, their delivery to the pledgee or in case of negotiable instruments, they must be delivered to the pledgee duly endorsed “in pledge” (en garantía) and, if such negotiable instruments are subject to registration (e.g. in the share registry book), the pledge must also be registered in the corresponding registry to be enforceable vis-à-vis third parties).

b) Floating Lien Pledge.
Formalities: (i) the execution of a floating lien pledge agreement; (ii) its ratification by a notary public; and (iii) its registration in the Sole Registry of Movable Collateral (Registro Unico de Garantías Mobiliarias, the “RUG”) to be enforceable vis-à-vis third parties.

c) Security Trust.
Formalities: (i) the execution of a security trust agreement (in a public deed in case the trust estate includes real property or ratified by a notary public in case the value of such trust estate meets certain threshold (approximately USD$76,315.00); and (ii) its registration in the corresponding public registries to be enforceable vis-à-vis third parties (i.e. in the public registry of property and/or in the RUG in case the trust estate includes real property and/or personal property, respectively).

d) Mortgage.
Formalities: (i) the execution of a mortgage agreement by means of a public deed issued by a notary public; and (ii) its registration in the public registry of property where the real property is located to be enforceable vis-à-vis third parties.

e) Industrial Mortgage.
Formalities: (i) execution of an industrial mortgage agreement by means of a public deed issued by a notary public; and (ii) its registration in the corresponding public registries to be enforceable vis-à-vis third parties (i.e. in the public registry of property and/or in the RUG in case the industrial mortgage includes real property and/or personal property,

respectively).

2. **What practical issues do secured creditors face in enforcing their security (e.g. timing issues, requirement for court involvement)?**

Except for the security trust (which could contemplate an extrajudicial foreclosure procedure), enforcement of all these collateral structures needs to take place by means of a judicial procedure. As in many other jurisdictions, judicial enforcement tends to be costly and lengthy. No self-help remedies are available in Mexico.

3. **What is the test for insolvency? Is there any obligation on directors or officers of the debtor to open insolvency procedures upon the debtor becoming distressed or insolvent? Are there any consequences for failure to do so?**

As a general rule (the "Insolvency Standard"), a company may be declared insolvent (in "Concurso Mercantil") when it has defaulted in its payment obligations to two or more creditors, and on the date of filing of the insolvency petition:

1. its due obligations that have been delinquent for more than 30 days represent 35% or more of its total outstanding obligations; and/or
2. it does not have sufficient liquid assets to pay for at least 80% of its obligations that are due and payable on such date (the "General Default").

Once the company has defaulted in its payment obligations to two or more creditors, it may file a voluntary insolvency petition when only one of the conditions described in items (a) and (b) above has been satisfied. In contrast, creditors of the company or the attorney general's office may also file an insolvency claim against the company, but only if it satisfies both such conditions.

There is no obligation on directors or officers of the debtor to open insolvency procedures upon the debtor becoming distressed or insolvent.

What insolvency procedures are available in the jurisdiction? Does management continue to operate the business and / or is the debtor subject to supervision? What roles do the court and other stakeholders play? How long does the process usually take to complete?

The Mexican insolvency law (Ley de Concursos Mercantiles, the "Insolvency Law") contemplates a single proceeding for reorganization (concurso mercantil) and bankruptcy (quiebra) (the "Insolvency Proceeding") with two successive stages:

1. Mediation. The first stage, known as the "mediation" stage, is compulsory and is designed to reorganize the insolvent entity (the "Mediation Stage").
2. Bankruptcy. The second stage, known as the "bankruptcy stage", provides for the bankruptcy and liquidation of the insolvent entity (the "Bankruptcy Stage").

During Mediation Stage, the directors or managers of the insolvent entity will remain in their respective positions, and the mediator (conciliador, the "Mediator") will be in charge of supervising the accounting books and all transactions carried out by the insolvent entity, with the goal of maintaining the insolvent entity as an on-going business.

In order to preserve the estate of the insolvent entity, the Mediator may request the insolvency court (the "Insolvency Court") to (i) remove directors or managers; or (ii) order the insolvent entity to cease operations. During the Bankruptcy Stage, directors or managers of the insolvent entity will be removed and the insolvent entity will be brought under the management of a bankruptcy trustee appointed by the Insolvency Court.

The Mediation Stage has a maximum term of 365 calendar days. If a valid reorganization agreement (the "Reorganization Agreement") has not been reached upon the conclusion of such term, the insolvent entity will be automatically declared in bankruptcy. The Bankruptcy Stage will end upon the sale of the estate of the insolvent entity and the payment of its obligations up to the amount of its estate, as described in our answer to Question 5 below.

4.

How do creditors and other stakeholders rank on an insolvency of a debtor? Do any stakeholders enjoy particular priority (e.g. employees, pension liabilities)? Could the claims of any class of creditor be subordinated (e.g. equitable subordination)?

The proceeds obtained from the liquidation of the assets of the insolvent entity will be applied to make payments to creditors in the following order of priority:

First, labor claims for salaries and severance for the calendar year immediately preceding the insolvency judgment (the "Insolvency Judgement").

Second, claims derived from financing incurred for the management of the estate of the insolvent entity or financing that is indispensable to maintain the ordinary operations of the company and the necessary liquidity during the insolvency proceeding ("DIP Financing"), in each case, as approved by the Mediator or by the Insolvency Court.

Third, liabilities and obligations of the estate of the insolvent entity (i.e. management costs, fees and expenses incurred after the Insolvency Judgment is issued).

Fourth, costs and expenses derived from judicial and extrajudicial proceedings for the benefit of the insolvency estate.

Fifth, amounts paid to secured creditors as described below.

Sixth, labor claims (different than those described in first paragraph) and tax claims.

Seventh, claims of creditors that qualify as "privileged" under Mexican commercial laws (e.g. creditors that are entitled to retain an asset until payment is made), but only to the extent of the value of the respective privilege.

Eighth, claims of unsecured creditors.

5. Ninth, claims of (a) subordinated creditors, and (b) creditors that are related parties of

the insolvent entity (“Subordinated Creditors”).

Notwithstanding the foregoing, claims of secured creditors would be paid on a “super-priority” basis up to the amount of the respective collateral, and only the following claims would have priority over the amount of such collateral:

First, labor claims for salaries and severance for the calendar year preceding the issuance of the Insolvency Judgment.

Second, litigation expenses related for the defense or recovery of secured assets.

Third, necessary expenses for the repair, maintenance and disposition of the secured assets.

6. **Can a debtor’s pre-insolvency transactions be challenged? If so, by whom, when and on what grounds? What is the effect of a successful challenge and how are the rights of third parties impacted?**

Yes, during the Mediation Stage creditors (the “Recognized Creditors”) holding title to recognized claims (i.e. claims recognized and ranked by the Insolvency Court, the “Recognized Claims”) may challenge any pre-insolvency transaction carried out by the insolvent entity when such transaction is deemed or presumed fraudulent pursuant to the Insolvency Law.

Any action consummated by the insolvent entity prior to the date of the Insolvency Judgment will be deemed fraudulent when the insolvent entity is knowingly defrauding its creditors, and the third party participating in any such action had actual knowledge of such fraudulent intent. If the action is gratuitous, the action will be deemed fraudulent even if the third party had no actual knowledge of the fraudulent intent.

As a general rule, the Insolvency Judgment will become effective retroactively on the date that is 270 calendar days (which could be extended in certain particular cases) prior to the date of the applicable Insolvency Judgment (the “Effective Date”).

Any action consummated by the insolvent entity at any time after the Effective Date, (i) will be deemed fraudulent when, inter alia, (a) the insolvent entity receives no consideration, or the consideration received or paid by the insolvent entity, or the terms and conditions of the transaction, are clearly or materially below market, or (b) the insolvent entity makes a payment of indebtedness not yet due, or forgives receivables owed to it; and (ii) will be presumed fraudulent, unless the interested third party proves that it was acting in good faith, when, (a) the insolvent entity grants or increases collateral that was not originally contemplated, and (b) the insolvent entity makes any payments in-kind that were not originally contemplated. In addition, certain transactions among related parties will also be deemed fraudulent.

The effects of challenging pre-insolvency transactions that are deemed or presumed fraudulent is to declare such transactions null and void, thus returning things to their former conditions as though the transactions shall have never existed.

7. What restructuring and rescue procedures are available in the jurisdiction, what are the entry requirements and how is a restructuring plan approved and implemented? Does management continue to operate the business and/or is the debtor subject to supervision? What roles do the court and other stakeholders play?

The Concurso Mercantil is considered a restructuring proceeding as the Mediation Stage is designed to restructure the debts of an insolvent entity. In order for a Reorganization Agreement to become effective, it is required to be entered into by the insolvent entity and those Recognized Creditors that represent more than 50% of the sum of (a) the amount of all Recognized Claims of all unsecured Recognized Creditors and Subordinated Creditors of the insolvent entity, plus (b) the amount of all Recognized Claims of those secured Recognized Creditors that enter into the Reorganization Agreement.

However, if the Recognized Claims of Subordinated Creditors of the insolvent entity (including certain unsecured related party claims) represent 25% or more of total amount of all Recognized Claims, then such subordinated claims will not be taken into account for the voting requirements described above.

With respect to the management, supervision and the role of the court during the Mediation Stage, please refer to our answer to Question 4 above.

8. **Can a debtor in restructuring proceedings obtain new financing and are any special priorities afforded to such financing (if available)?**

   Yes, DIP Financings are available under Mexican law with the prior approval of the Mediator or the Insolvency Court. DIP Financings are paid on a “super-priority” basis only after labor claims for salaries and severance for the calendar year immediately preceding the Insolvency Judgment, as described in our answer to Question 5 above.

9. **How are existing contracts treated in restructuring and insolvency processes? Are the parties obliged to continue to perform their obligations? Will termination, retention of title and set-off provisions in these contracts remain enforceable? Is there any an ability for either party to disclaim the contract?**

   As a general rule, the insolvent entity must continue to comply with its obligations under existing agreements, except (i) if the Mediator opposes to such performance in protection of the entity’s estate or (ii) as provided in the Insolvency Law. The Insolvency Law provides specific rules for certain types of contracts, for example:

   1. Purchase of goods. If an insolvent entity acquired goods prior to the Insolvency Judgement, the relevant seller shall not be bound to deliver them unless the price has been paid or secured. In the event of goods in transit for their delivery that have not been paid, the seller may oppose to such delivery.
   2. Purchase of real property. If the seller of real property is declared insolvent, the purchaser shall have the right to receive the real property, provided that (i) such transaction was duly perfected prior to the Insolvency Judgement; and (ii) seller received the relevant purchase price.

10. **What conditions apply to the sale of assets/the entire business in a restructuring or insolvency process? Does the purchaser**

acquire the assets “free and clear” of claims and liabilities? Can security be released without creditor consent? Is credit bidding permitted?

As of the issuance of an Insolvency Judgment, any sale of assets should be approved by the Insolvency Court. In a liquidation scenario, all assets should be transferred free and clear of claims and liabilities.

A security interest cannot be released without creditor´s consent.

Credit bidding is not regulated by the Insolvency Law.

11. **What duties and liabilities should directors and officers be mindful of when managing a distressed debtor? What are the consequences of breach of duty?**

Pursuant to the Insolvency Law, the managers and relevant employees shall be liable for damages and lost profits (daños y perjuicios) caused to the insolvent entity in certain specific cases provided by the Insolvency Law. In addition, they would be liable when acting in breach of their duties of care and loyalty, and when acting with willful misconduct (dolosamente), bad faith (mala fe) or illegally.

The Insolvency Law also contemplates that Directors could be criminally liable.

12. **Is there any scope for other parties (e.g. director, partner, parent entity, lender) to incur liability for the debts of an insolvent debtor?**

Except for guarantors, joint obligors, co-borrowers, or similar parties, third parties are not liable for the Recognized Claims of an insolvent entity. Partners’ and shareholders’ are generally limited to the value of their equity contributions.

13. **Do restructuring or insolvency proceedings have the effect of**

releasing directors and other stakeholders from liability for previous actions and decisions?

Neither Restructuring nor Insolvency Proceedings release directors, managers or other stakeholders from liability. Please refer to our answer to Question 11 above.

14. **Will a local court recognise concurrent foreign restructuring or insolvency proceedings over a local debtor? What is the process and test for achieving such recognition?**

The Insolvency Law provides that foreign restructuring or insolvency proceedings may be recognized by local Insolvency Courts, provided that the following requirements are met: (i) the respective proceeding must be a foreign collective proceeding (judicial or administrative in nature), carried out pursuant to a law regulating the insolvency, bankruptcy or reorganization of insolvent entities and in which the assets and business of such insolvent entities are subject to the control or surveillance of a foreign court for their restructuring or liquidation; (ii) the recognition must be requested by a foreign representative that must be a person or corporate body duly appointed in a foreign proceeding to manage the restructuring or liquidation of the assets or business of insolvent entities or to act as a representative of the foreign proceeding; and (iii) the recognition request must meet certain requirements provided by the Insolvency Law (e.g. it must be filed together with certain documents and with the competent court).

15. **Can debtors incorporated elsewhere enter into restructuring or insolvency proceedings in the jurisdiction?**

Yes, provided that such foreign entity complies with the provisions or Title XII of the Insolvency Law.

16. **How are groups of companies treated on the restructuring or insolvency of one of more members of that group? Is there scope for cooperation between office holders?**

Entities of the same corporate group are entitled to file a petition for joinder insolvency with the only requirement that one of the entities of the corporate group complies with

any of the Insolvency Standards (as described in our answer to Question 3 above), and such event results in one or more of the corporate group´s entities being in the same situation.

The Insolvency proceedings of entities belonging to a corporate group accumulate as a single proceeding but are dealt with on a separate basis. Furthermore, the estates of each entity shall remain independent throughout the Insolvency Proceedings.

17. **Is it a debtor or creditor friendly jurisdiction?**

We consider that our law is a well-balanced law. Its main purpose is to allow an insolvent entity to get a fresh start by reaching out an agreement with its creditors, but at the same time provides good protection to those creditors. Our Insolvency Law is based on the UNCITRAL Law.

18. **Do sociopolitical factors give additional influence to certain stakeholders in restructurings or insolvencies in the jurisdiction (e.g. pressure around employees or pensions)? What role does the state play in relation to a distressed business (e.g. availability of state support)?**

As in many other jurisdictions, socio-political factors may have some influence in certain restructurings, particularly depending on the industry.

In the recent past, the state has not provided support even in important cases like the Mexicana de Aviación insolvency procedure.

19. **What are the greatest barriers to efficient and effective restructurings and insolvencies in the jurisdiction? Are there any proposals for reform to counter any such barriers?**

The greatest challenges to effective restructurings lie within Mexico’s judiciary system. The workload of Mexican courts is huge.

Given the specialization that insolvency cases require, we understand there are some preliminary discussions about appointing judges that would only hear insolvency cases (currently general federal courts hear insolvency cases), which would be ideal.