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# THE GUIDE TO RESTRUCTURING

THIRD EDITION

Editors
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# Publisher's Note

Latin Lawyer and LACCA are delighted to publish the third edition of *The Guide to Restructuring*.

Edited by Joy K Gallup and Michael L Fitzgerald of Baker & McKenzie LLP, the Guide brings together leading practitioners from throughout the region and across a variety of disciplines to provide guidance designed to benefit all those advising on restructurings on Latin America.

Restructurings are, by their nature, both international and deeply domestic; while moves to standardise and draw together the legislative framework in the region demonstrate both the benefits and challenges of this trend. Understanding the commonalities, but also the differences, in black letter law and common practice in this area is thus critical. The Guide draws on the expertise of highly sophisticated practitioners to analyse the latest happenings in order to provide readers with the tools that they need. Its aim is to be a valuable resource for insolvency and restructuring advisers of all stripes as they play their part in the complex economic situation facing Latin America today.

We are delighted to have worked with so many leading individuals to produce *The Guide to Restructuring*. This third edition expands on the previous two editions with the addition of chapters on the Mexican Insolvency Law, equity versus debt in Mexican restructurings, the impact of the banking crisis in Mexico, and a broader look at the growing importance of ESG in restructurings.

If you find it useful, you may also be interested in the other Guides in the Latin Lawyer series, including *The Guide to Infrastructure and Energy Investment*, *The Guide to Corporate Crisis Management*, *The Guide to International Arbitration in Latin America*, *The Guide to Mergers & Acquisitions*, *The Guide to Environmental, Social and Corporate Governances* and *The Guide to Corporate Compliance*.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

Liz Rutherford-Johnson
*Latin Lawyer*
London, September 2023

## CHAPTER 3

# Recent Restructuring Reforms in Mexico

**Thomas S Heather and Christian Dorantes Picazo**[1]

Since the creation of the Instituto Federal de Especialistas de Concursos Mercantiles (IFECOM) in 2000 (an auxiliary body of the federal judiciary council (Consejo de la Judicatura Federal)) when the Ley de Concursos Mercantiles (LCM) was enacted, there have been only 903 insolvency proceedings admitted in Mexico,[2] compared with 387,721 bankruptcy filings in the United States in the year 2022[3] alone. These numbers demonstrate that in-court insolvency proceedings in Mexico continue to be perceived with caution, and are considered as unreliable or impractical owing to the following factors, among others:

- The LCM is out of step with the current legal and financial environment and is in dire need of revision after 23 years.
- Large restructuring cases continue to be much more successfully addressed through out-of-court negotiations and agreements or, in more recent complex cases involving large corporations, through Chapter 11 filings in the United States (although this alternative may not be always available, depending on the nature of the corporation's debt structure, the status of its tax and labour liabilities and other relevant factors, such as being in a regulated industry or subject to a government concession).
- There is the perception that the LCM lacks legal certainty. For example, in a recent case, a minority shareholder of a public company alleged that, according to the provisions of the Mexican General Law of Commercial Companies (*Ley General de Sociedades Mercantiles*), a corporate law statute dating back

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2 Accurate as at 30 November 2022, https://www.ifecom.cjf.gob.mx/resources/PDF/informesEst/6.pdf.

3 https://www.uscourts.gov/news/2023/02/06/bankruptcy-filings-drop-63-percent.

to 1934, the company had lost more than two-thirds of its equity, and thus was subject to dissolution and liquidation under such statute. A judgment was obtained from a local court, whereby a liquidator was appointed to begin the process of liquidating the assets of said company and selectively applying the proceeds to the payment of the company's debt in a process that arguably lacked transparency and accountability. The referred statute upon which this action was founded has no provisions as to creditors rights, nor any recognition process or ranking of claims, priority rules, voting requirements or other basic rules that are included in the LCM, the legal statute that, in our view, should govern the insolvency proceedings. However, there is no legal mechanism requiring the application of the LCM in such a case.

- In the aftermath of the case, such company has filed a voluntary *concurso mercantil* in Mexico with the objective of adressing its very substantial bondholder debt issued further to 144A placements in the US.
- Cases have stalled amid daunting formalities, creative delaying tactics and a growing litigious environment fuelled by challenges to the growing practice relating to the request for and granting of wide-ranging pre-petition precautionary measures.
- 'Mandatory' time frames established in the LCM have been largely ignored.
- Influence peddling has on occasions become prevalent and the independence of the judiciary has often been questioned. Nevertheless, there are recent promising developments.

## Key developments

A welcome development has been the creation of two specialised Federal district courts with exclusive nation-wide jurisdiction over all *concurso mercantil* filings. Insolvency proceedings in Mexico used to be processed by federal district courts all around the country as opposed to specialised courts, which seemed to be generally reluctant to take on insolvency proceedings in addition to their jurisdiction on constitutional matters. These specialised insolvency courts were created, inter alia, to provide greater certainty that the insolvency petitions will not be denied due to the workload of other federal courts and to have judges specialised and focused only on insolvency proceedings. In addition, the IFECOM has issued guidelines on the supervision of its registered specialists (*conciliadores*) and bankruptcy trustees (*sindicos*), and, for the first time, a code of conduct. These are steps in the right direction, especially if the provisions contained in the guidelines are adhered to. Time will tell if these specialised courts will continue to comply with the purpose for which they were created but, in the meantime, the number of insolvency proceedings being accepted has increased compared to previous years.

Another recent development is that, while still an exception, a limited number of Mexican corporations have turned to the US Bankruptcy Courts for relief through Chapter 11 proceedings as an alternative to protect their viability since formal requirements are easier to address and the outcomes are more foreseeable and transparent than those for a *concurso mercantil*. Involuntary filings by creditors, however, have been unsuccessful up to now.

The LCM embraces, unfortunately only in form, the UNCITRAL Model Law on cross-border insolvency and international judicial cooperation and does not successfully encompass, in practice, a viable mechanism for cross-border insolvency and international judicial cooperation. Mexican courts have recognised and given judicial assistance only in a handful of foreign insolvency proceedings in the past 23 years. Rather than including provisions for foreign proceedings to be acknowledged and enforced in Mexico, the provisions of the LCM, as currently in effect, ultimately impose the need to file for a full *concurso mercantil* if the debtor has any establishment in Mexico, which may be ultimately considered as a waste of time and resources as it entails, in fact, a double proceeding rather than an efficient access to protection for a successful restructuring. Furthermore, the standing of the foreign representative or the application of stays is far from automatic and requires the acceptance of a concurso mercantil.

## Amendments to the LCM

The IFECOM has recently been promoting discussions aimed at proposing key amendments to the LCM to address the main issues of the Insolvency Proceeding in Mexico, such as:

- a better regulation of the 'automatic stay' to provide a higher degree of certainty and protection to insolvent entities with greater transparency;
- allowing express authority to the insolvency judges to grant additional precautionary measures (*medidas precautorias*) applicable to the insolvent entity's subsidiaries or affiliates in their capacity as joint obligors in order to protect the group of companies of the insolvent entity as a whole;
- the creation of collegiate circuit courts that would be specialised and focused only in solving appeals (*apelaciones*) and petitions for constitutional relief (*amparo*) related to insolvency proceedings, which would be a significant step in true development of consistent judicial precedents; and
- a holistic approach to multiple regulations applicable to DIP Financing, which is provided by the LCM but has rarely been used by distressed companies or granted by Mexican lenders due to a complex and burdensome regulation of capital reserves under the Law of Credit Institutions and the Circular regulating banking institutions, among other reasons.

## Insolvency proceedings before and after covid-19

### *Significant transactions and developments.*

During the covid-19 pandemic, the federal judiciary council determined that federal courts should limit their workload to 'urgent' cases, which resulted in the publication of a general agreement to expand on the definition of what an urgent case entailed. In this respect, a covid-19-related legal initiative worth mentioning was proposed, which consisted of an amendment, allegedly supported by the principal Mexican Bar Association, to alleviate the tardiness of the concurso proceeding in extraordinary circumstances, such as a pandemic (the Initiative).

The intention of the Initiative was to accelerate insolvency proceedings given the extraordinary emergency affecting the commercial, business and jurisdictional environments. With good reason, the Initiative recognised that there are industries and sectors of the economy that practically came to a halt, resulting in significant financial damage.

The Initiative included provisions permitting any company, irrespective of its size, to file for a *concurso mercantil* on a fast-track basis, as a tool to keep it in operation through an expedited procedure that could significantly limit the time and formalities of the process. The emergency insolvency regime, according to the Initiative, would apply to the extent that an unforeseen material adverse effect or a *force majeure* event, or a declaration of emergency, sanitary contingency, or natural disaster, at a regional or national level, aggravates the economic situation of the county or region, affecting individuals or legal entities. The application of the emergency insolvency regime presented by the Initiative was intended to be available for as long as any such emergency were to subsist, and for up to six months thereafter.

Notwithstanding the simplicity it sought, the Initiative was inconsistent with the rule of law, given its failure to include basic legal definitions, leaving debtors and creditors with little assurance of legal protection as it prohibited appeals. The Initiative left open many questions regarding the emergency proceeding and its consistency with traditional notions of procedural due process embedded in Mexican law and jurisprudence. Furthermore, the attempted removal of several principles set forth in the Federal Tax Code would seem to materially affect the statutory preferences and the collection efforts of the federal tax authorities. Congress never discussed the Initiative as it did not make it to the floor, and it probably never will.

Generally speaking, the covid-19 pandemic did have a negative effect in the business and financial results of Mexican corporations. There was little, if any, support granted to businesses or consumers by the Mexican government, affecting economic and operating conditions. Additionally, the finance sector faced

numerous adversities, such as a lower liquidity and volatility in global financial markets. Access to credit has tightened as interest rates continue to be significantly higher than in other economic cycles. Consumer spending continues to rise, however, amid higher levels of inflation, which have impacted price stability.

In this context, where scepticism and avoidance of the insolvency proceedings in Mexico are not uncommon, there have been a few restructurings successes, including that of a certain non-bank lender, a principal airline of Latin America which emerged from Chapter 11 as a stronger, more viable company, effectively resorting to substantial DIP financing, and a leading hotel operator of Mexico, which also accessed Chapter 11 with positive results.

In the more recent *concursos mercantiles*, the debate as to priority of claims in trust structures and 'bankruptcy remote' vehicles has continued. Only registered mortgages and pledges have been given statutory preference on a clearly reliable basis, given a literal reading of the LCM. Creditors holding beneficiary rights under trusts have been recognised in most cases as common creditors only, although they are given the 'privilege' of being serviced through their trusts. The separation of assets in trust from those of the estate in question, a concept that makes little sense in view of the stated purpose of maintaining companies as operating concerns during the workout stage of *concurso mercantil*, has been seen as inconsistent with this objective. Although still common and generally recognised, in recent years, security trusts involving the assignment of receivables and future contractual flows assigned to creditors, have come under attack, although, fortunately, they have been defended by rulings of the Eighth Circuit Collegiate Court.

## Conclusion

There are several issues that continue to create friction in the process of fostering the growth of restructuring and bankruptcy proceedings in Mexico, the first being the lack of trust and reliance in the Mexican courts due to inconsistent rulings. Although there is hope that the recent creation of specialised insolvency courts will boost the fair implementation of these proceedings, there is an overriding need to revise the aging LCM, and many of its impractical provisions, including the means to recognise, implement and enforce foreign judgements in Mexico to achieve a more nurtured cross-border insolvency process and international judicial cooperation. In addition, the current federal administration and Congress do not seem to have an interest in or otherwise any priority regarding *concurso mercantil*, but rather seem to be focusing on ensuring control of each of the powers of government, now and for the immediate future, to pursue the agenda or so-called movement of the ruling party.