# Mexico

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Throughout 2020 and 2021, Mexico, like many other countries, has faced the consequences related to the health and economic impact derived from the global Covid-19 pandemic.

This pandemic exacerbated an already weak economic situation in Mexico causing an important economic contraction. Going into 2020, Mexico was already in a recession, due in part to falling investments resulting from political uncertainty and fiscal tightening.

Even as economies reopen – regardless of their size, and whether in the formal or informal sector –the recovery of most businesses and industries´ remains uncertain.

The government had earlier announced extended nationwide lockdowns and restrictions on non-essential economic activities. Businesses, among many other issues, faced a decrease in income and, in many cases, the need to continue incurring in fixed costs, which made them struggle financially and to default their credit payments and commercial obligations.

Courts were closed for almost three months and, currently, the operation of federal courts, regarding insolvency proceedings, still suffer many deficiencies due to the pandemic restrictions.

Unlike some other countries, which had quickly responded by enacting emergency legislation and implementing measures concerning restructurings, rights of creditors and insolvency proceedings, Mexico did not implement or modify its insolvency laws during the period.

On top of this, while many economies relied on government support which provided a significant relief to businesses (loan guarantees and wage subsidies for workers, tax stimulus and moratoria), this was not the case of Mexico. There has been very limited government support for the private sector. It is reported that Mexico has only spent around 0.7% of GDP on tackling this crisis, and mainly providing loans to low income households, compared to, for

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Alejandro has more than 30 years of experience advising and representing clients in the practices of cross-border insolvency and restructurings (out-of-court and in-court – concursos mercantiles), finance, refinancing and corporate reorganisations, as well as in the purchase and sale of assets in special situations and distress. Throughout his vast experience, he has represented clients from various industries, both nationally and internationally, domestic and foreign companies, public and private, as well as several ad-hoc committees of international bondholders and noteholders issued abroad by Mexican issuers.

Alejandro is a graduate of the Panamerican University and has completed further postgraduate qualifications at Harvard University. He is also a certified mediator by the Mexican Institute of Mediation, and was a professor at the Ibero-American University.

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example, an 8% of GDP in Brazil and an average of 4% in emerging markets.

It is unquestionable that the current worldwide health emergency, and its serious effects on the Mexican economy, will force businesses in various sectors and industries to evaluate their financial liquidity and define plans to avoid insolvency or even bankruptcy.

The effects of this pandemic, which are expected to be felt for at least an extended period of months (or even years), require that companies look for alternative sources of income and liquidity, organisational reorganisations and negotiation with their creditors, out-of-court and in-court.

These turbulent times have led and will continue to lead to a waterfall of restructurings and workouts in various industries. Companies will need to identify inefficiencies, suspend non-essential operations, optimise activities, and negotiate amendments to their business plans and contractual terms considering the current scenario.

Corporate reorganisations and out-of-court restructurings to stabilise business operations should be definitely considered before deciding for an in-court insolvency or liquidation proceeding of any business. However, when this is not possible, the restructuring and insolvency proceeding, known as *concurso*, which is the only formal insolvency procedure available in Mexico, will be the alternative for both debtors and creditors.

In the coming months and years, insolvency lawyers will be focusing on mitigating the impact of the global pandemic on companies' operations, finances and disputes. Experts will have to provide, more than ever, creative and agile strategies to adopt responsive actions to present and future threats that this pandemic could generate in different areas.

## Framework

The Concursos Law provides for a single insolvency proceeding known as *concurso mercantil* (conciliation/restructuring or insolvency/bankruptcy procedure). The applicable laws to restructurings and insolvency proceedings are mainly the Concursos Law, the General Law on Business Organisations, the Law of Credit Institutions, and the Law of Insurance and Bonds Institutions.

A debtor may consider a corporate reorganisation and out-of-court restructuring to stabilise business operations before deciding for an in-court insolvency or liquidation proceeding of any business.

Many restructuring proceedings in Mexico begin as informal and/or consensual efforts. Ending in a judicial proceeding would depend on the various circumstances around the negotiations and status of the debtor. The possibility of aligning interests and positions of different creditors is essential as well as the ability to reach a

reorganisation agreement. It is likely that if, sophisticated creditors (banks, funds) are involved – which occurs in major restructurings – they will try to be co-operative to reach a reorganisation agreement that may serve to restructure the debtor out-of-court or prepare it for pre-pack, in-court proceedings – a more expeditious procedure than a regular proceeding.

## Processes and procedures

The debtor itself, any creditor, the district attorney, a judge, and tax authorities in their capacity as creditors, may file insolvency claims. With the petition filed by creditors or authority (involuntary) or the insolvency petition filed by the company (voluntary), as the case may be, a guaranty or bond must be posted to secure the examiner's fee payment.

Debtors which are part of the same corporate group may simultaneously request the joint judicial *concurso* declaration, without need of estate consolidation. For the joint *concurso* procedure it is enough that one of the parties of the group is under the assumptions of insolvency under the Concursos Law, and that such condition places one or more of the parties forming the corporate group under the same situation.

Creditors of debtors that are part of a group that meet the assumptions described above may claim the joint judicial *concurso* procedure. The joint judicial *concurso* procedure can be cumulative with other *concurso* procedures.

### Formal filing

All creditors of the debtor, whether domestic or foreign, shall have access to the *concurso* procedure, and shall collect in equal proportion (according to the class) from the assets located within the territorial jurisdiction of the court.

The general rule is that contracts must be honoured by the debtor, unless the conciliator rejects the contract. Even if the debtor or its management remains in control of its business, the conciliator is entitled to accept or reject executory contracts, incur new indebtedness, substitute collateral and sell assets outside the regular course of business.

With some exceptions, any contractual stipulation, which – due to the filing of a voluntary petition for *concurso* or the issuance of the declaration of insolvency – sets modifications that worsen the contract terms for the debtor, shall be deemed as not included.

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In most cases, it is unlikely that a successful out-of-court restructuring may be reached over the dissent of a minority of creditors. An express procedure for cramming down creditors that do not approve proposals approved within these procedures, as permitted under other foreign jurisdictions, is not expressly contemplated by the Concursos Law. However, when an in-court restructuring agreement is reached by more than 50% in a *concurso* proceeding the conditions of unsecured creditors are uniformed.

There are various legal actions available to creditors prior to a formal insolvency proceeding to recover on a defaulted loan or obligation of a debtor. The action proceedings (foreclosure, attachment, temporary restraining orders, preliminary discovery or pre-filing motions, etc) would vary depending on the type of agreement, source of the action to be followed (civil, mercantile, ordinary, special), whether collateral was granted, whether promissory notes were issued, type of collateral, etc.

Creditors are entitled to challenge resolutions issued within a *concurso* proceeding. Although the proceeding will not be suspended, such actions may certainly disrupt or delay the process.

It is important to bear in mind that following the *concurso* judgment and even in the preliminary stage of *visita*, the court (based on its own opinion or the examiner's recommendation) may issue restriction orders on the debtor's business operations, including a prohibition to make any due payments of existing obligations or disposing of any property.

### Distressed assets and businesses

During insolvency proceedings, the sale of assets to protect the ongoing concern of the debtor shall be subject to the conciliator or intervenor's approval. The purchaser will acquire good title as long as the sale is conducted in the same terms as a public auction. The receiver shall follow the rules of publicity and operability to guaranty the transparency of a sale procedure.

The directors of a company that has not been declared insolvent by a competent court may not be liable for continuing to operate a company under financial distress. However, the transactions related to the collection of a creditor's rights could be subject to review when the company is declared insolvent.

In the event that the company is declared insolvent, directors engaging in any malicious act or conduct that causes the non-performance of the company's payment obligations might be liable to civil actions or even criminal liability, if those acts are proven to be fraudulent.

The Concursos Law provides for events during which a director or managing officer will become liable to the debtor, for the benefit of the estate of the company in a *concurso* procedure, for any damages and losses of anticipated earnings caused by any unlawful decision they had made, provided they cause damage to the estate of the debtor which led to the insolvency situation of the company. This is regardless of any liability incurred by the director or managing officer under any other law.

Unless good faith and compliance with the duties of care and loyalty can be evidenced members of the board of directors, as well as relevant employees, of the debtor shall be liable for damages and losses.

Furthermore, as the company is a legal entity, criminal liability might be pursued against the members of its board of directors, administrators, managers or liquidators who were the authors of, or participated in any criminal offence.

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Pursuant to the Concursos Law, some transactions may be invalidated if entered into during the period starting on the day which is 270 calendar days prior to the declaration of insolvency by a competent court. Such period can be extended up to three years under some situations regulated by law and would be doubled for intercompany transactions.

Creditors are also entitled to challenge resolutions issued within a *concurso* proceeding. Although the proceeding will not be suspended, such actions may certainly disrupt or delay the process.

**Protection for post-petition credit**

The existing Concursos Law classifies creditors into the following categories or classes (and with the following rankings or preferences):

- First priority claims against the 'estate' of the debtor (*créditos contra la masa*), which includes:
- Special labour claims under Section XXIII, Chapter A, of Article 123 of the Constitution, and applicable regulations;
- Debt incurred for the management of the estate of the debtor with the authorisation of the conciliator or the receiver, as the case may be, or those contracted directly by the conciliator;
- Debt incurred to cover ordinary expenses for the safety and protection of the estate; and
- Debt incurred from the judicial or extra-judicial acts for the benefit of the estate; provided, however, that under Article 225 of the Concursos Law against the secured creditors, with mortgages or pledges, or creditors with special privilege, the preference or privilege of the claims against the estate would not apply, except for the following claims: the special labour claims referred in subsection (a) above, the litigation expenses incurred for the defense or recovery of the goods or assets subject to the security interest of the secured claims or over those assets related to the 'special privilege', and the expenses necessary for the repair, conservation and sale of those assets;
- Singularly privileged creditors;
- Secured creditors (with mortgages and pledges over assets of the debtor) and tax claims secured with a security in rem (up to the value of such guaranty) are paid first with proceeds from the sale of mortgaged or pledged items; if the items have a value or a price in excess of the debt, any such excess or remaining value is directed to cover subsequent debt payments to other creditors; if the price does not cover the debt, mortgage or pledge, the corresponding creditor may participate, pro rata, as a common or unsecured creditor, to collect the remaining amount);
- Other tax claims and labour claims;
- Creditors with a special privilege (i.e. those with a guaranty trust)
- Unsecured creditors; and
- Subordinated creditors (inter-company claims).

Special provisions govern the reorganisation of public service companies, credit institutions and bonded warehouses. These procedures shall be subject to the Concursos Law and to the specific applicable laws, regulations, and concession titles, as the case may be. The agencies responsible for

overseeing such public service companies have the right to commence a case and direct the *Instituto Federal de Especialistas de Concursos Mercantiles* (the Federal Institute of Experts in Insolvency Proceedings – IFECOM) to appoint the specialists ordinarily appointed at its discretion

## Crossing-borders

According to the Concursos Law, a foreign proceeding is as a collective or universal proceeding, whether judicial or administrative, including provisional proceedings, in a foreign state pursuant to a law governing bankruptcy, liquidation, or insolvency matters of the debtor.

The Concursos Law recognises foreign proceedings in bankruptcy, insolvency and reorganisation matters, and it recognises foreign representatives appointed through a recognition request. In this regard, the Concursos Law recognises foreign proceedings when legally held in a foreign country in accordance with bankruptcy or insolvency laws applicable to the debtor due to its activities, the location of assets or other similar causes.

Pursuant to the Concursos Law, the following are the alternatives under which a Mexican court can recognise a foreign bankruptcy procedure:

- As a principal procedure, when the foreign procedure is brought to a court with jurisdiction in the place where the business has its main place of interests; or
- As a non-principal procedure, when the foreign procedure is brought to a court with jurisdiction in the place where the business has an establishment. The main difference between the two is in the direct effect of such recognition over the business's assets located in Mexico.

If a foreign bankruptcy procedure is recognised as a principal procedure then any and all foreclosure over the business's assets, and any and all rights to transfer or grant any lien over business' assets, shall be suspended.

A Mexican court shall recognise the foreign bankruptcy procedure as a non-principal procedure if the debtor has a permanent place of business outside Mexican territory, but not as a principal foreign bankruptcy procedure.

Upon the recognition of a foreign procedure, the foreign representative will be able to ask the receiver, conciliator or examiner, to entrust, through a foreign representative, the distribution of all the business' assets located in Mexican territory. The Mexican court must make sure that the creditors' interests domiciled in Mexico are sufficiently protected so that it may decree the injunctions briefed above.

The foreign representative has the power and capacity to ask that the examiner, the conciliator or the receiver initiates the recovery of assets actions for the recovery of assets that belong to the entirety of a property, and of nullity acts concerning the defrauding of creditors. The authorisation of the foreign representative to take part in the procedures promoted against the businessman that are in the proceedings and that have a patrimonial content can take place.

The injunctions that may arise from the recognition of a foreign bankruptcy procedure under a *concurso* procedure depend on the procedural phase, namely as from the filing of the recognition request throughout the corresponding resolution, and as from the issuance of the recognition resolution.

Therefore, and provided that the above-mentioned is followed, if a company organised under the laws of Mexico entered into extraterritorial bankruptcy or insolvency proceedings then those proceedings would be recognised within Mexican jurisdiction.

With respect to the insolvency matters, the international documents that served as basis for the current provisions of the Concursos Law are the 'Model Law for Cross Border Insolvency' of the UNIDROIT and the 'Effective Insolvency Systems' of the World Bank.

## Looking ahead

Mexican companies and creditors have always faced uncertainty in their local insolvency and restructure proceedings. Some serious disadvantages are that local courts are not educated and specialised on these matters. There is no certainty on the admission of the petition, timing of the proceeding or courts decisions. The courts' discretion and contradictions in precedents make the process unpredictable.

Likewise, the preliminary *visita* (inspection) stage is not expedite and in many cases, it only deteriorates the economic situation of the distressed companies. Appeals and *amparos* (constitutional remedy) are available and frequently used by the parties delaying the process. On the other hand, pre-packed reorganisation proceedings are available and have proven successful outcomes for many debtors and participating creditors.

In Mexico, due to the health emergency that begun mid-March 2020, the federal courts were initially closed and afterwards the operation of federal courts were limited to 'urgent cases'. The courts refused initially to hear insolvency cases by rejecting petitions and filings, as well as the reorganisation process of on-going *concursos* were delayed, which caused negative impact on debtors and stakeholders in delaying filings or outcomes of reorganisations.

An initiative to modify the Concurso Law was published in the Senate Gazette in April 2020, and it intended to include an 'Emergency Regime' to serve as a tool in assisting debtors in having an expedite access to courts in an unforeseen circumstance, *force majeure* or emergency declaration, health contingency or natural disaster. This Emergency Regime provided a 'fast-track' proceeding to allow debtors to have rapid access to debtor-in-possession (DIP) financing, automatic-stay, other measures to preserve the on-going concern, and be able to emerge through a summarised procedure. To date, this initiative has not been approved and the road ahead may be a long one.

However, amendments of this nature are undoubtedly necessary to provide legal certainty and some relief to businesses and an environment to thrive and survive exceptional times and will certainly affect all areas of society and doing business.

These modifications alone will not be enough if additional changes in the insolvency and restructuring Mexican legislation are not made. Various amendments and new rules and regulations are required at various levels: The Ministry of Finance, the Mexican Securities and Exchange Commission and the IFECOM.

Ideally, specialised courts should be created given the particular and complicated nature of insolvency proceedings and the significant increase in the filing of these measures. The judicial power should receive constant training and education on insolvency and bankruptcy matters so they are prepared to assist companies in distress and maintain their existence to avoid that a generalised default in its payment obligations, put at risk their viability and that of those with whom it makes business.

Moreover, the insolvency sector should be strengthened by increasing the number of courts and courts' capacity as well as the implementation of technology to have full electronic access to the docket, filing of motions and even including virtual hearings.