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Insolvency as a Prerequisite for Filing a Bankruptcy Procedure in Mexico

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In 2000, Mexico published its new Mexican Bankruptcy Law (MBL), which substitutes the one that governed bankruptcy issues since 1943. This new law was drafted based on the model law issued by the United Nations Commission on International Trade Law (UNCITRAL) and Mexico was the first country that adapted its law to such model.

This law incorporated new elements that were not considered before, establishing a two-phase procedure to handle a bankrupt business. The first phase of the procedure, known as conciliation, is contemplated to preserve the bankrupt company, trying to achieve an agreement between the debtor and its creditors that allows the bankrupt company to continue its operations. This phase is contemplated to endure 185 calendar days and can be extended twice for a 90-day period each. In this phase, the debtor continues with the administration of its business and a trustee appointed by the Instituto Federal de Especialistas en Concursos Mercantiles (IFECOM) will help it try to reach an agreement with its creditors.

The second phase, formally known as bankruptcy, is the liquidation process of the bankrupt company that includes the selling of the assets in order to obtain the greatest payment for the creditors. The MBL establishes the selling of the bankrupt

company as an ongoing concern as the main objective of this phase. This phase will endure until all of the debts are paid or all of the assets of the bankrupt company are sold. The IFECOM will name a trustee that will administer the bankrupt company and will lead the selling process.

Notwithstanding the development of bankruptcy matters in Mexico during the past 12 years and the benefits that can be obtained using this kind of procedure, Mexican bankruptcy rules are based on a problem solving model rather than a warning like in other countries. Article 9 of the MBL[1] states that a debtor will be declared in bankruptcy when it is in general default on its debts. The bankruptcy declaration can be sought by the creditors or the debtor itself. In Article 10[2], the MBL provides the basis for considering when the debtor is in general default on its debts: (1) overdue debts with more than 30 days of default and represent more than 35 percent of the whole debt of the debtor, and (2) the debtor does not have enough assets to cover at least 80 percent of its debts.

Considering this, one can state that the MBL establishes as a prerequisite for filing a bankruptcy procedure that the debtor has breached his obligations and he is not capable of paying his remaining debts. This situation is known as insolvency.

According to Black's Law Dictionary insolvency is "The condition of being unable to pay debts as they fall due or in the usual course of business," which, as seen before, is the main requisite for filing a bankruptcy procedure in Mexico.

Having this prerequisite for filing a bankruptcy procedure is one main difference between the Mexican system and other countries in which insolvency is not required to file a bankruptcy procedure, as in the U.S. or Canada, whose bankruptcy systems contemplate a reorganization process that can be used prior to default. This prerequisite means that companies in Mexico wait until they have serious economic and/or financial problems to try to find a solution or even avoid using the MBL to attend this kind of problem and instead call for a private debt restructuring.

There is a clear disadvantage of not using the MBL and opting for a private debt restructuring that mainly consists in the fact that dissident creditors cannot be bound by the agreement executed outside of a bankruptcy procedure. Mexican bankruptcy rules have demonstrated that they are quite useful for addressing and clarifying insolvency problems once they appear; nevertheless it is important to generate a preinsolvency culture in Mexico that reinforces the prevention of bankruptcy, thus a company with possible future economic and/or financial problems will not have to wait for a default on its debts to provide a solution and can reduce negative consequences for its creditors. A pre-insolvency strategy will be one of the main study points on the legislative agenda for bankruptcy issues in future years in Mexico.

1. **Article 9.-** The Merchant who defaults generally in the payment of its obligations will be declared in commercial bankruptcy (concurso mercantil).
It will be understood that a Merchant defaulted generally in the payment of its obligations when:
I. The Merchant requests to be declared in commercial bankruptcy and it falls under any of the premises set forth in sections I or II of the following article, or
II. Any creditor or the Public Prosecutor has demanded the declaration of commercial bankruptcy of the Merchant and the latter falls under the two premises indicated in sections I and II of the following article.

2. **Article 10.-** For purposes of this Law, the general default in the payment of the obligations of the Merchant referred to in the above article consists of the default in its payment obligations to two or more different creditors and the existence of the following conditions:
I. of the overdue obligations referred to in the above paragraph, those that are at least thirty days overdue represent thirty-five percent or more of all the obligations of the Merchant as of the date on which the demand or request for bankruptcy has been presented, and
II. The Merchant does not have assets listed in the following paragraph, to be able to cover at least eighty percent of its obligations overdue on the date of presentation of the demand or request.
The assets that shall be considered for purposes of section II of this article will be:
a) Cash and deposits on hand;
b) Term deposits and investments whose due date is not greater than ninety calendar days subsequent to the date of presentation of the demand or request;
c) Clients and accounts receivable whose due date is not greater than ninety calendar days subsequent to the date of presentation of the demand or request, and
d) Securities for which purchase and sale operations in the relevant markets are recorded regularly, which could be sold in a maximum term of thirty banking days, whose value at the date of presentation of the demand or request is known.
The opinion of the examiner and any expert opinions that the parties may offer, shall expressly refer to the premises established in the above sections.