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Mexico's insolvency response to Covid-19

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A wave of bankruptcies could soon be hitting Mexico as a by-product of the Covid-19 outbreak. Currently Mexican Commercial Concursos Law does not provide special rules to deal with emergencies, crises, disasters, or force majeure and acts of God events. The Bankruptcy and Restructuring Committee of the Mexican Bar Association has been preparing an amendment proposal to provide an extraordinary concurso proceeding in case of such emergencies. This article looks at how the exceptional concurso proceeding could be quicker, more efficient, with a lower cost for the debtor, and favour electronic judicial proceedings.

Introduction

The Mexican Commercial Concursos Law (the 'Concursos Law') provides the only commercial insolvency proceeding available in Mexico, known as *Concurso Mercantil*. The Mexican Federal Government enacted the Concursos Law on 12 May 2000,¹ and since then it has had four amendments (in 2007, 2014, 2019 and 2020).

The primary purpose of the Concursos Law is conservation of the company in general default of its payment obligations, and if not possible, payment to its creditors through liquidation.² Moreover, it seeks to prevent jeopardising the viability of the debtor's stakeholders.³

However, companies seldom use the commercial concurso proceedings in Mexico. According to data provided by the Mexican administrative authority in charge of overseeing commercial bankruptcy proceedings, the Federal Institute of Bankruptcy Proceedings (IFECOM), since 2000 the courts have admitted only 781 insolvency proceedings, amounting to about 40 cases a year.⁴ From these statistics, about 44 per cent of the concluded cases ended through a settlement agreement.⁵ These are negligible numbers for a country which ranks as one of the world's 15th largest economies.⁶ In other words, companies shy away from the *Concurso* regime.

Mexican ordinary commercial concurso proceedings overview

Under article 2 of the Mexican Concursos Law, a concurso proceeding has two successive phases: conciliation and liquidation. However, before the

conciliation stage (which begins with the concurso declaration judgment), there is a pre-concursal stage known as the 'concurso declaration stage' or 'visit stage'.

The concurso declaration stage may begin through a request from the debtor or with a claim filed by a creditor, the Attorney General's Office, or the National Institute to Return to the People that Which has Been Stolen.⁷ The petition must be filed with a federal court in the debtor's domicile.

During this pre-concursal stage, there can be specific arguments and evidence filed by the parties regarding whether the debtor meets the insolvency standards provided by the law. The court also appoints a third-party specialist, known as a visitor, to analyse the company's books and records and to conclude whether the debtor is in general default of its payment obligations. The visitor has the duty to prepare a report for the court establishing whether the company meets the insolvency standards provided under the Concursos Law.

Articles 10 and 11 of the Concursos Law provide that a company falls under general default of its payment obligations when it has two or more creditors and meets the following requirements: (1) 35 per cent of its total obligations have matured for at least 30 days; and (2) the company fails to have enough liquid assets and receivables to support at least 80 per cent of its overdue obligations. When the insolvent company is the petitioning party, meeting only one requirement suffices.

After the visit, and if the debtor is in general default of its payment obligations, the court enters the commercial concurso declaration judgment through which the court declares:⁸ (1) the debtor in concurso; (2) the outset of

the conciliation stage (or the liquidation stage if the debtor expressly requests it); (3) judicial protection against the execution of the debtors assets; and (4) a debtor's payment stay; among other decisions.

The conciliation stage seeks to restructure and preserve the company by a settlement agreement between the creditors and the debtor. The liquidation stage has the purpose of selling the company's assets and paying off its debts.

In the conciliation stage, the court appoints a conciliator, a third-party specialist charged with supervising the company's ordinary business operations, formulating a provisional and definitive list of creditors, and trying to reach a settlement agreement between the company and its creditors.

Conversely, in the liquidation stage, the court appoints a receiver, a third-party specialist charged with liquidating the debtor's entire estate and paying its creditors.

Ample room for improvement in the Concursos Law

As mentioned above, in the last 20 years the concurso proceeding has not proved an efficient and predictable way to restructure a company facing insolvency problems. Below we identify some of the issues that we believe have held back the development of an efficient, reliable and predictable restructuring environment in Mexico:

Lack of specialised courts in commercial and insolvency matters

Under article 17 of the Concursos Law, only federal courts (district courts) are entitled to hear commercial concursos proceedings. Depending on each state, concursos proceedings are heard by mixed district courts, civil district courts, or commercial district courts.

According to the IFECOM, Mexico City, Jalisco, and Nuevo León account for more than 60 per cent of Mexico's concursos proceedings.⁹ However, these states do not have commercial district courts, which means that district courts that hear concursos proceedings also hear civil and commercial federal procedures, family, civil, and commercial *amparo* claims (constitutional claims), and, in some cases, even administrative or labour *amparo* claims.

This lack of specialised commercial and insolvency courts means that judges and court personnel do not have experience and knowledge of accounting, finance, and insolvency in general. This situation also generates different and contradictory judicial interpretations of the law. It is noteworthy that in Mexico, law professionals rarely have any finance background. There is no

undergraduate system offering the possibility for future attorneys to obtain certain quantitative tools before seeking a law degree. High school students go straight into law school, which rarely offers courses on financial accounting, statistics or probability. Financial analysis is left to quantitative experts, not lawyers, who are taught to argue and explore human rights issues, not to see the world through the lense offered by balance sheets, profit and loss and cash flow statements.

In this sea of financial illiteracy, federal judges regard themselves as human rights judges whose mission is to protect companies and individuals from governmental breaches to individual rights set out in the constitution. Future judges often travel to Spain and South America to pursue masters degrees and PhDs in constitutional law. Only occasionally do they see any value in specialising in finance or accounting. Judges avoiding financial specialisation makes perfect sense when considering that the system offers practically no growth opportunities for their acquisition of such intellectual tools. As a result, Mexican justice genuinely has a vicious circle of lack of talent and lack of incentives for that talent to arrive and thrive in concursos.

Constant rejection of the Concurso petitions

Unsurprisingly, most of the concurso petitions (debtor's requests or claims) are rejected by federal district courts, arguing the lack of, or imprecision of, the information and documentation attached to the petition. Therefore, even though there is always an urgency to begin the trial, and for the granting of injunctions to protect the estate, the courts admit very few concurso petitions, thereby obstructing justice and jeopardising the viability of debtors.

Lack of legal certainty in judicial decisions

The Concursos Law allows the parties to challenge all judicial decisions entered by the concursos court. Specifically, the law provides two types of 'recourse': repeal (*recurso de revocación*) and appeal (*recurso de apelación*).

Through an appeal, the parties can challenge the judicial decisions expressly indicated by the law (mainly, the Law provides that an appeal proceeds against concurso judgments). This kind of recourse is heard and resolved by a Unitary Court (a second-instance court). Instead, the repeal proceeds against any judicial decision in respect of which the appeal does not apply. The concursos courts hear and resolve the revocation.

Also, the parties can file *amparo* claims¹⁰ arguing the violation of their human rights against the appeal or repeal judgment. In some cases, an appeal is admissible to challenge *amparo* judgments.

As a result, concursos judicial decisions entered by courts lack certainty and legal security, since there are several stages where they can be modified, even when already executed by the debtor or the creditors.

Excessive ancillary proceedings filing

Under article 267 of the Concursos Law, all the issues that arise during the concurso proceeding, and do not have a specific procedure, shall be brought through an ancillary proceeding. An ancillary proceeding is a small procedure among the concurso proceeding, and commonly there may be dozens of ancillary proceedings that delay the primary process.¹¹

Additional areas of opportunity

The Mexican insolvency system offers abundant areas for improvement, including the following:

- In practice debtor-in-possession (DIP) financing rules eliminate this financing alternative. Some finance-specific statutes make it a crime to lend to companies posing a risk of default. In short, they scare away any remote possibility of a DIP financing market from ever gaining traction in Mexico.
- The labour authorities can execute their awards or judgments without informing the concursos court and without delivering the remnants of the sales or auctions.
- In certain cases the concursos courts have entered overstretched injunctions, whose legality may be seriously debatable, that do not benefit the estate and seriously affect creditors and third parties' rights. These decisions seriously undermine the trust of companies and investors in the insolvency system.
- Verification visits (which only evaluate whether a company passes muster on the insolvency standards) often reach the ridiculous point of lasting for more than a year, due to the lack of organisation and accuracy of the debtor's accounting books. Often by the time a court reaches a decision the company's value has been gravely impaired.
- Lack of electronic processing of concurso proceedings.

Covid-19 and the concurso proceedings in Mexico

Mexico, like many of the world's largest economies, is facing a severe health emergency due to the Covid-19 outbreak. As a consequence, the federal and state governments have adopted several measures to avoid the spread of cases. Specifically, on 30 March 2020, the federal government declared that Mexico was facing a

sanitary emergency and that the Health Ministry would enter general decrees to protect people.

On 31 March 2020 and 21 April 2020, the Health Ministry entered two decrees ordering the suspension of all non-essential activities in Mexico. Essential activities were defined as the health and pharmaceutical sector, public security, financial services, production and distribution of electric energy and hydrocarbons, telecommunications, sales of food, among others.

All these measures adopted to fight against the spread of Covid-19 have provoked, and will continue generating, a severe deterioration of the Mexican economy and serious damage to large companies and SMEs.

For instance, according to Mexico's central bank, in the second quarter of 2020 the country's GDP fell by 14.3 per cent, and in the third trimester of 2020 is expected to fall by a further 7.6 per cent.¹² According to the Tourist Business National Council and Anáhuac Tourist Competitiveness Investigation Center, from March to June 2020, the Mexican receptive (international) and domestic tourism consumption fell by 80 per cent.¹³ Moreover, according to the Mexican Automobile's Distribution Association, in April 2020, national automobile sales fell by 64.5 per cent.¹⁴

Under this adverse situation, Concursos Law does not provide special rules in the event of an emergency. As briefly touched upon above, the ordinary proceeding is inefficient, slow and unpredictable.

Key points of the amendment proposal to the Concursos Law

It is in this context that the Bankruptcy and Restructuring Committee of the Mexican Bar Association worked between March and June 2020 on an amendment proposal to the Concursos Law, to provide an effective and immediate solution to the harmful effects of Covid-19 outbreak and other potential future emergencies.

The proposal seeks to create an extraordinary, agile and exceptional proceeding that allows the restructuring of companies in general default of their payment obligations as a result of a disaster or emergency. It also wants to bring the concursos alternative closer to small and medium enterprises, making their reorganisation faster, more efficient, and more cost efficient. Some key features of the proposal include the following:

- The exceptional proceeding will be *extraordinary* since it will only apply in the case of an act of God or force majeure event, an official emergency declaration, a health contingency declaration, or an official natural disaster statement entered by the federal or local authorities.

- Companies may use the extraordinary concurso proceeding from the time of the existence of the emergency, and up to six months after its conclusion.
- The extraordinary concurso proceeding shall only apply to the debtor's request. If any third party seeks to claim the insolvency of a debtor, it shall use the ordinary concurso proceedings.
- Concursos courts shall process the extraordinary concurso proceedings through electronic files, without the need of a physical file.
- The extraordinary concurso proceeding does not provide a concurso declaration stage or a visit stage. Consequently, a debtor shall only file its concurso petition stating under oath that it is in a general default of its payment obligations, offering evidence to support that it meets the law's standards. If the debtor fails to file supporting evidence, it must do so within ten days of the respective court entering the commercial concurso declaration judgment.
- The court, in its first decision, shall admit the concurso request and automatically enter the commercial concurso declaration judgment, with no recourse allowed.
- The concurso declaration judgment shall: (1) forbid the debtor to transfer the principal assets of the company and to make payments of overdue obligations except for expenses considered as indispensable for the ordinary operation, and credits to maintain the day-to-day operation and liquidity of the company; (2) lift attachments or bank account seizures; (3) suspend all attachment or execution of the debtor's assets (except attachment or executions ordered by labour authorities to pay salaries or compensations); (4) forbid the termination or rescission of agreements indispensable for the ordinary operation of the company.
- The suspension of the execution of assets shall apply, during the conciliation stage, to any guarantee or joint obligor of the debtor.
- The court is entitled to grant any injunctions to protect the estate and the creditors' rights in the commercial concurso declaration judgment.
- During the conciliation stage, the debtor can request and obtain debtor-in-possession financing to maintain the company's ordinary operations.
- For the recognition of credits, the conciliator shall only have to provide a single list of creditors to the court. The creditors may object to the conciliator's list.
- Tax credits shall be considered as ordinary creditors, except for secured tax claims. Labour claims shall receive the same preferential treatment as in the standard procedure, meaning that no matter the nature of urgency of the concurso proceeding, the employees shall always be protected, and their constitutional guarantees respected.

Conclusion

The Mexican Bar Association amendment proposal does not seek to fix all the outstanding issues of the concurso proceeding in Mexico: rather it opens the window to enhance the importance of the insolvency proceedings and fosters the discussion of a future comprehensive amendment to the Concursos Law.

Notes

- 1 Mexican Federal Official Gazette, Mexican Commercial Concursos Law, published 12 May 2000: www.dof.gob.mx/nota_detalle.php?codigo=2054799&fecha=12/05/2000 accessed 21 July 2020.
- 2 Mexican Commercial Concursos Law, art 1.
- 3 See n 1 above.
- 4 See the Federal Institute of Insolvency Practitioners, Statistics of Concursos filed under the Mexican Concursos Law regime: <https://www.ifecom.cjf.gob.mx/applications/aspx/reporte.aspx?op=1&fiSemIni=1&fiSemFin=41&fiSemestreC=1&fiAnioC=2000> accessed 20 June 2020.
- 5 Federal Institute of Insolvency Practitioners, Statistics of Concursos finished under the Mexican Concursos Law regime: <https://www.ifecom.cjf.gob.mx/applications/aspx/reporte.aspx?op=9&fiSemIni=1&fiSemFin=1&fiSemestreC=1&fiAnioC=2000> accessed 20 June 2020.
- 6 Caleb Silver, 'The Top 20 Economies in the World'; www.investopedia.com/insights/worlds-top-economies accessed 21 July 2020.
- 7 Mexican Commercial Concursos Law, art 21.
- 8 Ibid, art 43.
- 9 Federal Institute of Insolvency Practitioners, Statistics of Concursos filed under the Mexican Concursos Law in the Mexican territory. <https://www.ifecom.cjf.gob.mx/applications/aspx/reporte.aspx?op=13&fiSemIni=1&fiSemFin=1&fiSemestreC=1&fiAnioC=2020> accessed 20 June 2020.
- 10 An 'amparo claim' is a constitutional action that allows individuals and corporations to seek federal judicial relief against authorities' acts that violates human rights.
- 11 For example, separatory action, modification or suspension of injunctions, lack of jurisdiction motion, objections to the constitution of guarantees, objections to the selling of assets of the debtor, modification to the clawback period, among others.
- 12 Bank of Mexico, 'Mexican Finance and Economic Data': www.banxico.org.mx/SieInternet/consultarDirectorioInternetAction.do?sector=12&accion=consultarCuadroAnalitico&idCuadro=CA126&locale=es, accessed 21 July 2020.
- 13 Tourist Business National Council and Anáhuac Tourist Competitiveness Investigation Center, 'Estimations of the damages in Mexican tourism sector due to the COVID-19 outbreak' (18 May 2020): www.anahuac.mx/mexico/cicotur/sites/default/files/2020-05/Doc14_Cicotur_Estimacion_afectaciones_turismo_mexicano_Covid19.pdf accessed 21 July 2020.
- 14 Mexican Automobile's Distribution Association, 'Mexican automobile sales' <http://www.amia.com.mx/ventasp.html> accessed 20 June 2020.

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