BANKRUPTCY AND
INSOLVENCY MEXICAN
LEGAL FRAMEWORK

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BANKRUPTCY AND INSOLVENCY

- Reorganization and bankruptcy have become interesting subjects in Mexico as a consequence of the economic and commercial changes that the country has passed through in the last years.

- In order to adapt the reorganization and bankruptcy legal framework to deal with the economic problems faced by businesses, on May 12, 2000, the Commercial Bankruptcy and Insolvency Law ("CBIL") was published on the Federal Official Gazette. The CBIL only applies to businesses.
According to CBIL, there are two successive stages or phases in insolvency proceedings:

(i) Reorganization or Conciliation stage:
- The reorganization stage is aimed at the preservation of the company or of the business (the “Debtor”) through the execution of a reorganization agreement between the Debtor and its creditors.

(ii) Bankruptcy:
- The bankruptcy proceeding is aimed at selling the assets of the Debtor in order to pay its creditors.
The most important effects of insolvency declaration are:

(i) the suspension of creditor debt enforcement proceedings during the reorganization stage;

(ii) the separation of third party property from that of the Debtor;

(iii) the maintenance of the management of the business by the Debtor (however the conciliator may request the removal of the Debtor and appointment of a receiver in order to protect the assets of the Debtor);

(iv) the creation of a special regime for the treatment of the Debtor’s obligations;

(v) the requirement that creditors prove amounts owing to them; and

(vi) the dealing with fraud to the detriment of the Debtor’s creditors.

(vii) union contracts still in full force and effect
The decision containing the bankruptcy declaration, among others:

(i) Suspends the legal capacity of the bankrupt to exercise its rights over its property;

(ii) Requires the Debtor and those who have in their possession property of the bankrupt, to deliver to the trustee in bankruptcy, such possession and the administration of the estate in bankruptcy;

(iii) Prohibits the Debtor from making payments or delivering its assets to others; and

(iv) Orders the Federal Institute of Bankruptcy and Insolvency Specialists (FIIP) to appoint the conciliator as receiver.
EFFECTS OF BANKRUPTCY DECLARATION

- The main effect of the bankruptcy declaration is to transfer the administration of the property of the Debtor from it to the receiver, the latter having the same powers and obligations as the conciliator had.

- Once bankruptcy is declared, the receiver sells the property of the Debtor, trying to obtain the best price for it.
EFFECTS OF BANKRUPTCY DECLARATION

Based on the above, the CBIL establishes that:

- Any and all acts of administration and ownership carried out by the bankrupt person, after the declaration of bankruptcy, will be null and void, if detrimental to the interest of creditors.

- Any and all actions of an economic nature, filed by or against the bankrupt person, will be handled by the receiver, and those in which said person is the defendant shall be added to the bankruptcy proceedings, except for those in which judgment has been passed and notified to the parties, and those guaranteed with a mortgage or pledge.

- All pending economic obligations of the bankrupt person shall mature.
EFFECTS OF BANKRUPTCY DECLARATION

- Interest shall cease to accrue, except in the case of credits guaranteed with a mortgage or pledge, which can accrue up to the value of the property given in guaranty.

- Pending obligations under bilateral contracts may be totally or partially discharged, at the receiver’s discretion, after obtaining the approval of the court. The other party to the contract may suspend performance of its obligations until the receiver fulfills those undertaken by the bankrupt person or guarantees compliance therewith.
EFFECTS OF BANKRUPTCY DECLARATION

Main Actions To Be Taken by a Receiver

- Once the receiver has taken possession of the documents and assets of the bankrupt person, he has to prepare an inventory thereof in order to be able to sell the assets after the procedures to acknowledge credits are completed. The receiver must present for the court’s approval the suggested terms and conditions for the sale of assets. The intervenor, on behalf of creditors, must be heard before approval is granted.
EFFECTS OF BANKRUPTCY DECLARATION

Main Actions To Be Taken by a Receiver

- The “ratio legis” behind the CBIL is to preserve the economic source and, therefore, the sale of assets is to be made in a certain order, generally, as follows:

1) The enterprise sold as a whole;

2) In the event that such a sale is not possible and there are several branches or divisions, or taking into account the structure of the enterprise, then partial sales, by groups of assets;

3) if it is not possible or convenient to proceed in accordance with (1) and (2) above, then assets are to be sold in an independent manner.
Payment to Proven Creditors and Conclusion of the Proceedings

- Payment to creditors are to be made in the following priority:
  
  (i) creditors holding a singularly privilege, which means employees salaries for the 2 years before the reorganization stage (prior finding resolution);

  (ii) creditors holding a pledge or mortgage;

  (iii) creditors holding a special privilege (Taxes); and

  (iv) general creditors (without security or privilege).

- The proceedings conclude when:

  i) the reorganization agreement made between the Debtor and its creditors is approved by the Court;

  ii) total payment is made to proven creditors;

  iii) while payment is made to proven creditors, no other assets are left to be transferred and the estate of the bankruptcy is not enough to make a total payment of proven indebtedness; or

  iv) if the Debtor and all proven creditors so request.
Acknowledgment of Credits and Preference for Payment

- Creditors must file their claims for acknowledgments of credits within forty-five days, beginning from the date of the last publication of the sentence declaring bankruptcy (three consecutive publications in the Federal Official Gazette and in one of the major newspapers of the jurisdiction in which such judgment was passed). At the court’s discretion, it may extend said term for the benefit of foreign creditors.

- Secured creditors who fail to submit their claims in proper form and time, will lose their privilege, and be treated as common creditors. If the petition is filed after the assets and/or proceeds of the bankrupt person have been allocated, the claim will be rejected.

- Demands for acknowledgment of credits have to indicate the claims, facts on which they are based and applicable legal provisions. Documents and evidence supporting the claims and the facts must be attached to the complaint.
Acknowledgment of Credits and Preference for Payment

The receiver shall review the claims, and in consultation with the intervenor, shall prepare a provisional list of creditors including, among other aspects, the following information:

1) Name and address of creditors;
2) His and the intervenor’s opinion as to the admissibility of the claim, its nature (secured/privileged or not) and preference for payment; and amount of value of the claim;

Thereafter, at the meeting for acknowledgement of credits, the bankrupt person, the receiver, the intervenor and the creditors may contest the credits claimed by the different creditors. The court will then rule on which credits are acknowledged, which ones are excluded and which are still pending resolution. Ruling on the latter credits has to be passed within thirty days after the first resolution of acknowledgment of credits.
Acknowledgment of Credits and Preference for Payment

Concerning preference for payment of credits, the CBIL establishes the following order:

1) Those singularly privileged, i.e., those for salaries of employees who worked for the bankrupt person the year before the declaration of bankruptcy. Debtor shall pay to its employees its salary generated for two years of work and any indemnification derived before the declaration of bankruptcy.

2) Those guaranteed with a mortgage or pledge;

3) Those with a special privilege (Taxes); and

4) Those of unsecured creditors
The proceeds from assets of the bankrupt person shall be distributed first among the first category of creditors and, then, any successive balances, if any, among those of the second, third and fourth categories, respectively.

Mention must be made of the fact that certain expenses must be covered before any category of creditors is paid. Such expenses are those related to the preservation and administration of the assets and those arising from actions beneficial to creditors.
Termination of Bankruptcy Proceeding

According to the CBIL, bankruptcy proceedings may terminate for any of the following reasons:

1) **As a result of payment to creditors either in full or at the bankruptcy rate.** This section of the CBIL presents several practical problems. In fact, bankruptcy means that debtor has less assets than liabilities and, therefore, payment in full is not only a remote possibility, but a highly improbable one.

2) **As a result of lack of assets.** This type of termination of proceedings occurs when, at any time during the proceedings, it is proven that the assets are not sufficient to even pay expenses caused by, or arising from, the same proceedings.

The CBIL also establishes that if assets are discovered within two ears of the ruling whereby bankruptcy proceedings were declared terminated for this reason, the proceedings are to be re-opened.
3) As a result of creditors not appearing. This is another unrealistic situation which arises from a CBIL provision that establishes that if the term for submission of claims elapses with only one creditor having filed his claim, the court, after hearing the receiver and the bankrupt party, shall rule the proceeding terminated. The appearing creditor is then able to refile his claims through a new legal action.

4) As a result of the unanimous consent of all creditors (except those derive from Taxes duties which still in full force and effect). Bankruptcy may also be terminated if all creditors whose credits have been acknowledged consent to it. However, there is a problem to the extent there are credits outstanding that have not yet been recognized and whose beneficiaries have not been previously heard by the court.
Termination of Bankruptcy Proceeding

5) As a result of settlement. Finally, the CBIL contemplates the possibility of terminating bankruptcy proceedings as a result of a settlement between debtor and creditors, duly reached at a creditors meeting.