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Chapter 12

Bankruptcy

Introduction

With the aim of regulating states of insolvency which commercial entities may face, a new bankruptcy law was adopted in 2000 which allows for the reorganization of a business through a process of conciliation with creditors, or allows for the commencement of a bankruptcy proceeding in the event that the continuation of the business is no longer possible. Individuals, businesses, and institutions engaged in commercial activities can be subject to a restructuring proceeding and/or bankruptcy.

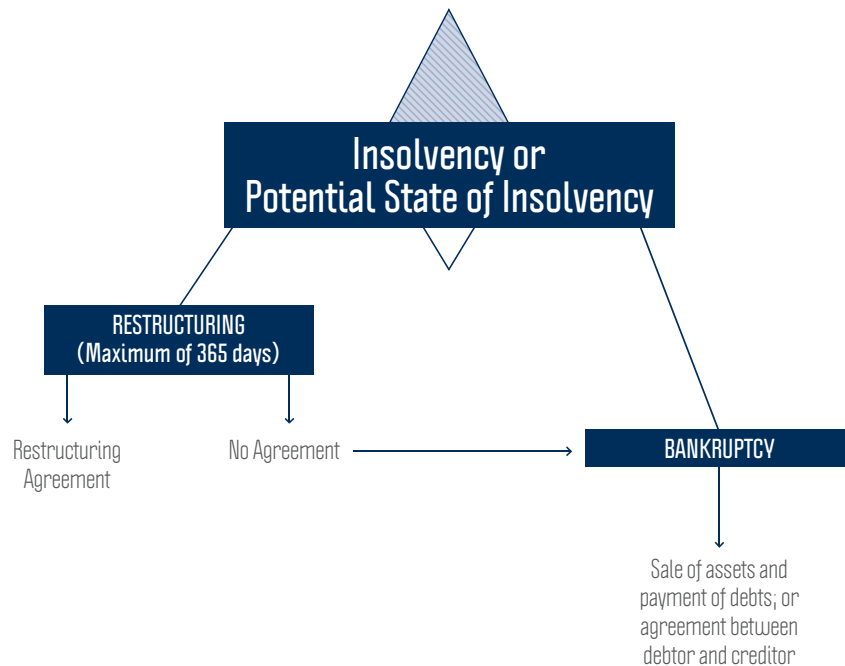
The UNCITRAL Model Law on Cross-Border Insolvency has been incorporated into Mexican law, allowing for the recognition of foreign insolvency proceedings.

The proceedings are divided into two categories: restructuring and bankruptcy. The duration of restructuring proceedings varies and depends upon the possibility of reaching an agreement which allows for the debt to be reorganized and for the debtor to continue conducting business, but cannot exceed 365 days. If the restructuring period expires without an agreement, then the bankruptcy proceeding begins. It is also possible to skip the restructuring proceeding and proceed directly to bankruptcy.



KEY POINTS

- The objectives of the bankruptcy legislation are to: (i) create a system that encourages the restructuring of the debt of a business facing insolvency; (ii) provide greater certainty, a timetable, and help predict the results of bankruptcy proceedings; (iii) minimize the delays arising from litigation in the courts; (iv) separate the work of the court from administrative, commercial, and financial duties; and (v) establish rules for judicial cooperation in cross-border insolvency.
- There are three factors that are necessary in order to initiate a bankruptcy proceeding: (i) a commercial debtor, (ii) multiple creditors, and (iii) a general failure to pay obligations.
- There are 3 procedural bodies that handle commercial, administrative, and financial matters: (i) the investigator (before the proceeding); (ii) the mediator (during restructuring); (iii) the trustee (during bankruptcy). Legal matters are handled by the competent court. The Public Ministry also plays an important role in representing the interests of the Treasury, the workers, or other public institution that may be a creditor.
- In the case of bankruptcy and the sale of assets, the trustee will pay creditors in the following order: tax liabilities, labor liabilities, secured creditors, and then other creditors.



QUESTIONS AND ANSWERS

1. When is a debtor considered to be in a general state of non-payment of obligations?

When: (i) the debtor has debts due to at least two creditors that are at least 30 days overdue, and that overdue amount represents 35% or more of the debtor's total debts; or (ii) the debtor does not have sufficient liquidity to meet 85% of its outstanding debts. The determination that a debtor is in a general state of non-payment of obligations is made at the time the bankruptcy proceeding is initiated.

2. In the case of a cross-border bankruptcy proceeding, can the trustees in the foreign proceeding participate in the Mexican proceeding?

Yes, principally when a request for provisional measures has been made over the assets of the debtor that are located in Mexico. Mexican trustees have the power to intervene in foreign proceedings, in accordance to the Model Law.

3. Which is the competent court for a bankruptcy proceeding?

The competent court is the federal court where the debtor's business is located. However, in the case of concurrent jurisdiction, a local court can also hear the proceeding.

4. What happens if the debtor and the creditors reach an agreement during the restructuring proceeding?

The agreement is formalized and must be approved by a judge of the competent court. The agreement then becomes mandatory for both the debtor and the creditors, and the bankruptcy proceeding terminates.

5. What happens if the restructuring period expires without an agreement being reached with the creditors?

The judge will declare the start of the formal bankruptcy proceeding, in which the trustee replaces the mediator. The trustee takes possession of the debtor's assets in order to manage them, and ultimately sell them and pay creditors. The primary goal is to sell the business as a unit, in case it is not possible to sell the assets separately.

CASE STUDY

“Company A” is a Mexican company that makes auto parts and accessories. Its main clients are major automakers. As a result of the financial crisis in late 2008, “Company A” was involved in various credit transaction which increased their liabilities. This coupled with the external factors, such as a drop in the number of product purchase orders from clients, resulted in “Company A” being in a state of insolvency.

Who can initiate a bankruptcy proceeding?

“Company A” can initiate a proceeding, or a group of creditors with whom “Company A” already has past due debts can also initiate a proceeding.

“Company A” can request the initiation of an investigative stage in order to determine if the company can be restructured. The investigator can determine if the restructuring proceeding should begin, or if the company is in such a state that it should proceed directly to bankruptcy.

In the case of bankruptcy and the sale of assets, can “Company B,” a company that also manufactures auto parts, acquire “Company A”?

The acquisition proposal of “Company B” should be presented to a judge for approval. The primary goal is to purchase the business as a whole unit, although in doing so “Company B” also assumes all the liabilities of “Company A,” such as tax and labor liabilities.