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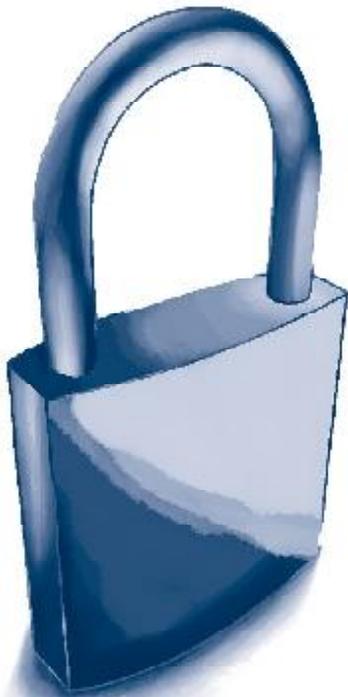
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Chapter 11

Secured Transactions

Introduction



When addressing certain issues, such as, mergers and acquisitions, restructurings, starting business operations in Mexico, and acquiring the essential assets for business, among others, two questions often arise:

Where and how does an individual or entity obtain the necessary capital to accomplish a project? How is payment of a credit transaction guaranteed?

The most important issue when entering into an agreement granting a security interest is selecting the correct choice of transaction for the parties to enter into in order to meet the needs of both parties – the lender and the borrower.

Therefore, it is necessary to analyze the range of possibilities offered by Mexican law, taking into account the most important elements and distinctive features of each project. These elements often include the economic capacity of the borrower, credit references (if applicable), the particular characteristics of each project, the payment structure, the repayment period for the amount due, and other characteristics.

KEY POINTS

A. Security Interests (linked to assets).

- Pledge or pawn. Personal property which is physically delivered to the lender in order to ensure the fulfillment of the obligation.
- Pledge without the transfer of possession. A security interest in personal property held by the lender without the physical delivery of the property in order to ensure the fulfillment of the obligation. This kind of interest can be granted over all of an individual's or entity's assets, and accounts receivable of a business.
- Mortgage. A security interest, generally in real property, held by the lender without the delivery of the asset in which the lender holds a passive right to retain the property until the obligation is discharged. If the obligation goes unmet and certain conditions apply, the property can be sold and the amount received on the sale applied to the original debt.
- There are also industrial, maritime, and aeronautic mortgages.

B. Personal Guaranties (obligations which require an individual or company to personally pay debts).

- Promissory Note. A negotiable instrument which generates an unconditional promise in writing to pay a specified amount to the payee. This document is considered an executive title because it is enforceable through a summary proceeding that can be brought by the payee which allows for the seizure of goods in order to recover the amount due.
- Solidary Obligation or Guaranty. When a person besides the principle debtor assumes obligation for the same debt. This person is bound for the entire performance of the obligation, which may be enforced upon this additional debtor under the same terms and conditions as the principal debtor. Solidary obligation is analogous to joint and several liability in common law.
- Commercial Letter of Credit. Normally used in international transactions. It allows the vendor of merchandise to receive payment through a bank, who will only pay upon receipt of documentation evidencing the delivery or shipment of goods purchased.
- There also exist instruments such as a Standby Letter of Credit and Surety.

C. Trust. A contract where the debtor conveys property or ownership rights to a trustee for the benefit of a creditor as a security interest for an obligation. The trustee holds legal title and manages the assets which have been provided as a security, and will retain title and management for the duration of the contract. The trustee manages the assets for the benefit of the creditor, and accordingly will be obliged to pay the creditor if the debtor fails to comply with its obligation towards the creditor.

1. Obtaining resources through financing:

- ↳ Economic capacity
- ↳ Credit references
- ↳ Amount of funding
- ↳ Payment schemes
- ↳ Terms, etc.

2. Assets which can be used to create a security interest

- ↳ Personal property
- ↳ Real estate

3. Types of secured transactions

- ↳ Collateral or security interests
- ↳ Personal
- ↳ Both

QUESTIONS AND ANSWERS

1. What types of pledges exist, and what are the primary differences?

There are two types of pledges: The civil pledge which is governed by private civil law and the pledge without the transfer of possession which is regulated by commercial law. In both types, the creditor acquires a security interest.

a) The civil pledge has as a requirement that the property pledged must transfer possession, this is achieved by: (i) the delivery of the pledged asset to the creditor; (ii) the endorsement of the security agreement to the creditor; (iii) the delivery to the creditors of non-negotiable instruments and the corresponding registration; (iv) the deposit of the goods in a place where they are available to the creditor; or (v) the deposit of the goods in a depository designated by the creditor.

b) The pledge without transfer of possession allows the debtor to retain possession of the collateral. It is especially useful because the collateral can be intellectual property rights, accounts payable, inventory, or the entire assets of an individual.

The contract for a pledge without the transfer of possession must be notarized and registered with the Public Registry of Commerce.

Although the creditor has the right to seek a court order for the sale of the pledged assets, the creditor can become the owner of the property through the enforcement of the pledge only with the written authorization of the debtor. This authorization must be granted after the pledge is formed.

2. What are the requirements that a mortgage loan must meet in order to be enforceable against third parties?

The loan must be notarized before a notary public and registered in the Public Registry of Property in the locality where the property is located.

It is also important to note that registration fees vary from locality to locality, and are usually correlated to the property value, and thus should be considered an important expense.

3. Can any company enter into a security agreement with a third party?

Yes, as long as this type of activity is allowed for in the articles of incorporation or bylaws. Before entering into a security agreement, it is essential to review the articles and bylaws of the company in order to ensure that this type of activity is permitted.

4. What are the advantages of using a promissory note in credit transactions?

A promissory note is a document whose preparation involves minimal legal costs, the legal means for executing collection is accomplished through an executive commercial court, and the resolution is much faster than an ordinary trial.

CASE STUDY

“Company X” is a Mexican company which was formed in 2000 as a Variable Capital Corporation (S.A. de C.V.), and which has never purchased real property. In 2009, the company seeks to purchase the machinery necessary to begin production in Mexico, and not focus solely on the import and sale of products.

In order to purchase the machinery, “Company X” has applied for financing with a foreign lender, who in order to grant credit requires the provision of sufficient collateral to assure the loan repayment within 10 years.

a) Although the company does not own any real property, can “Company X” grant a security interest?

If the foreign lender necessarily requires collateral in order to grant the requested funding, it is possible to enter into a contract for a “Fixed Asset Loan” which is a loan extended by a bank for the purpose of financing the purchase of machinery. The machinery becomes the security interest for the loan. Thus this type of transaction is considered a pledge without the transfer of possession, in favor of the debtor.

b) If the lender requires additional collateral, what would be more convenient?

Being that the company has no real property, the company should consider the possibility of making another pledge, be it a civil pledge or a pledge without transfer of possession over any other assets that the company holds.

Likewise, if necessary, the shareholders or the partners of the company can make a pledge against the shares or capital stock of the company.

