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IV. Securing transactions

Many types of security measures are available in Mexico to foreign or local lenders, and may be granted as either rights in-rem or rights in-personam. The following are some of the most prominent types of guarantees:

A. Mortgages/Liens

The most widely used security device in Mexico is the mortgage. Mortgages may be established on real estate, vessels, aircraft, or on complete production (industrial) facilities.

1. Real estate mortgages

Real estate mortgages are in-rem guarantees that are created on specifically determined property, and give the creditor, in the event of default, the right to be paid out of the proceeds of a foreclosure proceeding.

Mortgages are regulated by the Civil Code of the location of the mortgaged property, and may be created by agreements between the parties, by voluntary unilateral acts, or pursuant to a legal disposition.

The mortgage lien extends to the natural accessions of the mortgaged property, any improvements and fixtures made by the owner, the movable objects permanently attached to the property which cannot be separated therefrom without damaging the property, new buildings constructed by the owner of the mortgaged land, and to additions to the mortgaged buildings.

For a mortgage to be effective against third parties, it must be registered in the Public Registry of Property of the location of the property. The mortgage lien takes priority over all others except previously registered liens.

In an event of default under a mortgage, the mortgagee may foreclose and enforce, through a judicial proceeding, the sale of the mortgaged property. The mortgagee may bid in the corresponding public auction. Once the sale takes place, the mortgagee may have access to the proceeds. If the proceeds are insufficient to cover the amounts owed a deficiency, judgment will be rendered.

2. Maritime mortgages

The Navigation and Maritime Commerce Law provides that mortgages may be placed on any vessel, whether constructed or in the process of construction, and must be recorded at the Mexican Shipping Registry to be effective against third parties.

Maritime liens on the vessel have priority over a vessel mortgage. The mortgage created on a vessel will have preference over any maritime lien on the vessel, after the following priorities: (i) wages and amounts owed to the crew; (ii) credits derived from indemnities by death or injuries at sea, or on land and in direct relationship with the operation of the vessel; (iii) rewards for the salvage of a vessel; (iv) fees for the use of port infrastructure, navigational aids, and pilotage; (v) compensation due for damages or losses caused by oil pollution or by the toxic, explosive, or radio active properties of nuclear fuel, or radioactive waste or products; and (vi) credits derived for the indemnities for extra-contractual claims for loss, or material damages caused by the operation of the vessel, excluding loss or damage to the cargo, the containers, or passengers' effects aboard the vessel.

The priority of a vessel mortgage over other vessel mortgages is determined by the date of registration. Prior mortgages have priority over subsequent mortgages.

3. Mortgages/Liens on aircrafts

Mortgages may be established over aircrafts, real estate, and chattels of an air transport company. Mortgages on aircrafts that are used in public air transportation service have to be recorded in the Mexican Aeronautic Registry.

Aircraft equipment, such as engines, spare parts, and instruments, may be given in pledge. Constructive delivery is recognized. Mortgages and pledges must be recorded in the Mexican Aeronautical Registry. Mortgages on aircrafts have preference, except for tax salvage and maintenance credits.

4. Complete production facilities (industrial) mortgages

Industrial mortgages are created in favor of Mexican credit institutions over the complete industrial, agricultural, ranching, or service units of the mortgagor, and include all assets, movable and immovable, that are used for exploitation of said unit. This mortgage includes any concession or permission granted, as well as moneys and credits in favor of the mortgagor.

The mortgagor retains possession of the mortgaged assets and continues to use and exploit the industrial unit. The mortgagee must consent to a sale of any of the mortgaged assets, or to any merger, except when made or replaced within the scope of its normal operations, unless otherwise agreed.

The mortgage must be recorded in the Public Registry of Property to produce effects against third parties.

5. Chattel mortgages

Chattel mortgages are not commonly used as a security measure; more often, a pledge is used for chattels.

B. Pledges

There are three kinds of pledges under Mexican legislation: the commercial pledge, the commercial pledge without transmission of possession, and the civil pledge.

The Law of Negotiable Instruments and Credit Transactions defines and regulates commercial pledges with and without possession. A commercial pledge exists when the subject matter of the pledge falls into the definition of commercial, as stated in article 75 of the Commerce Code, or if a party to the pledge is a businessman or engages in commerce, or is a company, as per articles 3 and 4 of the Codeo All other pledges are considered civil and therefore, are regulated by the Civil Codeo In 2000, the Mexican Congress created a new kind of commercial pledge which permits pledges without transmission of possession. The commercial pledge was reformed in June 2003.

Although commercial pledges, pledges without transmission of possession, and civil pledges are similar in many aspects, they have different means of creation and perfection.

1. Commercial pledges

A commercial pledge is constituted by any of the following: (i) the delivery to the creditor of the goods or negotiable instruments; (ii) in the case of nominative instruments, by endorsement of the negotiable instruments in favor of the creditor, and in the case of instruments subject to registration, by endorsement and the corresponding notation in the registry; (iii) in the case of non-negotiable instruments, by delivery of the instrument or the document representing the credit to the creditor, and by recording the lien in the applicable registry or by notification to the debtor; (iv) the deposit of the goods or bearer instruments

at disposal of the creditor, along with a third party designated by the parties; (v) the deposit of the goods at disposal of the creditor in places to which the creditor has keys, even though such places are owned by or located within the establishment of the debtor; (vi) the delivery or endorsement of the instrument representing the goods that are object of the contract, or by the issue or endorsement of a pledge bond relative thereto; (vii) the registration of the contract for the equipment or operating credit in the manner set forth in the Law; and (viii) compliance with the requisites set forth in the Law of Negotiable Instruments and Credit Transactions with respect to account receivables (book credits).

Pledges of fungible goods continue to be effective even when the original goods are substituted by goods of the same type. Although constructive delivery of pledged goods is not recognized for commercial pledges, there are a number of cases where the pledged goods may be placed with a third party or under the joint control of the debtor and the creditor. These pledges produce effects against third parties upon registration of the corresponding pledge in the Public Registry of Commerce of the location where the pledged goods or instruments are to be kept.

If the value of the assets given in the pledge drops below an amount that is not sufficient to cover the original obligation plus 20 percent, and if the debtor does not provide sufficient funds to liquidate the debt represented by the credit instruments, the creditor may petition the court to authorize the sale of the collateral upon maturity of the principal obligation.

The creditor may not become owner of the property given in the pledge without the express written consent of the debtor given after the creation of the pledge.

a) Warehousing

Goods may be granted in the pledge through a deposit of those goods in an authorized general deposit warehouse. After deposit is made, a deposit certificate is issued by the warehouse certifying ownership, along with a pledge bond, evidencing the creation of a pledge on the goods placed in the warehouse. Warehoused goods may only be released by the warehouse to the holder of both the deposit certificate and the pledge bond.

A person holding a deposit certificate retains dominion over the goods deposited in the warehouse. However, such goods may not be removed without payment of all amounts due to the warehouse and deposit of the amount covered by the respective pledge. The holder of the warehouse receipt will have rights in the pledged goods superior to those of judgment creditors, and without a court order to the contrary, superior rights in the proceeds of such goods, whether in the form of sale proceeds or insurance proceeds as a result of damage or destruction. A person holding a pledge bond may request that the warehouse sell the goods deposited in order to collect its credit after maturity.

b) Confidential warehouse receipts

This type of security, although not established by the law, provides a simplified method for security arrangements in practice. The confidential warehouse receipt is a personal note from a warehouse that, when issued with a pledge bond, is accepted by many banks as collateral for commercial financing purposes. This receipt allows for the financing of goods kept in warehouses, without the need of a federal warehouse license, thus avoiding the stringent requirements of the law governing warehousing, in which the risks seem to be outweighed by the practical advantages.

c) Equipment-operating and financing credits

Since a commercial pledge requires the pledgor to forfeit possession of the assets given

in pledge, alternative methods are available that allow the debtor to retain possession of the collateral. Such methods include the equipment-operating credit agreement (crédito refaccionario) and the financing credit agreement (crédito de habilitación o avío).

The assets underlying these credit agreements are also subject to the summary foreclosure proceedings provided in the Commerce Code. Both liens continue attached to the equipment or raw materials for which the credits were granted and/or from which the finished products were produced.

These credits may only be used for the precise acquisitions stipulated in the financing agreement. The creditor should verify the proper use of the credit or risk loss of the lien. Improper use of the credits by the debtor constitutes default and the creditor may rescind the agreement or demand immediate payment, and in either case, can claim damages.

Both credits are generally granted by the opening of a credit line against which the debtor may draw. The agreements must be in writing and recorded in the Public Registry of Property when the security is on real property, and in the Public Registry of Commerce when the security is on personal property. The agreement must establish the duration and purpose of the loan, the use of the funds, and a precise description of the collateral. The primary obligation of the borrower in both cases might be evidenced by one or more promissory notes.

i) Equipment-operating credits

The collateral related to this credit (crédito refaccionario) must be used for the acquisition of any of the following: tools, instruments, farming equipment, fertilizer, cattle or breeding stock, the development of farms and raising of crops (whether seasonal or permanent), the preparation or developing of land or farming, the purchase or installation of machinery and equipment, and the construction necessary for the business of the debtor. The proceeds of the loan may also be used to pay for operating expenses, the acquisition cost of real and personal property, and taxes incurred therewith, provided that the debts were incurred in the year preceding the date of the credit agreement.

These operating credits are secured simultaneously or separately with real property, improvements, fixtures, machinery and equipment, and in general, all that is acquired or improved by the use of the proceeds of the credit, even future products.

ii) Financing credits

This type of security agreement (crédito de habilitación o avío) is used for the financing of the direct and immediate production costs of a business. Financing credits are granted for the acquisition of raw materials or for the payment of wages, salaries, and other direct expenses required for the operation of the business. The financing credits are secured by raw materials acquired with the proceeds of the credit, as well as by the products resulting therefrom.

2. Pledge without transmission of possession

The pledge without transmission of possession is an in-rem right concerning movable property or rights that guarantee the fulfillment of an obligation while enabling the debtor to maintain the material possession of the pledged property. This kind of in-rem right allows the debtor to use the assets for his commercial activities even if they are pledged in favor of a creditor. The pledged goods may be combined with other property, and even sold by the debtor within the usual course of his predominant commercial activities.

The agreement containing the pledge of any movable asset without transmission of its possession has to be ratified before a Public Notary if the value of the operation is equal to or exceeds the equivalent amount in Mexican Pesos, of two hundred fifty thousand Investment Units. The pledge must be recorded in the Public Registry to produce effects against third parties.

The rules of the commercial pledge are additionally applicable to the pledge without

transmission of possession.

3. Civil pledges

The Civil Code defines a civil pledge as a property right over chattels for the purpose of guaranteeing the performance of an obligation and its priority in payments. Nearly every chattel may be given in pledge and must be evidenced in a written agreement, and is perfected by actual or constructive delivery. In the latter case, the pledge must be recorded in the Public Registry of Property.

In the event of default by the debtor, the creditor may demand, and the judge shall order, the sale of the pledged collateral at a public auction. If the collateral cannot be sold at a public auction, it may be transferred to the creditor for two-thirds of the legally required minimum bid. The debtor may agree after default that the creditor may retain the collateral in satisfaction of all or a portion of the debt, or that the pledged item may be sold extrajudicially.

Priorities among competing mortgages and pledges of constructively-delivered property are determined by the recording date, and by the transaction date for pledges actually delivered.

C. Guaranty

The guaranty is the simplest form of security in Mexican Law and takes two forms: the bond ("fianza") or the unconditional guarantee ("aval").

1. Bond

A bond is an agreement accessory to a principal contract between the creditor and the debtor whereby the guarantor assumes the debtor's obligation in the event of default. A bond may not exist without the existence of a valid obligation.

Bonds may be granted by an individual, a legal entity, or a bonding company. However, a company may not guarantee obligations of third parties unless provision is made in its corporate object clause.

A guarantor under a bond may not be called upon to meet his obligations until the creditor has first exhausted his rights of action against the debtor and his assets; however, this benefit may be expressly waived. Bonds are mainly used both in judicial proceeding and in administrative contracts.

2. Unconditional guarantee endorsement

This endorsement guarantees payment of specific obligations is evidenced by a negotiable instrument and is regulated by the Law of Negotiable Instruments and Credit Transactions. The obligation appears on the face of the instrument it guarantees. The unconditional guarantee is deemed to guarantee the entire amount of the instrument interest included, unless otherwise established therein.

The grantor of the unconditional guarantee endorsement (aval) is jointly and severally liable for the debt, even if the principal debt is cancelled, totally or partially, due to a defect. The creditor may not institute an action against the debtor or exhaust remedies against him.

The holder of a negotiable instrument is entitled to a summary "executory commercial action" against the issuer or the guarantor, attaching assets simultaneously with initiation of the action of collection. For this unconditional guarantee to be effective, the use of the words "por aval" above the signature is sufficient.

3. Joint and several liability

It is a usual legal practice in agreements that a third party voluntarily and expressly becomes jointly and severally responsible with the debtor for the payment of a debt.

D. Conditional sales-reservation of title

Seller may reserve title to the goods sold until complete payment by purchaser of the purchase price. If the goods sold consist of real estate or movable goods which can be identified, the clause containing the reservation of title shall be recorded in the Public Registry of Property in order to produce effects before third parties.

Should movable goods cannot be identified, the parties may also include in their agreement a clause stating that the sale will be rescinded in the event of lack of payment of the purchase price. However, this clause will not produce effects before a third party who purchased the goods in good faith.

When the seller rescinds and repossesses the goods upon judicial order, payments received must be returned to buyer less depreciation and fair rental.

Provided that recordation in the Public Registry of Property takes place, and in the event of bankruptcy of purchaser, the seller may request the judge to separate the goods sold, which have not been paid for, from the assets of the bankruptcy proceeding.

E. Trusts

Although trusts are widely used for many different purposes and in a wide variety of transactions (such as to manage assets, to transfer properties, to invest in shares and other securities and to create a business concern), trusts may be used as a vehicle to guarantee debts when the security involves a substantial amount of property.

A trust is created through an agreement between the grantor or grantors, and the trustee must be a Mexican Financial institution, such a bank or brokerage. A beneficiary or beneficiaries are also named, and are entitled to the benefits of the trust agreement. Grantors may also be designated as beneficiaries.

The trustee will perform its duties through its agents which may accomplish the purposes of the trust by instructions from a technical committee designated by the grantors. Property and rights of any type may be placed in trust. Those trusts affecting real property must be recorded at the Public Registry of Property of the location in which the real property is located. Trusts involving movable property will be effective against third parties once the following requirements have been fulfilled:

1. If on non-negotiable credit or personal rights, from the date the obligor is notified of the trust;
2. If on nominative instruments, from the date of endorsement of the instrument to the trustee and the recording of such endorsement in the registry of the issuer if applicable;
3. If on tangible property, from applicable transfer of title to the trustee; and
4. If on bearer instruments, from the moment of possession by the trustee.

Trusts are extinguished, among other reasons:

1. By the fulfillment of its purposes;
2. By the impossibility to fulfill its purposes;
3. By impossibility to fulfill a suspensive condition, by lack verification within the term identified in the trust, or within a 20 year term after its constitution;
4. Through the exercise by the grantors of the right to revoke, if applicable;
5. By the fulfillment of the condition made by the trust;
6. By agreement between the grantors, trustee and the beneficiaries; and
7. By the removal or resignation of the trustee without designation of its substitute.

Foreclosure may be achieved extrajudicially in a guaranty trust by incorporating a

conventional procedure in the trust agreement, or with the intervention of a court following the procedure applicable to conventional pledges for the sale of assets.

Finally, a conditional Deposit (escrow) is an agreement whereby something is deposited with a trustee to be delivered to a third party subject to its complying with certain obligations within a certain period. An escrow can take the form of a trust according to Mexican law.

F. Guarantee trust

In May 2000, the Mexican Congress established a new kind of trust especially designed as an instrument to serve as guarantee for any sort of debt. The chapter regulating this kind of trust, is found within the Law of Negotiable Instruments and Credit Transactions, and was amended in June 2003.

Only Mexican credit institutions, insurance and bonding companies, brokerage and warehouses, and special purpose financial entities, may be trustees of this new kind of trust.

Guarantee trusts may be used to guarantee several simultaneous or successive obligations, even if they are in favor of different creditors. The parties to the trust may agree that the grantor may use movable assets affected by the trust, combine them with other goods, or instruct the trustee to sell them within the usual course of the activities of the grantor.

When the guarantee trust is equal or superior to the amount equivalent in Mexican Pesos of two hundred and fifty thousand Investment Units, parties shall ratify their signature before a Public Notary.

G. Letters of credit

Letters of credit are instruments used, among other things, to secure payment in the sale of goods. Letters of credit allow the seller of merchandise to be paid by a bank or its agent upon instructions from the purchaser, or upon presentation of certain documents such as invoices or bills of lading by the seller. The bank or its agent will pay the seller with funds from a line of credit extended to the purchaser. Stand by letters of credit have become a frequent instrument in Mexico.

H. Leases

Lease agreements may be structured in certain cases to be, in effect, security arrangements.

1. Lease with purchase option

These are governed by the general rules contained in the civil codes for each State or the Federal District regarding lease agreements. A lease agreement may grant the lessee an option to purchase the leased merchandise either during the lease term or the expiration thereof. The purchase price and payment conditions may be determined in the lease agreement.

The local civil codes usually require registration at the Property Public Registry of leases for real estate beyond a certain duration (i.e. 6 years) to be effective against third parties.

2. Financial lease

Financial lease agreements are regulated by both, the General Law of Negotiable Instruments and Credit Operations, and by the General Law of Auxiliary Credit Organizations and Activities and may be granted only by financial leasing, which acquire the title of the merchandise, and lease the merchandise to individuals or legal entities for a compulsory period of time. The most recent amendment to the financial lease legal framework was effected en July 2006. Financial lease agreements are normally executed with Financial Lease Institutions, which, in order to grant the financial lease require promissory notes and insurance cover to guarantee the transaction. The lessee pays a determined amount, which includes the price of the goods, as well as the financial and other costs. Unless otherwise agreed, the price has to be paid even if the goods have not been delivered. The lesee is responsible for the maintenance and preservation of the goods and it is liable for any damage the goods may suffer, including loss, deterioration or destruction. Upon termination of the lease, the lessee may: (i) purchase the merchandise at a value lower than the original purchase price paid by the lessor or market value; (ii) extend the agreement and pay a lower rent in accordance with the terms established in the agreement; or (iii) participate in the proceeds from the sale of the leased merchandise to a third party, as may be agreed.