CROSS-BORDER INSOLVENCY WITH MEXICO

by

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I. INTRODUCTION

A trip across the Mexican border is often a pleasurable experience. The ability to do business in Mexico has also become a profitable experience for many businesses. Increasingly, however, many United States and Canadian businesses doing business in Mexico are finding their venture into Mexico to be less a bus ride to a sunny beach and more a trip on a windy mountain road. They are finding the pit-falls of cross-border insolvency have created a bridge they did not want to cross.

In the 1990's, the United States, Canada and Mexico adopted the North American Free Trade Agreement ("NAFTA"). As a result many United States and Canadian businesses have embraced NAFTA and expanded business into Mexico. Just like any other business, a business taking advantage of the expanding NAFTA market may suffer financial problems. When companies doing business in each of the NAFTA countries have financial problems, their creditors in the United States, Canada or Mexico may encounter not only the exigencies of ordinary insolvency and bankruptcy, including when and how much will they get paid, but also cross-border issues that the United States, Canada and Mexico are far from considering or solving. With an emphasis on Mexico and business going south, this article will attempt to identify some of the most common problems encountered in NAFTA cross-border insolvencies. This article will also explain how two recently enacted Mexican financial reforms, the Law on Commercial Insolvency and the Miscellany of Secured Lending, may help alleviate some of those problems.

A. United States/Mexico Commercial Transactions

Success or failure of a business venture in Mexico for a U.S. business is the result of many diverse factors, some of which are controllable by the parties. Such factors include the quality of products, choice of business counterparts, commercial terms of a transaction, and compliance guarantees. Other external factors that are outside the parties' control include changing government economic policies, devaluation of the peso in relation to the dollar, high interest rates, and changing tax laws and policies. Regardless of whether the factors are controllable or uncontrollable, in all trading and lending transactions there is always the risk of business failure and insolvency problems.

Doing business in Mexico or conducting business with Mexican businesses is not an impossible task. Commerce has flourished for thousands of years between nations and people of different races, cultures, religions, and economic structures. In many instances these differences are much greater than those existing between Mexico and the United States. Although Mexicans and Americans have different customs, language, beliefs, values, and generally, a different culture, understanding how business is conducted in the United States

and Mexico is not a matter of being bilingual. It is a matter of understanding the essential elements needed to guarantee the success of an enterprise.

Within the legal profession, particularly litigation matters, attorneys are involved with those transactions that were not successful. The main reason a U.S. party is unsuccessful in collecting monies or enforcing other contractual obligations against its Mexican counterpart is the improper documentation of the commercial transaction and the obligations derived therein.

Often, a U.S. business doing business in Mexico attempts to conduct a transaction in exactly the same manner as they would a U.S. domestic transaction. At the other extreme, the U.S. party completely relaxes its normal standards under the excuse of "It's Margaritaville." Either path is full of perils. The proper documentation of commercial transactions and guarantees of the obligations contained therein is essential to successfully conduct business in Mexico, particularly when the Mexican counterpart does not voluntarily comply with its contractual obligations. There are various methods to preserve and protect creditors' rights and to secure a monetary obligation from a Mexican debtor and to deal with United States/Mexico cross-border insolvency.

II. DOWN MEXICO WAY, THE LAW SOUTH OF THE BORDER

Like the United States, Mexico is a union of states with a constitution and federal and state laws. Mexico has a court system which parallels that of the United States (with some notable exceptions) and has a great body of law controlling all manner of commercial transactions. Parties extending credit and doing business in Mexico must realize that in attempting to document and secure transactions in Mexico, they must comply with the Mexican Civil Law. Mexican Civil Law is based upon the Napoleonic Code rather than the English common law and is substantially different from laws in the United States. Moreover, the familiar and comfortable Uniform Commercial Code is not part of Mexican jurisprudence.

A. Mexican Judicial Structure and Procedural Law

Essentially, the Mexican court system is structured in a very similar manner to the court system in the United States. In Mexico, there are both state and federal courts. In both state and federal courts, there are trial courts and courts of appeal. One essential difference between the court system of Mexico and that of the United States is a special procedure called the "*amparo*" proceeding. In essence, the *amparo* is a judicial action granted as a

defense against violations of Mexican Constitutional civil rights. *Amparo* proceedings are conducted before Mexican federal courts.

Civil and commercial cases are typically resolved in trial courts. The resolution by the trial court is subject to an appeal to the appellate courts. The decision of the court of appeals is subject to an *amparo* proceeding review. The *amparo* proceeding review determines whether the court of appeals violated the constitutional civil rights of the losing party under Articles 14 and 16 of the Mexican Constitution. Articles 14 and 16 of the Mexican Constitution guarantee that all courts shall resolve the cases presented to them pursuant to the letter of the law or its due legal interpretation. The *amparo* proceeding review, for all practical purposes, serves as a second appellate procedure.

1. A Little Procedure

There are many similarities and many differences between the Mexican procedural system and the United States system. The following points contrast some of the differences and the similarities:

a. In a typical lawsuit in Mexico, judicial procedures are conducted in writing, forming a docket. The first document of the docket is the plaintiff's petition. The plaintiff's petition must state precisely what relief is claimed from the defendant and state the facts of the case that lead to the relief claimed.

b. After service, the defendant must answer each paragraph of the petition and respond to the facts as described by the plaintiff. Further, the answer shall establish, if necessary, additional facts on which the defense may rely.

c. The differences in the facts of the case and in the application of the law asserted in the initial petition and the answer constitute the "litis" or disputed issues of the case.

d. The plaintiff's petition and the defendant's answer to the claim may **not** be subsequently modified or amended in any way.

e. The case is then open for evidence. Depending on the type of procedure, the evidence period may be anywhere between fifteen (15) and forty (40) working days. During this time the parties shall offer and present the evidence to prove the facts of the case as contained in the initial petition or the answer.

f. The rules of evidence are very rigid. For example, copies of documents are not valid in court if they are not recognized expressly by the opposing party; the interrogation of witnesses must be conducted through approved questions, which must be directly related to the disputed facts of the case; the deposition of the parties is subject to a questionnaire that must be drafted in an affirmative manner (open questioning between the parties is not allowed); i.e., a question to a party must be stated affirmatively by stating "that on the 15th of April, 1998, you executed the purchase and sale agreement which is the basis of this litigation," so that the party may answer yes or no, allowing the answering party to expand on his or her response to clarify the answer.

g. Expert witness reports are filed in writing and must be drafted as answers to questions posed by the party offering the evidence.

h. Procedural law does not provide a pre-trial discovery period since the plaintiff should know exactly the facts upon which the claim is based at the time the petition is filed.

i. Once the evidence period is concluded, written final arguments of the parties may be presented and thereafter a judgment is rendered by the judge.

j. Civil and commercial cases are not heard by a jury, but are reviewed and resolved by judges.

k. Theoretically, the civil procedures are fast and expeditious, but in practice there are many ways to suspend and delay proceedings. Consequently, cases may continue for lengthy periods of time before final resolution.

2. A Little Evidence

After briefly analyzing Mexican civil procedure you may understand why it is necessary to have any type of transaction, civil or commercial, properly documented. One of the most common mistakes committed by U.S. businesses doing business in Mexico is the failure to properly document a business transaction. Proper documentation does not require a complicated agreement. It is essential, however, to have an original document executed by the parties containing the essence of the transaction. Signed original contracts and agreements must always be maintained because a photocopy or a fax copy may not be admissible as evidence in a Mexican court. Maintenance of executed original documents avoids procedural problems concerning the presentment of evidence before the Mexican courts.

Another common error in documenting a transaction is the manner in which the statement of an account is made. Normally, pursuant to U.S. law, an affidavit of the creditor stating the amount owed to him is proper evidence. In Mexico, however, such a document would be considered invalid since it was unilaterally produced by the party offering the evidence. Consequently, it is helpful to have a document executed by the debtor expressly recognizing and acknowledging the debt. For ongoing commercial relations, it is also helpful to have periodic statements of account executed by the parties. The documents would be acceptable evidence in a Mexican court.

3. Letter of Credit (Carta de Credito)

The letter of credit is widely used in international sale transactions. Essentially, a Mexican banking institution assumes the payment obligation to the creditor when the conditions set forth in the letter of credit have been met, typically, when the bill of lading of the sold merchandise is presented.

The letter of credit is also usually confirmed by a U.S. banking institution whereby the U.S. bank jointly assumes the payment obligation under the letter of credit. The U.S. creditor presents the original letter of credit to the confirming U.S. bank, complying with all conditions set forth in the letter of credit to draw upon the letter of credit. The letter of credit may be issued for one specific transaction, or as a stand-by letter of credit in an ongoing commercial relationship. The General Law for Title Documentation and Credit Operations applies to letter of credit transactions. It describes the basic requirements for a letter of credit and the remedies upon default.[1]

4. Promissory Note (Pagare)

The best way to document a payment obligation in Mexico is through the use of a promissory note known as a *pagaré*. Typically, for international purposes, *pagarés* are prepared in English and Spanish versions, both contained in the same document. *Pagarés* to be collected in Mexico should be prepared in a simple form stating that it is a promissory note and contain (i) an unconditional promise of payment of a fixed amount of money; (ii) the name of the person to whom payment should be made; (iii) the time and place of payment; (iv) the date and place in which the document is executed and the signature of the maker; and if applicable (v) the signature of the guarantors. Due to the nature and the procedural benefits of the *pagaré* it is best that it contain only the essential elements

[1]Gayou and Gilbert, *Legal Building Blocks for Structuring Sales in the Mexican Market*, 25 ST. MARY'S L.J. 1115, 1130 (1994).

described above. A lengthy and complicated document may only give grounds for the borrower to use it as elements of his defense or to delay prosecution of the case.

In Mexico, there are three basic procedural advantages of filing a claim based on a *pagaré*. The first advantage is that the creditor may attach assets belonging to the borrower at the time of service. Mexican law allows a creditor to place a lien on property belonging to the borrower before a judgment is rendered, with no further requirements.

The second advantage concerns the burden of proof. A *pagaré* constitutes prima facie evidence that the monies are owed to the creditor. Consequently, the lender is not required to prove that the monies are owed to him; rather, the borrower would have to prove that he does not owe the money.

The third advantage is that the defendant may assert only limited defenses in court, as prescribed by Article 8 of the General Law on Negotiable Instruments and Credit Operations (*Ley de Títulos y Operaciones de Credito*). In essence, the defenses are (i) lack of jurisdiction or representation on the plaintiff or on the signatory; (ii) failure to meet the requirements for a negotiable instrument; (iii) partial payment; (iv) statute of limitations; and (v) personal defenses.

5. Mortgage Guaranty (Hipoteca)

Typically, under Mexican law as under U.S. law, a mortgage guaranty is placed upon real property to guarantee the performance of a contractual obligation. A mortgage is considered an "in rem" guarantee, which means that the real property itself is the payment guaranty of the obligation. Consequently, if real property is transferred to a new owner, the real property will continue to guarantee the payment obligation.

A mortgage needs to be established through a Public Deed issued by a Notary Public (*Notario Publico*) in Mexico. It should be recorded in the Public Registry of Property of the state where the mortgaged real property is located. Once the mortgage is established, the creditor will be secured before any other creditors, with some exceptions, up to the value of the mortgaged property. In the event of bankruptcy, the creditor will hold its preferential rights and may foreclose on the property separately from the bankruptcy procedure. The only preferential creditors with priority over the holder of a mortgage guaranty will be any previous lienholder of the property and certain labor claimants.

In order to establish the mortgage guaranty, it is necessary for a *Notario Publico* to issue a public deed containing the mortgage guaranty. This may result in a number of costs,

including notarial fees, local taxes, and registration fees. The costs involved vary depending on the state where the mortgaged real property is located.

6. Pledge Guaranty (Prenda)

A pledge is also considered an "in rem" guaranty. Consequently, the pledged goods serve as collateral for the performance of an economic obligation, notwithstanding the future owner of the pledged goods. In commercial transactions, the pledge is perfected when the goods are delivered to the creditor or deposited with a person appointed by the parties, by the proper endorsement of the negotiable instrument, when applicable, or the delivery of the documents pertaining to the pledged goods.

The pledge has the inconvenience that if the pledged goods are delivered to the creditor, they may not be used by the debtor. If the pledged goods are deposited with a third party, allowing the pledged goods to be used by the debtor, the goods are frequently not found at the time of default and foreclosure. The pledge guaranty should be recorded with the Public Registry of Commerce where the goods are located so that the pledge may have legal priority over any third-party claims.

It is essential to understand that even if a security interest has been properly granted in the United States, if the assets are being used in Mexico, the security interest must be prepared in accordance with Mexican law and recorded with the Public Registry of Commerce where the assets are located. Recordation with the Public Registry of Commerce assures the preferential rights with respect to third-party creditors. In addition, recordation serves as general notice that the assets belong to the entity or individual who holds title to them, and thus do not necessarily belong to the individual or entity that uses those assets within Mexico.

In many cross border transactions, a U.S. bank lends money to a U.S. business that has a Mexican subsidiary operating in Mexico. To secure the loan, the borrower grants to the bank a security interest in equipment, inventory, and accounts receivable of the U.S. corporation. The bank files a UCC-1 with the Secretary of State in the state of the borrower's business. The U.S. business allows the Mexican subsidiary to use the equipment and inventory to manufacture products in Mexico. To the extent the pledged assets are located in Mexico, the rights and priorities of the bank will not be protected unless the security interest has been granted in compliance with Mexican law and properly recorded. Filing a UCC-1 in the United States will not create an enforceable lien upon assets located in Mexico. Further, if a Mexican user of the pledged assets has any creditors, including labor claims, the recordation of the pledge guaranty with the Public Registry of Commerce will serve as evidence that the pledged assets do not belong to the Mexican user of the goods.

Therefore, the pledged assets should not be subject to any attachment by any creditor of the Mexican user.

7. Bond (Fianza)

Contractual obligations may be guaranteed through a bond, issued by a Mexican bonding institution. Mexican bonding institutions are licensed by the Mexican government. Bonding institutions are not allowed to issue bonds to guarantee payment of a loan unless specific authorization is obtained from the Mexican Treasury Department. Nevertheless, many bonding institutions issue bonds to guarantee obligations under a commercial transaction that does not appear to directly guarantee a payment obligation. An example of a proper use of a bond is to guarantee the return of equipment leased and used in Mexico.

It is extremely important to review the terms of the bond so that in the event of non-performance it may be enforced through the Mexican courts. Unfortunately, the theory that a bond, issued by a Mexican bonding institution, assures recovery, does not always apply. In reality, a bond claim may become the subject matter of lengthy litigation with no guaranteed results.

8. Personal Guaranty (Aval)

Those conducting business in Mexico should consider obtaining the personal guaranty of the owners of the Mexican enterprise. Just like in the United States, there are many insolvent corporations in Mexico with wealthy owners. If the contractual obligations are assumed by the Mexican company, it is essential to review and confirm the financial situation of such company. It is not good practice to merely rely on what you may believe to be a solvent company, just to find out that the company has no assets to guarantee payment to its creditors.

9. Other Security Contracts

Various other means of securing liens on personal property exist, including the conditional sale contract (*venta con cláusula rescisoria*) and title retention contract (*venta con reserva de dominio*). While the conditional sales contract appears to be similar to an unsecured financing contract, the title retention contract is similar to a secured financing contract. In a title retention contract, the title remains with the seller until full payment has been made. Title retention contracts must be recorded with the Public Registry of Property where the buyer is domiciled to be valid.

10. Miscellany of Secured Lending

On April 30, 2000, the Mexican Congress approved a group of important financial reforms called the Miscellany of Secured Lending (Miscelanea de Garantias). The MG creates a new legal framework for granting security interests and giving secured creditors expeditious judicial and extrajudicial means to foreclose on those security interests in the event of default by the debtor.

The MG approves the creation of two new forms of secured contracts, the nonpossessory pledge and the collateral trust, and provides for both an extrajudicial process and an expeditious judicial process for foreclosing on the new forms of security interests.

As its name suggests, the ***nonpossessory pledge*** permits a debtor to grant to a secured creditor a nonpossessory security interest in chattels, including working capital, goods in production and other business goods. The debtor maintains title and possession of the chattels, which eliminates the inconvenience established by the pledge guaranty, discussed above, pursuant to which either the creditor or a third party maintains possession of the chattels.

Pursuant to the ***collateral trust***, the debtor acts as the grantor and the creditor the beneficiary for the security in the trust. The trust may secure subsequent obligations. Credit institutions, insurance companies, bonding institutions are among those entities qualified to act as trustees under a collateral trust.

In conjunction with the passage of the MG, the Mexican Congress also approved an initiative related to e-commerce and the modernization of the public registers of commerce. The new law regulating electronic commerce governs electronic payments and creates legal mechanisms for resolving disputes. Previously, development of e-commerce in Mexico was stifled by a requirement that only original signed documents were evidence of contractual obligations.

B. A Little Labor Law: Labor Preferential Rights

The Mexican legal system is extremely protective of the rights of workers. In the event of a company's insolvency, labor claims are preferred over any other claim or right of any third party, including secured creditors. Article 113 of the Federal Labor Law of Mexico provides as follows:

> ARTICLE 113. The salaries earned during the last year and the owed indemnity to the workers have preference over any other creditor, including

those who enjoy "in rem" guarantees, taxes and those in favor of the Mexican Social Security Institute, over all assets of the employer.

There are several issues that must be considered regarding this short but strong legal provision, the most significant of which are as follows:

1. The preferential rights exist for earned and unearned salaries for the year immediately preceding the insolvency or business failure. If the salaries of the workers were paid, obviously there is no subject matter to the labor preference. The preference is established only for salaries, and not for other benefits such as extra hours, vacation payments, Christmas bonus, etc.

2. The "indemnity" are severance payments that workers are entitled to receive when a labor relationship concludes on grounds imputable to the employer. The severance payment consists of three months salary plus an amount equivalent to twelve (12) days of pay for each year of service. The years of service benefit is computed at the maximum amount of two times the minimum salary applicable in the location where the worker rendered his or her services. There could also be an additional benefit for the workers equivalent to twenty (20) days pay for each year of service, computed at the amount of the last salary, with no maximum limit.

3. The preferential rights are superior to the rights of any and all creditors of the employer, and any and all assets of the employer are subject to the preferential rights. For example, if a business closes its doors and terminates its production, the workers enjoy the preferential rights to collect the labor benefits described above, notwithstanding that there is a creditor (i.e., banking institution, Mexican or foreign), holding a mortgage guaranty on the real property belonging to the employer.[2] This situation needs to be taken into account when analyzing a credit risk since a creditor may be holding a mortgage upon certain real property, thinking that the credit is well protected, when in reality there could be a potential and substantial labor risk.

The labor preference affects the assets belonging to the employer. To close the risk to the assets, some employers lease real property, equipment, and machinery from a third party. Consequently, if in operation an employer is using assets belonging to the third party, the assets should not be subject to any lien for a credit, preferred or not, against the employer. To preserve these rights, it is necessary to have proper evidence to show that the assets being used or in the possession of an employer do not belong to it.

[2] *See* J. Westbrook and J. Ziegel, *The American Law Institute NAFTA Insolvency Project,* 23 BROOK. J. INT'L Law 7, 18 (1997) (hereinafter *NAFTA Project*).

C. Default

In the event of default by a Mexican debtor, creditors must turn to the Mexican courts. There is no self help in Mexico or non-judicial foreclosure. To enforce creditors' rights in Mexico through litigation, it will be necessary to retain Mexican counsel. If the transaction has been properly documented and records have been properly maintained, the pursuit of a Mexican debtor through the Mexican courts should be no more painful than the process encountered in the United States.

D. "Old" Bankruptcy Law South of the Rio Bravo

Until recently, there were only two types of bankruptcy proceedings available in Mexico: the liquidation proceeding and the suspension of payments proceeding. This section will provide an overview of both proceedings and compare them to their counterparts under the United States Bankruptcy Code. As explained below, there is a new bankruptcy regime in Mexico called the Law on Commercial Insolvency. The new bankruptcy law, however, does not apply retroactively to cases filed before May 2000. Moreover, during a five-year transition period, the new bankruptcy law will not apply to commercial debtors with debts of less than approximately $175,000. Therefore, an understanding of the "old" insolvency regime is still critical.

1. An Overview

The overall concepts and many specific provisions of the Mexican liquidation and suspension of payments proceedings are similar to those of Chapter 7 and Chapter 11 of the United States Bankruptcy Code, respectively. Due to the age and history of the Mexican law, however, many of the law's provisions and its application will seem (appropriately) foreign to a U.S. bankruptcy practitioner. Commentators have noted the Mexican bankruptcy law contains many ambiguities and has been subjected to inconsistent interpretations by the courts.[3]

The Mexican liquidation and suspension of payments proceedings have not been utilized to the extent that their American counterparts have been. In fact, historically few businesses voluntarily filed liquidation or suspension of payments proceedings. This circumstance is not surprising, since criminal penalties and jail time often awaited the debtor and its officers. In addition to the low number of filings, there are few successful reorganizations. Often, suspension of payments proceedings result in liquidation proceedings

[3] *See* R. GITLIN and R. MEARS, INTERNATIONAL LOAN WORKOUTS AND BANKRUPTCIES, at 531 (1989).

or in all of the debtor's assets being sold to a third party. Further, there are few lawyers in Mexico who are bankruptcy specialists.[4] Bankruptcy filings have increased since the passage of the new bankruptcy law, but are still far fewer than in the United States.

2. Governing Law

Business bankruptcies (for individuals in business and corporations) have been governed primarily by the Law of Bankruptcy and Suspension of Payments (*Ley de Quiebras y Suspensión de Pagos*) ("LQSP"). The LQSP is a Federal law, enacted in 1943. The LQSP is published in the Federal Register. The LQSP has been amended only once since its inception, and that modification was not substantial.[5] The LQSP translated into English can be found in Bonime-Blanc and Mooz, *Doing Business in Mexico*, appendix 8 (1994).

Individual nonbusiness proceedings, called *concursos*, are governed by the law of the state in which the individual is domiciled.[6] Little is written on the state laws for a concurso.

State courts and federal courts share jurisdiction over bankruptcy proceedings.[7] There are no bankruptcy courts *per se*; there are, however, certain judges in Mexico City with special expertise in the laws of bankruptcy.[8]

3. Bankruptcy (Liquidation) Proceedings

Mexican bankruptcy (liquidation) proceedings have much in common with Chapter 7 cases under the United States Bankruptcy Code. Many of the rules described herein are applicable to both bankruptcy proceedings and suspension of payments proceedings.

A bankruptcy proceeding may be commenced by the debtor, any creditor, or the local or federal attorney general.[9] The debtor must allege in a voluntary case that it has ceased paying its obligations. If a creditor petitions the court for an involuntary proceeding, it must

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[4]Agustin Berdeja-Prieto, *Debt Collateralization and Business Insolvency: A Review of the Mexican Legal System*, 3RD NAT'L. INST. ON MULTINATIONAL COMMERCIAL INSOLVENCY (1993) (hereinafter *Debt Collateralization*).

[5] Berdeja-Prieto, *Debt Collateralization*, at O-2.

[6] *Id.*

[7]*Id.*

[8]*See* Westbrook and Ziegel, *NAFTA Project* at 14.

[9]Heather, *Mexico's Bankruptcy and Suspension of Payments Law*, 671 Practicing Law Institute, 121 (1993).

prove the debtor falls in any one of three categories, the most important being that the debtor has ceased paying its obligations. The debtor can contest an involuntary proceeding by filing an objection within five (5) days of the petition.[10]

If the court accepts the proceeding, it will notify the debtor, the attorney general, and the creditors, and notice of the bankruptcy will be published in the local newspaper on three (3) occasions. A bankruptcy trustee (*síndico*), acting as an auxiliary to the department of justice, is then appointed by the court. The trustee's duties include taking possession of the business and the assets of the debtor, preparing inventories of the debtor's assets, preparing or rectifying a balance statement, examining the books, records, and documents of the company, depositing and, when appropriate, making payments on behalf of the debtor, preparing a detailed report for the court on the business, and establishing the provisional list of privileged and ordinary creditors.[11]

Once the proceeding is accepted, most property of the debtor becomes the bankruptcy estate to be administered by the trustee. The trustee can continue to operate the debtor's business or proceed with liquidation.

a. Creditor Participation and Claims

Creditors whose addresses are known are notified in writing of the proceedings.[12] In addition, the trustee publishes notice in the Federal Register and in a major newspaper in the place where the proceeding is commenced.[13] Creditors are deemed to have received notice after the last publication.[14]

Creditors must file claims within the time set by the court in the bankruptcy declaration, typically forty-five days (45) from the date of the last notice of bankruptcy published in the newspaper. Claims are asserted by written petition as in any other lawsuit. The claims must be supported by original documentation, including a translation if necessary. Claim petitions must include the name and address of the creditor, a short statement of the factual and legal basis for the claim, the amount, and the asserted priority. An "intervenor" is

[10]*See* Gitlin and Mears, *supra,* at 538.

[11]Berdeja-Prieto, *Debt Collateralization,* at O-11.

[12]Berdeja-Prieto, *Debt Collateralization,* at O-13.

[13]*Id*.

[14]*Id.*

appointed to represent and look out for the interests of the creditors. The trustee and the intervenor review the filed claims, and then the trustee submits to the court a provisional list of creditors. Each claim is reviewed as to the amount, priority, and sufficiency of documentation. The judge convenes a creditors' meeting, at which time the creditors vote to approve the intervenor and to approve certain agreements. At the meeting of creditors, the claims are conclusively set, unless a claim is referred to the court for resolution.

b. Priorities

The debtor's property is distributed to creditors subject to the following priorities:

i. "Singularly privileged creditors." This class includes costs of administering the bankruptcy estate, and labor claims given preference under Article 113 of the Constitution and the Federal Labor Law for accrued wages during the past year and severance pay.
ii. Properly perfected secured creditors with respect to the collateral. Secured creditors can recover their debt from the collateral, and in some circumstances may proceed to enforce their lien outside of the bankruptcy, *i.e.*, by filing or proceeding with a foreclosure suit in another court. Secured creditors with competing liens are ranked by the time they recorded their respective liens.
iii. Federal taxes. The amount owing on these taxes is determined by the taxing authority, not by the court in which the bankruptcy is pending.
iv. Creditors with special privileges. This class includes commission agents, merchandise vendors, and carriers.
v. Common creditors due to business transactions.
vi. Civil law common creditors (non-business related debts that arise out of the Civil Code, mainly those relating to individuals).[15]

Expenses of administration are always paid in full. Creditors may lose their priority status if they do not timely file or properly document their claims.

c. Effects of the Declaration of Bankruptcy

Once the bankruptcy proceeding is declared, most property becomes part of the bankruptcy estate, the *masa*. Certain property is excluded from the *masa*, such as property not legally attachable and post-bankruptcy personal earnings.

[15]Berdeja-Prieto, *Debt Collateralization*, at 0-13.

Under the LQSP, certain types of fraudulent or preferential transfers can be set aside. Generally, actions taken by the debtor to defraud creditors can be voided if the third party knew of the fraud. Further, the court can declare the bankruptcy proceeding retroactive to a certain date, and certain acts occurring after the retroactive date are void. Typically, the retroactive date is fixed at six months prior to the bankruptcy filing.[16]

Once the bankruptcy is filed, most actions against the debtor or its assets must be taken through the bankruptcy court. This provision is similar to the automatic stay under U.S. Bankruptcy Code; however, the Mexican counterpart is not as broad. Under the Mexican law, commercial creditors may continue mortgage foreclosure actions pending in other courts. Also, laborers and taxing authorities may continue to pursue their claims outside of the bankruptcy proceeding.

The bankruptcy filing has other consequences, many of which will be familiar to the U.S. bankruptcy practitioner. For example, interest stops accruing on all debts except secured debts, and then only to the value of the collateral. Also, debtors must declare their intentions regarding executing contracts.

d. Discharge and Criminal Ramifications

The bankruptcy proceeding may be concluded either by payment to creditors in part or in full through liquidation of assets, by a determination there are not sufficient assets to pay expenses of administration, or by unanimous consent or agreement of the creditors. The debtor apparently receives a discharge of its debts upon conclusion of the proceeding.

Bankruptcies are classified as fortuitous, culpable, or fraudulent. A fortuitous bankruptcy is generally one in which the business was properly managed, and the bankruptcy could not have been foreseen. A culpable bankruptcy is one that is caused by certain acts described by statute, which acts include excessive personal spending or excessive losses due to speculation of capital. A bankruptcy may be found to be fraudulent if certain facts described by the statute are shown. Fraudulent bankruptcies generally involve the debtor altering, destroying, or maintaining insufficient records, or absconding with assets. Fraudulent and culpable bankruptcies carry criminal penalties for the individuals assisting, cooperating in, or directly inducing the fraudulent or culpable act. The criminal penalties are prison sentences of one to ten years, and in the case of fraudulent bankruptcies, additional monetary fines.

[16]Berdeja-Priento, *Debt Collateralization*, at 0-12.

4. Suspension of Payments

The LQSP provides that business debtors may file a suspension of payments proceeding prior to declaring bankruptcy. The suspension of payments proceeding is an alternative to bankruptcy, and is similar to Chapter 11 of the United States Bankruptcy Code. Most of the rules described above for bankruptcy proceedings apply to suspension of payments proceedings as well.

Like Chapter 11 cases, most of these actions end in liquidation, and assets are often consumed by the expenses of administration.[17] Suspension of payments proceedings can languish for years. Successful cases are generally those in which a settlement is reached prior to conclusion of the proceeding.

Only the debtor can commence a suspension of payments proceeding. Further, a debtor is not eligible to file this proceeding if (i) it or its directors have been convicted of property or deceit related crimes; (ii) it has defaulted on a prior suspension of payments plan; (iii) it had previously declared bankruptcy and had not been rehabilitated, unless the case was concluded for lack of creditors or with the unanimous consent of the creditors; (iv) it failed to produce all of the required documents; (v) it presented its petition more than three days after the cessation of payments; or (vi) it is an irregular (de facto) corporation. A petition for a suspension of payments proceeding will stop any pending involuntary bankruptcy petition.

The filing must be accompanied by the documentation required for a bankruptcy filing and by a "proposed preventive agreement" to present to creditors. The preventative agreement must comply with the statutory requirements. The preventative agreement can delay payments over a three-year period and/or discount claims by up to sixty percent (60%) of the claim.

In a suspension of payments proceeding, the debtor may continue to operate the business, subject to supervision of the trustee and the court. The trustee's role is more limited than in a bankruptcy proceeding. The debtor remains in control of its assets, subject to the oversight of the trustee. Unless a sale or use of property is within the ordinary course of business, the debtor must obtain court approval. The debtor is obligated not to increase the company's liabilities or diminish its assets beyond its "ordinary management." Breach of the debtor's obligations can lead to the judge’s declaring bankruptcy.

[17]Clark, *Cross Border Insolvency Issues Between Mexico and the United States*, The University of Texas 13th Annual Bankruptcy Conference (1994).

Partners of the debtor and creditors must first approve the preventative agreement. Creditors vote on the preventative agreement by simple majority. Each creditor has one vote, regardless of the size of its claim. If a proposed preventative agreement is rejected, the judge must declare bankruptcy.

Once the preventative agreement is approved by the creditors, the court must approve the agreement. The court must determine that the debtor is eligible for the suspension of payments proceeding, that the amount offered is not less than the debtor can pay, and that performance is sufficiently guaranteed. Court approval typically takes twelve to thirty-six months.[18] The suspension of payments proceeding will conclude if (i) bankruptcy is declared; (ii) a preventative agreement is approved at the creditors' meeting; or (iii) the debtor's solvency improves so that it can repay its debts.[19]

E. "New" Bankruptcy Law South of the Rio Bravo

On May 12, 2000, the Law on Commercial Insolvencies (Ley de Concursos Mercantiles or "LCM") was published in Mexico's Official Gazette (Diario Oficial) and became law on May 13, 2000. The LCM applies prospectively to cases filed after May 13, 2000 and repeals the former laws on Bankruptcy and Suspension of Payments Proceedings. The LCM promises a more streamlined insolvency regime than the LQSP. The LCM contains many provisions that are similar to those of the LQSP, such as classification of claims, notice to creditors, and avoidance of fraudulent transfers. The LCM also contains many novel provisions, including new stages and bankruptcy officers and provisions for cooperation in cross-border insolvencies.[20] This portion of the paper focuses on the new and different provisions.

1. Merchants

The LCM applies to "comerciantes," or merchant debtors. The LCM refers to the Mexican Code of Commerce to define "comerciante." A merchant debtor may be a natural or legal person engaged in trading, commerce, or other business activity whose debts are

[18]Berdeja-Prieto, *Debt Collateralization,* at 0-21.

[19]*Id*.

[20]*See generally* Jose Maria Abascal, *The Main Features of the New Mexican Law on Commercial Insolvency,* International Insolvency and Secured Lending Law Reforms, Southwestern Legal Foundation's Int'l and Comparative Law Center, Dallas, Texas, June 12, 2000; Francisco Romero, *The New Proposed Mexican Bankruptcy Law*, American Bankr. Inst. 2000 Annual Spring Meeting, Washington, D.C., April 29, 2000; Josefina Fernandez McEvoy, *Mexico's New Insolvency ActBIncreasing Fairness and Efficiency in the Administration of Domestic and Cross-border Cases (Part I &II),* AM. BANKR. INST. J., August 2000, at 16, September 2000, at 12.

commercial or business in nature. The LCM excludes from its scope insurance companies, surety companies, and unincorporated governmental enterprises, which are governed by special insolvency laws. The LCM also excludes from its coverage small merchants, which are those with liabilities that do not exceed $400,000 UDIs (Inversion Units).

2. Courts

Unlike the LQSP, which granted jurisdiction over bankruptcy matters to both federal and state courts, the LCM grants to federal district courts original and *exclusive* jurisdiction over LCM proceedings. All cases must be filed in the district of the debtor's domicile, which is the debtor's place of incorporation or principal place of business. If the debtor is an individual, his domicile is his company's principal place of business or, if he cannot be served there, then his permanent residence. The LCM grants broad, discretionary powers to the judges, who are responsible for serving most documents submitted by the parties in connection with the case and for providing all notices in the case.

3. Federal Institute of Reorganization and Bankruptcy Specialists

The LCM creates the "Instituto Federal de Especialistas de Concursos Mercantiles," or Federal Institute of Bankruptcy Specialists (the "Institute"). The Institute is an autonomous branch of the recently created Federal Judicial Council, consisting of the federal district courts, federal courts of appeal, and the Mexican Supreme Court. The Institute exercises great control over insolvency proceedings by, among other things, appointing and supervising officers of the bankruptcy estate, including, visitors, conciliators, and trustees, and establishing certain procedures for bankruptcy cases. The Institute performs a function similar to that of the Office of the U.S. Trustee in American bankruptcy cases.

5. No Creditors' Committee

Curiously, the LCM eliminates the role of the creditors' committee. Instead, on the request of creditors holding at least 10% in amount of claims listed in the conciliator's preliminary list of creditors, an ***intervenor*** may be appointed. The invervenor represents the interests of all creditors, both secured and unsecured, and monitors the debtor and trustee or conciliator in the administration of the case.

6. LCM Stages

The LCM insolvency regime contains three stages: (a) Examination Stage; (b) Conciliation Stage; and (c) Liquidation Stage.

a. Examination Stage

The purpose of the Examination Stage is to verify, by objective criteria, whether the debtor is in general default on its obligations. Both voluntary and involuntary petitions may be commenced under the LCM by the filing of a petition in federal district court. When the petition is filed, the court directs the Institute to appoint an examiner to examine the debtor's financial affairs and to determine whether the debtor is insolvent.

A debtor is insolvent if it is in general default on its obligations to two or more creditors and either (i) the delinquency represents thirty-five percent (35%) of more of the debtor's liabilities (whether or not subject to a bona fide dispute) as of the petition date and are at least thirty (30) days past due; or (ii) the debtor lacks sufficient liquid assets to satisfy at least eighty percent (80%) of its petition-date obligations.

In addition, under the LCM, there is prima facie evidence of a generalized default if the debtor (i) has insufficient assets to satisfy a judgment; (ii) defaults on obligations to two ore more different creditors; (iii) is absent or absconds; (iv) closes the business; (v) commits fraudulent or deceitful activities in connection with its obligations; (vi) breaches its obligations under a prior plan of reorganization; or (vii) performs any other similar act.

The examiner must generally file his report with the court within fifteen (15) days from the date the examination began. The examiner may recommend to the court interim measures to protect the debtor during the Examination Stage, including removal of the debtor's management. After the examiner files his recommendation with the court, parties-in-interest have ten days to respond. Within five days of that response deadline, the court shall issue its judgment, either granting or refusing to grant a "concurso" judgment or order for relief.

b. Conciliation Stage

The "concurso" judgment or order for relief shall contain, among other things, (i) the date and name of the debtor; (ii) an order directing the Institute to appoint a Conciliator (or if Liquidation is sought, a Trustee); (iii) an interim order allowing the debtor to remain as debtor-in-possession; (iv) an order staying all payments except for administrative expenses required to keep the business operating; (v) an order staying all attachments, foreclosures, or seizures of estate assets; (vi) an order directing the conciliator to publish in the Official Gazette a summary of the concurso judgment and to record the judgment in the Public Registry of Commerce.

If a "concurso" judgment is granted and the case does not involve a straight liquidation, a conciliator is appointed to oversee the debtor's operations and financial affairs and to facilitate the negotiation and implementation of a plan of reorganization. In extreme cases, the court may remove the debtor as a debtor-in-possession and appoint the conciliator as administrator of the estate. Otherwise, the debtor retains possession of its assets and negotiates with creditors on approval of a reorganization plan. The LCM gives the conciliator authority to order studies and appraisals to help prepare the plan, which must be approved by the debtor and by a majority of the debtor's unsecured creditors.

In a vast improvement over the LQSP, the LCM places a limit on the duration of the Conciliation Stage in which the debtor and its creditors may approve a plan of reorganization. The Conciliation Stage is limited to 185 days and can be extended for 90 extra days with the approval of two-thirds of recognized claims. In exceptional circumstances, the Conciliation Stage may be extended yet another 90 days with the approval of 90% of recognized claims. In no event may the Conciliation Stage exceed one year in duration.

Confirmation of a plan of reorganization requires approval of the debtor and more than fifty percent of creditors holding allowed claims. The plan is binding on an unsecured creditor who rejects the plan if the plan (i) defers payment of its claim, including postpetition interest at the legal rate, for a period of time that does not exceed the minimum term accepted by thirty percent of the general unsecured creditors that voted to accept the plan; (ii) reduces its claim to an amount equal to the smallest sum accepted by thirty percent of the general unsecured creditors that voted to accept the plan; or (iii) provides a combination of debt reduction and payment deferral so long as the ensuing treatment of its claim is identical to the treatment received by thirty percent of the general unsecured creditors that voted to accept the plan. Secured creditors who opt out of the plan process may continue to enforce their liens unless the plan provides for payment in full of the value of their liens and any deficiency claim is treated like other similarly situated claims.[21]

c. Liquidation Stage

The debtor may enter into the LCM's liquidation stage if (i) the debtor petitions for bankruptcy rather than for reorganization; (ii) the debtor fails to obtain approval of a plan of reorganization within one year; *or* (iii) the conciliator petitions the court to convert the reorganization case to a liquidation.

The bankruptcy judgment must contain, among other things, (i) the name of the debtor and the date; (ii) an order suspending the debtor's powers as debtor-in-possession; (iii) an

[21]McEvoy, *supra* note 20, at 12.

order directing the debtor and its management to surrender administration and possession of the estate to the trustee; (iv) an order directing parties in possession of estate assets to turn over such assets to the trustee; and (v) an order to creditors prohibiting them from conducting business with the debtor without trustee approval.

The trustee then begins administering the estate, collecting assets, and running the business. Within sixty days of his appointment, the trustee must file with the court an inventory, accounting, and balance sheet. The trustee is responsible for conducting an auction of the debtor's assets pursuant to the Institute's guidelines and distributing the proceeds to creditors.

6. UNCITRAL Model Law on Cross-Border Insolvency

The United Nations Commission on International Trade Law ("UNCITRAL") adopted the Model Law on Cross-Border Insolvency at its annual meeting in May 1997. Application of the Model Law to cross-border insolvencies would produce these results: (1) creditors, regardless of nationality, will receive equal, nondiscriminatory treatment; (2) courts and representatives of insolvent estates will cooperate and communicate with each other to coordinate the administration of insolvent estates and the conduct of concurrent insolvency proceedings involving a common debtor; and (3) administrators of insolvent estates will have access to foreign courts to protect the assets of the debtor or the interest of creditors.

Title 12 of the LCM adopts the Model Law, which should ensure greater cooperation in Mexican/American cross border insolvencies.

III. INTERNATIONAL JURISDICTIONAL ISSUES AND INSOLVENCY ISSUES

Issues of international insolvency are not new. Increasing commerce between the United States and Mexico only highlights the need for solutions to the problem. As early as 1888, a commentator in the Harvard Law Review stated the following:

> It is obvious that, in the present state of commerce and of communication, it would be better in nine cases out of ten that all settlements of insolvent debtors with their creditors should be made in a single place, better for the creditors, who would thus share alike and better for the debtor because all his creditors would be equally bound by his discharge.[22]

[22] J. Lowell, *Conflict of Laws as Applied to Assignments for Creditors*, 1 Harvard Law Rev. 258, 264 (1888).

Both Mexico and the United States have rules establishing jurisdiction for their courts. Various theories apply to what happens to jurisdiction and enforcement of domestic laws once the issues become international. Courts and nations have attempted to resolve the issue in various ways. The effectiveness of domestic insolvency provisions in a foreign country depends upon the cooperation of the foreign courts in the jurisdiction where the foreign assets are located.[23]

A. Universality v. Territoriality

The cooperation of international courts in insolvency matters is based on the theoretical principals of "universality" or "territoriality."[24] Universality is based on recognizing the full international effect of local insolvency adjudications and is supported by the principals of the unity of the debtor estate, equality among creditors, and the efficiency of the local insolvency proceeding.[25] The concept of universality envisions a single proceeding to administer the assets of the debtor.

Territoriality, however, does not recognize the foreign insolvency proceeding and requires administration of the assets in each jurisdiction where the assets are located.[26] It has been characterized as the "Grab Rule."[27] Under the territoriality approach, the court will focus almost exclusively on the effect of the foreign laws on the domestic creditor or debtor. A court applying the territoriality approach will refuse to recognize the foreign proceeding to the extent such proceeding prejudices the domestic creditor or debtor. In effect, the local court will grab as much for local creditors as possible.

B. Modified Universalism

[23]*See* Gitlin and Mears, *supra*, at 31.

[24]*See generally* L. Unt, *International Relations and International Insolvency Cooperation: Liberalism, Institutionalism and Transnational Legal Dialogue*, 28 Law and Policy in International Business 1037, 1040 (1997); J. Westbrook, *Choice of Avoidance Laws in Global Insolvencies*, 17 BROOKLYN J. INT'L. L. 499, 512-515 (1991); R. Gitlin and E. Flaschen, *International Void in the Law of Multinational Bankruptcies*, 42 The Business Lawyer 307, 310 (1987); M. Knecht, *The "Drapery of Illusion" of Section 304--What Lurks Beneath: Territoriality in the Judicial Application of Section 304 of the Bankruptcy Code*, 13 U. PA. J. INT'L. BUS. L. 287 (1992); B. Unger, *United States Recognition of Foreign Bankruptcies*, 19 INT'L LAW 1153 (1985); Gitlin and Mears, *supra*, at 31.

[25]Gitlin and Mears, *supra*, at 31-32; Knecht, *supra*, at 288-289; Unger, *supra*, at 1154-1155.

[26]Gitlin and Mears, *supra*, at 32.

[27]Westbrook, *Choice of Avoidance Laws, supra*, at 513.

The United States in the Bankruptcy Code has established itself clearly in the middle. Section 304 of the Bankruptcy Code addresses issues of international insolvency. Section 304 has been referred to as "Modified Universalism."[28] Modified Universalism accepts the control premise of Universalism but reserves to local courts discretion to evaluate the fairness of the home country procedures and the protection of local creditors. Moreover, it creates a mechanism for foreign representatives of a foreign insolvency court to take action in the United States, subject to the limitations described in Section 304(c).

In determining whether to grant a foreign representative relief under Section 304, a court must consider all the factors described in Section 304(c). Courts often rely, however, exclusively on the theories of universality or territoriality in making such determinations. Many courts rely almost entirely on possible prejudice to U.S. creditors when deciding whether to grant relief to a foreign representative.[29] Other courts will determine relief by applying the universality approach.

Applying the territoriality approach, courts have ignored the interests of the foreign proceeding.[30] In contrast, several courts have applied the universal approach, recognizing the principals of international comity.[31] United States courts "generally are increasingly supportive of the philosophy underlying universality and are employing the doctrine in an ever growing number of cases."[32]

In re Hourani involved the Liquidation Committee of the Estate of Petra Bank, a debtor in a Jordanian liquidation proceeding. In determining whether to grant Section 304 relief to the Jordanian Liquidation Committee, the court applied all six factors set forth in Section 304(c) as an objective standard. The court recognized, however, the difficulty

[28]Westbrook, *Choice of Avoidance Laws,* at 530.

[29]*See generally, Overseas Inns S.A. v. United States,* 911 F.2d 1146 (5th Cir. 1990); *Laker Airways Ltd. v. Sabena, Belgian World Airlines,* 731 F.2d 909, 937 (D.C. Cir. 1984); *Companía Mexicana Radiodifasora Fronterizo v. Spann,* 41 F.Supp. 907, 909 (N.D. Tex 1941, aff'd, 131 F.2d 609 (5th Cir. 1942). Rimmel, *American Recognition of International Insolvency Proceedings: Deciphering Section 304(c)* 9 BANKR. DEV. J. 453, 462 (1992).

[30]*See In re Toga Manufacturing, Ltd.* 28 B.R. 165 (Bankr. E.D. Mich. 1983); *In re Lineas de Nicaragua S.A.*, 10 B.R. 790 (Bankr. S.D. Fla. 1981).

[31]*See Cunard Steamship Co. v. Salen Reefer Services,* 773 F.2d 452 (2d Cir. 1985); *In re Culmer*, 25 B.R. 621 (S.D. N.Y. 1982).

[32]*In re Hourani*, 1995 WL 153153, 4 (Bankr. S.D. N.Y. 1995) *citing Euromepa S.A. v. R. Emersian, Inc.*, 1995 WL 127165 (2d Cir. 1995), *Philadelphia Gear Corp. v. Philadelphia Gear de Mexico, S.A. de C.V.*, 44 F.3d 187 (3d Cir. 1994).

inherent in reviewing the Jordanian legal system based upon a fair and reasonable standard shaped by the U.S. system and values.[33] After application of all the factors to the applicable Jordanian law, the U.S. court refused to grant Section 304 relief to the Jordanian Liquidation Committee. The court found the Jordanian insolvency system failed to provide fundamental protections and failed to provide procedural safeguards to ensure the fair and equal treatment of all creditors.[34] The court held that "deference should only be given to those insolvency proceedings that provide a reasonable degree of certainty that the consideration of all parties' rights will be fair and impartial."[35]

The majority of recent cases applying Section 304, as evidenced by the court's opinion in *Hourani*, recognize foreign insolvency proceedings as long as such proceedings comport with the notions of fairness and due process.[36]

C. The Bankruptcy Reform Act of 1999.

The Bankruptcy Reform Act of 1999 passed by the Senate in the form of SB625 on February 7, 2000, contains many important provisions applying to cross-border and

[33] *Id.* at 5.

[34] *Id.* at 11-12.

[35] *Id.* at 4.

[36] *See, e.g.*, *A.P. Esteve Sales, Inc. v. Manning* (*In re Manning*), 236 B.R. 14 (B.A.P. 9th Cir. 1999) (concluding that the British Insolvency Act and Code were worthy of comity under § 304); *Rodgers v. Seaward*, No. 99 CIV. 10043(DC), 1999 WL 1129066 (S.D. N.Y. Dec. 9, 1999), *aff'd*, 216 F.3d 1073 (2d Cir. 2000) (affirming the bankruptcy court's award of § 304 relief to the debtor undergoing liquidation proceedings pending in the Isle of Man); *Haarhuis v. Kunnan Enterprise, Ltd.*, 223 B.R. 252 (D. D.C. 1998) (concluding that Taiwan's reorganization proceedings were also worthy of comity under § 304), *aff'd*, 177 F.3d 1007 (D.C. Cir. 1999); *In re Singer*, 205 B.R. 355 (S.D. N.Y. 1997) (affirming the bankruptcy court's entry of a preliminary injunction under § 304 against known and unknown creditors of an insurance company undergoing an English winding-up proceeding); *Pravin Banker Associates, Ltd. v. Banco Popular del Peru*, 165 B.R. 379 (S.D. N.Y. 1994) (recognizing Peruvian insolvency proceeding since Peruvian law was consistent with notions of fairness and due process); *Lindner Fund, Inc. v. Polly Peck Int'l, PLC*, 143 B.R. 807 (S.D. N.Y. 1994) (granting Section 304 relief and recognizing United Kingdom insolvency because the proceeding comported with notions of fairness and due process); *New Line Int'l Releasing, Inc. v. Ivex Films, S.A.*, 140 B.R. 342 (S.D. N.Y. 1992) (dismissing proceeding against foreign debtor in Spanish insolvency proceeding since Spanish procedure did not prejudice domestic creditors' rights nor violate domestic laws or policies); *Petition of Board of Directors of Hopewell Int'l Ins. Ltd.*, 238 B.R. 25, 44 (Bankr. S.D. N.Y. 1999) (granting § 304 relief to a Bermuda reinsurer whose "scheme of arrangement" under Bermuda law had been sanctioned or confirmed). For a recent case demonstrating the flexibility of § 304, see *In re I.G. Servs. Ltd.*, 244 B.R. 377, 390 (Bankr. W.D. Tex. 2000) (employing § 304 to deny motion to vacate confidentiality order that protected from disclosure the names of the foreign debtor's Mexican creditors, based on those creditors' fears of personal injury in light of violent kidnappings and murders of wealthy individuals in Mexico: "[S]ection 304 of the Bankruptcy Code . . . [permits a court] to inter alia "order other appropriate relief." 11 U.S.C. § 304(b)(3) . . . to wit, eliminating a substantial impediment to active creditor participation, thus advancing the salutary end of just treatment of investor claims in the foreign proceedings.").

international insolvency. It appears to continue and expand on the current theory of Modified Universalism. The new provisions, if enacted, fill many of the holes and questions concerning the administration and function of international insolvencies in U.S. bankruptcy proceedings.

D. The Inter-American Convention on the Jurisdiction in the International Sphere for the Extraterritorial Efficiency of Foreign Judgements.

In an attempt to resolve international jurisdictional matters, the Inter-American Convention on the Jurisdiction in the International Sphere for the Extraterritorial Efficiency of Foreign Judgments was executed in La Paz, Bolivia on May 24, 1984 (the "La Paz Convention"). Mexico and the United States are contracting parties to the La Paz Convention.

Pursuant to the La Paz Convention, jurisdictional matters are to be resolved on the following terms:

1. For economic personal claims, the court holding jurisdiction shall be that of the defendant's domicile or normal place of residence if he or she is an individual; the place of the main business establishment, if a commercial entity; or if dealing with agencies or branches of companies, the place where the activities which originated the claim took place. For claims dealing with specific goods, the court holding jurisdiction would be that of the place where the assets are located at the time the suit is filed, or jurisdiction may be established following the previously mentioned rules. Additionally, the jurisdiction of a court may be agreed upon in writing by the parties.

2. For real property and related judicial actions, the court holding jurisdiction shall be that of the place where the real property is located.

3. For commercial agreements, jurisdiction may be established by the parties if they agree in writing to submit to the jurisdiction of a certain court unless the agreement was obtained by duress or undue influence. Pursuant to Article 4 of the La Paz Convention, when a foreign judgment is presented to a court of a different country for execution, the judgment may be denied based on the lack of jurisdiction pursuant to the rules contained in the La Paz Convention.

Pursuant to Section E of Article 6 of the La Paz Convention, bankruptcy and analogous procedures are excluded from such jurisdictional bases. Consequently, jurisdictional matters concerning bankruptcy and insolvency have not been resolved through the La Paz Convention.

Nevertheless, Mexican courts may recognize some U.S. Bankruptcy Court orders based on two arguments. First, the Inter-American Convention on Extraterritorial Efficiency of Foreign Judgments and Arbitration Awards, approved in Montevideo, Uruguay, on May 8, 1979 (the "Montevideo Convention") and ratified by both Mexico and the United States, prescribes enforcement procedures for judgments and arbitration awards in civil, commercial, and labor proceedings unless expressly reserved at the time of ratification. Under Mexican law, bankruptcy matters are considered commercial proceedings. Consequently, judgments issued in bankruptcy proceedings may be respected and applied pursuant to the Montevideo Convention.

At the time of ratification, however, Mexico made an express reservation to limit the effect of the Montevideo Convention only to foreign money judgments. Accordingly, Mexican courts will recognize a judgment issued in the courts of the United States only when it contains a judgment against a party for a fixed amount of money. A Mexican court would probably decline to enforce a bankruptcy court order providing for any other kind of relief.

Article 14 of the Mexican Bankruptcy Law appears to provide some relief from the confines of the Montevideo Convention, however, because it provides for recognition of foreign bankruptcy decrees. Article 14 relief is probably illusory because such decrees must fully comply with the formalities and preconditions of the applicable Mexican bankruptcy law.[37] A party seeking to enforce such a decree would have to follow the procedures for issuance of a letter rogatory (discussed below) to have the decree recognized by the Mexican courts. The Mexican court will review the letters rogatory and determine whether the order is enforceable under Mexican law.[38] The Mexican court can proceed with enforcement of the order or determine that enforcement of the order is against Mexican public policy and refuse to enforce the order. [39] Moreover, the Mexican court can refuse to enforce the judgment or order if there is no reciprocity of enforcement in similar cases with the jurisdiction rendering the judgment or order.[40]

As evidenced by the number of governmental entities involved and the inherent bureaucratic red tape of two federal governments, this procedure is fairly complicated and

[37]Agustin Berdeja-Prieto, *Debt Collateralization and Business Insolvency: A Review of the Mexican Legal System*, 25 U. MIAMI INTER-AM. L. REV. 227, 277 (1993).

[38]*See* R. GITLIN and R. MEARS, *supra*, at 529.

[39]GITLIN and MEARS, *supra,* at 70.; R. Anderson, *supra,* at 1111.

[40]R. Anderson, *supra,* at 1112.

time consuming. In a bankruptcy situation, it is likely that any assets a party is trying to reach will be gone well before this procedure can be completed.

E. Letters Rogatory and the Mysteries of the Aztecs

To enforce money judgments, obtain discovery, and pursue debtors in Mexico, parties may use letters rogatory. Just as Indiana Jones had to make his way through the traps and perils of the temple to obtain his treasure, so too will creditors have to forage their way through the Mexican legal system to collect the assets of the debtor across the border. Professor Jones had a trusty bull-whip to help him along. Fortunately, creditors can gird themselves for the international insolvency adventure, not with a bull-whip, but with letters rogatory. As Indy discovered, however, the treasure hunt is not exactly a quick and painless process, even for one skillful in the art of the bull-whip.

A letter rogatory is a letter of request from a court in the United States to a court in a foreign country requesting international judicial assistance. A letter rogatory, also called a letter of request, provides a procedural avenue for cross border service of process, the taking of evidence in the foreign country, and the enforcement of U.S. judgments or orders by the foreign court. Whether a party wishes to file suit against a Mexican national, enforce an order or judgment in Mexico, or just obtain evidence from Mexico, the letter rogatory provides a reliable procedure for accomplishing these actions.

The Inter-American Convention on Letters Rogatory and the Additional Protocol (the "Inter-American Convention") thereto, an international judicial assistance convention to which Mexico and the United States are signatories, establish the procedures to follow when countries transmit judicial documents across borders to obtain some legal effect.[41] Under the Inter-American Convention, each member country is required to establish a central authority to serve as a receiving agent for requests from other member countries. Members are required to use the standardized forms for transmitting letters of request and returning the executed documents.

[41]R. Anderson, *Transnational Litigation Involving Mexican Parties*, 25 ST. MARY'S L.J. 1059 (1994).

Mexican courts often use a similar letter of request to effect service in lawsuits involving Mexican parties residing in different Mexican states.[42] To obtain service of process upon a Mexican citizen or corporation in Mexico, the U.S. party will need to prepare a letter rogatory in accordance with the standardized form. The standardized form requires a brief description of the documents, the remedies sought, and the action requested of the party being served.[43] Additionally, the person being served must be informed of the deadline for response, where to respond, and the consequences for failing to respond.[44] It is also advisable to obtain the assistance of Mexican counsel to assist in the preparation of the letter of request. Mexican counsel can be of great assistance in drafting the letter so that it incorporates Mexican laws and customs as well as assisting with any actions that need to be taken in Mexico.

The party should then file a motion with the U.S. court requesting issuance of the letter rogatory. The proposed letter rogatory should be attached to the motion. Once the U.S. court approves the issuance of the letter rogatory, the letter rogatory and all attachments thereto, including the complaint or pleading, any documents attached to the complaint or pleading, and the order issuing the letter rogatory, need to be translated into Spanish. While the Inter-American Convention requires the translation only of the letter rogatory and the complaint or pleading, it is probably helpful to attach and translate all attached documents for the convenience of the Mexican court. Such translations will provide the Mexican court with all the issues and facts when the court is determining whether to grant the request.

Once the letter rogatory and attachments are translated, the English and Spanish versions of the letter rogatory, along with additional copies, are returned to the issuing court. The court will transmit the letter rogatory to the Department of Justice, which is the designated central authority for the United States. The Department of Justice will transmit the letter rogatory to the Mexican Ministry of Foreign Affairs, which will forward the request to the appropriate Mexican court. Once the complaint is served, the documents are returned via the Mexican Ministry of Foreign Affairs via the Department of Justice to the U.S. issuing court.

The process for obtaining evidence in Mexico follows the same procedures. Parties should be aware, however, that most foreign countries, including Mexico, do not allow the broad pre-trial discovery used in American proceedings. Mexican law requires that a

[42]R. Anderson, *supra*, at 1069.

[43]*Id.* at 1073.

[44]*Id.*

proceeding be commenced before discovery may take place.[45] Mexican law also limits discovery to documents that are specifically identified by the requesting party, in the Mexican party's possession, and clearly relevant to the proceeding.[46] Additionally, the discovery will be conducted by the Mexican court, with the Mexican judge asking the questions. The court may allow the U.S. party to attend the proceeding. Again it is strongly advised to retain Mexican counsel to assist in the preparation of the discovery request and the actual discovery.

The Inter-American Convention procedures for issuing a letter rogatory are only briefly summarized herein. For a more detailed treatment of this particular subject, see D. EPSTEIN and J. SNYDER, INTERNATIONAL LITIGATION: A GUIDE TO JURISDICTION, PRACTICE AND STRATEGY (2nd ed. 1994); Ryan G. Anderson, *Transnational Litigation Involving Mexican Parties* Vol. 25 ST. MARY'S L.J. 1059 (1994). Additional information on letters rogatory under the Inter-American Convention may also be obtained by contacting the Inter-American Services Division of the Office of Citizens Consular Services in Washington, D.C. at (202) 647-5118.

[45]R. Anderson *supra*, at 1083.

[46]*Id.*

IV. CROSSING THE BORDER: HOLES IN THE BRIDGE

Texas and a number of other states provide a mechanism for the enforcement of foreign money judgments. The Uniform Foreign Country Money Judgment Recognition Act (the "Texas Recognition Act")[47] provides for the recognition of money judgments obtained in a foreign country. The Texas Recognition Act provides in pertinent part that a foreign country judgment that complies with the requirements of the Texas Recognition Act "is conclusive between the parties to the extent that it grants or denies recovery of a sum of money."[48] Unfortunately for a number of foreign creditors, the existence of a mechanism for the enforcement of a foreign country judgment has not equaled the actual enforcement of a foreign country judgment. The respect or lack thereof for Mexican judgments may affect whether Mexican courts will respect U.S. judgments.

The Texas Recognition Act contains a laundry list of reasons that a Texas court may decline to enforce a foreign judgment.[49] The list of exclusions include judgments based on causes of action that are repugnant to the public policy of the State of Texas and foreign country judgments from countries that do not recognize Texas judgments.

Although there is not a great deal of case law on the subject, it is clear that Texas defendants who may be liable for a foreign judgment often raise the laundry list of exceptions to prevent enforcement of a foreign judgment in Texas.[50]

In 1996, a United States District Court in San Antonio, Texas refused to recognize a Mexican judgment on the basis that it violated Texas public policy.[51] The District Court approved the Memorandum Opinion of the United States Magistrate dated September 30, 1996. In *Southwest Livestock*, Southwest Livestock and others (all residents of Del Rio, Texas) borrowed money from Riginaldo Ramon, a Mexican citizen. The loan originated in Mexico and was documented as a *pagaré*. The *pagaré* provided for interest at the rate of 52.79%, a legal interest rate in Mexico at the time. Southwest Livestock performed on the *pagaré* for a few years, but subsequently defaulted on the *pagaré*. Ramon filed suit on the *pagaré* in Mexico and obtained a judgment against Southwest Livestock for the amount due.

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[47] TEX. CIV. PRAC. & REM. CODE ANN. § 36.001 et.seq.,

[48] TEX.CIV. PRAC. & REM. CODE ANN. § 36.001.

[49] TEX.CIV.PRAC. & REM. CODE ANN. § 36.005.

[50] *Banque Libanaise Pour Le Commerce v. Khreich* 915 F.2d 1000 (5th Cir. 1990) (non-reciprocity); *Norkan Lodge Co. Ltd. v. Gillum*, 587 F.Supp. 1457 (N.D. Texas 1984) (non-reciprocity and public policy).

[51] *Southwest Livestock and Trucking Co. v. Ramon*, Case Number 94-CA-1082 (W.D. Tex. 1996).

Prior to the granting of the judgment in Mexico, Southwest Livestock filed suit in federal court in San Antonio, Texas seeking to avoid liability on the *pagaré*. Subsequently, the San Antonio court refused to enforce the Mexican judgment on public policy grounds. The San Antonio court found that it was not obligated to enforce the Mexican judgment because the interest charged in the *pagaré* would have been usurious in Texas.

Fortunately, the decision was appealed to the Fifth Circuit. In *Southwest Livestock and Trucking Company, Inc. v. Ramon*,[52] the Fifth Circuit reversed the District Court. The Fifth Circuit concluded that seeking to enforce a promissory note was not repugnant to Texas public policy, and if the cause of action is not repugnant, any judgment based thereon was not repugnant to Texas public policy. The decision seems to be splitting some very thin hairs, but does avoid a major blow to United States/Mexico cooperation on enforcement of judgments.

Additionally, while the District Court opinion at first blush appeared to conflict with the intent of laws similar to the Texas Enforcement Act, the decision in *Southwest Livestock* may be supportable by United States Supreme Court authority. In *Home Insurance Co. v. Dick*,[53] the plaintiffs brought suit in Texas to enforce a contract that was performable in Mexico. Mexico had a one (1) year statute of limitations for actions on the contract; Texas at the time had a two (2) year statute of limitation for similar actions. The suit was filed after one (1) year, but before two (2) years had expired. The Texas Supreme Court affirmed a judgment in favor of the plaintiffs and applied the Texas statute of limitations.

The defendant appealed to the United Supreme Court. The Supreme Court reversed, but only because the contract was not performable or enforceable in Texas. The Supreme Court said:

> A state may, of course, prohibit and declare invalid the making of certain contracts within its borders. Ordinarily, it may prohibit performance within its borders, even of contracts validly made elsewhere, if they are required to be performed within the state and their performance would violate its laws. But, in the case at bar, nothing in any way relating to the policy sued on, or to the contracts of reinsurance, was ever done or required to be done in Texas. All acts relating to the making of the policy were done in Mexico.... And, likewise, all things in regard to performance were to be done outside of Texas.

[52]169 F.3d 317 (5th Cir. 1999).

[53]281 U.S. 397 (1931).

> Neither the Texas laws nor the Texas courts were invoked for any purpose, except by Dick in the bringing of this suit.

If the *Home Insurance* contract had been performable in Texas or was to be enforced in Texas, the Supreme Court may have respected the Texas public policy and ruled for the plaintiffs. The Fifth Circuit opinion did not discuss the *Home Insurance* case.

V. BANKRUPTCIES IN THE UNITED STATES INVOLVING ASSETS AND CREDITORS IN MEXICO

Over the last few years, a number of companies and individuals doing business in the United States and Mexico have sought or have been subject to bankruptcy relief in the United States. To be eligible to be a debtor under the Bankruptcy Code, a person or entity need only reside, have a domicile, a place of business, or property in the United States. 11 U.S.C. § 109. Accordingly, almost any company or individual with operations or property on both sides of the border is eligible to file bankruptcy in the United States even if the debtor is a foreign citizen or a foreign corporation.[54]

Foreign companies and individuals may even find themselves subject to involuntary bankruptcy proceedings in the U.S. bankruptcy courts. The two Xacur cases filed in Houston in 1997 highlight the issues surrounding bankruptcies in one jurisdiction and assets in another. In *In re Xacur* ("*Xacur 1*"),[55] several Mexican banks were frustrated by the Xacur brothers, four brothers who were Mexican citizens and obligated as *avalistas* on debts to the Mexican banks for companies in *suspension de pagos* proceedings in Mexico. The banks filed an involuntary bankruptcy proceeding against three of the Xacur brothers in the bankruptcy court in Houston, Texas. A separate involuntary case was brought against the other brother.

The bankruptcy court held that it had jurisdiction over the Mexican citizens because they had assets in the United States. Moreover, the bankruptcy court granted the involuntary relief against the Xacur brothers in *Xacur 1* despite the fact that the obligations were between Mexican banks and Mexican citizens.

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[54] *In re Guardia*, Case No. 96-50744 (Memorandum Opinion June 3, 1997, 5th Cir. 1997) (Fifth Circuit determined that Bankruptcy Court had jurisdiction over all disputes involving the debtor, even those arising in Mexico.); *In re Echegaray*, Case No. 36-30367 (Bankr. W.D. Tex. 1996) (Bankruptcy Court retained jurisdiction over dischargeability action brought by Mexican banks in Mexican citizen's bankruptcy.); *In re Axona International Credit and Commerce*, 88 B.R. 597, 606 (Bankr. S.D. N.Y. 1989).

[55] 216 B.R. 187 (Bankr. S.D. Tex. 1997) *("Xacur 1").*

Contrasting with *Xacur 1* is *In re Xacur* ("*Xacur 2*").[56] In *Xacur 2*, Judge Brown again found that she had jurisdiction over the fourth brother, Nicolas Xacur, who also was a Mexican citizen. But, based upon different facts, Judge Brown decided to abstain from entering relief against the fourth brother.

The drama has not ended. Steve Smith, the Chapter 7 Trustee in *Xacur 1*, has proceeded to liquidate assets in the United States and has sought assistance from the Mexican courts with respect to the recovery of assets in Mexico.

The filing of a bankruptcy, at least in the United States, stays any and all actions to collect or assert claims against the debtor or its property.[57] Moreover, 28 U.S.C. § 1334(e) provides that the court in which the bankruptcy is filed shall have exclusive jurisdiction of all the property, wherever located, of the debtor as of the commencement of the case, and of property of the estate. The extent of bankruptcy court jurisdiction into Mexico and the effect of the stay in Mexico are subject to some question. The Bankruptcy Code and related statutes contemplate a bankruptcy court jurisdiction that knows no borders, the stay of actions against the debtor and its property no matter where it is located and an intention that the bankruptcy laws are to apply to all creditors of the debtor no matter where located. United States bankruptcy court jurisdiction and the stay, however, appear to end at the Mexican border.

A. Theories of Jurisdiction

[56]219 B.R. 956 (Bankr. S.D. Tex. 1998).

[57]11 U.S.C. § 362.

As previously discussed, the cooperation of foreign courts is based on the concepts of universality or territoriality, or international treaty. The United States courts are purportedly moving towards universality and a greater recognition of foreign proceedings.[58] As U.S. increasingly cooperate with foreign courts in multinational bankruptcies, the foreign courts will allegedly reciprocate with the same level of cooperation.[59] Other commentators, however, reject this idea of increased universality by U.S. courts and assert that U.S. courts recognize foreign proceedings only when such proceedings are substantially similar to U.S. proceedings.[60] Unfortunately, in an insolvency emergency, the theories of jurisdiction remain merely theories and offer little practical relief to the parties. While the courts ponder the extent of their jurisdiction, creditors act and collateral loses its value.

B. Practical Applications of Theories of Jurisdiction

Cross-border bankruptcies teach lawyers, judges, debtors, and creditors that there is some merit to that childhood maxim of law: Possession is 9/10ths of the law. Creditors in Mexico who have no intention of appearing in the U.S. bankruptcy proceedings, who have access to assets located in Mexico, and who can take action against the assets under color of Mexican law, can and often do ignore the jurisdiction of the U.S. bankruptcy courts. This consequence can profoundly and adversely affect creditors in the United States who have no choice but to obey the laws of the United States. The Bankruptcy Code was designed to equitably treat the claims of all creditors subject to certain rules of priority. To be equitable, the Bankruptcy Code assumes that all creditors will participate in the bankruptcy and that all assets of the debtor will be available for the treatment of creditor claims. Additionally, the equitable treatment assumed by the Bankruptcy Code includes the disparate treatment of creditor claims. Some creditors will have priority over other creditors depending on contractual rights or liens granted on certain assets. Additionally, the Bankruptcy Code describes certain types of claims that shall have priority over other types of claims. The ability of the Mexican creditor to sever from a debtor's estate assets located in Mexico, especially if they are significant, upsets the equitable balance contemplated by the Bankruptcy Code. It grants the creditor that ignores the U.S. bankruptcy proceeding a distinct advantage over creditors participating in the U.S. bankruptcy proceeding.

[58]Unger, *supra*, at 1183.

[59]*See* Hon. J. Farley, *Co-ordination in Cross-Border Insolvencies and Restructuring*, 1994 NAT'L. CONF. BANKR. JUDGES 2-5 (1994); Unger, *supra*, at 1183.

[60]*See* Knecht, *supra;* Clark, *supra*, at 9-16.

As a practical matter, even the suggestion that Mexican creditors will not participate in the U.S. bankruptcy proceeding and will rely instead upon the laws of Mexico for collection of monies due has altered how U.S. bankruptcy courts have treated Mexican creditors. United States bankruptcy courts have recognized that their jurisdiction to control debtors' assets stops at the border and that the ability to recover assets in Mexico for distribution or treatment in the U.S. bankruptcy process requires the cooperation of the Mexican creditor. Usually that means the payment in full or sufficient satisfaction of the Mexican creditor. When dealing with sparse assets, this preferential treatment of Mexican creditors adversely affects creditors participating in the U.S. bankruptcy proceeding.

Not only do Mexican creditors generally receive preferential treatment, but also, the policies behind the treatment of claims in the United States and Mexico differ. Mexican workers have significantly greater influence in bankruptcies involving a company with assets in Mexico than do their American counterparts in U.S. bankruptcy proceedings. Although subject to priority treatment in United States bankruptcies for pre-petition wage claims up to $4,000.00 per employee,[61] and an unsecured claim for the balance, the Mexican labor claims discussed earlier alter the strategy for the United States creditor in a cross border insolvency situation. Because Mexico grants to a severed employee a superpriority lien upon all assets located in a Mexican plant or facility to secure his or her severance pay, a decision to close a factory or refuse to allow the use of cash collateral is far different than the decision in a strictly U.S. bankruptcy proceeding. The normal analysis of cash collateral and the application of sale proceeds from a Section 363 sale is altered because the labor lien is superior to the liens of secured creditors and superior to the rights of unsecured creditors. The Mexican worker is more inclined to preserve and protect his or her rights in a Mexican court than is an American worker in a U.S. bankruptcy court.

This superpriority lien places an additional dynamic on any party doing business with a business with substantial assets in Mexico. A party doing business with a Mexican entity or extending credit to a Mexican entity must be careful to balance the needs for payment with the danger of forcing a Mexican business out of business or into bankruptcy in Mexico. Creditors must also hope that other creditors are similarly patient and wise. This Mexican policy is especially dangerous to a creditor who holds a lien upon assets located in Mexico.

The only protection provided by the Bankruptcy Code to the creditor is contained in Section 508. In the event foreign assets are collected by a creditor, Section 508 of the Bankruptcy Code will prevent such a creditor from collecting from the estate to the extent

[61] 11 U.S.C. § 507(a)(3).

such creditor received prior payment.[62] Pursuant to Section 508, if a creditor receives payment of a claim in a foreign proceeding, the creditor is not entitled to payment under the U.S. bankruptcy proceeding until the other holders of claims which are entitled to share equally with the creditor receive an amount equal in value to the consideration received by the creditor in the foreign proceeding. This remedy is useless in many cross-border bankruptcies because many of the valuable assets are in Mexico, far from the reach of U.S. creditors.

Other issues also abound. Is a discharge granted by a U.S. bankruptcy court to a Mexican citizen of obligations created in Mexico enforceable in Mexico? Are bankruptcy causes of action such as preference and fraudulent transfer actions viable against Mexican defendants? If so, what defenses should apply to such actions? May a bankruptcy court find that a debt that is dischargeable under Mexican law is nondischargeable in the United States? The U.S. bankruptcy courts and parties before them and those who choose not to appear before them will struggle to resolve these issues and others for years to come.

VI. CONCLUSION

Careful planning can alleviate some of the problems encountered in cross border insolvency matters. The border simply adds a little salsa to the stresses and strains of enforcing rights and collecting debts along the border. The new LCM promises to take a little spice out of the salsa.

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[62] 11 U.S.C. § 508.