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Editor
Donald S Bernstein

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Chapter 23

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Dario U Oscós Coria[1]

I INSOLVENCY LAW, POLICY AND PROCEDURE

i Statutory framework and substantive law

The Commercial Insolvency Law (LCM), enacted on 12 May 2000 and amended as of 14 January 2014, governs commercial insolvency. It is a federal law and it applies to merchants and traders, individuals and legal entities, including commercial companies, trusts engaged in business activities, financial institutions and state-owned commercial companies and in connection with small businesses with written agreements.

The federal district courts are the only courts with jurisdiction over commercial insolvency proceedings for traders. Non-traders are subject to state and local civil jurisdiction, and there are no specialist insolvency courts. Special federal district courts will be set up to hear insolvency cases.

Insolvency proceedings for traders start when relief begins – that is to say, when it is adjudicated – which creates the bankruptcy estate. Insolvency adjudication creates a special legal situation for the debtor and the stay, subject to the LCM.

Claims being pursued by the debtor and claims against the debtor before the insolvency proceeding adjudication may not be joined to the insolvency proceeding, including those involving arbitration.

Post-insolvency declaration claims, including post-arbitration claims, must not join the insolvency proceeding.

The final judgment on pre and post-insolvency actions will be recognised by the insolvency court without review of the amount of the claim and its priority.

1 Dario U Oscós Coria is a senior partner at Oscós Abogados.

Transactions that may be annulled

In general, all fraudulent transactions executed against creditors and the insolvency estate may be set aside. The LCM defines as 'felonious' those fraudulent acts that cause or aggravate the cessation of payments, as provided by law. Such acts may also be set aside.

The LCM prescribes a 270-calendar-day 'suspect period' to be reviewed, counting backwards from the date the order for relief was made This term may be doubled in the case of related subordinated creditors (intercompany or insiders' debt). A request for a longer review period of up to three years must be filed before the judgment on recognition, ranking and priority is entered. The burden to prove is more flexible to obtain extension of the suspicious period without need to prove the actual fraud, which is a separate cause of action.The new retroactive period must be announced by publication in the court's list of orders.

Director and officers liability regime

Legal standing to enforce action seeking civil liability (damages) when upon fraudulent transactions (voidance actions) may be brought by: (1) one-fifth or more of the allowed creditors; (2) allowed creditors that jointly represent 20 per cent of the total allowed credits; (3) receivers (4) the debtor; and (5) shareholders holding 25 per cent of the debtor's shares. The time-bar on damages actions is five years.

In the context of an insolvency proceeding, the LCM now provides a regime of strict civil and criminal liability for the debtor, debtor's general director, sole administrator, board of directors, legal representatives and key employees, including insiders and relatives when causing damages in regard to the facts and circumstances provided by the LCM. Damages shall be to the benefit of the estate. Civil liability is joint and several and is independent from criminal liability, which may be from three to 12 years' imprisonment.

ii Policy

As a matter of public policy, the LCM favours maximising the value of the insolvent estate's assets as well as the rehabilitation of enterprises (preservation) and creditor's rights. Consequently, liquidation only takes place when rehabilitation is impossible, reflecting the government's priorities of the preservation of jobs and of businesses as going concerns. During previous periods of systemic financial distress, the government has set up rescue programmes to assist companies to recover or start afresh, but these programmes have mainly applied following insolvency proceedings.[2]

Expedited reorganisations

Pre-packaged reorganisation is allowed by an agreement between the debtor and creditors holding simple majority 51 per cent of the total debt. The debtor and creditors execute the petition. The debtor must state under oath that it is already in a state of insolvency and explain why, or state that insolvency is imminent within 90 working days and that

2 The FICORCA (Foreign Exchange Risk Coverage Trust Fund) programme was instigated in 1982, and the FOBAPROA and UCABE programmes in 1995.

the creditors signing the petition hold at least simple majority 51 per cent of the total debt. A reorganisation plan proposal must be enclosed with the petition. Full insolvency proceedings will be followed without an audit. Protection measures and stays may be requested and granted upon filing of the petition.

iii Insolvency procedures

The insolvency of non-merchants such as individuals, consumers (civil insolvency) is governed by the state civil codes and state codes of civil procedure. Insolvency proceedings for merchants consist of a single process, comprising two major stages: conciliation and bankruptcy (liquidation). In conciliation, a conciliator is appointed and seeks to establish a reorganisation plan. If no reorganisation plan is agreed, the process is converted into bankruptcy (liquidation). A trustee is appointed for liquidation.

There is also a sub-stage – the initial audit (inspection) wherein an auditor is appointed to inspect the debtor's premises and accounts to confirm that the standard for insolvency is met and reports accordingly to the competent district court, which may judge the debtor to be in an insolvency proceeding (known as an insolvency proceeding adjudication).

The LCM is the law providing for the general insolvency procedures available to wind up and rescue companies. The Corporations Law also provides for private out-of-court corporate dissolution and liquidation of a company. In essence these are very similar, again effecting the liquidation of assets to pay creditors, and if there is any balance remaining it goes to shareholders. Corporate liquidation does not, however, provide court orders to stay payments and executions. Liquidators may apply for a voluntary insolvency proceeding seeking a stay.

The debtor remains in possession of the assets during a conciliation proceeding and may continue in its ordinary course of business as a going concern. Assets may be used for such ends, but the conciliator oversees the management of the debtor.

Creditors that supply goods and services may continue to do so. Post-petition creditors may be paid and have priority against estate assets as well as post-financing. Creditors may supervise the debtor by means of a receiver, who represents and protects creditors' rights and has the authority to supervise the debtor and report to the court accordingly. The court has full authority to supervise debtors.

From this point, the procedural steps of the insolvency proceeding are as follows:

a the debtor is ordered to surrender its financial statements and accounting;
b the debtor is ordered to cooperate and allow an auditor (visitor) and conciliator to perform their duties;
c executions and attachments are stayed, except for labour credits (salaries of the past two years);
d a suspect period is set (see below);
e a summary of the order for relief is published;
f the order for relief is recorded in public registries;
g notice is given to creditors to file their claim (proof of claims);
h the proof of claims process begins; and
i a certified copy of the order of relief is issued upon request.

As previously mentioned, the LCM favours rehabilitation of the enterprise, and liquidation only takes place when rehabilitation is impossible. A reorganisation plan requires approval from 51 per cent of the creditors holding approved claims.

The conciliation phase is intended to create the best conditions for a reorganisation plan. The LCM does not regulate terms or conditions for the plan, but only sets out minimum rules to ensure its legality. The LCM, however, provides mandatory notices and access to information to enable interested parties to exercise and protect their rights. Accordingly, the conciliator may recommend that appraisals and studies be conducted when they are necessary to achieve a reorganisation plan, which would be given to creditors through the court. When the conciliator considers that there is an agreement of 51 per cent of the recognised creditors in the plan, he or she will give the plan to the other recognised creditors to give their opinions thereon or to execute the plan.

In order to approve a viable reorganisation plan that favours all or most creditors under the circumstances, the LCM provides mechanisms to protect the rights of minority creditors by giving them the most favourable terms possible under the plan. This thereby avoids unnecessary or burdensome objections by minorities that, in fact, will benefit from the plan.

Only those creditors with accepted claims may agree on the plan. Labour and tax creditors do not participate in the plan (see Section I.vi, *infra*). To facilitate approval of the plan, both unsecured and participating secured creditors must be taken into account to determine the necessary majority.

The reorganisation plan, regarding non-participating creditors holding recognised debt, may only provide extension of time to pay the debt or debt discount or combination of both, provided that terms and conditions are equal to those agreed by at least 30 per cent of creditors holding unsecured allowed claims.

The plan may provide for an increase of capital, and shareholders must be notified in order to exercise rights of first refusal. If shareholders do not exercise their rights, the court may simply approve the capital increase.

Dissenting recognised unsecured creditors holding a simple majority or recognised unsecured creditors holding 50 per cent of the debt may veto the plan proposal. If there are no objections, the plan may be approved by the court. Since the approved plan is binding upon absent and dissenting creditors, the most favourable terms and conditions of the plan will be allocated to them.

Upon the court's approval of the plan, the insolvency process terminates and parties cease to perform their functions.

The plan must provide payment for:

a labour creditors – wages (the highest priority);

b creditors (administration costs and fees of the insolvency estate) whose claims are secured by assets of the estate;

c claims for burial costs when death of the debtor occurs before the insolvency proceeding;

d claims for costs of sickness that caused the death of the debtor when the death occurs after the commencement of insolvency proceeding;

e secured creditors with mortgage or pledge;

f claims holding a special privilege in law;

g tax credits;