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Bankruptcy, Insolvency & Rehabilitation Proceedings in Mexico

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## KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER MEXICAN LAW

### Preface

On 12 May 2000, the Commercial Insolvency Law (the “**CIL**”) was published in the Federal Official Gazette, and it entered into full force and effect the next day. This law replaced the 1943 Law governing the Suspension of Payments and Bankruptcy, and all other legal provisions that opposed the provisions of the new CIL.

Pursuant to its preface, the CIL has the principal purpose of creating a modern regulatory framework that allows the conservation of companies undergoing a financial and economic crisis. To this end, the figure of ‘conciliation’ was created to make sure that the merchant and its creditors reach an agreement for the payment of the merchant’s liabilities over a reasonable period. If reaching a reorganization agreement is unfeasible, the CIL establishes a procedure for the orderly liquidation of the merchant’s assets and rights while attempting to maximize the proceeds of the sale, applying the funds obtained therefrom to the payment of the merchant’s liabilities, following a fair order and preference regarding the differences between the relevant creditors.

The CIL maintains the federal judge as the central body and rector of the commercial insolvency proceeding; however, as previously stated, it recognizes that she or he must be aided in the performance of his or her functions by specialists in administrative, commercial, industrial, economic and financial aspects, so that the judge may focus efforts on strictly legal tasks. As a result, the CIL created the Federal Institute of Commercial Insolvency Specialists (widely known for its initials in Spanish as “**IFECOM**”). According to the indications of the CIL and the General Rules issued to this effect by this Institute, specialists are appointed by means of a random procedure.

In 2007, the CIL underwent several reforms, most importantly, the addition of a pre-packed

reorganization proceeding, whereby the company and the majority of its creditors may file for a proceeding in which a pre-agreed reorganization agreement is accompanied by an insolvency petition.

In 2014, the government adopted a major banking sector reform (the Financial Reform), which reformed the Commercial Insolvency Law, as well as other legislation. One of the main purposes of the Financial Reform was to eliminate legal gaps in the Commercial Insolvency Law that permitted the courts to interpret the legislation broadly and, on a case-by-case basis.

Furthermore, the Financial Reform also introduced certain provisions regulating inter-company debts to determine whether the company is to be declared commercially insolvent or be approved for a reorganization agreement between the company and its creditors.

On August 9, 2019, the CIL was amended to incorporate provisions that would allow majority state-owned companies to request to be declared commercially insolvent or in bankruptcy.

Additionally, on March 4, 2022, an order issued by the Council of the Federal Judicature was published in the Federal Official Gazette, stating the creation of two new Federal Courts specialized in attending insolvency proceedings



governed by the CIL<sup>1</sup>. Therefore, starting March 7, 2022, the First and Second District Courts, specialized in insolvency matters, assumed jurisdiction to hear insolvency and bankruptcy matters, including those proceedings filed since November 16, 2020, which were consequently remitted to said courts.

Moreover, members of the house of representatives are proposing a legislative reform to the CIL, to streamline the insolvency process and allow more proactive measures to safeguard the companies' assets from individual creditors' actions. The amendment will also introduce a new system for small and medium-sized companies, making insolvency proceedings a more viable option for them due to the high associated costs. This reform is still being discussed and has not yet been submitted for legislative approval.

We consider that there is still a need to reform the CIL, given that there are matters that are not properly regulated, such as: (i) the application and duration of injunctive measures; (ii) protection to creditors' rights; or (iii) conditions that do not adjust to current market practices. This lack of regulation has led to merchants taking advantage to the detriment of creditors' rights.

Having stated the foregoing, we hereby give a

brief presentation of key aspects of the commercial insolvency proceeding, as regulated by the CIL, and the protections granted by the CIL to debtors who are declared insolvent.

### **1.- Merchants - Insolvency Conditions.**

Individuals or legal entities that are Merchants pursuant to the provisions of the Commercial Code may be subject to the commercial insolvency proceeding<sup>2</sup>. All commercial insolvency proceedings are conducted before the specialized insolvency Federal District Judges (the "**Insolvency Courts**"), located in Mexico City.

The necessary condition for a Merchant to be declared commercially insolvent is that it can be demonstrated that the Merchant has defaulted on the payment of its obligations in a general manner. In order to prove this condition of general non-performance, a payment default to two or more different creditors should exist, and one of the two following conditions should exist if the insolvency petition is filed by the Merchant, or both conditions if the insolvency petition is filed by the creditors: (i) that of its matured obligations, those that are at least thirty (30) days overdue represent thirty-five percent (35%) or more of all the obligations of the Merchant to the date on which the insolvency petition is filed; and/or (ii) the

<sup>1</sup> The above-mentioned reform has not yet been included in the CIL, which currently states that all commercial insolvency proceedings are conducted before Federal District Judges, located across the Country, and which are appointed based on the domicile of the relevant Merchant.

<sup>2</sup> According to the CIL, the following persons may be subject to a commercial insolvency proceeding: (i) Individuals whose normal occupation is commerce; (ii) Business corporations, including state-owned companies

created as corporations and companies with majority state participation, when they initiate processes of disincorporation or extinction; and (iii) branches of foreign companies that perform acts of commerce in Mexico; however, in this case, the declaration of commercial insolvency will only encompass the assets and rights that are located and enforceable in Mexico, and the creditors related to transactions entered into with such branches.



Merchant has insufficient assets, of those listed below, in order to satisfy at least eighty percent (80%) of its matured obligations on the date the petition is filed. The assets that should be considered for the effects established in this paragraph are: (i) cash on hand and on-sight deposits; (ii) deposits and investments with a term less than ninety (90) calendar days following the date of the petition; (iii) clients and accounts receivable whose maturity does not exceed ninety (90) calendar days following the date of the petition; and (iv) securities for which purchase-sale transactions are regularly conducted in the respective markets, which may be sold in a maximum term of thirty (30) banking days, and whose value is known to the date on which the petition is filed.

If a Merchant has not yet incurred into the provisions beforementioned to be declared commercially insolvent, the CIL allows the Merchant to request so, by stating under oath that it will imminently fall into a generalized non-compliance in the payment of obligations, presumed that any of said situations will inevitably occur within ninety days following the request.

### **2.- Verification Visit.**

To determine whether a Merchant is found within the premises contemplated by the CIL to be declared commercially insolvent, there is a preliminary stage within the insolvency proceeding named the “Visit”, in which an inspection is made of the financial and economic status of the Merchant (the “**Verification Visit**”) by a specialist called the “Visitor”, who is appointed by the IFECOM.

The CIL stipulates that the Verification Visit will have a duration of 15 calendar days, which, at the request of the Visitor, may be extended by the Insolvency Court up to an additional 15 days. Based on the opinion submitted by the Visitor and considering the contents of the petition for

the declaration of commercial insolvency, the Insolvency Court will determine whether the Merchant is declared commercially insolvent or not, by means of a ruling passed to this effect.

If the Merchant refuses to facilitate the Visitor the financial information needed for the Verification Visit, the Insolvency Court will apply enforcement measures against the Merchant, giving warning that, if the Merchant's reckless conduct continues, the Merchant will be sanctioned by declaring it commercially insolvent.

### **3.- Conciliatory Stage.**

If the Merchant is declared commercially insolvent by the Insolvency Court, the conciliatory stage will commence in order for the Merchant and its acknowledged creditors to be in a position to reach an agreement regarding the terms and conditions according to which the Merchant will repay its debts (the “**Reorganization Agreement**”). As indicated by the CIL, the initial term that the parties have to reach a Reorganization Agreement is 185 calendar days, which, under certain circumstances, may be extended by the Insolvency Court up to an additional 180 calendar days.

The task of procuring that the Merchant and its acknowledged creditors agree on the terms of, and execute the Reorganization Agreement, is commissioned to a specialist called the “Conciliator”, who is appointed by the IFECOM; however, the CIL stipulates that a majority of creditors, with the Merchant's consent, can appoint the Conciliator.

During this stage, the Conciliator must prepare the list of creditors of the Merchant, and determine the amount, order, and level of preference of their respective credits. During the conciliatory stage, the Merchant (except in specific cases) will continue to manage its company and business under the supervision





and, in some cases, requiring the explicit authorization of the Conciliator.

#### **4.- Bankruptcy Stage.**

To the extent that the Merchant and its acknowledged creditors are unable to execute the Reorganization Agreement during the maximum conciliatory term of one year established by the CIL or, if the Merchant or its creditors file a bankruptcy petition and it's accepted by the Insolvency Court, the Merchant will be declared in bankruptcy.

At such time, the objective of this stage shall become to sell all the assets and rights of the Merchant, in order to apply the proceeds thereof to the payment of the Merchant's debts, in the order and preference established by the CIL.

In contrast to the conciliatory stage, upon declaration of bankruptcy of the Merchant, management is handed over to a specialist, called the "Receiver", who is also appointed by the IFECOM, whose main objective, as set forth above, is to sell all of the Merchant's assets to repay its debts, whereas the Conciliator's objective is to reach a Reorganization Agreement.

Notwithstanding the beforementioned, the CIL stipulates that even in the bankruptcy stage, the Merchant may reach a Reorganization Agreement with its recognized creditors.

#### **5.- Prepackage Plan.**

Pursuant to article 339 of the CIL, the Merchant and the majority of his creditors may file for a pre-packaged reorganization proceeding, in which a pre-accorded Reorganization Agreement is accompanied with the insolvency petition, so that once the Merchant is declared commercially insolvent, such Reorganization Agreement is submitted for the Court's approval.

In a pre-packaged proceeding the Insolvency

Court decides whether to declare the Merchant as commercially insolvent, based on the information provided by the Merchant and the majority of his creditors, without the need to perform the Verification Visit. Once the commercial insolvency ruling is issued by the Insolvency Court, the insolvency procedure will be conducted as any other ordinary insolvency procedure.

#### **6.- Protections during Verification Visit.**

The Merchant, the Visitor or any demanding creditor, if such is the case, may request the Insolvency Court during the visit to adopt, alter or lift injunctive measures for the purposes of protecting the Merchant's Estate and the rights of the creditors. The determination of the application of the injunctive measures will be left to the discretion of the Insolvency Court, who may also adopt them by operation of law. In any case, the injunctive measures that are issued will be in force until the date on which the Merchant is declared insolvent by the Insolvency Court; however, such measures will be substituted by the injunctive measures set forth in Section 7 below.

These injunctive measures may consist of the following: (i) the prohibition of the Merchant to make payments of obligations due prior to the date of admittance of the petition of commercial insolvency; (ii) the suspension of any enforcement procedure against the assets and rights of the Merchant; (iii) the prohibition of the Merchant to perform sales or transfers or encumbrances of the principal assets of its enterprise; (iv) the prohibition of the any attachment of property; (v) the intervention of the Merchant's treasury; (vi) the prohibition of the Merchant to perform transfers of funds or securities in favor of third parties; (vii) the placing of a house arrest order on the Merchant, for the sole purpose of not allowing it to leave its place of residence without leaving an



attorney-in-fact with sufficient instructions and funds; and (viii) any others of a similar nature.

Notwithstanding the foregoing, it has become a common practice for the Insolvency Courts to extend the beforementioned injunctive measures to the subsidiaries or related companies of the Merchant, no matter whether such entities are subject to a commercial insolvency proceeding. We consider this practice to be against the purposes of the CIL, giving grounds to any affected party to challenge such measures.

### **7.- Protections after the Insolvency Ruling.**

The declaration of commercial insolvency of a Merchant by means of a ruling issued by the Insolvency Court (the “**Insolvency Ruling**”), as well as the opening of the conciliatory stage, produces diverse effects, granting the Merchant primarily the following protections:

*(a) Suspension of Payments.* Suspension of payments of the debts contracted prior to the date on which the Insolvency Ruling enters into effect, except for those that are indispensable for the day-to-day operation of the company, regarding which the Merchant should in due time inform the Insolvency Court.

Notwithstanding the foregoing, the declaration of commercial insolvency will not be grounds for interrupting the payment of labor, tax or social security obligations, which should continue to be paid in due course.

*(b) Stay of Attachments and Foreclosures.* From the moment the Commercial Insolvency Ruling is passed and until the end of the conciliatory stage, no enforcement, attachment or foreclosure order may be executed against the assets and rights of the Merchant, except for those practiced to secure or pay, as applicable, accrued wages and labor compensation for the period of two (2) years prior to the date of the Insolvency Ruling.

As of the Insolvency Ruling and until the conclusion of the term for the conciliatory stage, administrative enforcement proceedings of tax credits will also be suspended. Notwithstanding the foregoing, the competent tax authorities may continue the necessary acts for the determination and securing tax credits against the Merchant. We consider that the power given to the tax authorities to “secure” property after the Insolvency Ruling, violates the principles of fairness that should exist between creditors, and that any “securing” performed by the tax authorities to guarantee any credit, cannot give them any privilege over the “secured” asset.

*(c) Property Separation.* The assets in the possession of the Merchant that can be identified, and whose ownership has not been transferred thereto by any definitive and irrevocable legal means, may be separated by their legitimate owners.

In terms of the CIL, the following assets may be separated, as an example: (i) the real-estate sold to the Merchant, but not paid, to the extent the relevant deed has not been duly recorded in the corresponding public registry; (ii) the chattels purchased and payable in cash, if the Merchant has not paid the full price at the moment of the Insolvency Ruling; and (iii) the chattels or real-estate acquired on credit, if a breach of payment resolution clause has been recorded in the corresponding public registry.

*(d) Contracts and Obligations.* With the exceptions established by the CIL, the contracts entered into by the Merchant, and any other obligations assumed thereby, continue to be valid in their terms, except when the Conciliator challenges them for being in the best interests of the Estate.

Anyone who contracted with the Merchant, will be entitled to request that the Conciliator indicates whether he opposes the performance of the relevant contract, and if the Conciliator



express that he will not oppose it, the Merchant will have to perform or guarantee its performance, and if the Conciliator manifests that he will oppose it, or does not give a reply within a term of 20 days, the party contracting with the Merchant may at any time terminate the contract, by notice to the Conciliator.

Once the Insolvency Ruling is issued, the injunctive measures ordered by the Insolvency Court during the visit stage are substituted by the protections granted by such Ruling; provided that: (i) once the Reorganization Agreement is approved pursuant to the provisions stated in the CIL, any protection granted by the Insolvency Court is lifted as the Merchant is no longer considered as commercially insolvent; and (ii) if the Merchant is declared in bankruptcy, then injunctive measures subsist until the Court orders their lift.

### **8.-Foreign Proceedings.**

The CIL contemplates several provisions that regulate assistance and interaction between Mexican courts and foreign courts in connection with procedures involving insolvency that are brought in respect of a Mexican merchant that has an establishment, place of business or assets abroad, and of a foreign merchant that has an establishment, place of business or assets in Mexico.

Our interpretation of the CIL concludes that there are two classes of foreign procedures in these type of insolvency or bankruptcy procedures: (1) a principal foreign procedure, which is defined as that brought against a Merchant, in a foreign state, who has its principal place of business in that foreign state, and (2) a non-principal foreign procedure, defined as one brought against a Merchant that has its principal place of business in Mexico but also has an establishment abroad.

The provisions of the CIL are clear and congruent in the matter of the acknowledgement of a

foreign procedure in respect of a Mexican merchant that has an establishment abroad. For this case, there are provisions that permit the Mexican judge to work in a coordinated manner with the foreign Court to have the proper measures adopted with respect to the assets that the merchant has and the activities that the Mexican merchant performs abroad.

In the case of the acknowledgement of a foreign procedure in respect of a foreign merchant that has an establishment in Mexico, the CIL states that the rules regarding the verification visit have to be observed to determine if the foreign merchant is in effect found to be within the requisite premises of the law to be declared commercially insolvent and that, if such conditions are present, the Mexican judge will issue a ruling to declare such foreign Merchant in commercial insolvency, and the procedure of commercial insolvency will be followed in accordance with the provisions that are stated in the CIL; provided that the effects of this declaration of commercial insolvency are to be limited to the establishment of the foreign merchant in Mexico.

For a foreign procedure to be recognized by the Mexican courts, a petition must be brought before the Insolvency Court for the recognition thereof by the foreign representative, who is the person defined by the CIL as the person or body, including someone designated in a provisional manner, who shall have been empowered in the foreign procedure to manage the reorganization or liquidation of the assets or business of the merchant or to act as the representative of the foreign procedure. The appearance of the foreign representative before the Mexican courts does not imply the submission of the foreign representative nor that of the assets and businesses of the merchant brought to the jurisdiction of the Mexican courts.