

International Insolvency & Restructuring Report

2023/24



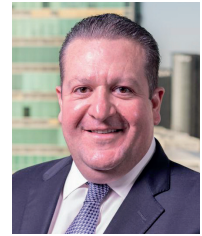
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Mexico's new specialised insolvency courts and the much-needed reforms to the insolvency law



By Luis Palomino, Palomino Flores Hernandez Abogados.

The idea behind this article is that in a few lines the reader will have a clear idea of the four basic changes needed to improve the Mexican insolvency system. The great news is that one of them just happened a year ago in 2022.¹ Regarding the other three, the forum of Mexican lawyers dedicated to insolvency, together with the competent authorities, are working hard to make them happen soon, and it is in these spaces where we hope to draw the attention of institutions such as the World Bank, UNCITRAL, IIL², IICD³, INSOL and our colleagues within these institutions to achieve it.

Since the entry into force of the Mexican Insolvency Law "Ley de Concursos Mercantiles" (LCM) in May 2000, we have had a problem: The Federal District Courts were given exclusive jurisdiction to hear all insolvency proceedings in Mexico.⁴

As a result, all insolvency proceedings in our country were heard by judges who were not specialised in the matter, since they were specialists in amparo proceedings and in civil, administrative and labour matters, including criminal matters.

Said courts had never conducted an insolvency trial, they were never prepared for it and for 22 years they have more or less rejected this type of proceeding. Proof of this is that in Mexico, from 2000 to date, less than 1,000 proceedings of this nature have been processed and the proceedings that have been rejected by district judges throughout the Mexican Republic are countless.

As a cultural fact, restructuring and bankruptcy proceedings before the LCM became effective in Mexico⁵ were processed in the local courts of each state in Mexico. It was these state courts that were the ones that had the knowledge and experience to carry out the conduct of all "suspensiones de pago" and bankruptcies in Mexico.

From one day to the next, given that our insolvency legislation is of public order, concurrent jurisdiction in this matter was

eliminated, so local judges were no longer legislated to handle this type of proceeding and when the LCM entered into force, it was the Mexican Federal Judges who assumed full legislation. They were not qualified for the task, however, and due to administrative circumstances, they were never able to organise themselves to be so.

In multiple national and international forums I have been asked my opinion on why, in spite of Mexico being one of the 20 largest economies in the world with more than six million companies, there has only been an average of 30 or 40 insolvencies per year:

My answer has always been the same, we need four fundamental changes to happen:

1. Specialised insolvency courts with sufficient powers to enforce their determinations.
2. Automatic Stay.
3. An Insolvency Law (LCM) that provides for an effective regulation of MSMEs (Micro, Small and Medium Enterprises).
4. Fast and efficient access to fresh money, new money, DIP financing.

Courts specialised in insolvency. A required reality in Mexico.

We have already taken a first big step towards this reality.

On February 24, 2022, General Agreement 4/2022 of the Federal Judiciary Council was

issued and was published in the Official Gazette of the Federation on March 4, 2022. It became effective the day after its publication.

By means of this agreement, the First and Second District Courts in Commercial Bankruptcy Matters were created in Mexico City with jurisdiction throughout the Mexican Republic to hear all cases in bankruptcy matters in our country.

Finally, in Mexico we have the long-awaited specialised insolvency courts, and they have been in operation for more than a year now.

The results have been quite good, since rejections of bankruptcy proceedings have decreased considerably and every day the deadlines are becoming more agile and the criteria of both courts are taking shape.

This does not mean that the LCM should not be modified so that the creation of court and its regulation is not only not passed into law but also extends to more cities or forums within the country. But above all, I consider that the LCM should provide the insolvency judge with more powers to enforce its determinations in such a way that there is no person or institution that would hesitate to comply with or execute immediately any order issued by such a court.

The expected insolvency reform.

In January of this year, for the first time in the history of our country, a woman - Minister Norma Lucía Piña Hernández - was elected President of the Supreme Court of Justice of the Nation and of the Federal Judiciary Council for a four-year term.⁶

In her proposal and work plans, the Minister President proposed an improvement of IFECOM⁷, which is the Mexican organism that regulates insolvency practitioners and insolvency law (LCM).

Since then, conferences and panels have been held in Mexico where various lawyers and specialists in the field have presented the problems they have encountered in the past and the parts of the law that they consider should be reformed and changed so that our insolvency system can be effective and efficient.

As I mentioned earlier, it is imperative that any reforms contain, in addition to the previously mentioned specialised courts, the following:

1. Automatic stay

Automatic stay (or the “Stay”) is one of the most important and powerful protections and tools available to a debtor in bankruptcy in Section 362 of the Bankruptcy Code of the United States of America.

Triggered immediately on filing of the bankruptcy petition, it automatically stops the majority of all acts and proceedings against the debtor and their property. It is a nationwide injunction barring almost all actions against the debtor and their property, including the exercise of remedies concerning collateral, enforcement of pre-petition judgments, litigation, collection efforts, and acts to create, perfect, and enforce liens granted before the date the bankruptcy petition was filed.

The automatic stay has a broad scope, applying to all creditors, whether secured or unsecured, and to all of the debtor’s property, wherever located. It forbids creditors from pursuing both formal and informal actions and remedies against the debtor and their property. It also covers remedies that could be exercised outside of the US.

The concept is very simple: We should have the automatic stay in Mexico.

2. Regulation of MSMEs

In Mexico we must be allowed to make the LCM more flexible with regard to MSMEs. The latter are subject to a slew of requirements before they can access any insolvency proceeding. The verification, for example, requires a lot of documentation⁸, which is why in México it has only been used by large corporations.

Also, the insolvency process of the company in distress must be allowed to proceed alongside the insolvency process of its joint obligors or guarantors, even when they are not merchants, given that they are normally 100% involved in the whole business.

The main problems facing an MSME when filing are:

- a) If you are filing as a debtor, you need to present substantial information that most MSMEs won't have ready.⁹
- b) In most cases¹⁰ the judge will order a practice known as the *Visita*, where a professional will audit the company to analyse if it qualifies for the procedure. This *Visita* incurs a cost for the debtor that a lot of MSMEs cannot afford¹¹. It is also a process that takes a lot of time that the debtor cannot spare before entering the restructuring process.
- c) Once entered into the restructuring process, an insolvency professional¹² must be appointed, whose fees the debtor must pay. That is expensive.

It would obviously be very complex to create new legislation designed purely for MSMEs. However, if we modified the existing legislation to apply to MSMEs it could work as follows:

- a) Reduce to a minimum the documents that you need to present.
- b) Reduce the cost of the insolvency professional, or transfer these costs to the court instead.
- c) Reduce court participation.
- d) March 2022 did see the implementation of special courts, but we only have two for the whole country, we need more.
- e) If the debtor requires it, allow the natural parties that are collateral to the process, to join the process as a group of companies, even if they are not merchants.
- f) Allow a discharge for the natural parties and a fresh start.
- g) Give options to the debtor facing tax and labour problems.
- h) In liquidation, let the trustee sell with the minimum formalities.
- i) New money, as I will discuss in the next point.

New money. Fresh money.

Finally, even with specialised judges and perfect legal regulation for small and medium-sized companies, there is no way we can move forward

towards orchestrating successful restructurings in our country without companies having access to financing.

New, fresh money is what allows a company to move forward, since the suspension of payments, the write-offs and the terms that can be achieved with a restructuring plan are often not enough without a fresh injection of capital.

The problem in Mexico is not only that it is necessary to reform the insolvency law so that these types of determinations, for example when the judge authorises a credit against the estate, are not subject to appeal. This generates legal certainty for the new creditor and encourages them to lend.

The national banking legislation and the circulars issued by the Bank of Mexico restrict the granting of this type of credit. This needs to be modified. Without this, it will be practically impossible to grant financing to companies undergoing restructuring processes in our country.

That is why many companies go to the U.S. courts to apply for Chapter 11, because, although it is very expensive and does not protect them from any enforcement in Mexico, it allows them access to financing, which at the end of the day is what ends up rescuing companies. If we change our legislation in this regard, Mexican companies would not have to go to other jurisdictions to restructure, they could do it perfectly well in our own country.

Conclusion

Based on the above, and given the 22-year backlog, it is clear that Mexico has taken a giant step forward by establishing specialised insolvency courts. We hope that the restructuring processes will be expedited and that more specialised courts will be created to meet the demand generated. However, this one step does not overcome all of the obstacles and the fact remains that the law must be further reformed based on these three fundamental axes:

1. The granting of 'automatic stay'
2. More agility given to the restructuring of MSMEs and

3. The elimination of all restrictions on financing for companies in insolvency proceedings.

As I have pointed out, I believe that it is very important to take into account the work carried out with respect to the MSMEs to allow these companies, which represent more than 99% of our economy, to be able to restructure quickly. This means, without much paperwork and in such a way that the costs and the requirements that are requested today are eliminated so that these companies can enter the insolvency procedure to solve their financial crisis and get access to new money with an automatic stay in all matters.

If we achieve the above, our insolvency system will be efficient, agile and effective, and this will generate legal certainty for investment and provide the basis for Mexico's economic growth.

Notes

- ¹ We will comment later on how it should be improved.
- ² International Insolvency Institute
- ³ Instituto Iberoamericano de Derecho Concursal

⁴ Article 17 LCM.

⁵ They were processed in accordance with the Bankruptcy and Suspension of Payments Law.

⁶ Until December 2026. We should appoint that one of the insolvency Judges is a woman also.

⁷ Instituto Federal de Especialistas de Concursos Mercantiles.

⁸ Article 20 LCM.

⁹ Article 20 LCM.

¹⁰ Except if you file a prepack.

¹¹ Around 7,000 US Dollars.

¹² *Conciliador*.

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