Perez Correa Gonzalez partners discuss DIP financing, visita stage and IFECOM role in Mexican bankruptcy framework – Part 2

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Fernando Perez Correa[1] and Zulima Gonzalez,[2] partners at Mexican law firm Perez Correa Gonzalez, have been involved in several of Mexico's high-profile in-court restructurings, including Oro Negro, Oceanografia, Desarrolladora Metropolitana (DEMET) and Grupo FAMSA. *Debtwire*'s Legal Analyst for Latin America recently talked[3] with the two practitioners to discuss their thoughts about the country's bankruptcy system. In the second of this two-part series,[4] the attorneys offered their opinions about why Debtor-in-Possession (DIP) financing loans are rarely used by Mexican distressed companies in *concurso* proceedings, and commented on the *visita* stage – a proceeding courts adopt in advance of deciding whether to grant a bankruptcy protection request. The specialists also explained and praised the role played by the IFECOM (Federal Institute of Specialists in Bankruptcy Procedures – "*Instituto Federal de Especialistas de Concursos Mercantiles*") in the Mexican bankruptcy regime.

Post-petition funding: provided by law, rarely reached

Mexican bankruptcy law provides for the possibility of DIP financing, and post-petition funding in general, in several sections. First, in the chapter that governs the *visita* stage (*see below*), Section 37 of the "*Ley de Concursos Mercantiles*" sets forth that, once a company files for bankruptcy, it may request the court's authorization to obtain financial loans to both (i) deal with urgent expenses regarding the company's operational activities and (ii) support the bankruptcy process. This Section also provides DIP lenders with priming liens on assets securing prepetition loans, under certain circumstances.[5]

Additionally, in the chapter that governs the management of the debtor throughout the bankruptcy, Section 75 states that contracting financial loans to pay urgent expenses during the conciliation stage[6] requires the approval of the conciliator,[7] while Section 224 provides for the seniority of claims stemming from post-petition loans in the waterfall priority recovery structure during the liquidation stage. Last but not least, Section 189 establishes that, in the liquidation stage, liquidators that decide to reach post-petition financial agreements must follow the procedures stated in Sections 75 to 77 of the law, which provides for the loans contracted by the manager of the company under the conciliator's oversight during the conciliation period.

In practice, however, DIP facilities are rarely, if ever, granted. According to Perez Correa and Gonzalez, banking regulation is not compatible with the bankruptcy law, and certain provisions of the country's Credit Institution Law[8] prevent banks and financial institutions from providing DIP facilities to distressed companies. The practitioners explained that, as stated in Section 65 of that law, DIP lenders must proceed with a bureaucratic analysis of quantitative and qualitative

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information regarding the borrowers' feasibility of payment, in advance of providing any financial loans.

Amendments to prepetition loans, including providing the company with new money, also require a similar information analysis, which must evidence an improvement of the debtor's repayment capacity. In addition, the financial institutions must adopt all measures available to be repaid and/or obtain additional guarantees to their claims, which distressed companies under bankruptcy are usually unable to provide.

Moreover, Section 112 of the Credit Institution Law establishes that employees of financial institutions that provide individuals or companies "in a state of insolvency" with financial loans may be punished with imprisonment of three months to two years, along with a fine of 30 to 2,000 days of salary. In this scenario, it is not surprising that DIP lenders are not willing to take the risks of financing Mexican distressed companies under bankruptcy.

The *visita* stage – not that bad, but maybe not necessary

In advance of deciding whether to grant a bankruptcy protection request, Mexican bankruptcy law states that the court must order the *visitador* – an assistant appointed by IFECOM (*see below*) – to proceed with a visitation to the company, to confirm that it really exists and assess accounting books and certain other documents and information. The *visita* stage is designed to provide the court with grounds to evaluate if the company's financial situation fulfills the requirements provided for in the law to be considered in "generalized default" (*incumplimiento generalizado*),[9] and is theoretically also necessary to avoid fraudulent bankruptcy requests from being granted.

But Perez Correa and Gonzalez said they do not believe the *visita* stage is a really useful tool in Mexican bankruptcies. First and foremost, the practitioners pointed out that this process delays the reorganization process as a whole, which is not in accordance with the principles of public interest and company preservation stated in the first Section of the bankruptcy law.[10] In addition, as described in more detail in the first part of this interview, filing for bankruptcy is often used as a measure of last resort to avoid – or at least postpone – liquidations, in the cases in which out-of-court restructuring negotiations do not succeed. In practice, fraudulent bankruptcies are as rare as they are worthless.

The attorneys commented that, interestingly, in the past they saw certain companies refuse to receive the *visitador* by not opening their doors when it came time for the verification, as an attempt to simultaneously expedite the result of the *visita* proceeding and save costs stemming from the *visitador* activities. The idea behind this "strategic maneuver" is that, by verifying that the company physically exists but is closed, the court's assistant would conclude and report to the court that the company is in a generalized default situation, which would justify the granting of the bankruptcy protection request. Although ethically questionable, it sounds like a pragmatic, effective way to skip the damages stemming from a proceeding appearing to be expensive and time-wasting.

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As set forth in Section 311 of Mexican bankruptcy law, IFECOM is the Federal Judicial Council's auxiliary organ which provides Mexican courts assigned to oversee bankruptcies with assistants, including the *Visitador*, *Conciliador* and *Sindico*.[11] The IFECOM appoints almost all court assistants to act in Mexican bankruptcies, except in the cases in which distressed companies hold concession contracts for public services, in which the court's assistants are appointed by the government authority that granted the concession, according to Section 240 of the law. IFECOM's director is appointed by the President of the Mexican Supreme Court.

Perez Correa and Gonzalez concluded our interview praising IFECOM's activities in the Mexican bankruptcy system, which they consider transparent and trustworthy. The attorneys commented that, in addition to successfully appointing court assistants, IFECOM also represents a reliable source of information when it comes to both Mexican bankruptcy law and case law.

Endnotes

[1] Fernando Perez Correa has almost three decades of experience acting as a legal advisor, mediator, conciliator and trustee in bankruptcy and corporate-related disputes, including international commercial arbitrations. Perez Correa holds a law degree from the Universidad Nacional Autonoma de Mexico and an LLM from Cornell Law School, and is also admitted to practice in New York and in the federal courts of the Second Circuit of the United States.

[2] Zulima Gonzalez has broad experience in domestic and cross-border bankruptcy disputes, as well as civil and commercial litigation. Gonzalez holds a law degree from the Universidad Anahuac Mexico Norte and an LLM from University College London. In 2020, she was appointed Regional Director for the Latin American chapter of IWIRC (International Women's Insolvency & Restructuring Confederation) and ranked by The Legal 500 as "rising star" in bankruptcy and restructuring practice.

[3] The interview was conducted on 28 April 2021 via videoconference, and has been edited for brevity and clarity.

[4] Click here for the first part of the interview.

[5] "*Pursuant to article 37 of the Commercial Insolvency Law, lenders who provide this kind of financing are given priming liens on property subject to existing liens. In point of fact, DIP lenders will get a first-priority lien on the debtor's inventory, receivables, and cash (whether or not they are subject to an existing lien), as well as a second lien on any other encumbered property and a first-priority lien on all unencumbered property*". CORREA, Fernando Perez; HERNANDEZ, Abimael. DIP Financing in Mexico, 2017.

[6] Starting from the publication of the ruling that grants a bankruptcy request, the conciliation stage is a 185-day period (extendable for an additional 180 days) during which the company must evidence that the majority of the creditors impaired by the bankruptcy supports its reorganization plan, otherwise the court declares it insolvent and starts the liquidation stage.

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[7] The conciliator is responsible for mediating negotiations between company and creditors, and actively participating in the construction of a reorganization plan throughout the *Concurso Mercantil's* conciliation stage. It also serves as a claims administrator and has authority to both (i) to remove the debtor from the management of the company and take charge of the business, whenever it is deemed to be the best way to protect the stakeholders' rights and interests; and (ii) appeal on certain decisions, including those regarding claims' recognition and classification, and also the ruling that declares a company insolvent and triggers the liquidation stage of a bankruptcy.

[8] *Ley de Instituciones de Credito*, enacted in 1990 and last updated in 2009.

[9] According to Section 10 of the Mexican bankruptcy law, a "generalized default" consists of a default on payment obligations to more than one creditor, as well as some additional conditions, depending on who made the filing. When the bankruptcy request comes from a creditor or the Public Prosecutors' Office, the conditions are that: (i) the default on the payment obligations must be outstanding for more than 30 days, and the defaulted obligations must represent at least 35% of the company's total debt; and (ii) the company does not have enough assets to meet at least 80% of its total past due debt at the bankruptcy filing date. When the company files for bankruptcy, however, it's enough to fulfill either (i) or (ii).

[10] This Section states that preserving viable companies and avoiding generalized defaults preventing a company's viability and financial turnaround are issues of public interest.

[11] *Sindico* is the court assistant tasked with replacing the *Conciliador* when a company is declared insolvent and the bankruptcy's liquidation stage starts.

by Arthur Almeida

Arthur Almeida is a former restructuring attorney. Prior to joining Debtwire as a Legal Analyst, he practiced with Passos & Sticca Advogados Associados, and worked in the legal department of Banco Fibra S.A. Arthur's experience includes participating in major civil litigation on credit recovery, representing creditors such as banks and financial institutions in high-profile restructurings. He also obtained his LL.M in Financial and Capital Markets Law from Insper Instituto de Ensino e Pesquisa, and is currently enrolled in the Master's Program in Commercial Law at Universidade de Sao Paulo.

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