

By Frederick W. Hill

# Creditors' Rights in Secured Transactions Enhanced in Mexico

## Recent changes in Mexican law have improved the climate for secured lending

Secured financing in Mexico has recently taken a turn for the better, and there is little reason to doubt that recent amendments and additions to Mexican law will enhance the rights of secured creditors and thereby encourage the extension of credit in Mexico. Lenders that were reluctant to extend secured financing to Mexican borrowers in the past may now want to reconsider their practices.

In 2000 and 2003, new federal legislation took effect, altering Mexico's Law of Negotiable Instruments and Credit Transactions (Credit Transactions Law) as well as the Commerce Code.<sup>1</sup>

This legislation enhances the rights of creditors and, from the lender's standpoint, makes secured lending significantly more attractive. In particular, as a result of this legislation, loans that support real estate development in Mexico can be made more secure, because the new law clearly sets forth the provisions for nonjudicial foreclosure.

The new provisions have tremendously enhanced two instruments of Mexican law: the

pledge without transfer of possession (*prenda sin transmisión de posesión*) and the guaranty trust (*fideicomiso en garantía*). These instruments are sure to be the preferred choice for secured lending in Mexico for the foreseeable future. The statutory changes have augmented, substantively and procedurally, the rights of creditors.

For years, a pledge (*prenda*) of personal property to secure a debt under the Commerce Code required a transfer of possession of the collateral to the creditor. Under the law, this means actual rather than constructive possession. The only exception to this rule of the creditor taking possession in order to have a valid pledge was available when the collateral could be held under lock and key by an independent third party warehouse owner. Therefore, if it was not feasible for the borrower to surrender possession of the property offered as collateral, a security interest in the form of a pledge could not be employed.

For this reason, one of the most important parts of the new legislation is the amendment of Article 346 of the Credit Transactions Law, which holds that a pledge of personal property to secure a debt without transfer of possession of the collateral to the pledgee-creditor creates a chattel mortgage and gives the pledgee-creditor a right of first preference against the collateral as long as the debt that is secured by the collateral remains

unpaid. Further, the amendment to Article 353 of the Credit Transactions Law provides that all kinds of personal property (and rights thereto) may be pledged without the transfer of possession of the collateral to the pledgee-creditor.

The new legislation also amended certain articles of the Credit Transactions Law, specifically addressing the use of trusts as a vehicle for any legal purpose. Trust agreements (*fideicomisos*) have been used in Mexico for many years for different purposes. Since the enactment of the Foreign Investment Law of 1973, trusts have been used as a vehicle to allow non-Mexican persons to have the use and benefit of real property in the border and coastal areas. Trusts have also been used by developers of real property to divide a large parcel of real property into smaller units in the form of lots, single family homes, or condominiums that are later sold to different buyers. Trusts have also been used in past years as a vehicle for secure purchase money financing and other types of lending by creating security interests in real property and personal property. However, the statutory law of Mexico on the use of trusts for secured lending transactions was not adequate in many respects, and this created some doubts about the use of trusts for the purpose of securing debt. There were many unanswered questions regarding foreclosure on the collateral in the event of default by the debtor.

The new legislation includes articles of the Credit Transactions Law that specifically address the use of a trust agreement to

guarantee a debt. Thus, for the first time, the law of Mexico includes express statutory authority for the use of trust agreements to create security interests in real property and personal property. Prior to these new articles, only Mexican banks were statutorily authorized to act as trustees on trust agreements. Article 395 of this law stipulates that other institutions are authorized to act as trustees for trusts created for the purpose of guaranteeing the payment of a debt to the creditor named as beneficiary of the trusts. These other institutions include insurance and bonding companies, stock brokerages, limited object financial organizations, and general warehouses for deposit. This change will generate competition for Mexican banks in the business of providing trust services. The added competition should cause trustee services to be more efficient and less expensive, especially if foreclosure becomes necessary due to a default in the obligations of the trustor.

The amendments also require that financial institutions serving as trustees keep a separate accounting for each trust and indemnify the trustor-debtor for any loss caused by the trustee acting in bad faith or in excess of the trustee's authority as prescribed by law and the terms of the trust agreement. Under the new law, trustees have the legal capacity to transfer legal title to property held in trust and act as the judicial and administrative authority on behalf of the trustor.

Other new articles of the Credit Transactions Law set forth provisions that can be included in

Frederick W. Hill is a partner with Overton, Lyman & Prince LLP in Los Angeles and a business lawyer with extensive experience in Mexican law and procedure.

Even if the creditor is forced to commence a judicial proceeding against the debtor, it should be remembered that a complaint (*demanda*) that is based on public documents and/or a promissory note initiates what is known as an "executive action." This expedites judicial proceedings, limits the defenses that can be raised by the debtor, and permits a prejudgment attachment on all assets owned by the debtor by operation of law *ex parte*. Moreover, if the promissory note is cosigned by a third party, this constitutes an *aval* (a guarantee of repayment), and the cosigner (or *avalista*) becomes a primary obligor on the note and is subject to the executive action independent of the debtor on the note. The creditor holding the note is free to proceed against the *avalista* to collect the debt regardless of the action against the debtor.

Judicial enforcement of legal obligations in Mexico has been open to question. However, in recent years the integrity of the judiciary in Mexico has improved. One recent example is the action taken by supervisory officials of the federal court system in Mexico City. A case involving Grupo Transportación Marítima Mexicana, S.A. (TMM) arose wherein creditors, regulators, and tax authorities were pursuing their rights against TMM. Upon application by TMM attorneys, a Mexico City judge issued an injunction staying the ability of the creditors to enforce their rights. Immediately, court supervisory officials removed the judge from office and announced that he had been transferred to another jurisdiction and was currently being investigated on suspicion of granting an illegal injunction.<sup>4</sup>

The successful passage of the recent federal secured transaction legislation is an exception to the reforms that President Vicente Fox strived to make a part of his administration's accomplishments. Despite the efforts of the Fox administration, the Mexican Congress did not approve the administration's most coveted legislative reforms in the areas of energy, labor law, and taxation. Although the Congress did not grant Fox these crown jewels of reform, the jewel of increased protection for secured lenders was approved with the cooperation of the two major political parties.

Business transactions under this new legislation have not been tested in Mexican courts. Some legal scholars and lawyers in Mexico will undoubtedly question aspects of the legislation. However, many of the leaders in the federal government, the judiciary, and the business community in Mexico recognize the need to modernize laws and regulations affecting business. Moreover, the role of the judiciary in the business community of Mexico is not as broad as it is in the United States. For these reasons, it is believed that

this legislation will be followed when careful documentation is created for secured lending transactions in Mexico. ■

<sup>1</sup> The Mexican Commercial Code (*Código de Comercio*) and the Credit Transactions Law (*Ley de Títulos y Operaciones de Crédito*) are federal laws, applicable in all states of Mexico.

<sup>2</sup> The Public Registry of Property (*Registro Público de la Propiedad*) in Mexico is similar to a county recorder in the United States. However, as with registrations in the Public Registry of Commerce (*Registro Público de Comercio*), the state of Mexico where the property is located has jurisdiction. All transfers of real property must be recorded in the Public Registry of Property in order to be valid. The registry is also where title searches must be performed in order to determine

who has title to real property in Mexico. Fees for recording in the Public Registry of Property are based upon the value of the transaction, and as a result are much higher than the recording fees charged by county recorders in the United States.

<sup>3</sup> The federal Penal Code (*Código Penal*) applies when a depository commits an abuse of confidence. Articles 382 through 385 of this code specify a range of jail time and fines that are imposed on persons who violate their obligations as a depository or trustee. In general, prosecution is a summary proceeding compared to its equivalent in the United States. For this reason, creditors have added protection in Mexico.

<sup>4</sup> See Michael Allen & Joel Millman, *A Test of Mexican Bankruptcy Law?*, WALL STREET JOURNAL, May 30, 2003, at A15. The action taken by the federal court surprised many observers and indicated that the federal government of Mexico fully supported the action.

how can I grow  
without increasing  
fixed costs?  
we need to improve profits

**SPECIAL COUNSEL**

**THAT'S WHAT WE DO, EVERY DAY.** When your workload exceeds your workforce, Special Counsel has the answers. Leading law firms and corporate legal departments have come to rely on our full range of legal workforce solutions. From temporary staffing to direct hire, from litigation support to document management and more, we handle it all. We do it by containing costs so you can grow your bottom line. Call us today and find out how we can do it for you.

**(323) 658-6065**  
(800) 737-3436  
(323) 658-6495 FAX  
[specialcounsel.com](http://specialcounsel.com)

MPS LISTED NYSE  
A Member of the MPS Group