

Bill of Amendment: Proposed Emergency Regime for Concursos Mercantiles

Mexico City, May 4, 2020

On April 28, 2020, Senator Claudia Edith Anaya Mota (PRI) submitted a bill to amend (the “Bill”) the Mexican Insolvency Law (*Ley de Concursos Mercantiles*) to include a special *concurso* regime applicable in emergency situations (*Régimen Concursal de Emergencia*) designed to tackle the businesses’ insolvency and restructuring issues that arise from emergency situations.

The Bill:

- relaxes commencement requirements,
- obviates the visit stage,
- expands the automatic relief and extends the benefit to non-debtors (co-obligors and guarantors),
- introduces some hurdles to interim financing,
- relaxes the rules for allowance of claims,
- enhances creditor benefits relative to tax claims,
- increases the countdown to reorganize by delaying its starting point,
- introduces the concept of relative priority rule, and
- introduces the concepts of rehabilitation and discharge (for debtors to have a fresh start).

Legislative Process

This Bill is in its first steps. The Senate will first review and vote the Bill, because a Senator proposed it. If approved at the Senate, the House of Representatives will then discuss it and vote it. Throughout these steps, legislators may make modifications to the Bill or even dismiss it altogether.

The yearly period for ordinary meetings in the Congress ended on April 30 and will resume on September. Therefore, for Senate to discuss this Bill, it will have to call for extraordinary meetings, which we would expect, considering the purpose if the Bill is to bring financial relief during emergency situations.

Stated Purpose

In her explanatory preamble, Sen. Anaya explains that the purpose of this emergency regime is to provide a more flexible and quick relief for struggling businesses, than the current *concurso* proceedings.

Commencement

The Bill contemplates that the emergency regime is only available to debtors (i.e., creditors who want to demand involuntary proceedings would not have access to these flexible proceedings) when an emergency, an act of God, force majeure or similar events arise on a regional or national level, aggravating the whole regional or national economy, for as long as the event persists and for the next six months. To expedite the process, the case file, parties’ motions and even the petition itself can be electronically handled. With the

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same intent, the Bill shortens or eliminates altogether most deadlines (especially, in regards to deadlines for appeals).

The debtor need not demonstrate it meets the regular commencement standards, a simple declaration under affirmation (*bajo protesta de decir verdad*) will suffice. The judge will thereafter declare the commencement of the *concurso* proceeding. Parties cannot appeal this declaration. Interestingly, because the Bill does not provide for a dismissal of the petition, declaration of *concurso* is, apparently, a given. This is a significant difference from a traditional *concurso* proceeding where, upon the initial petition or demand, the court will conduct a preliminary stage (which can, in practice, last up to two months) called the "visit", where a court-appointed visitor will review the debtor's books and records to determine whether it meets the commencement standards. The Bill obviated the visit stage in these emergency regime.

The debtor shall attach to its petition, generally, the same documents (which can be electronic copies) than those required for a traditional petition. However, the debtor may attach these documents up to ten days after the *concurso* declaration, lest the judge terminate and dismiss the proceeding. Instead of requiring shareholder approval for entities to file for *concurso*, a board of directors' determination will suffice.

Automatic Relief

The *concurso* declaration is, mainly, similar to a traditional *concurso* declaration, providing a suspension of payments and a stay of execution, but adding an injunction to transfer or encumber assets outside the ordinary course of business an automatic lifting of bank account freezes, an injunction to terminate or revoke any essential governmental concession or construction agreement, and other relief that the judge deems fit (either upon petition by the debtor or *ex officio*).

One of the greatest differences from a traditional *concurso* declaration is that the stay of execution extends its effect to benefit non-debtors. This extension would create a shift of paradigm for financial obligations, whereby, currently, most creditors rely on guarantees (including downstream guarantees) in the understanding that a debtor's *concurso* would not affect execution against other guarantors. Should this Bill become law, we would expect an increased cost of borrowing to compensate the weakening of the usefulness of guarantors.

If the debtor, any creditor or any other third party violates these orders after the court has already warned them, the court will issue an order terminating any rights in the *concurso* of the violating party. For creditors, that would probably mean losing their standing as creditors. However, it is not clear what it means for third parties and, especially, for debtors.

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Interim Financing

One novelty that would contradict the purpose of making the *concurso* more flexible is granting the court the power to authorize or deny the contracting of interim financing. In a traditional *concurso*, the conciliator decides on this issue and only informs the court. Not only does this new mechanism take more time, but it is also counterintuitive to the purpose of having a conciliator, who is a business and accounting specialist who helps the court oversee business decisions. It is generally accepted that a conciliator is better equipped for making these decisions than the judge.

Allowance of Claims

The process for allowing claims is substantially abbreviated. In a traditional *concurso*, the conciliator files a preliminary and afterwards a definite list of claims, which serves as the basis for issuing the judgment of allowance of claims (*sentencia de reconocimiento, graduación y prelación de créditos*, "Recognition Judgment"), with the creditors having three opportunities for filing their proofs of claims: at the outset of the conciliation stage, after the preliminary list and after the issuance of the Recognition Judgment in the form of appeal. In the emergency regime, there is only one list and two windows for filing proofs of claims: at the outset of the *concurso* declaration and after the issuance of the Recognition Judgment.

Reorganization Countdown

One true novelty is that the conciliation stage now begins upon the issuance of the Recognition Judgment instead of upon *concurso* declaration. This would mean that the *concurso* proceeding lasts longer (contradicting the purpose of the regime). However, it is a reasonable approach, considering that, in practice, negotiations among creditors and debtors before the Recognition Judgment are almost non-existent).

Relative Priority Rule

Under the traditional *concurso* absolute priority rule, the court cannot cram down on secured or privileged creditors, while it can cram it down on unsecured creditors to the extent the haircuts and maturity extensions imposed to them are similar to those afforded to the least-impaired 30% of unsecured creditors.

A poorly drafted provision introduces the concept of relative priority rule. Under the proposal, the court can cram down the plan on any creditor, provided that dissenting creditors are not afforded a worse treatment than what they would receive should the debtor be put in liquidation. However, that same provision states that the court can cram down a plan on a creditor if the proposed treatment for said creditor is the best for creditors in the same ranking, in terms of haircut and maturity extension. Clearly, receiving anything better than what one would receive in liquidation is a much lower standard than receiving the best treatment granted to creditors in the same ranking. Nonetheless, both cramming down on a liquidation-value standard or on the

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best-treatment standard assume the adoption of a relative priority rule, where junior creditors can receive something under the plan even when dissenting senior creditors are not paid in full.

Tax Claims

By giving unsecured tax claims *pari passu* treatment to the rest of unsecured claims, this new regime would remove the discretionary ability afforded to tax creditors to negotiate haircuts parallel to those negotiated within the restructuring plan.

Rehabilitation and Discharge

Finally, another novelty is the discharge and rehabilitation order. In a traditional *concurso*, it seems that the proceeding has no closure, with creditors retaining a valid claim for their shortfalls in liquidation recovery and no order of rehabilitation to engage in commercial activity after *concurso* termination. The emergency regime, however, provides that, upon sale of all of the debtor's assets in liquidation, the court will issue an order discharging any pending indebtedness and rehabilitating it for a fresh start.

Final observations

The Bill is a great initiative for creating a more flexible and accessible regime useful for these uncertain times. Some of its novelties are consistent with this goal, whereas some of them seem to run afoul to it. Most of the proposals, however, would be useful in any context (emergency or not), such as the starting point of the reorganization countdown or the discharge and rehabilitation order. In any event, assuming the legislative process cleans up the inconsistencies of the Bill, this new regime could be a very useful resource for distressed business amidst current or future emergencies.

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