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Legal Aspects of Lending to Mexican Borrowers

by James E. Ritch, Jr.*

The growth of the Mexican economy has led to an increase in borrowing by the Mexican public and private sectors from foreign lending institutions. The extent of the activity of foreign banks in Mexico is evidenced by the fact that almost 1000 foreign lending institutions are registered with the Ministry of Finance and Public Credit for tax purposes and more than 140 foreign banks have representation offices.¹ Many United States banks which were once considered as regional banks have developed their international business in general and their activity in Mexico in particular.²

This lending activity has resulted in the need to develop loan documentation which satisfies the requirements of the lender while trying to give maximum protection to the lender under Mexican law. This article will cover the activities permitted to foreign lenders and will present some of the most common matters which arise under Mexican law in drafting loan documentation involving foreign lenders and Mexican borrowers.

I. Permitted and Prohibited Activities

The basic law covering banking is the General Law of Credit Institutions and Auxiliary Organizations (Banking Law).³ It applies to those entities engaged in doing banking business in Mexico, which is defined as the habitual exercise of banking and credit activities.⁴ The habitual nature of the activity refers to having an establishment which offers bank-

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¹ The author obtained these approximate figures from *Dirección General de Bancos, Seguros y Valores* (General Bureau of Banks, Insurance and Securities), a division of the Ministry of Finance and Public Credit of Mexico.

² North Carolina National Bank, First Union National Bank of North Carolina and Wachovia Bank and Trust Company appear in the list of foreign banks registered for tax purposes. See *Diario Oficial [D.O.]* (Official Daily of Mexico) (Apr. 11, 1974).

Editor's Note: *Diario Oficial*, which publishes the official texts of such materials as the constitution, laws and regulations of Mexico, will be cited as D.O. throughout the remainder of this article.

³ *Ley General de Instituciones de Crédito y Organizaciones Auxiliares* (General Law for Credit Institutions and Auxiliary Organizations), D.O. (May 31, 1941, as amended) [hereinafter cited as *Banking Law*].

⁴ *Id.* art. 1.

ing services to the public on a continuous and open manner. Concessions from the Federal Government are required to do banking business.⁵

Banking operations in Mexico are divided into active transactions (*operaciones activas*) and passive transactions (*operaciones pasivas*). Active transactions are those appearing on the bank's balance sheet as assets and are, basically, loans.⁶ Passive transactions are those appearing on the balance sheets as liabilities and are, essentially, deposits.⁷ Any entity carrying out active or passive transactions on any open, continuous basis must have a concession from the Ministry of Finance and Public Credit. Such concessions may not be granted to foreign entities. Prior to 1974, the Banking Law provided that foreign entities could obtain limited concessions for branches in Mexico.⁸ When the Law was changed to eliminate this possibility, Citibank, N.A., was the only foreign bank with a Mexican branch. It was allowed to keep its concession, and the branch continues to operate. Thus, the provisions allowing foreign banks to obtain concessions were eliminated from the Banking Law, but they remain in effect with regard to Citibank, N.A.⁹

Effective in 1979, the Banking Law was modified to provide that the Ministry of Finance and Public Credit could authorize foreign banks to establish branches in Mexico, "the asset and liability transactions of which could be carried out exclusively with foreign residents."¹⁰ Nevertheless, such branches were prohibited from carrying out any activity in Mexico requiring a concession under the Banking Law.¹¹ Rules containing requirements for the authorization have never been issued. Apparently, no authorizations have been issued for such branches, and foreign banks have shown little interest in opening them. No complete official explanation was given of the reasons for this change in the Banking Law; however, the Mexican authorities have been interested in the possibility of making the country an international financial market. Moreover, the Mexican government may have acted in order to alleviate the problems that Mexican banks were encountering in getting authorization to establish branches or agencies in foreign countries. Even though Mexico has adopted this new Banking Law,¹² foreign financial activities are still strictly limited. For example, foreign financial institutions, foreign governments or governmental agencies, and groups of foreign entities or individuals may not hold stock in Mexican banking institutions,¹³ although those foreign institutions which held shares in Mexican banks when the restriction was enacted continue to do so under the constitu-

⁵ Id. art. 2.

⁶ J. Rodríguez y Rodríguez, *Derecho Bancario* 34 (3d ed. 1968).

⁷ Id. at 35.

⁸ Banking Law, *supra* note 3, art. 6 (amended Jan. 3, 1974).

⁹ Banking Law, *supra* note 3.

¹⁰ Id. (as amended Dec. 27, 1978).

¹¹ Id. art. 6 (as amended Dec. 27, 1978).

¹² Banking Law, *supra* note 3.

¹³ Id. art. 8.

tional guarantee prohibiting laws from having retroactive effects.¹⁴

Certain activities are open to foreign banks. For example, foreign banks can have representation offices in Mexico. Some 140 of them do have representation offices, and new offices are opened periodically.¹⁵ Prior to 1972, there were no written rules concerning requirements to open representation offices or covering their prohibited and permitted activities. However, the unwritten rules developed through custom and through application of the principles governing "doing banking business." The Rules on the Representation of Foreign Institutions issued by the Ministry of Finance and Public Credit were published on April 11, 1982.¹⁶ Subsequently, article 6 of the Banking Law was modified to refer to representation offices.¹⁷

The Ministry of Finance and Public Credit has the power to authorize a foreign bank to open a representation office in Mexico, but it must give consideration to the opinion of the National Banking and Insurance Commission and the Banco de Mexico, S.A. (the central bank).¹⁸ Representation offices have an informational function in dealing with Mexican borrowers. They have the right to hire employees and rent out the space needed for their offices; however, they cannot carry out any activities requiring a concession under the Banking Law.¹⁹ A representation office may give information on loan arrangements and negotiate loans, but the respective agreements must be signed by the bank abroad.²⁰ They are prohibited from receiving or promoting deposits, and they must furnish the Mexican banking authorities with any information requested and must follow any guidelines issued by the Ministry of Finance and Public Credit or the Banco de Mexico, S.A.²¹ The Ministry of Finance and Public Credit must approve the representatives of the foreign bank and its place of domicile.²² A violation of Mexican law may result in revocation of the authorization to open a representation office.²³

There are no general rules covering the activities of foreign banks without representation offices. Such banks can make loans to Mexican borrowers, provided the loans are made from abroad. Any bank which has registered with the Ministry of Finance and Public Credit for tax purposes accepts a commitment to refrain from activities in Mexico to promote deposits and to follow the guidelines issued by the Ministry of

¹⁴ *Constitucion Politica de los Estados Unidos Mexicanos (Mex.)* art. 14, reprinted in 10 *Constitutions of the Countries of the World* (A. Blaustein & G. Flanz ed. 1982) (1977 O.A.S. translation) [hereinafter cited as *Mexican Constitution*].

¹⁵ Information from Ministry of Finance, *supra* note 1.

¹⁶ D.O. (Apr. 11, 1972).

¹⁷ *Id.* (Jan. 3, 1974).

¹⁸ *Banking Law*, *supra* note 3, art. 6 and D.O. (Apr. 11, 1972).

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

the Banco de México. Interest paid to a registered bank enjoys a lower income tax rate than that paid to an unregistered bank.²⁴

Foreign banks, with or without representation offices, are extremely active in making loans to Mexican borrowers, and their officers may travel to Mexico without restriction, although technically such officers should have immigration permits for business conferences and should not enter the country just on tourist visas.²⁵

Mexico cannot prohibit foreign banks from receiving deposits from Mexican residents, since Mexican laws cannot have extraterritorial application. It is perfectly legal for Mexican residents to have deposits abroad. However, the Mexican government is attempting to discourage foreign banks from activity in Mexico promoting foreign deposits.²⁶

The only guidelines which have been issued to foreign banks registered with the Ministry of Finance and Public Credit for tax purposes have included a recommendation that such banks refrain from activities involving: financing in Mexican pesos, guaranteeing a loan in Mexican pesos, or arranging financing from one Mexican entity to another.²⁷

II. Control of Borrowing by Mexican Entities

In contrast to many other countries, Mexico is distinguished by relative freedom with regard to foreign borrowing by Mexicans. No permits are required for individuals or private sector entities to borrow abroad. Mexico has no exchange controls or restrictions on sending funds in any currency into or out of Mexico.

In the terms of the General Public Debt Law,²⁸ the borrowing power of public sector entities, however, is subject to controls. The Law defines the public sector²⁹ to include:

1. The Mexican Federal Government.
2. The District Department, which is the government body of the Federal District where Mexico City is located, and is part of the Federal Government in any case.
3. Decentralized agencies of the Federal Government, which are separate legal entities created by law, such as *Petroleos Mexicanos* or the Federal Electricity Commission.
4. Companies of Majority State Participation, which are, in most cases, stock corporations, controlled directly or indirectly by the Federal Government through stock ownership, control of the Board of Direc-

²⁴ *Ley de Impuesto sobre la Renta* (Income Tax Law) art. 154, D.O. (Dec. 30, 1980) and *Reglas para el Registro de Instituciones Extranjeras Domiciliadas fuera de la República* (Rules Governing the Registration of Foreign Institutions Domiciled Outside the Republic), D.O. (Apr. 10, 1972).

²⁵ See *Ley General de Población* (General Population Law), D.O. (Jan. 7, 1974).

²⁶ See *supra* text accompanying note 21.

²⁷ Banco de México, S.A., Letter Circular 1/80 (Apr. 7, 1980) and Supplementary Letter Circular (July 17, 1980) (available at office of N.C.J. Int'l L. & Com. Reg.).

²⁸ *Ley General de Deuda Pública* (General Public Debt Law), D.O. (Dec. 31, 1976) [hereinafter cited as *Public Debt Law*].

²⁹ *Id.* art. 1.

tors, or veto powers, such as Aeronaves de Mexico, S.A. and Altos Hornos de Mexico, S.A.

5. National banking, insurance and bonding companies, which are those controlled by the Federal Government, such as Nacional Financiera, S.A., and Banco Nacional de Obras y Servicios Públicos, S.A.
6. Trusts in which any entity mentioned above is the grantor.

The Public Debt Law defines "financing" as credits or loans arising from the signing or issue of negotiable instruments or other documents payable in a given term,³⁰ or the acquiring of property and contracting for goods and services on an installment payment plan.³¹ "Financing" also includes the creation of contingent liabilities on a loan, credit agreements, property purchases, or installment contracts for goods or services.³² Moreover, the Law defines "financing" as any act which is similar or analogous to the activities actually enumerated in the legislation.³³

The General Public Debt Law is administered by the Ministry of Finance and Public Credit.³⁴ Public sector entities require written authorization of the Ministry to negotiate and contract financing.³⁵ In order for the loan documentation to be valid it must bear the stamp of registration of the Ministry, except in the case of national banking, insurance and bonding institutions.³⁶ Also, the Ministry keeps a registry of the financial obligations of the public sector entities.³⁷

The Ministry has made great strides in coordinating the administration of the public debt, and in some cases it participates actively in negotiating the agreements. Under the Law, the Ministry should make a determination that the financing is within the budget of the borrowing entity and that it has the capacity to repay the financing.³⁸ Approval by the Ministry does not constitute a guaranty of the Federal Government in a legal sense. However, from a practical point of view, the Ministry is careful to see that all foreign borrowings by public sector entities are repaid promptly, since a default by any entity would affect the credit standing of the public sector as a whole.

The foreign obligations of three national banking institutions—Nacional Financiera, S.A.,³⁹ Banco Nacional de Obras y Servicios Públicos,

³⁰ *Id.* art. 2.

³¹ Public Debt Law, *supra* note 28. Financing for services on an installment basis includes financial leases. Leveraged leases have been increasingly used by the public sector in recent years.

³² *Id.*

³³ *Id.*

³⁴ *Id.* art. 3.

³⁵ *Id.* art. 6.

³⁶ *Id.* art. 22.

³⁷ *Id.* art. 27.

³⁸ *Id.* arts. 6, 8, 15.

³⁹ Ley Orgánica de Nacional Financiera, S.A. (Organic Law of the National Financing Institution) art. 156, D.O. (Jan. 2, 1975).

S.A.,⁴⁰ and Banco Nacional de Credito Rural, S.A.⁴¹—are, by law, guaranteed by the Federal Government.

III. Loan Agreements

Foreign lenders have developed documentation to cover their loans, both domestic and international, and, logically, they prefer to use their established forms. The duty of the lawyer who represents the lender is to adapt this documentation to the extent necessary to give the lender maximum protection under Mexican law. In this endeavor, the same problems arise in practically every transaction, particularly where it is the lender's first Mexican experience. Some of these matters will be discussed here.

A. Governing Law

Lawyers, by nature, are provincial, even those practicing in the larger cities and in international law firms. Some of them insist, without any analysis of the consequences, that the loan documentation be governed by the law of the lender's home state or country.

The general Mexican conflicts of law rules are rather territorialistic. They are contained in the Civil Code for the Federal District in Local Matters and for the Entire Republic in Federal Matters,⁴² which is applicable to commercial matters, supplementing the Commercial Code.⁴³ The pertinent articles of the Civil Code are:

Article 13. The legal effects of acts and contracts executed abroad which must be performed in the territory of the Republic shall be governed by the provisions of this Code.

Article 14. Real property located in the Federal District and the personal property located therein shall be governed by the provisions of this Code even when their owners are foreigners.

Article 15. Legal acts, in everything regarding their form, shall be governed by the laws of the place where they are signed. However, Mexicans or foreigners residing outside of the Federal District, are free to subject themselves to the forms prescribed in this Code when the act is to be performed in the mentioned locality.⁴⁴

The General Law of Negotiable Instruments and Credit Transac-

⁴⁰ Ley Orgánica del Banco Nacional de Obras y Servicios Públicos, S.A. (Organic Law of the National Bank for Public Works and Services) art. 29, D.O. (Dec. 31, 1980).

⁴¹ Ley General de Crédito Rural (General Law on Rural Credit) art. 14, D.O. (Apr. 5, 1976).

⁴² Código Civil para el Distrito Federal, en Materia Común, y para toda la República en Materia Federal (Civil Code for the Federal District in Local Matters and for the Entire Republic in Federal Matters), D.O. (Mar. 29, 1928, as amended) [hereinafter cited as Civil Code].

⁴³ Código de Comercio (Commercial Code) art. 2, D.O. (Oct. 7-13, 1889, as amended) [hereinafter cited as Commercial Code].

⁴⁴ *Id.* arts. 13, 14, 15 (author's translation). Since commerce is a federal matter and since the mentioned Civil Code is applicable to commerce, supplementing the Commerce Code, throughout the country, the reference to the Federal District in the above articles should be interpreted as referring to the entire country.

tions⁴⁵ has more traditional rules governing negotiable instruments.⁴⁶ Such provisions include:

Article 5. Negotiable instruments are those documents necessary to exercise the literal right incorporated therein.

Article 252. Authority to issue negotiable instruments abroad or to execute any of the acts incorporated therein shall be determined in accordance with the law of the place where the instrument is issued or the act is executed.

Mexican law shall govern the capacity of foreigners to issue negotiable instruments or to execute any of the acts incorporated therein, in Mexican territory.

Article 253. The essential conditions for the validity of a negotiable instrument issued abroad or of the acts incorporated therein are determined by the law of the place in which the instrument is issued or the act is celebrated.

Nevertheless, instruments which must be paid in Mexico are valid if they fulfill the requirements prescribed by Mexican law even though they may be irregular under the law of the place where they were issued or where any act was incorporated therein.

Article 254. If it has not been expressly agreed that the act is governed by Mexican law, the obligations and the rights that are derived from the issue of an instrument abroad or of an act incorporated therein, if the instrument must be paid totally or partially in Mexico, will be governed by the law of the place of issue, provided that such law is not contrary to Mexican laws of public order.

Article 255. Instruments guaranteed with a real right over real property located in Mexico shall be governed by Mexican law in all matters related to the security.

From these laws governing loan agreements, one can draw several conclusions regarding choice of law clauses in loan agreements. First, in the loan contract, the choice of Mexican law is the only one recognized. In spite of the choice of foreign law in a contract, in the event of a suit in Mexico involving performance in Mexico, Mexican law will be applied.

Second, in regard to negotiable instruments, the election of Mexican law as the governing law is permitted. If such election is not made, the law of the place of issue will govern. In any case, the law of the place of issue governs the authority of the parties executing the instrument. Even where the application of foreign law is valid, the instrument must qualify as a negotiable instrument under the basic definition of Article 5 that it be a literal, autonomous instrument.

Third, as a practical matter and as a result of the combined efforts of foreign and Mexican counsel to the lender to achieve maximum protection for their common client, the solution which has been reached is to have dual governing law clauses in the loan agreement and in the promissory note, where used. A typical governing law clause is as follows:

This Agreement (Note) shall be deemed to have been executed under

⁴⁵ *Ley General de Títulos y Operaciones de Crédito* (General Law of Negotiable Instruments and Credit Transactions), D.O. (Aug. 27, 1932, as amended) [hereinafter cited as *Law of Negotiable Instruments*].

⁴⁶ *Id.* arts. 5, 252-255 (author's translation).

the laws of the State of North Carolina, United States of America, and for all purposes shall be governed by and construed according to the laws of the State of North Carolina; provided, however, that for any legal action or proceeding brought with respect to this Agreement (Note) in the courts of the United Mexican States or any political subdivision thereof, this Agreement (Note) shall be deemed to have been made under the laws of the United Mexican States and for such purposes shall be construed in accordance with the laws of the United Mexican States.

This solution is based upon practical considerations. An argument may be made that foreign law can be applied to the loan agreement, since the place of performance of important obligations under the agreement, including payment, is abroad. It is easy to have foreign law govern the negotiable instrument, usually a promissory note, by issuing the instrument abroad. However, in most cases, the debtor's property is located in Mexico, and in the event of a default by the debtor in payment, the lender wishes to proceed with collection proceedings as quickly as possible. This means, in most cases, a suit in Mexico on the loan documentation, usually on the promissory note. The procedural advantages of suit on a note and procedures to enforce foreign judgments will be discussed later.

If the loan documentation is governed by foreign law, then the applicable law must be proved.⁴⁷ The debtor may claim that the agreement or the note is invalid under foreign law. Substantial time may be spent in litigating the collateral issue of foreign law, thus delaying progress toward a final judgment on the substantive issue of the collection of the debt.

B. Foreign Judgments

The same considerations that lead lawyers and lenders to prefer their own laws to govern loan documentation also make them feel more comfortable with their own courts. The lender would prefer to sue in the courts of its own jurisdiction, obtain a judgment, and then enforce the foreign judgment in Mexico.⁴⁸

A foreign judgment is enforceable in Mexico only if it meets certain requirements. First, it must be a final judgment, qualifying for enforcement under the laws of the place where it was rendered. Second, the enforcement of the judgment must not be contrary to Mexican law, treaties or principles of international law. Third, the judgment must have been rendered in a personal action in which the defendant was personally served under the requirements of Mexican law. Fourth, if there is no treaty between Mexico and the other country involved regarding the enforcement of foreign judgments, then reciprocity must exist between the

⁴⁷ S. Bayitch & J. Siqueiros, *Conflict of Laws: Mexico and the United States* 229, 230 (1st ed. 1968).

⁴⁸ See *id.* at 232-37 for a more detailed analysis of enforcement of foreign judgments in Mexico.

two countries on the subject. Reciprocity has been held to exist between the United States and Mexico. Finally, the requirements as to authority of the foreign judgment and other procedural requirements must be met.⁴⁹

Even though foreign judgments are enforceable under Mexican law, it is obvious that considerable time can be spent in meeting requirements for their enforcement. If the requirements are met, the debtor may not relitigate the substantive issues involved;⁵⁰ however, the debtor can claim that the requisites for recognition have not been fulfilled. In practice, the defense most frequently presented by debtors is that the debtor was not personally served in accordance with Mexican rules. Even though service on a duly appointed agent for service of process is personal service under Mexican law, considerable time can be required for a final determination of this question, leading to a delay in collection of the indebtedness.

Therefore, the conclusion usually reached by Mexican and foreign counsel to the lender is that where the defaulting borrower's property is located in Mexico, it is best to proceed immediately with an original suit in Mexico based on the loan documentation and not to waste time obtaining a foreign judgment.

C. Jurisdiction of Courts

The jurisdiction of the courts is a matter closely related to the enforcement of judgments. Lenders and their counsel are frequently reluctant to mention submission to Mexican courts for reinforcement of the loan documents. Articles 1092, 1104 and 1105 of the Commercial Code⁵¹ set forth Mexican rules of jurisdiction in commercial matters:

Article 1092. The competent judge is the one to whom the litigants have submitted, expressly or tacitly.

Article 1104. Whatever the nature of the suit, there shall be preferred over any other judge:

- I. That of the place which the debtor has designated to be judicially demanded for payment.
- II. That of the place designated in the contract for performance of the obligation.

Article 1105. If the designation authorized in the foregoing article is not made, the judge of the domicile of the debtor will be competent, whatever the nature of the action filed.

Therefore, if the loan documentation makes no mention of the courts before which actions should be filed or if only the courts of the lender's domicile are indicated, in the event of an original suit in Mexico, the debtor could object to the jurisdiction of the Mexican court based on

⁴⁹ Código de Procedimientos Civiles para el Distrito Federal y Territorios (Code of Civil Procedure for the Federal District and Territories) art. 605, D.O. (Sept. 1-21, 1932) [hereinafter cited as Code of Civil Procedure].

⁵⁰ *Id.* art. 603.

⁵¹ Commercial Code, *supra* note 43, arts. 1092, 1104, 1105 (author's translation).

the arguments that (1) the courts of the lender's domicile have been chosen by the parties, or (2) since the parties did not submit to specific courts, the courts of the place of performance (payment) have jurisdiction. Although it is likely that the lender could eventually have the courts sustain the position that a debtor may always be sued at its domicile, substantial time could be spent in obtaining a final determination of this issue, again delaying collection of the indebtedness.

The solution to this problem is a dual jurisdiction clause. The following is a typical clause used in a promissory note:

For everything related to the interpretation of, compliance with, or judicial request for payment of the obligations herein undertaken, the maker expressly submits to the jurisdiction of the competent courts of Mexico, Federal District, or of the Federal or State courts with jurisdiction over the State of North Carolina, United States of America, at the election of the holder hereof, waiving the jurisdiction of any other domicile.

Jurisdiction clauses in loan agreements are usually more complex although they embody the same principles. They frequently include the appointment by the borrower of an agent for service of process in the foreign jurisdiction. In this case it is important that the agent be properly appointed and accept its designation.

D. Use of Promissory Notes

In short term transactions, it is not unusual for a promissory note to be used as the only documentation. In more complicated operations, however, it is common for the lender to ask whether the loan agreement alone is sufficient documentation or whether, in addition, it is advisable to use promissory notes.

The Mexican Commercial Code provides for an "executory" or summary proceeding in commercial matters.⁵² The documents which qualify for such proceedings include: final judgments and arbitration awards; public notarial instruments; judicial confession of debt; credit instruments, such as promissory notes and bills of exchange, qualifying as such under Mexican law; insurance policies; decisions of experts appointed to determine the amount of loss under insurance policies; and invoices, open accounts and other commercial contracts when signed and judicially acknowledged by the debtor.⁵³

In the case of an unsecured term loan, the appropriate qualifying negotiable instrument would be a promissory note. When the complaint is filed in summary proceedings, accompanied by the appropriate instrument, the judge will issue an order to serve the complaint on the debtor, ordering that payment be made and that property of the debtor be attached if payment is not made.⁵⁴ Attachment proceedings will not be

⁵² Id. art. 1055, II.

⁵³ Id. art. 1391.

⁵⁴ Id. art. 1392.

stayed for any reason.⁵⁵ Relatively short terms are provided for answer by the debtor, presentation of evidence and hearings, rendering of a judgment, and execution.⁵⁶ Defenses are limited, both under the Commercial Code⁵⁷ and the General Law of Negotiable Instruments and Credit Transactions.⁵⁸

Instruments, such as loan agreements, that do not qualify for executory proceedings are enforced through ordinary proceedings,⁵⁹ in which procedural terms are longer and orders of attachment, as a rule, are not issued until final judgment.⁶⁰

A description of applicable code provisions gives the impression that the summary proceedings is extremely expeditious and amounts to almost instant collection. This is not true in practice, however, if the debtor takes advantage of available defenses and delaying tactics. In both summary and ordinary proceedings, attachment may not be executed until after final judgment.

The value of the initial attachment may be limited in the case of a major borrower who is in serious difficulties. The first creditors who act may find property to attach. However, as soon as a creditor finds no property to attach, the result is usually the filing of a petition for bankruptcy or reorganization ("suspension of payments") proceedings, in which case the attachments would be lifted and the nature of the creditors' documentation would be irrelevant.⁶¹ However, in case of a solvent borrower, a promissory note does give procedural advantages.

Certain types of documents qualify as promissory notes under Mexican law. The requirement of literality mentioned above is that the basic right covered by a negotiable instrument should stand on its own and not be made subject to other instruments or outside proof.⁶² In addition, a promissory note should meet the requirements of article 170 of the General Law of Negotiable Instruments and Credit Transactions,⁶³ which states:

The promissory note must contain:

- I. The mention of being a promissory note (*pagare*) inserted in the text of the document.
- II. The unconditional promise to pay a determined sum of money.
- III. The name of the person to whom payment is to be made.
- IV. The date and place of payment.
- V. The date and place of signing.
- VI. The signature of the maker or the person who signs at his request

⁵⁵ Id. art. 1394.

⁵⁶ Id. arts. 1396-1399.

⁵⁷ Id. art. 1403.

⁵⁸ Law of Negotiable Instruments, *supra* note 45, art. 8.

⁵⁹ Commercial Code, *supra* note 43, arts. 1055, 1377.

⁶⁰ Id. arts. 1377-1390.

⁶¹ Ley de Quiebras y Suspensión de Pagos (law of Bankruptcy and Suspension of Payments) art. 128, D.O. (Apr. 20, 1943) [hereinafter cited as Bankruptcy Law].

⁶² Law of Negotiable Instruments, *supra* note 45, art. 5.

⁶³ Id. art. 170 (author's translation).

or in his name.⁶⁴

In recent years, most international loans have been made at a floating interest rate, which is usually a step above a determined bank's prime rate or over the London Interbank Offered Rate for a stated period as quoted by reference banks; therefore, the question has arisen whether a provision for a floating rate in a promissory note affects its qualification as a negotiable instrument, for purposes of summary action.

There are no specific provisions of laws or regulations, nor are there any reported cases on this point. Some lawyers take the position that including a floating rate in a promissory note violates the principle of literality, since the determination of the interest rate requires proof of facts outside of the promissory note. The consensus of lawyers who handle international financial matters is that the inclusion of such provisions does not affect the qualification of a promissory note as a negotiable instrument.

Those attorneys within the consensus argue that stipulation of interest is not an essential provision; therefore, the note meets the requirements for a promissory note. Furthermore, banking custom and practice must be taken into account in the application of out-of-date legal provisions. Finally, in summary proceedings, the judge usually gives an order of attachment for the principal only, the alleged interest due being subject to proof in the proceedings.

Therefore, in practice, promissory notes are often used in international transactions. Such notes contain bilingual English and Spanish texts with one set of signatures. In addition to the legal requirements of the General Law of Negotiable Instruments and Credit Transactions,⁶⁵ the note should also contain interest provisions. In the case of "prime rate," the term should be defined. In the case of the London Interbank Offered Rate, the essential definitions should be set forth in the instrument, including the names of reference banks, interest periods, and business days. Since Mexican law prohibits the collection of interest on interest,⁶⁶ a higher rate of default interest should be provided. There should also be a clause covering the payment of Mexican taxes, as well as a dual choice of law clause, and a dual jurisdiction clause.

IV. Security Interests

In comparison with the Uniform Commercial Code, Mexican legal provisions with regard to the creation of security interests are out-of-date and cumbersome. It is difficult for the foreign lender to understand the time and expense required to achieve a perfected security interest.

⁶⁴ Id. art. 2, III.

⁶⁵ See *supra* text accompanying note 63.

⁶⁶ Commercial Code, *supra* note 43, art. 363.

A. Security Interests in Real Property

Legislation concerning the holding by foreigners of interests in real property is one of the most restricted areas under Mexican law. Article 27 of the Constitution and the laws and regulations enacted and issued thereunder contain these rules.⁶⁷ Foreign corporations may not hold title to real property, except as a result of enforcement of a security interest and except in the case of an authorized branch of a foreign bank.⁶⁸ Foreign individuals may not hold title to real property in the so-called "prohibited zones" located 100 kilometers along the borders and 50 kilometers along the coasts of Mexico.⁶⁹ Outside of the prohibited zones, foreign individuals residing in Mexico, who obtain the required permits, may acquire real property in certain limited situations.⁷⁰

Nonresident foreigners may hold security interests in Mexican real property. The two types of security interests are mortgages and security trusts.

A mortgage must be granted in a public notarial instrument, which must be recorded in the appropriate Public Registry of Property in order to be effective against third parties.⁷¹ As an exception to the rule that foreign corporations cannot hold title to real property,⁷² in the event of foreclosure of a mortgage, a permit can be obtained for the mortgagee to acquire title of mortgaged property for a limited period of time, usually one or two years.⁷³

Under a security trust, a Mexican bank, as trustee, acquires title to real property which it holds in trust to guarantee indebtedness owed to a lender, who is the beneficiary of the trust. Under banking requirements and the terms of the applicable permit, in the event of a default under the secured obligation, the trustee must sell the property under the rules set forth in the trust to a qualified buyer. A foreign lender beneficiary could not acquire title. The trustee bank requires permits from the Ministry of Foreign Relations⁷⁴ and from Banco de México, S.A.,⁷⁵ to set up a security trust over real property, which would have to be executed in a public notarial instrument.

⁶⁷ Mexican Constitution, note 14 *supra* (as amended); *Ley Orgánica de la fracción I de del artículo 27 de la constitución general* (Organic Law of the Constitution, art. 27, I), D.O. (Jan. 21, 1926); *Reglamento Ley Orgánica* (Regulations to the Organic Law) art. 27, D.O. (Mar. 29, 1926).

⁶⁸ Mexican Constitution, *supra* note 14, art. 27.

⁶⁹ *Id.*

⁷⁰ *Reglamento Ley General de Población* (Regulations to the General Population Law) art. 127, D.O. (May 3, 1962).

⁷¹ Code of Civil Procedure, *supra* note 49, art. 494.

⁷² General Population Law, *supra* note 25, art. 66.

⁷³ *Ley Orgánica de la Constitución* (Organic Law of the Constitution) arts. 6, 27, D.O. (Jan. 21, 1926).

⁷⁴ Decreto (Decree) de Junio 29, 1944, D.O. (July 7, 1944).

⁷⁵ Banking Law, *supra* note 3, art. 94 bis 2.

B. Security Interests in Personal Property

Mexican laws concerning the creation of security interests in personal property have not been brought up to date with commercial practices. A foreign lender who is accustomed to the Uniform Commercial Code finds it difficult to understand the frequently cumbersome requirements for creating a valid security interest in personal property located in Mexico, which under Mexican conflicts rules must be governed by Mexican law.⁷⁶

Except in the case of aircraft and ships, chattel mortgages are not recognized under Mexican law; therefore, the basic security interest is a pledge. There is an exception to this principle in that furnishings located in real property may be mortgaged with the real property, when the mortgagee is the owner of both.⁷⁷ In commercial matters, the requirements for creating a pledge are set forth in article 334 of the General Law of Negotiable Instruments and Credit Transactions,⁷⁸ and they include (1) delivery of the pledged property or bearer instruments to the pledgee; (2) endorsement of order or registered negotiable instruments to the pledgee, and a notation of the pledge in the respective registry, where appropriate; (3) in the case of non-negotiable credits, such as open account receivables, assignment and delivery of the document covering the credit, with notification of the account debtor; (4) delivery of the property to a third party, at the disposition of the pledgee; (5) deposit of the property in premises, the keys to which are delivered to the pledgee; (6) the delivery, and endorsement where necessary, of warehouse receipts to the pledgee and (7) recording of fixed asset financing contracts (*contractos de credito refaccionario*) and current assets financing contracts (*contractos de habilitacion y avio*) in the terms of article 326 of the Law.⁷⁹

Therefore, the creation of a pledge lien requires either delivery to the pledgee of the pledged property, notice to the account debtor in the case of receivables, or recording in the case of the two types of contracts mentioned. The practical problems of having a security interest in a large number of relatively small open account receivables are almost insurmountable, since it can be difficult and costly to notify a large number of account debtors in the manner provided by law. The only types of pledge liens that can be created by recording are those under the two types of contracts mentioned, which have very limited purposes and requirements. It is not possible to record any other type of pledge. Since there is no chattel mortgage in Mexico, except in the case of aircraft and ships, there are many situations in which it is impossible to obtain a security interest in fixed assets.

Although there are restrictions on various types of ownership of

⁷⁶ Code of Civil Procedure, *supra* note 49, art. 14.

⁷⁷ Civil Code, *supra* note 42, art. 2898.

⁷⁸ Law of Negotiable Instruments, *supra* note 45, art. 334.

⁷⁹ *Id.* art. 326.

stock in Mexican corporations by aliens, foreign lenders can have a pledge lien on stock, even where they could not hold title. Such pledges must be registered in the National Foreign Investments Registry.⁸⁰ This registration is required in order that the foreign investment authorities can determine that the pledge arrangement is not a subterfuge to get around restrictions on foreign ownership of the stock.

Mexican law does provide for a conditional sales contract (*contrato de compraventa con reserva de dominio*) which, in essence, is a security device. Under a conditional sales contract, the seller retains title to the item sold until payment of the purchase price is made.⁸¹ A similar arrangement is the sales contract, subject to the condition subsequent that the seller can recover the property if payment is not made (*contrato de compraventa sujeto a condicion resolutoria*).⁸² In order for these contracts to be effective against third parties, the items covered must be individually identifiable (by serial numbers, for example) and the contracts must be recorded in the appropriate Public Registry of Property.⁸³ These contracts are usually used when a seller is financing a buyer's purchase of equipment.

Under provisions of the Banking Law,⁸⁴ Mexican banks enjoy greater flexibility than other lenders in the creation of security interests. Under an industrial mortgage loan, a Mexican institution can have a floating lien on practically all assets of the borrower.⁸⁵ A Mexican bank can hold a lien on financed consumer goods by merely holding the invoice;⁸⁶ and in some circumstances can have a lien on open account receivables without the need of notifying the account debtor.⁸⁷

V. Preferences in Bankruptcy

Finally, a reference will be made to preferences under Mexican bankruptcy legislation, since this is always an area of concern to foreign lenders. The so-called Mexican banking preference was repealed in 1978.⁸⁸ Previously, unsecured loans by Mexican banks had a preference over other unsecured loans. They are now on equal footing.

The order in which the assets of the bankrupt are distributed at the end of the proceedings may be summarized as follows: first, accrued wages and severance pay of workers and employees; second, the expenses of the proceedings; third, certain tax liens; fourth, secured debts up to the

⁸⁰ Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera (Law to Promote Mexican Investment and Regulate Foreign Investment) art. 23, IV, D.O. (Mar. 9, 1973).

⁸¹ Civil Code, supra note 42, art. 2312.

⁸² Id. art. 2310.

⁸³ Id. arts. 2310, 2312.

⁸⁴ Banking Law, supra note 3.

⁸⁵ Id. art. 124.

⁸⁶ Id. art. 111.

⁸⁷ Law of Negotiable Instruments, supra note 45, arts. 288, 290.

⁸⁸ Banking Law, supra note 3, art. 109 (repealed Dec. 26, 1978).

value of the security; and fifth, unsecured debts.⁸⁹

Claims of workers and employees are absolutely the first priority, and they are not obligated to go into the bankruptcy proceedings in order to collect them.⁹⁰ They may proceed directly and immediately against property of the debtor without awaiting the outcome of the proceedings. This preference frequently negates the value of a mortgage on an industrial plant which has a large number of workers and employees. Secured creditors must await the outcome of the proceeding before realizing the value of the property subject to their liens, if property is left after satisfying prior preferences.

Mexican law also provides for reorganization proceedings, referred to as suspension of payments (*suspension de pagos*). When a debtor becomes aware that a cause for its bankruptcy exists, it may immediately initiate suspension of payments proceedings before the appropriate court.⁹¹ All pending suits must be joined to the suspension of payments proceedings, and creditors are prohibited from proceeding against the debtor.⁹² Creditors must prove their claims, and an attempt is generally made by the trustee to work out a program of restructuring and repayment of indebtedness.⁹³ If a plan is approved by the creditors, the suspension of payments is lifted. If a plan is not approved, then the debtor is placed in bankruptcy.⁹⁴

Bankruptcy and suspension of payments proceedings are slow, time-consuming, and expensive and provide unscrupulous debtors with what appear to the creditors to be almost endless delays in ultimate collection. There is a need for a more streamlined and effective law.

VI. Conclusion

The presentation of the legal aspects of any subject involves the danger of giving a negative impression, since lawyers must give attention to the resolution of problems. Among borrowing countries, Mexico is obviously one of the favorites of foreign lenders, who have determined that the potential problems can be solved and, to a large extent, are outweighed by the advantages. By using some of the practical suggestions outlined in this article, potential lenders and their counsel should be able to conduct their financial affairs in Mexico in a manner mutually advantageous to both the foreign lender and the Mexican authorities.

⁸⁹ Bankruptcy Law, *supra* note 61, arts. 261-264.

⁹⁰ Ley Federal de Trabajo (Federal Work Law) art. 114, D.O. (Apr. 1, 1970).

⁹¹ Bankruptcy Law, *supra* note 61, art. 394.

⁹² *Id.* art. 409.

⁹³ *Id.* art. 418.

⁹⁴ *Id.* art. 419.