

1998

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Recommended Citation

Charles A. Beckham & Roberto Fernandez, *Cross-Border Insolvency: The Bridge You Never Want to Cross*, 4 LAW & BUS. REV. AM. 50 (1998)
<https://scholar.smu.edu/lbra/vol4/iss1/5>

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Cross-Border Insolvency: The Bridge You Never Want to Cross

Charles A. Beckham, Jr. and Roberto Fernandez***

I. Introduction.

A trip across the border, for U. S. and Mexican citizens alike, is often a pleasurable experience. The ability to do business across borders has become a profitable experience for many businesses. Increasingly, however, many businesses in the United States and Mexico are finding their venture to a foreign land to be an adventure of many perils. They are finding the pitfalls of cross-border insolvency have created a bridge they do not want to cross.

Just like any other business, businesses taking advantage of the expanding U. S./Mexico market can and do suffer from insolvency problems. When bi-national companies have solvency problems, other companies doing business with them encounter not only the exigencies of ordinary collection problems and bankruptcy, including when and how much they will get paid, but also cross-border issues that the United States and Mexico are far from considering or solving. This article will attempt to identify some of the most common problems encountered in cross-border insolvencies.

II. Down Mexico Way, The Law South of the Border.

Like the United States, Mexico is a union of states with a constitution and federal and state laws. Mexico has a court system that parallels the United States with some notable exceptions and has a great body of law controlling all manner of commercial transactions. Parties extending credit and doing business in Mexico must realize that in attempting to document and secure transactions in Mexico, they must comply with Mexican Civil Law, which is based upon the Napoleonic Code rather than the English common law and is substantially different from laws in the United States. Moreover, the familiar and comfortable Uniform Commercial Code is not part of Mexican jurisprudence.

A. MEXICAN JUDICIAL STRUCTURE AND PROCEDURAL LAW.

Essentially, the Mexican court system is structured in a very similar manner to the courts in the United States. In Mexico, there are both state and federal courts. In both state and federal courts, there are first level courts and courts of appeal. One essential dif-

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ference between the court system of Mexico and that of the United States, is a special procedure called the "amparo" proceeding. In essence, the amparo is a judicial action granted as a defense against violations of Constitutional civil rights. These proceedings are conducted before federal courts.

Civil and commercial cases will typically be resolved in a first level court. The resolution by the first level court is subject to an appeal to be resolved by the appellate courts. The decision of the court of appeals is then subject to an amparo proceeding review. The amparo proceeding review determines whether the court of appeals violated the constitutional civil rights of the defeated party under Articles 14 and 16 of the Mexican Constitution.¹ Articles 14 and 16 of the Mexican Constitution guarantee that all courts shall resolve the cases presented to them pursuant to the letter of the law or its due legal interpretation.² The amparo proceeding review, for all practical purposes, serves as a second appellate procedure.³

1. *A Little Procedure.*

There are many similarities and differences to consider between the Mexican procedural system and the U. S. system. The following points reflect the main differences and similarities.

Judicial procedures are conducted in writing, forming a judicial docket. The first document of the judicial docket is the plaintiff's petition. The plaintiff's petition must state precisely what relief is claimed from the defendant, and the facts of the case that lead to the relief claimed. After service, the defendant must answer each paragraph of the petition and respond to the facts as described by the plaintiff. Further, the answer must establish, if necessary, additional facts on which the defense may rely. The differences in the facts of the case and in the application of the law asserted in the initial petition and the answer constitute the "litis" or disputed issues of the case. At this point, the plaintiff's petition and the defendant's answer to the claim may not be subsequently modified or amended in any way. The case is then open for evidence. Depending on the type of procedure, the evidence period may be anywhere between fifteen and forty working days. During this time, the parties must offer and present the evidence to prove the facts of the case as contained in the initial petition or the answer, respectively.

The rules of evidence are very rigid in many ways. For example, copies of documents are not valid in court if they are not recognized expressly by the opposing party; the interrogation of witnesses must be conducted through approved questions, which must be directly related to the disputed facts of the case; the deposition of the parties is subject to a questionnaire that must be drafted in an affirmative manner (open questioning between the parties is not allowed), i.e., a question to a party must be stated affirmatively by stating "that on the 15th of May 1995, you executed the purchase and sale agreement which is the basis of this litigation," so that the party may answer yes or no, allowing the answering party to expand on his or her response to clarify the answer. Expert witnesses reports are filed in writing and must be drafted as answers to questions posed by the party offering the

1. See MEX. CONST. arts. 14, 16.

2. *Id.*

3. *Id.*

evidence. Procedural law does not provide a pre-trial discovery period since the plaintiff should know exactly the facts upon which the claim is based at the time the petition is filed. Once the evidence period is concluded, written final arguments of the parties may be presented and thereafter, a judgment is rendered by the judge. Civil and commercial cases are not heard by a jury, but are reviewed and resolved by judges. Theoretically, the civil procedures are fast and expeditious, but in practice there are many ways to suspend and delay proceedings. Consequently, cases may continue for lengthy periods of time before final resolution.

2. *A Little Evidence.*

After briefly analyzing the Mexican civil procedure, you may understand why it is necessary to have any type of transaction, civil or commercial, properly documented. One of the most common mistakes incurred by U. S. nationals doing business in Mexico is the failure to properly document the transaction. This requirement in no way means that there is a need for a complicated agreement. It is essential, however, to have an original document executed by the parties containing the essence of the transaction. Always maintain signed original contracts and communications since a photocopy or a fax copy may not be admissible as evidence in a Mexican court. Maintenance of executed original documents avoids procedural problems concerning the presentment of evidence before the Mexican courts.

Another common error in documenting a transaction is the manner in which the statement of an account is made. Normally, pursuant to United States law, an affidavit of the creditor stating the amount owed to him is proper evidence. In Mexico, however, such a document would be considered invalid since it was unilaterally produced by the party offering such evidence. Consequently, it is helpful to have a document executed by the debtor expressly recognizing and acknowledging the debt. For ongoing commercial relations, it is also helpful to have periodic statements of accounts executed by the parties. The documents would be acceptable evidence in a Mexican court.

B. UNITED STATES/MEXICO COMMERCIAL TRANSACTIONS.

Doing business in Mexico may turn out to be an extremely lucrative enterprise or may become a most deceptive economic experience. Success or failure is the result of many diverse factors, some of which are controllable by the parties. Such factors include the quality of products, choice of business counterparts, commercial terms of a transaction and compliance guarantees. Other external factors that are outside the parties' control include changing government economic policies, devaluation of the peso in relation to the dollar, high interest rates, and changing tax laws and policies. Regardless of whether the factors are controllable or uncontrollable, there is always the risk of business failure and insolvency problems in all trading and lending transactions.

Doing business in Mexico or conducting business with Mexican individuals or entities should not be considered an impossible task. Commerce has flourished for thousands of years between nations and people of different races, cultures, religions, and economic structures. In many of those instances the differences were much greater than those existing between Mexico and the United States. Although Mexicans and Americans have different customs, language, beliefs, values, and generally, a different culture, understanding how

business is conducted in the United States and Mexico is not a matter of being bilingual. It is a matter of understanding the essential elements needed to guarantee the success of an enterprise.

Within the legal profession, particularly in litigation, an attorney is involved with those transactions that were not successful. The main reason a U.S. party is unsuccessful in collecting monies or enforcing other contractual obligations against their Mexican counterpart is the improper documentation of the commercial transaction and the obligations derived therein.

Time after time we encounter situations in which a U.S. party doing business in Mexico goes to the extreme of trying to conduct a transaction exactly in the same manner as a domestic transaction in the United States. At the other extreme, the U.S. party completely relaxes its normal standards claiming "it is not the way to do business in Mexico." The proper documentation of commercial transactions and guarantees of the obligations contained therein is essential to successfully conducting business in Mexico, particularly when the Mexican counterpart does not voluntarily comply with its contractual obligations. There are various methods to preserve and protect a creditor's rights and secure a monetary obligation from a Mexican debtor. These methods are described below.

1. *Letter of Credit. (Carta de Credito).*

The letter of credit is widely used in international sale transactions. Essentially, a Mexican banking institution assumes the payment obligation to the creditor when the conditions set forth in the letter of credit have been met, typically, when the bill of lading of the sold merchandise is presented.

The letter of credit is also usually confirmed by a U.S. banking institution whereby the United States bank jointly assumes the payment obligation under the letter of credit. The U.S. creditor presents the original letter of credit to the confirming U.S. bank, complying with all conditions set forth in the letter of credit to draw upon the letter of credit. The letter of credit may be issued for one specific transaction, or in the case of a stand-by letter of credit, in an on-going commercial relationship. The General Law for Title Documentation and Credit Operations applies to the letter of credit transactions. It describes the basic requirements for a letter of credit and the remedies upon default.⁴

2. *Documented Debt.*

It is very convenient that a payment obligation, besides being contained on a contractual document, be documented by a negotiable instrument such as a promissory note (*pagaré*). Typically, for international purposes, promissory notes are prepared in English and Spanish versions, within the same document. Promissory notes, to be collected in Mexico, should be prepared in a simple form stating the following: (1) that it is a promissory note; (2) there is an unconditional promise of payment of a fixed amount of money; (3) the name of the person to whom payment should be made; (4) the time and place of payment; (5) the date and place where the document is executed; (6) the signature of the maker; and, (7) if applicable, the signature of the guarantors. Due to the nature and the

4. Humberto Gayou & Robert G. Gilbert, *Legal Building Blocks for Structuring Sales in the Mexican Market*, 25 ST. MARY'S L. J. 1115, 1130 (1994).

procedural benefits of the promissory note, it is best that it contain only the essential elements above. A lengthy and complicated wording may only give grounds for the borrower to use it as an element of his defense or delay prosecution of the case.

In Mexico, there are three basic procedural advantages of filing a claim based on a promissory note. The first is that the creditor may attach assets belonging to the defendant at the time of service. Mexican law allows a creditor to place a lien on property belonging to the borrower before a judgment is rendered, with no further requirements.

A second advantage concerns the burden of proof. A promissory note, or any negotiable instrument, constitutes *prima facie* evidence that the monies are owed to the creditor. Consequently, the lender is not required to prove that the monies are owed to him, rather, the borrower would have to prove that he does not owe the money.

The third advantage is that the defendant may only assert limited defenses in court, as prescribed by Article 8 of the General Law on Negotiable Instruments and Credit Operations (*Ley de Títulos y Operaciones de Crédito*). In essence, the defenses refer to lack of jurisdiction or representation of the plaintiff or the signatory; not meeting the requirements of a negotiable instrument; partial payment; statute of limitations; and personal defenses.

It is important to understand that there would not be any specific payment guarantee by the sole issuance or execution of a promissory note. Any specific guarantee would only be established at the time of service of the claim, in the event of default. Therefore, such lien would have preference over future liens, but not over previously established liens on the property belonging to the defendant following the principle of "first in time, first in right."

3. Mortgage Guarantee (*Hipoteca*).

Typically, a mortgage guarantee is placed over real property to guarantee the performance of a contractual obligation. A mortgage is considered an *in rem* guarantee, which means that the real property itself is the payment guarantee of the obligation. Consequently, if such real property is later transferred to a new owner, the real property will continue to guarantee the payment obligations as set forth in the mortgage deed.

A mortgage needs to be established through a Public Deed issued by a Notary Public (*Notario Público*) in Mexico. It should be recorded in the Public Registry of Property of the state where the mortgaged real property is located. Once the mortgage is established, the creditor will be secured before any other creditors, with some exceptions, up to the value of the mortgaged property. In the event of bankruptcy, the creditor will hold its preferential rights and may foreclose on the property separately from the bankruptcy procedure. The only preferential creditors with priority over a mortgage guarantee will be any previous lien holder of the property and certain labor claims.

In order to establish the mortgage guarantee, it is necessary for a notary public to issue a public deed containing the mortgage guarantee. This may result in a number of costs, including notarial fees, local taxes, and registration fees. The cost involved varies depending on the state where the mortgaged real property is located.

4. Pledge Guarantee (*Prenda*).

A pledge is also considered an *in rem* guarantee. Consequently, the pledged goods serve as collateral for the performance of an economic obligation, notwithstanding the future owner of the pledged goods. In commercial transactions, the pledge is perfected

when the goods are delivered to the creditor or deposited with a person appointed by the parties, by the proper endorsement of the negotiable instrument, when applicable, or the delivery of the documents pertaining to the pledged goods.

This type of guarantee has the inconvenience that if the pledged goods are delivered to the creditor, they may not be used by the debtor. If the pledged goods are deposited with a third party, allowing the pledged goods to be used by the debtor, the goods are frequently not found at the time of default and foreclosure. The pledge guarantee should be recorded with the Public Registry of Commerce where the goods are located, so that the pledge may have legal effects before any third party.

It is essential to understand that even if a security interest has been properly granted in the United States, if the assets are being used in Mexico, the security interest must be prepared in accordance with Mexican law and recorded with the Public Registry of Commerce where the assets are located. Recordation with the Public Registry of Commerce assures the preferential rights with respect to third-party creditors. In addition, it serves as general notice that the assets belong to the entity or individual who holds title to them, and thus, do not necessarily belong to the individual or entity that uses those assets within Mexico.

In many cross-border transactions, a U.S. banking institution grants a loan to a U.S. corporation which has a Mexican subsidiary operating in Mexico. To secure the loan, the borrower grants a security interest in the equipment, inventory, and accounts receivables of the U.S. corporation. The U.S. corporation will allow the Mexican subsidiary to use the equipment and inventory to manufacture products in Mexico. To the extent the pledged assets are located in Mexico, the rights and priorities of the lender will not be protected unless the security interest has been granted in compliance with Mexican law and properly recorded. Further, if a Mexican user of the pledged assets has any creditors, including labor claims, the recording of the pledge guarantee with the Public Registry of Commerce will serve as evidence that the pledged assets do not belong to the Mexican user of the goods. Therefore, the pledged assets should not be subject to any attachment by any creditor of the Mexican user.

5. *Bond (Fianza).*

Contractual obligations may be guaranteed through a bond, issued by a Mexican bonding institution. Mexican bonding institutions only operate in Mexico and are licensed by the Mexican government. Bonding institutions are not allowed to issue bonds to guarantee payment of a loan unless specific authorization is obtained from the Mexican Treasury Department. Nevertheless, many bonding institutions issue bonds to guarantee obligations under a commercial transaction which does not appear to directly guarantee a payment obligation. An example of a proper use of a bond is to guarantee the return of equipment leased and used in Mexico.

It is extremely important to review the terms of the bond, so that in the event of non-performance it may be enforced through the Mexican courts. Unfortunately, the theory that a bond, issued by a Mexican bonding institution, assures recovery does not always apply. In reality, a bond claim may become the subject matter of lengthy litigation with no guaranteed results.

6. Personal Guarantee (Aval).

Another important aspect to take into account while conducting business in Mexico is to consider obtaining the personal guarantee of the owners of the Mexican enterprise. Time after time we find poor companies and rich owners. If the contractual obligations are assumed by the Mexican company, it is essential to review and confirm the financial situation of such company. It is not good practice to merely rely upon what you may believe to be a solvent company, just to find out that the company has no assets to guarantee payment to its creditors.

7. Other Security Contracts.

Various other means of securing liens on personal property exist including the conditional sale contract (*venta con cláusula rescisoria*) and title retention contract (*venta con reserva de dominio*). While the conditional sales contract appears to be similar to an unsecured financing contract, the title retention contract is similar to a secured financing contract. In a title retention contract, the title remains with the seller until full payment has been made. Title of retention contracts must be recorded with the Public Registry of Property where the buyer is domiciled to be valid.

C. A LITTLE LABOR LAW: LABOR PREFERENTIAL RIGHTS.

The Mexican legal system is extremely protective of the rights of workers. In the event of a company's insolvency, labor claims are preferred over any other claim or right of any third party including secured creditors. Article 113 of the Federal Labor Law of Mexico provides that the salaries earned during the last year and the owed indemnity to the workers have preference over any other creditor, including those who enjoy in rem, guarantees, taxes and those in favor of the Mexican Social Security Institute, over all assets of the employer.⁵

There are several issues that must be considered regarding these short but strong legal provisions, the most significant of which are as follows:

(a) The preferential rights exist concerning earned and unearned salaries for the year immediately preceding the insolvency or business failure. If the salaries of the workers were paid, obviously there is no subject matter to the labor preference. The preference is established only for salaries, and not other benefits such as extra hours, vacation payments, Christmas bonuses, etc.

(b) The "indemnity" are severance payments that workers are entitled to receive when a labor relationship concludes on grounds imputable to the employer. The severance payment consists of three months salary plus an amount equivalent to twelve days of pay for each year of service. The years of service benefit is computed at the maximum amount of two times the minimum salary applicable in the location where the worker rendered his or her services. There could also be an additional benefit for the workers equivalent to twenty days pay for each year of service, computed at the amount of the last salary, with no maximum limit. In our opinion this twenty days pay per year of service should not be included in the indemnity amount for purposes of the preferential rights as prescribed by Article 113 of the Mexican Federal Labor Law.⁶ Nevertheless, a contrary view considers the twen-

5. L.F.T. art. 113.

6. *Id.*

ty days pay per year of service as part of the indemnity for purposes of the labor preferential rights. There is no case law available on the subject.

(c) The preferential rights are superior to the rights of any and all creditors of the employer, and any and all assets of the employer are subject to the preferential rights. For example, if a business closes its doors and ceases operation, the workers enjoy the preferential rights to collect the labor benefits described above, notwithstanding that there is a creditor (i.e., a Mexican or foreign banking institution) holding a mortgage guarantee on the real property belonging to the employer. This situation needs to be taken into account when analyzing a credit risk since a creditor may be holding a mortgage guarantee in first place over certain real property, thinking that the credit is well protected, when in reality there could be a potential and substantial labor risk.

The labor preference affects the assets belonging to the employer. To close the risk to the assets, some employers lease real property, equipment and machinery from a third party. Consequently, if in operation an employer is using assets belonging to the third party, the assets should not be subject to any lien for a credit, preferred or not, against the employer. To preserve these rights, it is necessary to have proper evidence to show that the assets being used or in the possession of an employer do not belong to it.

(d) One last comment is based on the fact that the preferential rights are granted when they are based on obligations derived from a labor relationship. It may be possible that concerning a labor claim, as a manner of settlement of the claim, a settlement agreement may be executed. If in the settlement agreement a third party agrees to be jointly responsible for the obligations of the employer, and thereafter the payment obligations in favor of the workers are not paid, the workers may then execute the settlement agreement against both the employer and the jointly liable third party. In our opinion, the workers claim enforced on assets belonging to the jointly liable third party do not have the preferential rights discussed in this section, taking into account that the third party's obligations derive from a contractual source, and did not originate, in themselves, from a labor relationship between the workers and said third-party, even when the enforcement is being procured by the labor authorities and based on a labor case.

D. DEFAULT.

In the event of default by a Mexican debtor, creditors must turn to the Mexican courts. There is no self-help in Mexico or non-judicial foreclosure. To enforce creditor's rights in Mexico through litigation, it will be necessary to retain Mexican counsel. If the transaction has been properly documented and records have been properly maintained, the pursuit of a Mexican debtor through the Mexican courts should be no more painful than the process encountered in the United States.

E. BANKRUPTCY LAW SOUTH OF THE RIO BRAVO.

There are two types of bankruptcy proceedings available in Mexico: the liquidation proceeding and the suspension of payments proceeding. This section will provide an overview of both proceedings, and compare them to their counterparts under the U.S. Bankruptcy Code.

1. An Overview.

The overall concepts and many specific provisions of the Mexican liquidation and suspension of payments proceedings are similar to those of Chapter 7 and Chapter 11 of the U.S. Bankruptcy Code.⁷ Due to the age and history of the Mexican law, however, many of the law's provisions and its application will seem (appropriately) foreign to the United States bankruptcy practitioner.

Commentators have noted the Mexican bankruptcy law contains many ambiguities and has been subjected to inconsistent interpretations by the courts.⁸ Serious studies on reform have been undertaken by the Mexican Bar Association and other groups in Mexico. Authorities of commerce in Mexico are working on revisions to the bankruptcy law.

The Mexican liquidation and suspension of payments proceedings have not been utilized to the extent of their American counterparts. In fact, historically few businesses voluntarily filed bankruptcy or suspension of payments proceedings. This circumstance is not surprising, since criminal penalties and jail time often awaited the debtor and its officers. In addition to the low number of filings, there are few successful reorganizations. It has been estimated that in the last twenty years less than thirty businesses have emerged as operating businesses after a suspension of payments proceedings. Often, suspension of payments proceedings result in liquidation proceedings or with all of the debtor's assets being sold to a third party. Further, there are few lawyers in Mexico who are bankruptcy specialists.⁹ Bankruptcy filings have increased over the past ten years, however, and with the December 1994 Peso devaluation and its havoc on the Mexican business and banking community, and the efforts toward reform, this trend is likely to continue.

2. Governing Law.

Business bankruptcies (for individuals in business and corporations) are governed primarily by the Law of Bankruptcy and Suspension of Payments (*Ley de Quiebras y Suspensión de Pagos*).¹⁰ The L.Q.S.P. is a Federal law, enacted in 1943 and published in the Federal Register. The L.Q.S.P. has been amended only once since its inception, and that modification was not substantial.¹¹ The authorities of commerce in Mexico are working on new legislation to revise the L.Q.S.P.¹²

Individual nonbusiness proceedings (*concurso*) are governed by the law of the state in which the individual is domiciled.¹³ Little is written on the state laws for a concurso.

7. See generally 11 U.S.C. chs. 7, 11 (1994).

8. See RICHARD A. GITLIN & RONA R. MEARS, INTERNATIONAL LOAN WORKOUTS AND BANKRUPTCIES 531 (1989).

9. See AGUSTIN BERDEJA-PRieto, DEBT COLLATERALIZATION AND BUSINESS INSOLVENCY: A REVIEW OF THE MEXICAN LEGAL SYSTEM (3rd Nat'l Inst. on Multinational Commercial Insolvency, 1993).

10. See generally *Ley de Quiebras y Suspensión de Pagos* [hereinafter the "L.Q.S.P."].

11. BERDEJA-PRieto, *supra* note 9, at O-2. The L.Q.S.P. translated into English can be found in ANDREA BONIME-BLANC & WILLIAM E. MOOZ, DOING BUSINESS IN MEXICO app. 8 (1994).

12. Law of Restructuring of Indebtedness of Business Merchants, Note, May 5, 1995.

13. *Id.*

State and federal courts share jurisdiction over bankruptcy proceedings.¹⁴ There are no *per se* bankruptcy courts, however, there are certain judges in Mexico City with special expertise in the laws of bankruptcy, and practitioners may tend to file cases with these judges.

3. *Bankruptcy (Liquidation) Proceedings.*

Bankruptcy (liquidation) proceedings have much in common with Chapter 7 cases under the U.S. Bankruptcy Code. Many of the rules that follow are applicable to both bankruptcy proceedings and suspension of payments proceedings.

A bankruptcy proceeding may be commenced by the debtor, any creditor, or the local or federal attorney general.¹⁵ The debtor must allege in a voluntary case that it has ceased paying its obligations. If a creditor petitions the court for an involuntary proceeding, it must prove the debtor falls in any one of three categories, the most important being that the debtor has ceased paying its obligations. The debtor can contest an involuntary proceeding by filing an objection within five days of the petition.¹⁶

If the court accepts the proceeding, it will notify the debtor, the attorney general, the intervenor, the creditors, and publish notice of the bankruptcy in the local newspaper on three occasions. A bankruptcy trustee (*síndico*), acting as an auxiliary to the department of justice, is then appointed by the court. The trustee's duties include the following: taking possession of the company and the assets of the debtor; preparing inventories of the debtor's assets; preparing or rectifying a balance statement; examining the books, records, and documents of the company; depositing and, when appropriate, making payments on behalf of the debtor; preparing a detailed report for the court on the business; and establishing the provisional list of privileged and ordinary creditors.¹⁷

Once the proceeding is accepted, most property of the debtor becomes the bankruptcy estate to be administered by the trustee. The trustee can continue to operate the debtor's business or proceed with liquidation.

a. *Creditor Participation and Claims.*

Creditors whose addresses are known are notified of the proceedings in writing.¹⁸ In addition, the trustee publishes notice in the Federal Register and in a major newspaper in the place where the proceeding is commenced.¹⁹ Creditors are deemed to have received notice after the last publication.²⁰

Creditors must file claims within the time set by the court in the bankruptcy declaration which is typically forty-five days from the date of the last notice of bankruptcy published in the newspaper. Claims are asserted by written petition as in any other lawsuit. The claims must be supported by original documentation, including a translation if necessary. Claim

14. *Id.*

15. Thomas S. Heather, *Mexico's Bankruptcy and Suspension of Payments Law*, 671 PLI/COMM 121 (1993).

16. GITLIN & MEARS, *supra* note 8, at 538.

17. BERDEJA-PRIETO, *supra* note 9, at O-11.

18. *Id.* at O-13.

19. *Id.*

20. *Id.*

petitions must include the name and address of the creditor, a short statement of the factual and legal basis for the claim, the amount, and the asserted priority. An intervenor is appointed to represent and look out for the interests of the creditors. The trustee and the intervenor review the filed claims, and then the trustee submits to the court a provisional list of creditors. Each claim is reviewed as to the amount, priority, and sufficiency of documentation. The judge convenes a creditors' meeting, at which time the creditors vote to approve the intervenor and whether to approve certain agreements. At the meeting of creditors, the claims are conclusively set unless the claim is referred to the court for resolution.

b. Priorities.

The property of the debtor is distributed to creditors subject to the following priorities:

- (1) "Singularly privileged creditors." This class includes costs of administering the bankruptcy estate, and labor claims given preference under article 113 of the Constitution and the Federal Labor Law for accrued wages during the past year and severance pay.²¹
- (2) Properly perfected secured creditors with respect to the collateral. Secured creditors can recover their debt from the collateral, and in some circumstances may proceed to enforce their lien outside of the bankruptcy, i.e. by filing or proceeding with a foreclosure suit in another court. Secured creditors with competing liens are ranked by the time they recorded the lien.
- (3) Federal taxes. The amount owing on these taxes are determined by the taxing authority, not the court in which the bankruptcy is pending.
- (4) Creditors with special privileges. This class includes commission agents, merchandise vendors, and carriers.
- (5) Common creditors due to business transactions.
- (6) Civil law common creditors (non-business related debts that arise out of the Civil Code, mainly those relating to individuals).²²

Expenses of administration are always paid in full. Creditors may lose their priority status if they do not timely file or properly document their claim.

c. Effects of the Declaration of Bankruptcy.

Once the bankruptcy proceeding is declared, most property becomes part of the bankruptcy estate (*masa*). Certain property is excluded from the *masa*, such as property not legally attachable and post-bankruptcy personal earnings. Under the L.Q.S.P., certain types of fraudulent or preferential transfers can be set aside. Generally, actions taken by the debtor to defraud creditors can be voided if the third party knew of the fraud. Further, the court can declare the bankruptcy proceeding retroactive to a certain date, and certain acts occurring after the retroactive date are void. Typically, the retroactive date is fixed at six months prior to the bankruptcy filing.²³

Once the bankruptcy is filed, most actions against the debtor or its assets must be taken through the bankruptcy court. This provision is similar to the automatic stay under

21. See L.F.T. art. 113.

22. BERDEJA-PRieto, *supra* note 9, at 0-13.

23. *Id.* at 0-12.

the United States Bankruptcy Code; however, the Mexican counterpart is not as broad. Under the Mexican law, commercial creditors may continue mortgage foreclosure actions pending in other courts. Additionally, laborers and taxing authorities may continue to pursue their claims outside of the bankruptcy proceeding.

The bankruptcy filing has other consequences, many of which will be familiar to the U.S. bankruptcy practitioner. For example, interest stops accruing on all debts except those that are secured, and then only to the value of the collateral. Also, debtors must declare their intentions regarding executing contracts.

d. Discharge and Criminal Ramifications.

The bankruptcy proceeding may be concluded by: (1) payment to the creditors in part or in full through liquidation of assets; (2) a determination that there are not sufficient assets to pay expenses of administration; or, (3) by unanimous consent or agreement of the creditors. The debtor apparently receives a discharge of its debts upon conclusion of the proceeding.

Bankruptcies are classified as fortuitous, culpable, or fraudulent. A fortuitous bankruptcy is generally one in which the business was properly managed and the bankruptcy could not have been foreseen. A culpable bankruptcy is one that is caused by certain acts described by statute, which acts include excessive personal spending or causing excessive losses due to speculation of capital. A bankruptcy may be found fraudulent if certain facts described by the statute are shown. Fraudulent bankruptcies generally involve the debtor altering, destroying, or maintaining insufficient records, or absconding with assets. Fraudulent and culpable bankruptcies carry criminal penalties for the individuals assisting, cooperating in, or directly inducing the fraudulent or culpable act. The criminal penalties are prison sentences of one to ten years, and in the case of fraudulent bankruptcies, include additional monetary fines.

4. Suspension of Payments

The L.Q.S.P. provides that business debtors may file a suspension of payments proceeding prior to declaring bankruptcy. The suspension of payments proceeding is an alternative to bankruptcy, and is similar to Chapter 11 of the U.S. Bankruptcy Code. Most of the rules described above for bankruptcy proceedings apply to suspension of payments proceedings as well.

Like Chapter 11, most of these actions end in liquidation, and assets are often consumed by the expenses of administration.²⁴ Suspension of payment proceedings can languish for years. Successful cases are generally those in which a settlement is reached prior to conclusion of the proceeding.

Only the debtor can commence a suspension of payments proceeding. Further, debtors are not eligible to file these proceedings if the following apply: (1) the debtor or its directors have been convicted of property or deceit related crimes; (2) the debtor has defaulted on a prior suspension of payments plan; (3) the debtor had previously declared bankruptcy and had not been rehabilitated, unless the case was concluded for lack of creditors or with the unanimous consent of the creditors; (4) the debtor failed to produce all of the required doc-

24. Hon. Leif M. Clark, *Cross Border Insolvency Issues Between Mexico and the United States*, in THE UNIV. OF TEX. 13TH ANNUAL BANK. CONF. (1994).

uments; (5) the debtor presented its petition more than three days after the cessation of payments; or, (6) the debtor is an irregular (*de facto*) corporation. A petition for a suspension of payments proceeding will stop any pending involuntary bankruptcy petition.

The filing must be accompanied by the documentation required for a bankruptcy filing, and by a "proposed preventive agreement" to be presented to creditors. The preventative agreement must comply with the statutory requirements. The preventative agreement can delay payments over a three year period and/or discount claims by up to sixty percent of the claim.

In a suspension of payments proceeding, the debtor may continue to operate the business, subject to supervision of the trustee and the court. The trustee's role is more limited than in a bankruptcy proceeding. The debtor remains in control of its assets, subject to the oversight of the trustee. Unless a sale or use of property is within the ordinary course of business, the debtor must obtain court approval. The debtor is obligated not to increase the company's liabilities or diminish its assets beyond its "ordinary management." Breach of the debtor's obligations can lead to the judge declaring bankruptcy.

Partners of the debtor and creditors must first approve the preventative agreement. Creditors vote on the preventative agreement by simple majority. Each creditor has one vote, regardless of the size of its claim. If a proposed preventative agreement is rejected, the judge must declare bankruptcy.

Once the preventative agreement is approved by the creditors, the court must approve the agreement. The court must determine that the debtor is eligible for the suspension of payments proceeding, the amount offered is not less than the debtor can pay, and performance is sufficiently guaranteed. Court approval typically takes twelve to thirty-six months.²⁵ The suspension of payments proceeding will conclude if: (1) bankruptcy is declared; (2) a preventative agreement is approved at the creditors' meeting; or, (3) the debtor's solvency improves so that it can repay its debts.²⁶

III. International Jurisdiction Issues and Insolvency Issues.

Issues of international insolvency are not new. Increasing commerce between the United States and Mexico only highlights the need for solutions to the problem. As early as 1888 a commentator in the *Harvard Law Review* stated:

It is obvious that, in the present state of commerce and of communication, it would be better in nine cases out of ten that all settlements of insolvent debtors with their creditors should be made in a single proceeding, and generally at a single place; better for the creditors, who would thus share alike, and better for the debtor, because all his creditors would be equally bound by his discharge.²⁷

Both Mexico and the United States have rules establishing jurisdiction for their courts. Various theories apply to what happens to jurisdiction and enforcement of domestic laws

25. BERDEJA-PRIETO, *supra* note 9, at 0-21.

26. *Id.*

27. John Lowell, *Conflict of Laws As Applied to Assignments for Creditors*, 1 HAR. L. REV. 259, 264 (1888).

once the issues become international. Courts and nations have attempted to resolve the issue in various ways. The effectiveness of domestic insolvency provisions in a foreign country depends upon the cooperation of the foreign courts in the jurisdiction where the foreign assets are located.²⁸

A. UNIVERSALITY V. TERRITORIALITY.

The cooperation of international courts in insolvency matters is based on the theoretical principals of universality or territoriality.²⁹ Universality is based on recognizing the full international effect of local insolvency adjudications and is supported by the principals of the unity of the debtor estate, equality among creditors, and the efficiency of the local insolvency proceeding.³⁰ The concept of universality envisions a single proceeding to administer the assets of the debtor.³¹

Territoriality, however, does not recognize the foreign insolvency proceeding and requires administration of the assets in each jurisdiction where the assets are located.³² It has been characterized as the "Grab Rule."³³ Under the territoriality approach, the court will focus almost exclusively on the effect of the foreign laws on the domestic creditor or debtor. A court applying the territoriality approach will refuse to recognize the foreign proceeding to the extent such proceeding prejudices the domestic creditor or debtor. In effect, the local court will grab as much for local creditors as possible.

B. THE INTER-AMERICAN CONVENTION ON THE JURISDICTION IN THE INTERNATIONAL SPHERE FOR THE EXTRATERRITORIAL EFFICIENCY OF FOREIGN JUDGEMENTS.

In an attempt to resolve international jurisdictional matters, the Inter-American Convention on the Jurisdiction in the International Sphere for the Extraterritorial Efficiency of Foreign Judgments was executed in La Paz, Bolivia on May 24, 1984. Mexico and the United States are contracting parties to the La Paz Convention.³⁴

Pursuant to the La Paz Convention, jurisdictional matters are to be resolved on the following terms:

28. See GITLIN & MEARS, *supra* note 8, at 31.

29. See generally Jay Lawrence Westbrook, *Choice of Avoidance Laws in Global Insolvencies*, 17 BROOK. J. INT'L L. 499, 512-15 (1991); Richard A. Gitlin & Evan D. Flaschen, *International Void in the Law of Multinational Bankruptcies*, 42 BUS. LAW. 307, 310 (1987); Mary E. Knecht, *The "Drapery of Illusion" of Section 304--What Lurks Beneath: Territoriality in the Judicial Application of Section 304 of the Bankruptcy Code*, 13 U. PA. J. INT'L BUS. L. 287 (1992); Barbara K. Unger, *United States Recognition of Foreign Bankruptcies*, 19 INT'L LAW. 1153 (1985); GITLIN & MEARS, *supra* note 8, at 31.

30. GITLIN & MEARS, *supra* note 8, at 31-32; Knecht, *supra* note 29, at 288-89; Unger, *supra* note 29, at 1154-55.

31. *Id.*

32. GITLIN & MEARS, *supra* note 8, at 32.

33. Westbrook, *supra* note 29, at 513.

34. Inter-American Convention on the Jurisdiction in the International Sphere for the Extraterritorial Efficiency of Foreign Judgments, May 24, 1984 [hereinafter La Paz Convention].

- a. For economic personal claims, the court holding jurisdiction shall be that of the defendant's domicile or normal place of residence if he or she is an individual; the place of the main business establishment, if a commercial entity; or if dealing with agencies or branches of companies, the place where the activities which originated the claim took place. For claims dealing with specific goods, the court holding jurisdiction would be that of the place where the assets are located at the time the suit is filed, or jurisdiction may be established following the previously mentioned rules. Additionally, the jurisdiction of a court may be agreed upon in writing by the parties.³⁵
- b. For real property and related judicial actions the courts of the place where the real property is located is the appropriate court.³⁶
- c. For commercial agreements, jurisdiction may be established by the parties if they agree in writing, to submit to the jurisdiction of a certain court unless the agreement was obtained by duress or undue influence. Pursuant to Article 4 of the La Paz Convention, when a foreign judgment is presented before a court of a different country for execution, the judgment may be denied based on the lack of jurisdiction pursuant to the rules contained in the La Paz Convention.³⁷

Pursuant to the La Paz Convention, the bankruptcy and analogous procedures are excluded from such jurisdictional bases.³⁸ Consequently, regarding such issues, the jurisdictional matters have not been resolved through an international treaty.

Nevertheless, Mexican courts may recognize some U.S. Bankruptcy Court orders based on two main arguments. First, the Inter-American Convention on Extraterritorial Efficiency of Foreign Judgments and Arbitration Awards approved in Montevideo, Uruguay, on May 8, 1979, and ratified by both Mexico and the United States, prescribes enforcement procedures for judgments and arbitration awards in civil, commercial and labor proceedings unless expressly reserved at the time of ratification. Under Mexican law, bankruptcy matters are considered commercial proceedings. Consequently, judgments issued in bankruptcy proceedings would be respected and applied pursuant to the Montevideo Convention.

Mexico at the time of ratification made an express reservation to limit the effect of the Montevideo Convention only to foreign money judgments. Accordingly, Mexican courts will only recognize a judgment issued in the courts of the United States, when it contains a judgment against a party for a fixed amount of money. A Mexican court would probably decline to enforce a bankruptcy court order providing for any other kind of relief. Article 14 of the Mexican Bankruptcy Law appears to provide some relief from the confines of the Montevideo Convention, however, because it provides for recognition of foreign bankruptcy decrees. Article 14 relief is probably illusory because such decrees must fully comply with the formalities and preconditions of the applicable Mexican bankruptcy law.³⁹ A party seeking to enforce such a decree would have to follow the procedures for issuance of

35. *Id.*

36. *Id.*

37. *Id.* art. 4.

38. *Id.* art. 6, § E.

39. Agustín Berdeja-Prieto, *Debt Collateralization and Business Insolvency: A Review of the Mexican Legal System*, 25 U. MIAMI INTER-AM. L. REV. 227, 277 (1993).

a letter rogatory (discussed *infra*) to have the decree recognized by the Mexican courts. The Mexican court will review the letters rogatory and determine whether the order is enforceable under Mexican law.⁴⁰ The Mexican court can proceed with enforcement of the order or determine that enforcement of the order is against Mexican public policy and refuse to enforce the order.⁴¹ Moreover, the Mexican court can refuse to enforce the judgment or order if there is no reciprocity of enforcement in similar cases with the jurisdiction rendering the judgment or order.⁴²

As evidenced by the number of governmental entities involved, and the inherent bureaucratic red tape of two federal governments, this procedure is fairly complicated and time consuming. In a bankruptcy situation, it is likely that any assets a party is trying to reach will be gone well before this procedure can be completed.

C. LETTERS ROGATORY AND THE MYSTERIES OF THE AZTECS.

To enforce money judgments, obtain discovery and pursue debtors in Mexico, parties may use letters rogatory. Creditors have to forage their way through the Mexican legal system in order to collect the assets of the debtor across the border. Creditors can however, gird themselves for the international insolvency adventure with letters rogatory. The process is highly complex even for the skilled practitioner.

A letter rogatory is a letter of request from a U.S. to a foreign court requesting international judicial assistance. A letter rogatory, also called a letter of request, provides a procedural avenue for cross-border service of process, the taking of evidence in the foreign country, and the enforcement of U.S. judgments or orders by the foreign court. Whether a party wishes to file suit against a Mexican national, enforce an order or judgment in Mexico, or merely obtain evidence from Mexico, the letter rogatory provides a reliable procedure for accomplishing these actions.

The Inter-American Convention on Letters Rogatory and the Additional Protocol thereto, an international judicial assistance convention to which Mexico and the United States are signatories, establish the procedures to be followed when countries transmit judicial documents across borders for the purpose of obtaining some legal effect.⁴³ Under the convention, each member country is required to establish a central authority to serve as a receiving agent for requests from other member countries. Members are required to use the standardized forms for transmitting letters of request and returning the executed documents.

Mexican courts often use a similar letter of request to effect service in lawsuits involving Mexican parties residing in different Mexican states.⁴⁴ To obtain service of process upon a Mexican citizen or corporation, the U.S. party will need to prepare a letter rogatory in accordance with the standardized form. The standardized forms require a brief description of the documents, remedies sought, and action requested of the party being served.⁴⁵ Additionally, the person being served must be informed of the deadline for response,

40. See GITLIN & MEARS, *supra* note 8, at 529.

41. GITLIN & MEARS, *supra* note 8, at 70; Ryan G. Anderson, *Transnational Litigation Involving Mexican Parties*, 25 ST. MARY'S L.T. 1059, 1111 (1994).

42. Anderson, *supra* note 41, at 1112.

43. *Id.*

44. *Id.* at 1069.

45. *Id.* at 1073.

where to respond to, and the consequences for failing to respond.⁴⁶ It is also advisable to obtain the assistance of Mexican counsel to assist in the preparation of the letter of request. Mexican counsel can be of great assistance in drafting the letter so that it incorporates Mexican laws and customs, as well as to assist with any actions that may need to be taken in Mexico.

The party should then file a motion with the U.S. court requesting issuance of the letter rogatory. The proposed letter rogatory should be attached to the motion. Once the U.S. court approves the issuance of the letter rogatory, the letter rogatory and all attachments thereto, including the complaint or pleading, any documents attached to the complaint or pleading, and the order issuing the letter rogatory, need to be translated into Spanish. While the convention only requires the translation of the letter rogatory and the complaint or pleading, we recommend all attached documents be translated for the convenience of the Mexican court. Such translations will provide the Mexican court with all the issues and facts when the court is determining whether to grant the request.

Once the letter rogatory and attachments are translated, the English and Spanish versions of the letter rogatory, along with additional copies, are returned to the issuing court. The court will transmit the letter rogatory to the Department of Justice, which is the designated central authority for the United States. The Department of Justice will transmit the letter rogatory to the Mexican Secretariat for Foreign Affairs, which will forward the request to the appropriate Mexican court. Once the complaint is served, the documents are returned via the Mexican Secretariat via the Department of Justice to the issuing court in United States.

The process for obtaining evidence in Mexico follows the same procedures. Parties should be aware, however, that most foreign countries, including Mexico, do not allow the broad pre-trial discovery commonly permitted in American proceedings. Mexican law requires that a proceeding be commenced before discovery may take place.⁴⁷ Mexican law also limits discovery to documents that are specifically identified by the requesting party, in the Mexican party's possession, and clearly relevant to the proceeding.⁴⁸ Additionally, the discovery will be conducted by the Mexican court, with the Mexican judge asking the questions. The court may allow the U.S. party to attend the proceeding. Again, it is strongly advised to retain Mexican counsel to assist in the preparation of the discovery request and the actual discovery.

The Inter-American Convention on Letters Rogatory and Additional Protocol, along with the detailed procedures for issuing a letter rogatory, are only briefly summarized here.⁴⁹

46. *Id.*

47. *Id.* at 1083.

48. *Id.*

49. For a more detailed treatment of this particular subject, see DAVID EPSTEIN & JEFFREY L. SNYDER, INTERNATIONAL LITIGATION: A GUIDE TO JURISDICTION, PRACTICE AND STRATEGY (2d ed. 1994); Anderson, *supra* note 41. Additional information on letters rogatory under the Inter American Convention may also be obtained by contacting the Inter-American Services Division of the Office of Citizens Consular Services in Washington, D.C. at (202) 647-5118.

IV. What To Do When The Síndico Calls: Section 304 Of The Bankruptcy Code.

A. STATUTORY FRAMEWORK.

Unlike Mexican law or other foreign bankruptcy laws, the U.S. Bankruptcy Code provides for the filing of a case ancillary to a foreign proceeding in the U.S. Bankruptcy Courts pursuant to section 304 of the Bankruptcy Code. Section 304 provides:

- a. A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.
- b. Subject to the provision of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may --
 1. enjoin the commencement or continuation of --
 - A. any action against --
 - (i) a debtor with respect to property involved in such foreign proceeding; or
 - (ii) such property; or
 - B. the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
 2. order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
 3. order other appropriate relief.
- c. In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with --
 1. just treatment of all holders of claims against or interests in such estate;
 2. protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
 3. prevention of preferential or fraudulent dispositions of property of such estate;
 4. distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
 5. comity; and
 6. if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.⁵⁰

Section 304(a) fails to specify exactly what will qualify as a "foreign proceeding." Section 101(23) states that a proceeding commenced abroad has to fulfill a purpose similar to that under the U.S. Bankruptcy Code.⁵¹ Such a proceeding can be a liquidation of an estate, an adjustment of debts, or a reorganization proceeding. The foreign proceeding

50. 11 U.S.C. § 304 (1994).

51. *Id.* at § 101(23).

must also be administrative or judicial in nature. Private debt restructurings do not appear to qualify as foreign proceedings.

Additionally, the U.S. court must have jurisdiction over the foreign debtor under U.S. law. This requirement means a foreign debtor must have a principal place of business or principal assets located in this country. A foreign representative seeking relief under section 304 will also bear the burden of proof that a foreign proceeding is pending and that the foreign representative is a duly appointed representative or administrator of the foreign estate.

Section 304 was enacted to provide for an economical and expeditious administration of the estate and permits a foreign representative to administer assets located in the United States to prevent dismemberment by local creditors of assets located here.⁵² Section 304 provides three different forms of relief for a foreign representative: (1) the court may enjoin the continuation of pending actions or the commencement of actions against the foreign debtor's assets; (2) the court may order the turnover of property of the debtor's estate or the proceeds of such property to the foreign representative; or, (3) grant the debtor such other appropriate relief.⁵³

Section 304(b)(1) provides the court with the power to enjoin actions against the foreign debtor and its property, similar to the automatic stay in domestic bankruptcy cases.⁵⁴ The objective of section 304 is to prevent the dismemberment of the debtor's assets in the United States. Relief under section 304(b)(1) will preserve the status quo much like the automatic stay. Although there is no reported case law on the subject, it seems that a creditor could seek relief from the injunction, much like a request for relief from the automatic stay. Unlike the provisions in section 362, however, there are no factors enumerated for the court to consider such relief under section 304.

Section 304(b)(2) allows the court to order the turnover of all domestic assets to the foreign representative.⁵⁵ This relief is the main objective of the foreign representative and the majority of reported cases dealing with section 304 concern a request for such relief. This relief often gives rise to the conflict between the protection of local creditors and the goal of an economical and efficient administration of the foreign debtor's estate.

Section 304(b)(3) allows the court to order other appropriate relief in the proceeding similar to the court's power under section 105.⁵⁶ While most of the provisions of Chapters 3, 5, 7, and 11 of the Bankruptcy Code do not apply to actions under section 304, pursuant to section 304(b)(3), the court may order compliance with such provisions as equity might dictate.⁵⁷ Courts have also granted a foreign representative section 304(b)(3) relief to conduct discovery to determine whether there are assets located within the United States.⁵⁸

52. H. R. Rep. No. 95-595, at 324-25 (1977); S. Rep. No. 95-989, at 35 (1978).

53. 11 U.S.C. § 304(b).

54. *Id.* at § 304(b)(1).

55. *Id.* at § 304(b)(2).

56. *Id.* at § 304(b)(3).

57. *In re Rubin*, 160 B.R. 269, 274 (Bankr. S.D.N.Y. 1993).

58. See *In re Brierly*, 145 B.R. 151, 169 (Bankr. S.D.N.Y. 1992).

B. MODIFIED UNIVERSALISM.

Section 304 has been referred to as modified universalism.⁵⁹ Modified universalism accepts the control premise of universalism but reserves to local courts discretion to evaluate the fairness of the home country procedures and the protection of local creditors.

In determining whether to grant a foreign representative relief under section 304, the court should consider all the factors set forth in section 304(c). Courts often rely, however, exclusively on the theories of universality or territoriality in making such determinations. Many courts rely almost entirely on possible prejudice to U.S. creditors when deciding whether to grant relief to a foreign representative.⁶⁰

Applying the territoriality approach, courts have ignored the interests of the foreign proceeding.⁶¹ In contrast, several courts have applied the universal approach, recognizing the principals of international comity.⁶² U.S. courts "generally are increasingly supportive of the philosophy underlying universality and are employing the doctrine in an ever-growing number of cases."⁶³

The *Hourani* case involved the liquidation committee of the estate of Petra Bank, a debtor in a Jordanian liquidation proceeding. In determining whether to grant section 304 relief to the Jordanian liquidation committee, the court applied all six factors set forth in Section 304(c) as an objective standard. The court recognized, however, the difficulty inherent in reviewing the Jordanian legal system based upon a fair and reasonable standard shaped by the U.S. system and values.⁶⁴ After application of all the factors to the applicable Jordanian law, the U.S. court refused to grant section 304 relief to the Jordanian liquidation committee. The court found the Jordanian insolvency system failed to provide fundamental protections and failed to provide procedural safeguards to ensure the fair and equal treatment of all creditors.⁶⁵ The court held that "deference should only be given to those insolvency proceedings that provide a reasonable degree of certainty that the consideration of all parties' rights will be fair and impartial."⁶⁶

59. Westbrook, *supra* note 29, at 530.

60. *Overseas Inns S.A. v. United States*, 911 F.2d 1146 (5th Cir. 1990); *Laker Airways Ltd. v. Sabena*, 731 F.2d 909, 937 (D.C. Cir. 1984); *Compañía Mexicana Rediodifusora Franteriza v. Spann*, 41 F. Supp. 907, 909 (N.D. Tex. 1941), *aff'd*, 131 F.2d 609 (5th Cir. 1942). See also, Melissa S. Rimmel, Comment, *American Recognition of International Insolvency Proceedings: Deciphering Section 304(c)*, 9 BANKR. DEV. J. 453, 462 (1992). Other courts will determine relief by applying the universality approach.

61. See *In re Toga Mfg., Ltd.*, 28 B.R. 165 (Bankr. E.D. Mich. 1983); *In re Lineas Aereas de Nicaragua S.A.*, 10 B.R. 790 (Bankr. S.D. Fla. 1981).

62. See *In re Culmer*, 25 B.R. 621 (Bankr. S.D.N.Y. 1982); *Cunard Steamship Co. v. Salen Reefer Serv.* A.B. 773 F.2d 452 (2d Cir. 1985).

63. *In re Hourani*, 180 B.R. 58, 64 (Bankr. S.D.N.Y. 1995) (citing *Euromepa S.A. v. R. Emersian, Inc.*, 51 F.3d 1095 (2d Cir. 1995); *Philadelphia Gear Corp. v. Philadelphia Gear de Mexico, S.A.* 44 F.3d 187 (3d Cir. 1994)).

64. *In re Hourani*, 180 B.R. at 65.

65. *Id.* at 70.

66. *Id.* at 64.

The majority of recent cases applying section 304, as evidenced by the court's opinion in *Hourani*, recognize foreign insolvency proceedings as long as such proceedings comport with the notions of fairness and due process.⁶⁷

Under either the territoriality approach or the universality approach, however, most courts fail to consider the underlying goal of an economical and expeditious administration of the estate found in the preamble of section 304.⁶⁸ The underlying goal of section 304 relief is the efficient and economical administration of the foreign estate. While a foreign proceeding may be entitled to relief based on the factors set forth in section 304(c), such relief should be granted only if it will provide an efficient and economical administration of the estate.

Assuming the foreign representative can file for relief under section 304, there is still a question of venue. 28 U.S.C. §1410 specifically provides for venue of cases commenced under section 304.⁶⁹ Section 1410(a) provides that an action to enjoin a state or federal proceeding or an action under section 304(b)(1) may only be commenced in the district where such proceeding or judgment is pending.⁷⁰ Section 1410(b) provides that an action to require the turnover of property of an estate may be commenced only in the district in which such property is located.⁷¹ Section 1410(c) provides that any action for relief, other than relief specified in subsection (a) or (b), may be commenced in a district court in which the foreign debtor's principal place of business or principal assets in the United States is located.⁷²

A literal application of section 1410 is that it requires a foreign representative to file a separate petition for section 304 relief in each district in which the foreign representative seeks an injunction or turnover action. This procedure could create significant hardship for a foreign representative faced with the administration of assets in several different counties and states. The case law, fortunately, has allowed a foreign representative facing multiple lawsuits and/or far-flung assets throughout the United States to file one proceeding in the district where the debtor's principal place of business or principal assets are located.⁷³ The courts have found that section 1410 must be read in light of the policy of section 304 to assure an economical and expeditious administration of the estate.⁷⁴

67. See *Pravin Banker Assoc. Ltd. v. Banco Popular del Peru*, 165 B.R. 379 (Bankr. S.D.N.Y. 1994) (recognizing Peruvian insolvency proceeding since Peruvian law was consistent with notions of fairness and due process); *Lindner Fund, Inc. v. Polly Peck Int'l PLC*, 143 B.R. 807 (Bankr. S.D.N.Y. 1992) (granting section 304 relief and recognizing United Kingdom insolvency since proceedings comport with notions of fairness and due process); *New Line Int'l Releasing, Inc. v. Ivex Films, S.A.*, 140 B.R. 342 (Bankr. S.D.N.Y. 1992) (dismissing proceeding against foreign debtor in Spanish insolvency proceeding since Spanish procedure did not prejudice domestic creditor's rights nor violate domestic laws or policies).

68. Ulrich Huber, *Creditor Equality in Transnational Bankruptcies: The United States Position*, 19 VAND. J. TRANSNAT'L L. 741 (1986).

69. See 28 U.S.C. § 1410 (1994).

70. *Id.* at § 1410(a).

71. *Id.* at § 1410(b).

72. *Id.* at § 1410(c).

73. See *Evans v. Hancock, Rothert & Bunshoft*, 177 B.R. 193 (Bankr. S.D.N.Y. 1995); *Saleh v. Triton Container Int'l*, 175 B.R. 422 (Bankr. S.D. Fla. 1994); *In re Kingscroft Ins. Co.*, 150 B.R. 77 (Bankr. S.D. Fla. 1992).

74. See *Evans*, 177 B.R. at 197.

Acknowledging these goals, the courts recognize that requiring a foreign representative to commence a new ancillary proceeding every time he sought to enjoin litigation or recover property would thwart such goals, place an enormous burden on the foreign representative, and result in unnecessary litigation and excessive costs.⁷⁵

V. Bankruptcies in the United States involving Assets and Creditors in Mexico.

Over the last few years, a number of companies and individuals doing business in the United States and Mexico have sought bankruptcy relief in the United States. To be eligible to file a bankruptcy petition, a person or entity need only reside, have a domicile, a place of business, or property in the United States.⁷⁶ Accordingly, almost any company or individual with operations or property on both sides of the border is eligible to file bankruptcy in the United States even if the debtor is a foreign citizen or a foreign corporation.⁷⁷

Foreign companies and individuals may even find themselves subject to involuntary bankruptcy proceedings in the U.S. bankruptcy courts.⁷⁸ In *Xacur*, several Mexican banks frustrated by the movement of individuals and their assets from Mexico to the United States brought an involuntary bankruptcy proceeding against their Mexican customers in U.S. Bankruptcy Court in Houston, Texas.⁷⁹ The bankruptcy court held that it had jurisdiction over the Mexican citizens because they had assets in the United States.⁸⁰ Moreover, the bankruptcy court granted the involuntary relief despite the fact that the obligations were between Mexican banks and Mexican citizens.⁸¹

The effect of the filing of a bankruptcy, at least in the United States, is to stay any and all actions to collect or assert claims against the debtor or its property.⁸² Moreover, 28 U.S.C. § 1334(e) provides that the court in which the bankruptcy is filed shall have exclusive jurisdiction of all the property, wherever located, of the debtor as of the commencement of the case, and of property of the estate. The extent of bankruptcy court jurisdiction into Mexico and the effect of the stay in Mexico are subject to some question. Although it is clear that the Bankruptcy Code and related statutes contemplate a bankruptcy court jurisdiction that knows no borders and the staying of actions against the debtor and its property no matter where it is located and an intention that the bankruptcy laws are to apply to all creditors of the debtor no matter where located, United States bankruptcy court jurisdiction and the stay appear to end at the Mexican border.

75. *Id.*

76. 11 U.S.C. § 109 (1994).

77. *In re Guardia*, Case No. 96-50744 (5th Cir. 1997) (mem.) (Fifth Circuit determined that Bankruptcy Court had jurisdiction over all disputes involving the debtor, even those arising in Mexico); *In re Echegaray*, Case No. ____ (Bankr. W.D. Tex. 1996) (bankruptcy Court retained jurisdiction over dischargeability action brought by Mexican banks in Mexican citizen's bankruptcy); *In re Int'l Credit and Comm.*, 88 B.R. 597, 606 (Bankr. S.D.N.Y. 1988).

78. *In re Xacur*, Case No. 96-48538-H5-7 (Bankr. S.D. Tex. 1997).

79. *Id.*

80. *Id.*

81. *Id.*

82. 11 U.S.C. § 362 (1994).

A. THEORIES OF JURISDICTION.

As previously discussed, the cooperation of foreign courts is based on the concepts of universality or territoriality, or international treaty. The U.S. courts are purportedly moving toward universality and a greater recognition of foreign proceedings.⁸³ As U.S. courts are increasingly willing to cooperate with foreign courts in multinational bankruptcies, the foreign courts will allegedly reciprocate with the same level of cooperation.⁸⁴ Other commentators, however, reject this idea of increased universality by U.S. courts and assert that these courts recognize foreign proceedings only when such proceedings are substantially similar to proceedings in the United States.⁸⁵ Unfortunately, in an insolvency emergency, the theories of jurisdiction often remain merely theories and offer little practical relief to the parties. While the courts ponder the extent of their jurisdiction, creditors are acting and collateral may be losing its value.

B. PRACTICAL APPLICATIONS OF THEORIES OF JURISDICTION.

Cross-border bankruptcy teaches lawyers, judges, and creditors that there is some merit to that childhood maxim of law that "possession is 9/10ths of the law." Creditors in Mexico who have no intention of appearing in U.S. bankruptcy proceedings, have access to assets located in Mexico, and can take action against the assets under color of Mexican law, can and often do ignore the jurisdiction of the respective U.S. bankruptcy court. This consequence can profoundly and adversely affect creditors in the United States who have no choice but to obey the laws of the United States. The Bankruptcy Code was designed to equitably treat the claims of all creditors subject to certain rules of priority. To be equitable, the Bankruptcy Code assumes that all creditors will participate in the bankruptcy and that all assets of the debtor will be available for the treatment of creditor claims. Additionally, the equitable treatment assumed by the Bankruptcy Code includes the disparate treatment of creditor claims. Some creditors will have priority over other creditors depending on contractual rights or liens granted on certain assets. Additionally, the Bankruptcy Code describes certain types of claims that shall have priority over other types of claims. The ability of the Mexican creditor to sever from a debtor's estate assets located in Mexico, especially if they are significant, upsets the equitable balance contemplated by the Bankruptcy Code. It grants the creditor that ignores the U.S. bankruptcy proceeding a distinct advantage over creditors participating in the U.S. bankruptcy proceeding.

As a practical matter, even the suggestion that Mexican creditors will not participate in the United States bankruptcy proceeding and will rely upon the laws of Mexico for collection of monies due has altered how U.S. bankruptcy courts have treated Mexican creditors. U.S. bankruptcy courts have recognized that their jurisdiction to control the assets stops at the border and the ability to recover assets in Mexico for distribution or treatment of the claims of creditors in the United States requires the cooperation of the Mexican creditor. Usually that means the payment in full or sufficient satisfaction of the Mexican creditor. When dealing with sparse assets, this preferential treatment of Mexican creditors adversely affects creditors participating in the U.S. bankruptcy proceeding.

83. Unger, *supra* note 29, at 1183.

84. See HON. J. FARLEY, CO-ORDINATION IN CROSS-BORDER INSOLVENCIES AND RESTRUCTURING, 2-5 (National Conference Bankr. Judges 2-5 1994); Unger, *supra* note 29, at 1183.

85. See CLARK, *supra* note 24, at 9-16; Knecht, *supra* note 29, at 287.

Not only do Mexican creditors generally receive preferential treatment, but also, the policies behind the treatment of claims in the United States and Mexico differ. A creditor with a significantly greater influence in bankruptcies involving a company with assets in Mexico is the Mexican worker. Mexican laborers are subject to priority treatment in U.S. bankruptcies for pre-petition wage claims up to \$4,000 per employee under 11 U.S.C. § 507(a)(3) and an unsecured claim for the balance. The Mexican labor claims discussed earlier however, alter the strategy for the U.S. creditor in a cross-border insolvency situation. Because Mexico grants a severed employee a superpriority lien upon all assets located in a Mexican plant or facility to secure his or her severance pay, a decision to foreclose upon a factory or refuse to allow the use of cash collateral is far different than the decision in a strictly U.S. bankruptcy proceeding. The normal analysis of cash collateral and the application of sale proceeds from a section 363 sale is altered because the labor lien is superior to the liens of secured creditors and superior to the rights of unsecured creditors. The Mexican worker is more inclined to preserve and protect his or her rights in Mexico than in a U.S. bankruptcy court. This superpriority lien places an additional dynamic on any party doing business with a business with substantial assets in Mexico. A party doing business with a Mexican entity or extending credit to a Mexican entity must be careful to balance the needs for payment with avoiding forcing a Mexican business out of business or into bankruptcy in Mexico. Creditors must also hope that other creditors are similarly patient and wise. This Mexican policy is especially dangerous to a creditor who holds a lien upon assets located in Mexico.

The only protection provided by the Bankruptcy Code to the creditor is contained in section 508. In the event foreign assets are collected by a creditor, section 508 of the Bankruptcy Code will prevent such a creditor from collecting from the estate to the extent such creditor received prior payment.⁸⁶ Pursuant to section 508, if a creditor receives payment of a claim in a foreign proceeding, the creditor is not entitled to payment under the bankruptcy proceeding until the other holders of claims that are entitled to share equally with the creditor receive an amount equal in value to the consideration received by the creditor in the foreign proceeding. This remedy is useless in many cross-border bankruptcies because many of the valuable assets are in Mexico far from the reach of U.S. creditors.

Other issues also abound. Is a discharge granted by a U.S. bankruptcy court to a Mexican citizen concerning obligations created in Mexico enforceable in Mexico? Are bankruptcy causes of action such as preference and fraudulent transfer actions viable against Mexican defendants? If so, what defenses should apply to such actions? The U.S. bankruptcy courts, parties before them, and those who choose not to appear before them will struggle to resolve these issues and others for years to come.

VI. Conclusion.

Careful planning can alleviate some of the problems encountered in cross-border insolvency matters. The border simply adds a little salsa to the stresses and strains of enforcing rights and collecting debts along the border.

86. 11 U.S.C. § 508 (1994).