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LEGISLATIVE REFORM IN MEXICO SIGNALS POSITIVE TREND FOR U.S. LENDERS

New legislation passed by the Mexican Congress may herald a brighter future for U.S. asset-based lenders wishing to expand lending activities to Mexico. The goal of this new legislation is to encourage increased financings in Mexico after several years of restricted credit following the devaluation of the peso in 1994. This legislation aims to encourage lending by domestic and foreign lenders, including non-Mexican asset-based lenders, by streamlining the procedures for obtaining liens on assets and foreclosing on such assets.

Specifically, on May 23, 2000 the Mexican Law of Negotiable Instruments and Credit Transactions was significantly amended to create two new security devises: a guarantee trust and a non-possessory pledge. The non-possessory pledge in particular enables lenders to obtain liens on several categories of assets which under prior law were either impossible or impracticable to obtain. Additionally, pursuant to related legislation, a centralized electronic lien lien filing system was established and new laws were enacted aimed at streamlining the enforcement of liens.

I. Overview of New Legislation

Some significant items of interest to potential lenders to businesses residing in Mexico are as follows (further discussion on each of these issues is provided in Section III. below):

- Non-possessory liens can now be obtained on many forms of collateral.
- Lenders can now obtain a lien on a broad range of collateral types, including inventory, accounts receivable and intellectual property rights.
- Lenders can now obtain a lien on future acquired assets.

- Both present and future obligations can now be secured.
- The lien filing system has been improved.
- The priority of competing liens has been clarified.
- New extra-judicial enforcement procedures are now available and may help streamline foreclosure procedures.

II. Previous State of Mexican Secured Lending Laws

Prior to the enactment of this new legislation, the system of asset-based lending in Mexico was burdened by antiquated laws that did not reflect the realities of the modern global economy and by enforcement procedures that were often slow and unpredictable. Under the old regime, secured lending laws evolved primarily from laws pertaining to liens on real estate and, in most cases, did not provide effective means of obtaining liens on personal property.

The secured lending laws pertaining to personal property, except for certain limited exceptions, required that the borrower be "dispossessed" of the property – that is, the lender had to, either itself or through an agent, maintain physical possession of the personal property in order for the lender to obtain a lien on the property. As it is often impracticable or impossible to dispossess a borrower of many important categories of personal property assets, lenders were often unable to obtain liens on such assets. For example, since borrowers need to use inventory and equipment in their normal daily operations, they could not give possession of these assets to lenders. Additionally, intangible assets such as accounts receivable and intellectual property are not capable of being "possessed."

In situations in which a lender was able to obtain a lien on assets, the lender was required to comply with burdensome procedures to obtain a lien, such as having to: describe each item of collateral with great specificity, constantly update its collateral documents to reflect newly acquired assets and file lengthy collateral documents with multiple lien registries. These requirements greatly increased the costs of providing financing in Mexico, and in many cases inhibited financings altogether. Even lenders that were wiling to comply with these burdensome requirements were often hesitant to provide financing in Mexico as Mexico's foreclosure procedures were often seen as being inefficient and unpredictable.

III. Major Changes Under the New Legislation

New procedures for obtaining non-possessory liens. Both Mexican and non-Mexican creditors can now obtain non-possessory liens on a broad range of tangible and intangible assets, including inventory, accounts receivable, equipment and certain intellectual property rights. Lenders will now be able to obtain liens on such assets even when such assets remain in the possession of their borrowers and are used in their borrowers' operations.

Liens on future-acquired assets. The new legislation enables a lender to obtain a lien on future-acquired assets without having to constantly update its collateral documents and filings. This change is particularly helpful to inventory and accounts receivable lenders, as inventory and accounts receivable constantly turn over. To facilitate this change, the new legislation provides that lenders no longer need to describe each item of collateral with great specificity. Instead, lenders only need to provide general descriptions of the collateral.

Liens securing future advances. Under the new legislation, a lien can secure future advances in addition to advances made at or prior to the time that the lien is obtained. With this change, a lender no longer has to update its collateral documents and filings to reflect future advances and commitment increases. However, the new legislation clashes with existing Mexican common law which requires that a lien must secure a sum certain. Thus, uncertainty still remains with respect to securing future advances.

Improved filing system. While each Mexican state will continue to operate separate lien registries, the new legislation establishes a centralized electronic filing system that will provide access nationwide to such registries. The new legislation also provides that only short codified forms, rather than lengthy and detailed documents, need be provided for registration. These changes should result in time and monetary savings in conducting lien searches and in registering liens, while at the same time improving the accuracy and reliability of the registration system.

Clarification as to priority of liens. The new legislation clarifies the priority of competing liens. In general, a secured lender that has properly obtained and registered its lien has priority against all creditors that obtain a claim against the collateral after the registration date. However, there still remains significant claims that can trump a secured lender's lien. For example, certain labor claims may trump a secured lender's lien. In many instances these labor claims are so large that they deplete all or a majority of the lender's collateral.

Non-judicial enforcement; enforcement generally. The new legislation provides for non-judicial enforcement proceedings as an alternative to the often lengthy court foreclosure procedures. The new legislation also provides for new judicial foreclosure procedures, both in and out of bankruptcy, which hopefully will streamline foreclosure procedures and make their outcomes more predictable.

IV. Non-Recourse Issues

The new legislation provides that liens obtained pursuant to the new legislation must be non-recourse – that is, in the event that the lender forecloses on the collateral subject to such liens and the proceeds from the foreclosure sale are not sufficient to satisfy all of obligations owing to the lender, the lender must agree to waive such deficiency. This provision can not be waived.

As a result of this provision, great care must be taken when determining the amount of loan obligations that the various items of Mexican collateral secure. In making this determination, the Lender must carefully consider what amount it believes it would be able to obtain from foreclosing on such collateral and limit its lien on such assets to secure only such amount. If this amount is set too low, the lender may diminish the amount it otherwise would be able to recover from such collateral. If, on the other hand, this amount is set too high, the lender may lose its claim against the borrower altogether with respect to the resulting deficiency. Lenders must remember to re-evaluate this determination each time that the overall amount of their loan facilities change.

V. Conclusion

Although the passage of this new legislation in Mexico indicates that the climate for asset-based lending is improving, this legislation is yet to be fully implemented and tested. Whether this legislation effects significant change that makes asset-based lending in Mexico more viable for U.S. lenders will depend on how the legislation is carried out and interpreted by the Mexican courts. Conflicts with existing Mexican common law will also need to be rectified to ensure that lenders can rely on the legislation.

Other factors will also affect reform. Mexican courts must become more efficient and reliable to ensure that foreclosure procedures are carried out in a timely and predictable fashion. Moreover, Mexico elected Vicente Fox as its new President on July 2. Fox has promised widespread reforms in many areas of Mexican government and society. However, it remains unclear how effectively reforms can be implemented in a divided Congress in which no party has a majority.

If you have any questions or need further information, please contact Jonathan M. Cooper, Esq.[1] at (312) 201-4000 or via e-mail at **jonathan.cooper@goldbergkohn.com**.

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