

**OUTLINE OF
CANADIAN ISSUES RELATING TO ASSET-BASED LENDING
ACFA, MARCH 6, 1995**

1. OVERVIEW OF CANADIAN LEGAL SYSTEM

- (a) Federal Laws: Banking, Bankruptcy
 - Bank regulatory issues (limitations on foreign banks "carrying on business" in Canada)
- (b) Provincial: Property law, laws governing security and perfection thereof, etc.

2. CORPORATE STATUTES

- (a) Federal: Canada Business Corporations Act
- (b) Provincial: Each province has a corporate statute
- (c) Can incorporate under federal statute or provincial statute - can carry on business in any other province (subject to extra-provincial registration); partnerships (as borrowers) give rise to potential withholding tax issues - better to borrow through corporation

3. TYPICAL FINANCING STRUCTURES

- (a) **U.S. Lender: Loan to U.S. Borrower**
 - Borrowing base includes inventory and receivables of both U.S. Borrower and Canadian Subsidiary
 - U.S. loan is secured by:
 - (i) Canadian Subsidiary's Assets

- (ii) Upstream guarantee from Canadian Sub
- (iii) U.S. Borrower pledges shares of Canadian sub (up to $\frac{2}{3}$ because of U.S. deemed dividend problem)

Note: Either (i) or (ii) may give rise to U.S. deemed dividend (whether or not (iii) is used)

- (b) (i) U.S. Lender: Loan to U.S. Borrower; and**
- (ii) Canadian Lender (Subsidiary of U.S. lender): Loan to Canadian subsidiary of U.S. borrower**

- Cross-collateralization of security (guarantees and asset security flow upstream and downstream)

- (c) U.S. Lender: Loan to U.S. Parent**
- U.S. Parent: Downstreams loan to Canadian subsidiary**

- Canadian withholding tax on interest payments from Canadian sub to U.S. parent
- If no interest payable, may be other tax issues under Canadian law

- (d) U.S. Lender: Loan to Canadian Borrower**

- Interest paid by Canadian borrower to U.S. lender will be subject to Canadian withholding tax unless term of loan is five years and borrower is not obliged to pay more than 25% of principal within first five years. Unlikely structure for Borrowing Base loan (difficult to structure cross-border revolving loan without Canadian withholding tax)
- Currency Risk: Loans made in U.S. dollars would generally be required to be repaid in the same currency. Canadian courts will, however, only give judgments in Canadian dollars. Therefore, loan and security documentation should contain a "judgment currency" clause which effectively requires the borrower to gross-up amounts awarded in another currency if they yield less than the amount originally loaned.

4. BORROWING BASE FORMULAE

Until recently, relatively common to have advances based on 50% of eligible receivables and inventory. These days percentage may be as high as 85 or 90% but there are more carve-outs in the definitions of eligible receivables and eligible inventory. Ineligibles are similar to those in the U.S. Canadian Lenders have recently begun to exclude "30-day goods" - i.e. inventory delivered within the prior 30-day period for which the supplier has not yet been paid. Canadian bankruptcy law provides rights of reclamation to the unpaid supplier in specific circumstances (see further discussion later under Bankruptcy Issues).

5. REGULATORY APPROVALS FOR ACQUISITION FINANCINGS

(a) Investment Canada Approval/Notification

- U.S. or World Trade Organization acquiror
- non-U.S. acquiror

(b) Competition Act Approval (similar to HSR in U.S.)

- pre-notification thresholds
- Advance Ruling Certificate
- substantive lessening of competition

6. SECURITY

(a) Provincial:

(i) PPSA:

- Ontario and west (British Columbia, Alberta, Saskatchewan, Manitoba) as well as Prince Edward Island and New Brunswick (legislation about to be enacted): similar to UCC system;
- Can take security on receivables, inventory, machinery, equipment and all other assets pursuant to a General Security Agreement (everything except real estate); or a Debenture (all assets, including real estate)

- Perfection of personalty lien is through registration of a financing statement. There is a nominal recordation fee but no tax.
 - A. Receivables: Registration must be made in the location of the debtor (i.e. its place of business or, if more than one, its chief executive office)
 - Where borrower has several places of business, cautious approach is to register in all provinces.
 - B. Inventory: Perfection is where the inventory is located.
 - C. Real Estate: Separate registration of mortgage or debenture under land titles or land registry system.
 - D. Machinery and equipment: registration of General Security Agreement or debenture where located.
 - E. Fixtures: Fixtures filings available under PPSA (where debtor has granted mortgage) similar to UCC
- (ii) Newfoundland and Nova Scotia: Different registry system. Debenture Security covers all assets including real estate; separate assignment of receivables required; registration is in several different registry offices
- (iii) Quebec: New Regime as of January 1, 1994.
- Movable Hypothec covers all assets except real estate
 - Immovable Hypothec covers real estate
 - Enforcement provisions are somewhat different from other provinces
- (b) Federal Security:**
- (i) Bank Act Security on Inventory:
- Only available to Canadian banks (Schedule I & II)
 - Has advantage over provincial security on inventory in that it is subject to fewer statutory liens which rank ahead.
 - Can only be given by a borrower, not a guarantor.

(ii) Intellectual Property:

- a signed copy of the security agreement or debenture must be filed in the Intellectual Property Office in Ottawa (takes several weeks to receive confirmation of registration)

(c) **Perfection Issues:**

- U.S. account debtors of Canadian borrower: Can perfect in jurisdiction of borrower's place of business (except for eastern provinces with no central registry -have to file in separate counties)

(d) **Government Receivables:**

- Can perfect against third parties but cannot collect directly from the government unless borrower complies with formalities of assignment under Financial Administration Act and provincial equivalent statutes
- Government receivables are often carved out of definition of "eligible receivables".

(e) **Landlord's Right of Distress:**

- Landlord can seize property of tenant (or of any third party liable for rent) if goods are on the leased premises. Can seize for arrears (and for future rent if lease contains acceleration clause - although this is less certain);
- Landlord's right of distress prevails over PPSA registered security outside bankruptcy, but not in a bankruptcy. This may be sufficient motivation for a creditor to force its debtor's bankruptcy.

(f) **Other Prior Claims:**

- Crown claims: rank ahead or behind depending on whether competing security is fixed or floating; controversy re: nature of security on accounts (whether fixed or floating)
- compare priority of crown claims in bankruptcy (true deemed trusts)

7. LOCK BOXES

- Not as common in Canada as in the U.S.
- Generally only used where there is a Canadian tranche of a U.S. loan facility
- In Canada, PPSA allows one to take security in cash and deposits; therefore lock boxes are not as essential as in the U.S.

8. GUARANTEES

(a) Under Canadian Corporate Statutes:

- (i) Parent companies can guarantee direct and indirect subsidiaries
- (ii) Subsidiary can guarantee wholly-owning parent (and generally, indirect wholly-owning parent if 100% ownership exists through the corporate chain; fraudulent preference issues are not a concern with respect to guarantee itself)
 - Canada Business Corporations Act was recently amended to permit upstream guarantees to indirect wholly-owning parent.
 - Absent 100% ownership, subsidiary can only guarantee parent if a stringent solvency test can be met. This can give rise to interesting opinion issues. Normally there is reliance on a "solvency certificate" of the subsidiary's CFO.

(b) Exceptions:

- (i) Quebec: no upstream guarantees permitted without compliance with the solvency test (i.e. no wholly-owned subsidiary exception);
- (ii) New Brunswick and Nova Scotia: allow upstream guarantees to non-wholly owning parent if articles of incorporation so provide. Exception: where guarantee is given to finance acquisition of guarantor's shares.

9. GUARANTEES SECURED BY ASSETS

Security given to support guarantee, if given for **pre-existing debt**, will be deemed a preference under Bankruptcy and Insolvency Act if given within a three month preference period.

Note: presumption of preference can be rebutted if:

- agreement to give security made outside three month period
- security given to permit debtor to carry on business
- some new consideration given to debtor in exchange for security.

10. SHARE PLEDGES

(a) No Canadian Tax Issues

(b) Best Security:

- Canadian private companies must have restrictions (contained in their charter documents) on share transfers to avoid public company reporting requirements: Therefore board or shareholder approval is required for all share transfers
- Because board/shareholder approvals can be revoked prior to action authorized being effected, counsel to lenders always recommend that share transfers pursuant to the pledge be approved by board/shareholders and shares should then be registered in the name of the lender on closing. If not, board may refuse to approve transfer (or revoke prior approval) at the time lender wishes to enforce the pledge and sell the shares

(c) Second Best Security:

- Share certificates endorsed in blank and delivered to lender; shares remain registered with pledgor (risk that board/shareholders will refuse to approve transfer in lender's name at time of enforcement).

11. BANKRUPTCY ISSUES

(a) Bankruptcy & Insolvency Act

- Filing by debtor of a notice of intention to file a proposal triggers automatic 30 day stay (renewable 45 days - 3 times)
- Debtor can carry on business (contracts cannot be terminated by other parties - exception for derivatives)

- Debtor can cancel lease on payment of lesser of six months rent or balance of lease (landlord has right to object)
- Landlord loses priority (in favour of secured creditors) over goods on premises to cover arrears of rent
- Suppliers can reclaim goods not paid for if:
 - (i) supplier makes written demand to debtor within 30 days of delivery
 - (ii) debtor must be in bankruptcy or receivership
 - (iii) goods must be "identifiable"
 - (iv) goods must not have been resold or the subject of a contract of sale.

(b) CCAA (Companies Creditor Arrangement Act)

- Court has discretion to order stay of proceedings of any length; great flexibility under this legislation. Debtor proposes a "plan of arrangement" to be voted on by creditors.

12. ENFORCEMENT ISSUES

- Under Bankruptcy & Insolvency Act all secured creditors must give 10 day notice to debtor if they intend to enforce security on "substantially all" of inventory, accounts or other property; if 10 day notice has expired, or if secured creditor is already in possession, or if proposal not stated to apply to that secured creditor, filing of notice of intention by debtor to file proposal will not stay proceedings against the secured creditor
- Enforcing U.S. security in Canadian courts (e.g. against Canadian account debtors): Canadian courts will recognize choice of law if bona fide, and will enforce U.S. agreements if not against public order.
- Enforcing Canadian security against Canadian borrower:
 - Accounts: Most statutes require notification of account debtors; thereafter can collect against those account debtors.
 - Quebec:
 - notification of account debtors required to enforce assignment of accounts on a "floating hypothec" (prior notification by another secured creditor will prevail regardless of date of registration)
 - problem can be avoided by authorizing debtor to collect accounts on behalf of secured party and then withholding authorization
 - Other assets: Canadian security generally allows lender to send a receiver in to take possession, not generally court appointed, unless in Bankruptcy or Companies Creditors Arrangement Act; can sell by private sale; judicial sale or foreclosure (retain property in full satisfaction of debt). Quebec remedies somewhat different.

13. OTHER ISSUES

- Penal Interest Rates (i.e. higher rate of interest on arrears): Not enforceable where security on real estate is given; questionable enforceability in other circumstances.
- Interest Act provisions: Provide formula to calculate annual interest where interest is based on less than 365 days (e.g. LIBOR)
- Environmental/Lender Liability issues (evolving rapidly in Canada)
- Ministry of Environment entering into agreements with Lenders to limit liability conditional or assumption of specific clean-up costs by Lenders.
- Factoring: Not that common in Canada. The securitization market has largely replaced this. Banks used to have factoring subsidiaries - now virtually non-exist. Factoring still exists as an alternative to bank loans but is relatively rare compared to the U.S.

"HOW TO FINANCE TRANSACTIONS IN CANADA AND MEXICO: A LAWYER'S GUIDE"

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PANEL NOTES SUMMARIZING MEXICAN ISSUES

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These panel notes begin with the question whether or not a lender in the United States (a "U.S. lender") can do asset-based lending in Mexico, followed by a discussion of the Mexican legal restrictions and other legal obstacles to asset-based lending, in turn followed by a discussion of how to structure asset-based lending transactions in Mexico and the ways that a U.S. lender can realize on its collateral (together with how long it takes and a summary of the costs involved) and concludes with ancillary matters such as fraudulent transfer laws and withholding taxes.

The discussion will focus on these topics in the context of three common lending scenarios:

- (i) U.S. borrower with accounts receivable owing from Mexican account debtors and inventory located in Mexico,
- (ii) U.S. borrower with a Mexican affiliate located outside the U.S. and Canada willing to grant a security interest in accounts receivable owing from U.S. account debtors and inventory located in the United States as collateral for loans to the U.S. borrower, and
- (iii) Mexican borrower with accounts receivable owing from Mexican account debtors and inventory located in Mexico.

The U.S. lender needs to recognize that there is a genuine risk in each of these cases that its rights and remedies regarding collateral (as well as other matters) may be adjudicated in a Mexican court, and therefore it should carefully evaluate the means by which it attaches and perfects, and determines the priority of, its security interests. Unfortunately, there is not yet an international convention or treaty between the United States and Mexico which generally governs debtor-creditor obligations, security devices, perfection of security interests and liens in collateral or the effect of perfection and non-perfection and the consequences thereof as they apply to accounts receivable,

most inventory, most equipment, real estate and other items commonly taken as collateral and given loan value by U.S. lenders. Consequently, it is important that a U.S. lender be aware that it may not be able to avoid Mexican law governing at least some portions of its transactions.

I. CAN A U.S. LENDER DO ASSET-BASED LENDING IN MEXICO?

A U.S. lender cannot do asset-based lending in Mexico as broadly and as relatively straight-forwardly as it is done in the U.S. The reasons for this are both legal and cultural. The principal legal reasons for this are that under Mexico's legal system (i) the security devices generally available are not as broad and flexible as an Article 9 security interest and (ii) the corresponding enforcement rights and remedies for the most part require involving Mexican courts. A cultural reason for the difficulty of a U.S. lender doing asset-based lending in Mexico is that historically there had not been a push by the Mexican government or Mexican credit institutions to develop the type of asset-based lending industry that we have in the United States. However, there are some asset-based lending structures available under Mexican law that are analogous to those used in the United States (as well as some others that are analogous to those used in the United States prior to the U.C.C.), and at least in these areas the U.S. lender's legal risks can be identified and underwritten to an extent. Unfortunately, in other areas the problems of Mexican law cannot practically be overcome.

II. OVERVIEW OF GENERAL LEGAL RESTRICTIONS AND LIMITATIONS

It is important for a U.S. lender that desires to do asset-based lending in Mexico to be aware that Mexico, like many countries, has general restrictions on the rights of foreigners to engage in business in Mexico and to own property in Mexico. Once these restrictions are discussed, we will address more specific legal limitations on the types of security devices and types of remedies that are available to a U.S. lender.

A. Brief Overview of Mexican Legal System and Primary Relevant Laws

Mexico has a federal system of government which structurally is somewhat similar to that of the United States (e.g., one federal jurisdiction and 31 state jurisdictions). Each jurisdiction has the power to make laws, with federal law being superior to state law.

The principal Mexican laws which are relevant to asset-based lending by a United States lender in Mexico are:

- Code of Commerce (Federal) and General Law of Instruments and Credit Operations (Federal): Govern most commercial transactions (other than those involving real property) and related guarantees and security devices.
- Law of Bankruptcy and Suspension of Payments (Federal): Governs most bankruptcy proceedings involving merchants and commercial companies.
- General Law of Commercial Companies (Federal): Governs general activities and operations of commercial companies.

- Law of Credit Institutions (Federal) and Law of Auxiliary Credit Institutions (Federal): Govern specific activities and operations of most financial institutions and other financial services providers in Mexico and provide certain special rights to them.
- Foreign Investment Law (Federal): Governs property and stock ownership by companies and foreign individuals.
- Income Tax Law (Federal): Governs income taxation of domestic and foreign companies and individuals.
- North American Free Trade Agreement (Federal): Provided the basis or impetus for recent changes to many of the laws referred to above.
- Civil Code (State): Governs real property matters (including liens therein and perfection thereof), conflict of laws matters and various noncommercial matters

B. Restrictions on Conducting Business, Participation in Certain Activities and Property Ownership

1. Restrictions on Conducting Business in Mexico

In general, a foreign entity may not "do business" in Mexico without the authorization of and registration with the proper Mexican authorities. Furthermore, a foreign entity that "does business" in Mexico as a provider of certain financial services (e.g., banking, factoring, leasing and lending) also may be required to receive authorization to do so from the Ministry of Finance and Public Credit (also known as the "Hacienda").

2. Restrictions on Foreign Participation in Certain Activities and Foreign Ownership of Certain Assets

Since December 28, 1993, foreigners and Mexican companies controlled by foreigners generally may own without prior approval up to 100% of the capital of Mexican companies and otherwise engage in commercial activity in Mexico on the same basis as Mexican corporations without foreign investors, except for specific limitations in the Foreign Investment Law and, in the case of foreign investment in the financial sector, the specific limitations in the laws regulating the financial sector (prior to that time, foreign investment in Mexican companies generally was limited to 49% or less). However, the restrictions that do exist can pose a problem where the U.S. lender has a permanent establishment in Mexico or its putative collateral is real property or stock in (or assets of) companies that are engaged in activities regulated as to foreign participation.

a. Foreign Participation in Reserved or Restricted Activities and Ownership of Corporations Engaged in Those Activities

- In general, the reservations and restrictions can be classified as:
 - @ State-Reserved Activities (activities and ownership of corporations in certain specific strategic areas are reserved exclusively to the Mexican government).

- @ Mexican-Reserved Activities (activities and ownership of corporations in certain other specific areas are reserved exclusively to Mexicans or to Mexican companies with an "exclusion of foreigners clause").
- @ Restricted Foreign Participation Activities (foreign participation in certain other activities and ownership of corporations is limited in percentage).
- @ Conditional Foreign Participation Activities (foreign participation in certain other activities and ownership of corporations is limited to 49%, unless approved by the National Foreign Investment Commission).

Special rules apply where the foreigner's investment is "neutral investment."

b. Ownership of Real Property

The location of land and its use inside or outside of the "restricted zone" affects the ownership rights that a person may have in the land and whether or not any governmental registration or approval is required (beyond merely recording the deed in the real estate records). The "restricted zone" is land located within 100 kilometers of the borders and 50 kilometers of the coasts.

III. HOW TO STRUCTURE MEXICAN ASSET-BASED LENDING TRANSACTIONS

As mentioned above, this discussion will focus on three common lending scenarios:

- (i) U.S. borrower with accounts receivable owing from Mexican account debtors and inventory located in Mexico,
- (ii) U.S. borrower with a Mexican affiliate located outside of the United States and Canada willing to grant a security interest in accounts receivable owing from account debtors located in the United States and inventory located in the United States as collateral for loans to the U.S. borrower, and
- (iii) Mexican borrower with accounts receivable owing from Mexican account debtors and inventory located in Mexico.

We have assumed for purposes of this paper that the U.S. lender will have (i) required all parties to have executed in the United States all of the typical loan and security documentation that an asset-based lender would ordinarily require in connection with an asset-based loan (including stipulations that all matters pertaining to the transactions are to be governed by the laws of a jurisdiction in the United States, that all disputes relating to the transactions are to be contested in a forum in that jurisdiction, that all loans are to be funded only in United States dollars made available to the borrower at the U.S. lender's office in the United States and that all payments are to be made only in United States dollars in the U.S. lender's office in the United States), and (ii) perfected its security interests and liens as it ordinarily would under applicable United States law as though all of the parties to the transaction were located in the United States and all of the collateral was in the United States.

The U.S. lender needs to recognize that there is a genuine risk in each of these cases that the U.S. lender's rights and remedies with respect to its collateral (as well as other matters) may be adjudicated in a Mexican court, and therefore should carefully evaluate the means by which it attaches and perfects, and determines the priority of, its security interests. Unfortunately, there is not yet an international convention or treaty between the United States and Mexico which generally governs debtor-creditor obligations, security devices, perfection of security interests and liens in collateral or the effect of perfection and non-perfection and the consequences thereof as they apply to accounts receivable, most inventory, most equipment, real estate and other items commonly taken as collateral and given loan value by U.S. lenders. Even with the U.S. lender having done what we have assumed, there are still some portions of the transaction that will be governed by Mexican law because either applicable U.S. law will direct us to the laws of Mexico (e.g., UCC § 9-103) or realization against collateral located in Mexico will require the assistance of a Mexican court which will apply Mexican law to the matter.

A. Approaching the Conflict of Laws Issues

While the U.S. lender may have done all that it could to "Americanize" the transaction, there are some conflict of laws issues that will still have to be addressed. This discussion will address conflict of laws issues that relate to attachment and perfection, and will discuss them comparatively based on how the law might be applied by United States and Mexican courts in the context of the three common lending scenarios described above. (For simplicity, we will only address collateral consisting of accounts receivable, ordinary inventory goods and real property).

1. U.S. Borrower's Accounts Receivable Owing From Mexico Account Debtors and Inventory Located in Mexico.

a. Proceedings in United States Courts

In regards to the security interest in both accounts receivable and inventory, the United States court probably would (i) uphold the parties' choice of United States law as to attachment based on UCC § 1-105 (which allows parties to a transaction that bears a reasonable relation to two or more jurisdictions to agree that the laws of any of those jurisdictions will govern their rights and duties), and (ii) apply the laws of (a) the jurisdiction where the debtor is located (i.e., the United States) to determine whether or not the U.S. lender's security interest in accounts is perfected and the resulting effects on and priority of the security interest (under UCC § 9-103(3)(b)) and (b) the jurisdiction where the inventory is located (i.e., Mexico) to determine whether or not the U.S. lender's security interest in the goods is perfected and the resulting effects and priority of the security interest.

b. Proceedings in Mexican Courts

In regards to the security interest in accounts receivable, (i) the Mexican court should uphold the parties' choice of United States law as governing attachment issues (based principally on the facts that the assignor executed the assignment in the United States and the parties agreed to have United States law govern) and (ii) it is unclear whether a Mexican court would apply United States law or internal Mexican law to determine perfection and priority issues. However, the Mexican court will probably apply Mexican law to determine the obligations of the account debtors under the accounts receivable.

In regards to the security interest in inventory, the Mexican court probably would apply internal Mexican law as governing attachment issues (because the goods are located in Mexico), as well as apply internal Mexican law to determine perfection and priority issues.

c. U.S. Lender's Considerations

In regards to accounts receivable, the U.S. lender's general approach should be to comply with the attachment and perfection requirements under United States law. However, the U.S. lender also should consider notifying the Mexican account debtors in compliance with Mexican law in order to require them to remit payment directly to the U.S. lender. Furthermore, the U.S. lender will want to make certain that the debtor can prove that the accounts receivable are actually due and owing from the Mexican account debtors (which is much more difficult to determine legally in Mexico than it is in the United States) and make sure that the accounts receivable have not previously been assigned to another party under Mexican law.

In regards to inventory, the U.S. lender in all cases where it is lending on goods located in Mexico should attach and perfect its security interest under both United States law and Mexican law. In cases where the U.S. lender is not lending on the goods and is not interested in expending the time and expense to protect itself in regards to proceedings in Mexican courts, the U.S. lender should consider obtaining a written acknowledgement of its security interest from the third-party that has possession of the goods (which frequently is the case) in an effort to comply with UCC § 9-103(1) (which directs a secured party to perfect under the laws of the jurisdiction in which the goods are located) and thereby improve its position in the goods relative to a United States bankruptcy trustee under United States law.

2. Mexican Affiliate Located Outside the United States and Canada with Accounts Receivable Owing from U.S. Account Debtors and Inventory Located in the United States, as Collateral for Loans to a U.S. Parent.

a. Proceedings in United States Courts

In regards to the security interest in accounts receivable, the United States court probably would (i) uphold and apply the parties' choice of United States law as to attachment based on UCC §1-105, and (ii) apply UCC §§ 1-105 and 9-103(3) to determine the effect of perfection and priority matters (which probably would lead it to the conclusion that the U.S. lender would have to perfect either in accordance with the laws of jurisdiction in which the debtor is located (i.e., Mexico) or by notification of account debtors).

In regards to the goods, the United States court probably would (i) uphold and apply the parties' choice of United States law as to attachment based on UCC §1-105, and (ii) apply UCC §§1-105 and 9-103(1) to determine the effect of perfection and priority matters (which probably would lead it to the conclusion that the U.S. lender would have to perfect in accordance with the laws of the jurisdiction where the goods are located (i.e., the United States)).

b. Proceedings in Mexican Courts

In regards to the security interest in accounts receivable, (i) the Mexican court should uphold the parties' choice of United States law as governing attachment issues (based principally on the facts that the assignor executed the assignment in the United States and the parties agreed to have United States law govern) and (ii) it is unclear whether a Mexican court would apply United States law or internal Mexican law to determine perfection and priority issues.

In regards to the security interest in inventory, the Mexican court probably would apply internal Mexican law as governing attachment issues (because the goods are located in Mexico), as well as apply internal Mexican law to determine perfection and priority issues.

c. U.S. Lender's Considerations

In regards to the security interest in both the accounts receivable and the inventory, the U.S. lender should seek to perfect its security interest under the laws of the United States and the laws of Mexico. Because a Mexican entity is the debtor, the likelihood that proceedings will arise in Mexico are much greater, and courts generally are more comfortable with (and provide more predictable results) in applying the law of the jurisdiction in which they sit.

The U.S. lender's position would be strengthened where the ownership of the collateral is transferred out of the Mexican entity, either by requiring the collateral to be sold first to a United States entity (and have the security interest granted by the United States entity) or by requiring the use of a guaranty trust (in which the trustee would be the owner of the collateral and hold it for the benefit of the U.S. lender under the terms of the trust agreement).

3. **Mexican Borrower Located Outside the United States and Canada With Accounts Receivable Owing from Mexican Debtors and Inventory Located in Mexico.**

a. Proceedings in United States Courts

In regards to the security interest in accounts receivable, the United States court probably would (i) uphold and apply the parties' choice of United States law as to attachment based on UCC §1-105, and (ii) apply UCC §§1-105 and 9-103 to determine the effect of perfection and priority matters (which probably would lead it to the conclusion that the U.S. lender would have to perfect either in accordance with the laws of the jurisdiction in which the debtor is located (i.e., Mexico) or by notification of account debtors).

In regards to the goods, the United States court probably would uphold and apply the parties' choice of United States law as to attachment based on UCC §1-105, and (ii) apply UCC §§1-105 and 9-103(1) for perfection and priority matters (which probably would lead it to the conclusion that the U.S. lender would have to perfect in accordance with the laws of the jurisdiction in which the goods are located (i.e., the United States)).

b. Proceedings in Mexican Courts

In regards to the security interest in accounts receivable, (i) the Mexican court should uphold the parties' choice of United States law as governing attachment issues (based principally on the facts that the assignor executed the assignment in the United States and the parties agreed to have United States law govern) and (ii) it is unclear whether a Mexican court would apply United States law or internal Mexican law to determine perfection and priority issues.

In regards to the security interest in inventory, the Mexican court probably would apply internal Mexican law as governing attachment issues (because the goods are located in Mexico), as well as apply internal Mexican law to determine perfection and priority issues.

c. U.S. Lender's Considerations

In regards to the security interest in both the accounts receivable and the inventory, the U.S. lender should seek to perfect its security interest under the laws of the United States and the laws of Mexico. Because a Mexican entity is the debtor, the likelihood that proceedings will arise in Mexico are much greater, and courts generally are more comfortable with (and provide more predictable results) in applying the law of the jurisdiction in which they sit.

As was the case with the previous scenario where a Mexican entity was the owner of the collateral, the U.S. lender's position would be strengthened if the ownership of the collateral could be transferred out of the Mexican entity, either by requiring the collateral to be sold first to a U.S. entity (and have the security interest granted by the U.S. entity) or by requiring the use of a guaranty trust (in which case the trustee would be the owner of the collateral and hold it for the benefit of the U.S. lender under the terms of the trust agreement).

B. Mexican Guarantees and Security Devices

Under Mexican law, guaranties and security devices both are types of guaranties of credit in Mexico, and are referred to respectively as "**personal guaranties**" and "**guaranties over assets**".

Personal guaranties include a **general guaranty** and an **endorsement guaranty**. **Guaranties over assets** include a **guaranty trust**, a **mortgage**, an **industrial mortgage**, an **operating credit**, an **equipment credit**, an **assignment of accounts**, and a **commercial pledge**.

It is important to be aware that under Mexican law a guaranty by a corporation of the obligation of a third party is unenforceable unless the corporation's charter includes the power to make such a guaranty as a corporate purpose, and a spouse cannot guarantee obligations of the other spouse without court authorization.

1. Personal Guaranties

A **general guaranty** (known as a "fianza") is a guaranty under an agreement which is separate from the instrument which evidences the obligation guaranteed and is similar in many ways to the typical third-party guaranties used in the United States. The general guaranty has the benefit that it can cover any and all present and future indebtedness of an obligor, however its enforceability is dependent upon the validity and enforceability of the obligation guaranteed.

An **endorsement guaranty** (known as an "aval") is a guaranty executed physically upon the instrument which evidences the obligation guaranteed, and is similar in many ways to the obligation of a co-maker of the instrument under U.S. law. The endorsement guaranty is a guaranty only of a specific then-existing debt, but it has the benefit that the guarantor's liability under the guaranty is independent from the obligation guaranteed and the guaranty can be enforced against the guarantor without the need to first proceed against the obligor.

2. Guaranties Over Assets

a. Guaranty Trust

A guaranty trust (known as a "fideicomiso en garantia") is in many ways similar to the arrangement for asset management that is provided by corporate trust departments of banks in the United States in regards to credit and collateral. There typically are three parties involved in a collateral trust - the debtor, the trustee/fiduciary, and the beneficiary.

A guaranty trust can be created for the purpose of administration of a credit or collateral, and almost any kind of credit or collateral can be the subject of a trust. A guaranty trust has the benefit of removing legal and beneficiary ownership of the trust property from the debtor's bankruptcy estate, as well as enabling the trustee/fiduciary to proceed extrajudicially in the event of a default. However, only Mexican banks with trust powers are legally permitted to be fiduciaries under the guaranty trust, and consequently significant fiduciary fees are associated with a guaranty trust. Furthermore, the U.S. lender will be entirely dependent on the trustee/fiduciary for extrajudicial enforcement of the trust agreement.

A guaranty trust is created by a written instrument which conforms to the laws governing the transfer of rights in the property transferred to the trust. To have effect against third parties, the trustee must take whatever further action would be required if it was perfecting a lien on the trust asset. Consequently, there generally are notarial fees and taxes and recording fees that will be incurred in connection with the execution and registration of the trust agreement.

b. Mortgage

A mortgage (known as a "hipoteca") is similar in many ways in form and substance to a mortgage in the United States and encumbers land and certain other property and rights pertaining to or located on the land with a lien that can be foreclosed upon judicially by the creditor whose credit is secured by the lien. Unfortunately, the mortgagee has no right to a nonjudicial foreclosure of sale.

A mortgage can encumber not only land, but other items and rights pertaining to the land, such as machinery and equipment used in the business, industry and exploitation of the land, industrial fruits of the property mortgaged which were produced before the creditor demands payment of the secured obligation, and rents due and unpaid at the time that the creditor demands payment of the secured obligation. All of the property covered by the mortgage must be specifically described. When multiple properties secure the same credit, a part of the credit must be determined for each, and as the debt is paid down

the mortgagee must release collateral. This is also the case when the mortgaged property can be conveniently divided (whether or not it in fact was divided at the time that the mortgage was entered into).

A mortgage must be executed before a notario, and in order for it to have effect against third parties it must be registered in the Mortgage Registry where the property is located. Accordingly, notarial fees and recording fees and expenses will be incurred in connection with the execution and recordation of the mortgage.

c. Industrial Mortgage

An industrial mortgage (known as a "hipoteca industrial") is a type of mortgage available to a Mexican bank that encumbers the whole unit of agriculture, livestock, or industrial or service enterprises. Unfortunately, the industrial mortgage is available only to Mexican banks.

In order to be effective, the industrial mortgage must grant a lien in at least all movable and immovable property belonging to the enterprise (which is part of the whole) and also may include derivative cash and accounts receivable from its business operations (without prejudice to the debtor's right to dispose of them and substitute them for others in the ordinary course of business, except as otherwise agreed upon). Where a Mexican bank is taking a mortgage on a debtor's real property, with only minor adjustment the mortgage can be made into an industrial mortgage that will have the effect of creating a lien for all present and future financing and securing all property that is considered as comprising the enterprise.

An industrial mortgage is established with the same procedures and formalities as an ordinary mortgage and must be notarized and registered in the Mortgage Registry where the property is located. Accordingly, notarial fees and recording fees and expenses will be incurred in connection with the execution and recordation of an industrial mortgage.

d. Operating Credit

An operating credit (known as a "credito habilitacion o avio") is a special type of loan under a commercial pledge for financing production costs of a company, and the credit receives an automatic lien on the raw materials or merchandise acquired and with the products resulting from the credit (present, future and pending). The operating credit and the equipment credit (see below) are special forms of commercial pledges where there are additional formalities, but there is no requirement of delivery of the collateral to the creditor.

An operating credit is a useful working capital financing security device because the collateral secures all advances made under the credit. However, the operating credit does not provide the same scope of protection as a UCC Article 9 security interest because, among other things, (i) the proceeds of loan must be made to the debtor used entirely for the acquisition of raw materials and merchandise and payment of wages, salaries and the direct necessary expenses of an operation (or in some cases tax obligations and prior debts incurred by the borrower for operating expenses, purchases of property, provided that the acts giving rise to the debts in question have taken place within the prior year), and lien is limited to the amount so used, (ii) it is limited to manufacturing businesses (distribution or service businesses probably do not qualify), and (iii) its specificity requirements on description of credit, amount and

purpose and tracing of use of funds and collateral can be troublesome.

A lender acquires an operating credit by entering into written loan contract and pledge agreement with the debtor that complies strictly with the documentation requirements of the statute, and recording it in the proper registry. There generally will be notarial fees and recording fees and expenses that will be incurred in connection with the execution and recordation of an operating credit.

e. Equipment Credit

An equipment credit (known as a "credito refaccionario") is a special type of loan under a commercial pledge for financing capital improvements, and the credit receives an automatic lien on the real estate, buildings, constructions, machinery, fixtures and products resulting from the credit (present, future and pending). The equipment credit and the operating credit (see above) are special forms of commercial pledges where there are additional formalities, but no requirement of delivery of the collateral to the creditor.

An equipment credit is a useful equipment financing security device because the collateral secures all advances made under the credit. However, the equipment credit does not provide the same scope of protection as a UCC Article 9 securing interest because, among other things, (i) the proceeds of the loan must be used entirely for the acquisition, manufacture or installation of machinery and equipment necessary for the business of the borrower, and the lien is limited to the amount so used, (ii) it is limited to manufacturing businesses (distribution or service businesses probably do not qualify), and (iii) its specificity requirements on description of credit, amount and purpose and tracing of use of collateral can be troublesome

A lender acquires an equipment credit by entering into a written loan contract and pledge agreement with the debtor that complies strictly with the documentation requirements of the statute and recording it in the proper registry. There generally will be notarial fees and recording fees and expenses that will be incurred in connection with the execution and recordation of an operating credit.

f. Assignment of Credit

The assignment of credit (known as a "cesion de credito") is a means of a debtor assigning its accounts and other credits to a lender, either outright (as is the case in factoring) or as collateral for a loan. The assignment attaches and is perfected by obtaining specific assignments of the accounts receivable and giving proper notice of the assignment to each of the account debtors. In general, the assignment does not become effective against an account debtor until the account debtor is notified of the assignment in the presence of two witnesses.

Something to be aware of in Mexico is that English translations of the terms they use to describe the papers involved in an accounts receivable transaction can be misleading. For example, in Mexico the "invoice" is the instrument that the debtor or lender furnishes to the account debtor as proof that the debtor or lender has received payment on the account receivable described in the instrument (rather than the instrument which requests payment, which in Mexico often is referred to as a "debit note").

g. Commercial Pledge

A commercial pledge (known as a "prenda mercantil") is an encumbrance on personal property which guarantees an obligation. A commercial pledge is a versatile security device that in theory can be used with any personal property collateral, but is particularly useful where the creditor desires a lien on specifically identified tangible personal property of which it will take possession to secure a specific present indebtedness (e.g., share certificates, goods in storage in a public warehouse evidenced by warehouse certificates, etc.). Unfortunately, the commercial pledge generally does not provide the pledgee with a right to a nonjudicial foreclosure or sale.

The property encumbered by the commercial pledge must be described in specific detail in the pledge instrument and a new amended pledge instrument must be obtained whenever additional collateral is to secure the principal obligation. Also, the collateral is required to be delivered (actually or constructively) to the lender in order for the commercial pledge to be effective as against third parties, which makes it difficult to use a commercial pledge where the collateral consists of accounts receivable, or most types of inventory and equipment. Lenders in Mexico typically do not lend under a commercial pledge of those types of assets because of the difficulties with delivery (as well as conflicting opinion as to the privilege class priority of the commercial pledge), and prefer instead to rely on one of the other security devices described above.

The requirements for a commercial pledge are (i) a principal obligation, (ii) delivery of the collateral to the creditor (the form of delivery required varies based on the type of collateral) and (iii) a written agreement which evidences an intention that the collateral delivered serve as collateral for the principal obligation.

It is possible to use a combination of the foregoing security devices in the same transaction. There are special rules for security interests in vessels, aircraft and certain other personal property under which a secured party may make use of a security device similar to a chattel mortgage, but these are beyond the intended scope of our discussion. Also, there are special rights and remedies available to creditors under installment sales contracts, conditional sales contracts, leasing contracts and warehousing contracts, but these also are beyond the intended scope of our discussion.

C. Prior Mexican Liens and Where to Find Them - Some of Record and Some Not

In general, the priority of a lien or claim under Mexican law is determined by the rank of its privilege, with all creditors having a higher rank of privilege being entitled to payment out of the debtor's assets prior to those of lower rank of privilege. In order for most Mexican commercial security devices to attain a special privilege (and thereby be effective against the rights of ordinary third parties claimants), some action beyond the mere execution of a security agreement between the parties is required. The additional action permitted or required depends on the type of credit provided and the type of collateral to be covered by the security agreement, but generally can be categorized as recordation, possession and notice. In addition, certain liens have effect against the rights of third parties automatically and do not require recordation, possession or notice.

A creditor that is considering extending new credit will need to apprise itself of the prior liens that might exist, but doing so is not as simple as it is in the United States. As a general rule, a creditor can ascertain most prior contractual liens under Mexican law (i) on ordinary goods by searching the applicable public registry

and inquiring of the parties in possession of the goods, (ii) on real property by searching the property registry in the municipality in which the real property is located and (iii) on accounts by reviewing the debtor's evidence of the existence of the account, searching the applicable public registry and inquiring of the account debtors. Whether or not this is feasible for the creditor to do depends on the particular case.

In any event, there are some liens and privileges (such as laborer's claims and certain taxes) that arise automatically and the creditor will need to use other means to identify and quantify its corresponding exposure.

IV. HOW TO REALIZE ON MEXICAN COLLATERAL

The U.S. lender should carefully review the means through which it may pursue enforcement and realization action. Proper planning of forum selection and consents to jurisdiction can be helpful in this regard. While the United States presently is not a party to any international conventions on the enforcement of foreign judgments, many individual states have enacted statutes which, under certain circumstances, give recognition to foreign nation judgments. These state statutes, as well as federal and state common law, form the basis for comity under certain circumstances.

A. Enforcement Action through United States Courts

In general, a U.S. lender may use a United States court as a forum for claims involving Mexican collateral (other than real property collateral) provided that it has satisfied the jurisdictional requirements described below, although it ultimately may have to look to courts in Mexico to recognize and enforce the judgment against assets located in Mexico. The principal hurdles that the U.S. lender will have to prosecuting an action in a United States court are (i) obtaining personal jurisdiction over the debtor, (ii) obtaining suitable service of process on the debtor and (iii) having the debtor respect extrajudicial actions taken by the lender under United States law.

Of the various bases for obtaining personal jurisdiction over a debtor, the most expedient, convenient and reliable method would be for the U.S. lender to have obtained the consent of the debtor to the jurisdiction of a United States court. It is also conceivable that some Mexican account debtors also might consent to the jurisdiction of a United States court to resolve disputes in its contracts with the debtor, although less likely (especially if the accounts receivable arise out of sales from a Mexican debtor). Absent a consent to jurisdiction by the party, the U.S. lender will need either to (i) find another basis for jurisdiction for a court in the United States or (ii) bring an action in a foreign court which has jurisdiction over the party.

In regards to service of process, a Mexican court may look to matters of fairness (e.g., notice and an opportunity to defend) in determining whether or not to give effect to a foreign judgment. Consequently, the U.S. lender should plan ahead prior to serving a Mexican borrower or Mexican debtor through one of the expedited means by which private parties may serve process under United States law. The advisable practice today is to have defendants served through diplomatic channels (such as through a "letter rogatory" or through the Hague Convention on Service Abroad on Judicial and Extrajudicial Documents in Civil and Commercial Matters (Hague Service Convention)). Unfortunately, the use of these processes is cumbersome and time-consuming.

Enforcement by the U.S. lender of its UCC Article 9 rights and remedies in United States courts and extrajudicially in the United States is a relatively streamlined process. In many cases, no judicial involvement is necessary (e.g., direct notification of account debtors). However, the difficulty remains that the U.S. lender might need to invoke Mexican courts in order to compel Mexican account debtors to make payment on accounts receivable or to seize assets located in Mexico.

B. Enforcement Action through Mexican Courts

In general, enforcement of the U.S. lender's rights and remedies in a Mexican court can be a difficult and time-consuming process beyond the ordinary frustrations which generally are attendant to litigation. These include, among other things, language barriers and procedural obstacles. As an initial point, the U.S. lender counsel needs to be aware that all proceedings are conducted in Spanish and the U.S. lender's standing in the proceeding may depend as much on the power of attorney to its Mexican local counsel being in proper form as it does on the merits of its claim. Furthermore, the U.S. lender needs to know that generally there are no rights of "self-help" or private foreclosure sales on a security interest available to a secured party under Mexican law. For the most part, all enforcement action must be accomplished judicially under Constitution Art. 17 in the applicable Mexican court.

1. Civil Proceedings in Mexico

The prescribed course of civil judicial enforcement proceedings in Mexico under a security agreement can be briefly described as follows: (a) a complaining party files a complaint or petition; (b) the court demands defendant's payment; (c) judicial lien attaches to the collateral (which may involve seizure of the collateral for deposit with the court); (d) defendant answers the complaint; (e) pleading and proof stage; (f) upon resolution, the goods are sold by the court and the proceeds delivered to the creditor if the creditor prevails or returned to the debtor if the debtor prevails.

Certain documents entitle the holders to bring what is termed an executive action (of attachment), in which case the holder is entitled, as a matter of right, to attach its obligor's property. These documents include public instruments, properly executed commercial paper, and signed commercial contracts and current accounts which have been judicially recognized. If a debtor does not pay at maturity, the secured creditor may apply to a judge for sale of pledged property at an auction in accordance with rules provided in Code of Civil Procedure, but the parties may agree post-default that such a sale may be made extrajudicially.

Unfortunately, the simplicity and swiftness of result contemplated in the civil procedure code does not mirror the experience of litigants seeking to enforce security agreements.

2. Suspension of Payments and Bankruptcy in Mexico

While Mexican bankruptcy law is somewhat similar to United States bankruptcy law in its form and text, it is our understanding that in actual practice the Mexican suspension of payment proceedings and bankruptcy proceedings are slow and frustrating for secured creditors and generally result in negotiated settlements by the parties rather than adjudications of the merits of the cases by the courts.

Although it is beyond the scope of this presentation to discuss in any depth the implications of Mexico bankruptcy laws or special priority rules, it is important for U.S. lenders to be aware of the basic procedural aspects of Mexican law in this area and some of the more common significant differences between Mexican bankruptcy law and United States bankruptcy law that are relevant to this discussion.

a. Types of Proceedings

There are two types of commercial insolvency proceedings in Mexico - suspension of payments and bankruptcy. Suspension of payment proceedings are commenced by a debtor in an effort to restructure its debts with its creditors and continue on with its business in some reorganized form. Bankruptcy proceedings are essentially liquidation proceedings, and can be commenced by either a debtor or its creditors. The principles of each are similar to many of the concepts used in the United States Bankruptcy Code, although there are numerous substantive differences.

In the case of both suspension of payments proceedings and bankruptcy proceedings, an estate of the debtor (known as a "masa") which is similar to what we know as the "property of the estate" under United States bankruptcy laws is created. There also is a concept analogous to a stay of execution that applies to most claims against the estate, which requires these claims to be brought before the bankruptcy court in order to be recognized and classified. Importantly, this stay does not apply to certain claims of certain types of creditors, such as the claims of laborers (which are resolved by a labor court) and claims of taxing authorities. Similarly, certain foreclosure proceedings which were begun prior to the commencement of the suspension of payments or bankruptcy proceedings may be permitted to continue in the courts in which they were initiated.

In a suspension of payments proceeding, the debtor typically would be permitted to retain possession of its assets and to continue its business. However, the court may appoint a receiver (known as a "sindico") to supervise the debtor. In a bankruptcy proceeding, the debtor relinquishes possession of its assets to a receiver appointed by the court and the receiver has the duty to liquidate the business of the debtor. In each type of proceeding, some of the creditors (known as "interventores") may function in a manner similar to that of a creditors committee under United States bankruptcy law by overseeing the actions of the receiver.

b. Additional Substantive Differences

The other substantive differences between the Mexican bankruptcy system and the United States bankruptcy laws are too numerous to address individually, and range from the absence of a concept of adequate protection to the bankruptcy judge having the power to determine the duration of voidable preference periods on a case by case basis.

Of greater importance than these differences to the U.S. lender, however, is that the Mexican suspension of payments and bankruptcy system does not have a history of protecting foreign creditors through judicial adjudication of rights. Rather, foreign lenders have been forced into negotiating private settlements with the parties. Consequently, even the limited degree of predictability to which a creditor is accustomed in the United States bankruptcy courts is not available in Mexican suspension of payments and bankruptcy proceedings.

3. Enforcement of United States Judgments in Mexico

In general, Mexican courts will enforce foreign judgments and decrees only if: (a) they comply with regulations relating to letters rogatory; (b) they were given in a personal action; (c) the obligation on which they are based is legal in Mexico; (d) the defendant was personally summoned in the action; (e) they are final judgments according to law of the country of origin; and (f) they are properly authenticated. Furthermore, Mexican courts will give foreign court judgments and other judicial decisions the force required by treaty but, in the absence of a treaty, such judgments and other judicial decisions will have only the same force as Mexican judgments and decrees are given in such foreign jurisdiction (i.e., a judgment from a United States court will be enforced only to the extent that a Mexican judgment would be enforced in the jurisdiction in which that United States court sits). In other words, there is a reciprocity standard which must be satisfied (such as the corresponding state's enactment of the Uniform Foreign Money Judgments Recognition Act) and a Mexican court probably will refuse to enforce a foreign judgment if it concludes that the United States court had denied procedural fairness to the defendant or failed to obtain personal jurisdiction over the defendant in accordance with the Mexican concepts of personal jurisdiction it probably will refuse to enforce the judgment.

As a general rule, the original action on the merits would be commenced in the foreign jurisdiction and the foreign court must issue letters rogatory, which are forwarded to the appropriate Mexican officials and, under Mexican rules and regulations, must be served on the defendant at its domicile. To enforce a foreign judgment in Mexico, the foreign court that issues the judgment (which must be a final and non-appealable judgment) must have its judgment consularized and the signature of the judge authenticated, and must issue a letter rogatory to be addressed to a Mexican court asking for its assistance in enforcing the judgment.

The Mexican court in which to seek enforcement of a foreign judgment is the same court that would have had jurisdiction if the action on the merits had been brought in Mexico. The foreign judgment must be duly translated into Spanish, and both parties will be given an opportunity to be heard, as well as in some cases an attorney for the Mexican government. Generally, a Mexican court will not inquire into merits of foreign judgment but merely will determine its authenticity and whether or not it is enforceable under Mexican law. However, foreign judgment enforcement procedures vary from state to state and are extremely complicated and technical.

V. ASSORTED OTHER ISSUES

A. Tax Matters

- United States Federal Income Tax Issues Regarding Foreign Controlled Corporations.

The United States Internal Revenue Code under certain circumstances deems financing transactions involving the granting of liens on the assets or stock of a foreign corporation controlled by United States corporation to be a distribution by the foreign corporation to the United States corporation. This may give rise to tremendously unfavorable tax consequences to a United States corporation that has significant earnings and profits in a Mexican subsidiary and desires to use the assets or stock of that subsidiary as collateral for financing to the United States corporation.

- Mexican Withholding Tax.

Mexico imposes a withholding tax on interest, dividends and royalties paid by Mexican companies to foreigners. The United States and Mexico entered into a tax treaty which became effective as of January 1, 1994, which provides for significant reductions in the withholding tax rates.

B. Fraudulent Transfer

Under Mexican law, acts done by a debtor to the prejudice of an existing creditor's prior credit may be annulled by the creditor if the acts result in the debtor's insolvency (which under Mexican law means the sum of the properties and credits of the debtor, appraised at their fair price, is less than the amount of its debts). If the act was gratuitous (i.e., without valuable consideration), it can be annulled even if there was good faith on the part of the parties. If the act was for valuable consideration, it can be annulled only when there was bad faith both on the part of the debtor and on the part of the transferee (however, bad faith includes knowledge that the debtor is insolvent). Also, payments made by an insolvent debtor prior to maturity can be annulled.

VI. Planning Considerations

As discussed above, the U.S. lender's principal legal issues to address are (i) conflict of laws, (ii) the availability of security devices under the relevant local law and the effect thereof, and (iii) enforcement and realization of collateral.

In evaluating these issues, the U.S. lender should determine in advance which procedural, conflict of laws, security and enforcement issues are most important to the lender in a given transaction (taking into consideration, among other things, the identity of the primary obligor, the extent to which there are assets available for execution in the United States or Mexico and the likelihood of the U.S. lender obtaining a favorable judgment in Mexico versus the risk that a United States judgment would not be enforced in Mexico).

Generally, the U.S. lender will avoid a significant amount of complication if its borrower under its credit facilities is a United States company rather than a Mexican entity. Direct lending can give rise to many complex and unintended consequences, such as regulatory issues, limited enforceability of loan documents because of discretionary lending provisions, certain covenants and default provisions, tax problems (foreign withholding tax on agency fees, etc., as interest, etc.) and currency convertibility and exchange rate issues. The customary structure is for the U.S. lender to lend to the United States entity and obtain a personal guaranty and a guaranty over assets from the Mexican entities as collateral for the loans. In this regard, it is particularly important that the U.S. lender make certain that the Mexican entities have the corporate power grant the contemplated guaranties.

In any case, the U.S. lender should consider tailoring its security documents (and the debtor's sale of goods transaction documents in the case of accounts receivable financings) to conform as much as possible to agreements which are effective to achieve the desired ends under both United States law and Mexican law. At a minimum, this should reduce the likelihood that a court would refuse to enforce an agreement on the grounds that it provided for a right unknown under local law.

Planning strategies that a United States lender might wish to consider (together with hybrids) in analyzing its legal risks regarding Mexican collateral include:

A. United States Documentation, United States Judgement and Mexican Enforcement of the Judgment.

This strategy would involve the U.S. lender using the laws and courts of the United States (and the relative advantages thereof) to the maximum extent practical in pursuing its rights and remedies, and relying on a foreign court to enforce a United States judgment obtained in the event this becomes necessary. In terms of documentation of the transactions under this strategy, the U.S. lender might consider requiring the debtor to agree that United States substantive law would govern all of their transactions, that all disputes between the lender and the debtor would be resolved in a particular court in the United States and that the debtor consents and submits to the jurisdiction of such United States court for such purposes. In particular with respect to Mexican accounts receivable collateral, the U.S. lender might consider requiring the debtor, in its sale of goods transactions giving rise to accounts receivable, to have written agreements with its account debtors which contain similar agreements between the debtor and the account debtors regarding the selection of United States law and forum and the consent and submission to the jurisdiction of the United States forum in regards to all matters pertaining to the agreements. It should be noted that this would be inappropriate in the case of Mexican real property and fixtures, Mexican intellectual property, Mexican vessels, Mexican aircraft and certain other Mexican property covered by special laws regarding jurisdiction and venue.

This strategy has the advantage of a familiar and relatively expeditious dispute resolution vehicle through the final United States court judgment stage and would enable the U.S. lender to avoid incurring most of the time and expense associated with Mexican documentation and a Mexican forum until (and only if) the transactions required enforcement actions to be taken. However, it becomes more difficult in terms of service of process and procedural matters once foreign entities become involved in the proceeding since the U.S. lender may need to use (at least in Mexico) the letters rogatory or the provisions of the Hague Service Convention or the Panama Convention in order to accord sufficient procedural process to the Mexican entities that a Mexican court would not summarily dismiss an action to enforce the judgment on the grounds that the Mexican entity had not been accorded adequate procedural protections. Also, this strategy has the shortcomings of the U.S. lender having to rely on a Mexican court to enforce the United States court's judgment, without any firm assurances that this will in fact be done. In the event that the Mexican court does not enforce the United States court's judgment, the U.S. lender would have to go through the protracted process of translating documents and commencing litigation on the merits anew in the Mexican forum.

B. Mexican Documentation and Mexican Judgment and Enforcement.

This strategy would involve the U.S. lender documenting the foreign aspects of the transaction with security devices and agreements customary in the Mexico. In such a case, Mexican counsel should be consulted and Mexican documentation used if Mexican law is chosen to govern. The prudent course is to have the transaction strictly structured to conform to the Mexican legal principles and documentation, including being drafted in Spanish or as a dual-language document.

To the extent practical, the U.S. lender should consider requiring all operative documents and notifications certified by a notary. Also, the U.S. lender should consider requiring that all of its contracts are to be performed in the United States and that all payments of money are to be paid in the United States in United States Dollars. This strategy has the advantage of the Mexican court applying its own law to the entire proceedings and interpreting commercial documents with which it probably would be familiar, as well as the certainty that the judgment rendered by that court would be enforceable and not be subject to collateral attack on procedural or jurisdictional grounds. However, this strategy also has the disadvantage of requiring the U.S. lender to incur the time and expense pertaining to the documentation, translation and local counsel at the inception of the transaction.

C. Arbitration and Enforcement of Arbitral Judgment under Convention on Recognition and Enforcement of Arbitral Judgments

One strategy that the U.S. lender might wish to consider is arbitration, rather than litigation, of its international disputes. There are several advantages to arbitration. Internationally, arbitration awards generally are more consistently enforced than are judgments. Also, arbitration can have the advantages of selection of arbitrators, a neutral location, selection of languages, flexible procedures, selection of attorneys, privacy, reduced expense and speed. There are, however, certain disadvantages, such as a general unavailability of interim equitable relief, compromise results, limited discovery, limited judicial review, and delays of arbitrators.

VII. Conclusion

The overview and analytical framework embodied in this presentation should provide a United States counsel with a foundation upon which to build in advising his or her domestic lending clients as to the special legal risks to be addressed prior to lending against Mexican collateral. U.S. lenders (and their counsel) that are able to accurately analyze and underwrite the legal risks associated with this special type of collateral will be in a better position to take advantage of this segment of the North American lending market during the coming years.