

# Financing Cross-Border Businesses and Access to U.S. Capital Markets\*

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## I. INTRODUCTION AND BACKGROUND

Since the devaluation in Mexico several years ago, businesses have increasingly needed money both to finance ongoing operations and to finance expansion to acquire more businesses. Currently, cross-border businesses are booming, especially in the maquiladora industries. These businesses often confront difficulty in acquiring financing for Mexican operations because equity in these businesses is generally low and interest rates on domestically borrowed funds are exceptionally high. As a result, U.S. businesses and lenders are often confronted with opportunities requiring cross-border financing and must be aware of the security devices that are currently available.<sup>1</sup>

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1. This presentation is intended as an overview of issues and concerns associated with cross-border financing and secured lending in Mexico. This presentation is not intended to provide a comprehensive discussion of these issues. For detailed descriptions of the various security devices and the applicability of these security devices to different circumstances and types of transactions, see John Gerber, *Secured Credit Devices in Latin America: A Comparison of Argentina, Brazil, and Mexico*, 23 U. MIAMI L. REV. 677 (1969); John F. Munger, *Rights and Priorities of Secured Creditors of Personality in Mexico*, 16 ARIZ. L. REV. 767 (1974); Alejandro M. Garro, *Security*

Foreign lenders—that is non-Mexican lenders—are basically afraid of the uncertainty they perceive in Mexico. On numerous occasions, I have given presentations similar to this one about the mechanisms available for securing financing in Mexico to banks in this country who want to lend into Mexico. After I conclude telling them how they can structure the transaction and secure their loans, they have responded: “well, it’s all very nice, but it’s still Mexico.” I don’t know whether it is a result of unfamiliarity with Mexico or some sort of hangover from days when things were not as predictable in Mexico as they are today. The biggest impediment, however, that dissuades foreign lenders is their failure to appreciate that these types of transactions can be effectuated. Of course there is legitimate concern about political risk. The democratization in Mexico both in the economic and the political spheres is a good development for Mexico. However, it is difficult to argue that this development signals long-term political stability. Bankers hold a

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Interests in Personal Property in Latin America: A Comparison *With Article 9 and a Model for Reform*, 9 HOUS. J. INT’L L. 157 (1987); David B. Furnish, *Mexican Law on Secured Transactions*, in *DOING BUSINESS IN MEXICO* § 37.01 (SMU ed., 1987); Manuel O. Barragan, *Highlights of Mexican Law Concerning Contractual and Procedural Formalities*, in *DOING BUSINESS IN MEXICO* pt. III, § 106 (Michael W. Gordon ed., 1992); Ronald C.C. Cuming, *Harmonization of the Secured Financing Laws of the NAFTA Partners*, 39 ST. LOUIS U. L.J. 809 (1995); Paul D’Arelli, *Entering the Construction Services Industry in Mexico: Laws Affecting Foreign Participation, NAFTA, and Other Concerns*, 7 TRANSNAT’L LAW. 227, 251-56 (1994); Robert G. Gilbert & Carlos Angulo Parra, *The Financing of Commercial International Transactions and the Rights of Secured Parties in Mexico*, 6 SPG INT’L L. PRACTICUM 9 (1993); John M. Wilson-Molina, *Mexico’s Current Secured Financing System: the Law, The Registries and the Need for Reform* (National Law Center for Inter-American Free Trade 1997) (visited June 4, 1998) <<http://www.natlaw.com/pubs/ spmxbk3.html>>; James C. Chadwick, *A Practical Guide to Creating and Enforcing Security Agreements in Mexico—Secured Lending Transactions Involving Mexican Collateral* (March 24, 1995) (A.B.A. Section of Business Law, Spring Meeting 1995); John B. McNeece III, *Security for Contractual Obligations Under Mexican Law*, in *MEXICAN LAW: A TREATISE FOR LEGAL PRACTITIONERS AND INTERNATIONAL INVESTORS* ch. 26 (Jorge A. Vargas ed., forthcoming August 1998); David W. Banowski, *Practical Guide to Creating and Enforcing Security Interests in Mexico—Secured Credit Transactions in Mexico* (March 24, 1995) (A.B.A. Section of Business Law, Spring Meeting 1995); David W. Banowski & Carlos A. Gabuardi, *Secured Credit Transactions in Mexico*, 28 INT’L LAW. 263 (1994); Thomas S. Heather & Martha Traudt Collins, *Secured Financing of Machinery and Equipment, Including Cross-Border Leasing and Conditional Sales Contracts*, 5 U.S.- MEX. L.J. 23 (1997); David W. Baton, *Mexican Participation in the Maquiladora Industry: Loan Them the Money!!!*, 14 ARIZ. J. INT’L & COMP. L. 329 (1997); John E. Rogers, *The Prospects for Modernization of Financing of Mexican Businesses* (visited June 4, 1998) <<http://www.natlaw.com/pubslusmxlawlusmjnm26.html>>; John B. Rogers, moderator, & David Hurtado Badiola et. al., *Secured Financing of Real Property in Mexico: A Panel Discussion* (visited June 4, 1998) <<http://www.natlaw.com/pubs/usmxlaw/usmjnm26.html>>; Boris Kozoichyk, *The Basis for Proposed Legislation to Modernize Secured Financing in Mexico*, 5 U.S.- MEX. L.J. 43 (1997); Boris Kozolchik, *What To Do About Mexico’s Antiquated Secured Financing Law* (visited June 4, 1998) <<http://www.natlaw.com/pubs/bk9.html>>.

lingering concern about the potential nationalization of assets. American banks, of course, have ample historical justification for this concern and Mexico remembers past negative experiences with the Americans and the French, who the Mexicans have perceived as being let in through the front door and seated at the table, while the Mexicans have felt left at the table with the dishes. Also, repeated devaluations make American lenders nervous. Domestic lenders in Mexico don't have the availability of capital like American lenders and, as a result, charge dissuasively high interest rates. Furthermore, as vividly illustrated by the recent breakdown in the Mexican banking system, the Mexican banking system is weaker than the American banking system.

Banks in the United States would like to lend into Mexico. If you are associated with a business, your business would like to have access to more capital for Mexican operations, but again there is always some reluctance to acquire Mexican lending. Businesses clearly need the money for business expansion. Builders, mortgage lenders, and real estate developers who are building in the second home market in Mexico find that the greatest challenge they face is that homebuyers cannot obtain financing for the acquisition of the house they desire to purchase. Legitimate builders have difficulty attracting legitimate buyers if they can't offer mortgage financing.

Mortgage lenders, I think, see Mexico as an opportunity that they don't know how to fully or even partially engage. One of the challenges in Mexico is the lack of a secondary mortgage market. Because mortgage lenders in this country tend not to be portfolio lenders, they make the mortgage and then sell the mortgage paper to another lender. In the U.S., most people who own a house are not paying the same institution and the entity that is receiving the check is probably not the same bank who made the loan. Mexico does not have a secondary mortgage loan. There are a number of companies in the U.S. and in Mexico who would like to invest in and assist with the low income housing shortage in Mexico. But there is virtually no financing. There is little construction financing and as we already stated virtually no mortgage financing. Equipment financing, synthetic or off balance sheet leasing, and other types of leasing transactions all require the utilization of different security devices in Mexico.

If you look across the border to Tijuana, every one of the buildings on the Mexican side of the border is filled with industrial equipment that cost millions and millions of dollars. If that industrial equipment were

in the U.S., it would most likely be financed through leasing. However, lease financing in Mexico is something that is only starting to develop. There are a couple of very large operations in the business—GE Capital, for example—and some smaller ones. However, giving the leasing company assurances that the company is not going to lose the equipment is often times difficult.

Another common scenario for U.S. practitioners is the representation of distributors or others who are selling to the retail market in Mexico. Your client in the U.S. releases the goods and it is not uncommon that the Mexican buyer does not have the resources available to pay for the goods until the buyer resells them to the end user or customer. This arrangement requires that a U.S. company either swallow the risk or find some type of export financing. U.S. companies operating in Mexico need to finance their operations in Mexico. If these companies have lots of assets in the U.S., a bank will lend on those assets and provide them the money to use in whatever manner they prefer. However, if they do not have sufficient assets in the U.S., and the assets they wish to utilize to collateralize the loan are in Mexico, then the banks must assess the adequacy of security mechanisms in Mexico.

The garment industry is a good example of these challenges facing U.S. lenders. After much of the bad press related to allegations of the intolerable working conditions in “sweat shops” in the U.S., many of the garment manufacturers moved out of Los Angeles and into Mexico. The process of garment manufacturing requires substantial use of machines: sewing machines, pocket setters, and other small mechanized devices. These machines are relatively mobile such that one or two people can easily move them. Therefore, when a representative of one of these businesses enters a bank in the U.S. and says, “I’d like to buy a machine which you could put on the back of a truck, and I’d like to take it Mexico. Would you please lend me \$100,000 for that machine? I’ll give a security interest in the machine.” The bank is well aware of the true value of the security interest: that as soon as there is non-payment, they will see only dust coming out the back wheels of a truck. Thus, the banks must be educated as to the best manner to create and perfect adequate security mechanisms.

Whether we are advising businesses selling to Mexico that need financing, or businesses licensing into Mexico, franchising into Mexico, or financing acquisitions into Mexico, they all need money. Plus, they need to know the strengths and weaknesses and understand the proper situations in which to use the different security mechanisms available in Mexico.

The primary concern for practitioners is confronting the uncertainties and apprehensions associated with cross-border transactions involving

Mexican businesses. The primary answer is that we have to get over it and accept the reality of the current secured financing system while understanding the different mechanisms that can be used and the strengths and weaknesses of those mechanisms in different circumstances

We have to remember that Mexico is a foreign country. Just because many of us speak Spanish, eat Mexican food, and by growing up in California are generally familiar and comfortable with Mexican culture, we cannot forget that Mexico is a foreign country. It has a very sophisticated legal system, which while not always as transparent as the American legal system, still exists and has sophisticated mechanisms available to provide adequate security devices in even very sophisticated transactions. Fundamentally the system works. People successfully do business in Mexico. Just like we all have children and they live, they die, and they pay taxes. Mexico is not *terra incognita*. Therefore rule number one in understanding the secured financing system in Mexico is "get over it, it works; just do your homework."

For those of you who are familiar with doing any kind of secured financing in the U.S., you are accustomed to filing a financing statement. In the U.S. you make a loan, you fill out a one page financing statement (a UCC 1), you file this statement with the state where the security is located and you are done. You have created and perfected an adequate security device. In Mexico they do not utilize financing statements. However they do have other security mechanisms and by doing your homework, you can ascertain which mechanism is most effective in which circumstance and acquire adequate financing with enough security to satisfy your shareholders and your employer and thereby successfully conduct business in Mexico—without losing your shirt. Therefore, rule number two is to do your homework.

The third essential rule of successfully doing business in Mexico is to avoid being in such a hurry. Often my clients come to me and they say, "well, we want to do this or that in Mexico, how long is going to take?" I generally respond by stating: "however long you have, double it." Generally, every stage of a transaction takes longer in Mexico. This is the result of several factors. In part, business transactions take longer because the system does not work as quickly. In part, these transactions may be delayed because the business culture in Mexico is different from business culture in the U.S. If you go to a business meeting, generally you cannot say: "nice to see you, let's sit down, let's get to work."

Business meetings take an extra half hour, or an hour, or a month.

As long as you accept that you are dealing with a different set of variables, you do your homework, and you attempt not to be in such a big hurry, you should be able to do and finance business in Mexico. There is lots of opportunity: trade is increasing, direct investment is still rising in Mexico (although it has dipped in the short term occasionally), and merger and acquisition (M&A) activity in Mexico is still rising, both along the U.S.-Mexican border and in the interior. Additionally, from the perspective of an American lender, the facts that Mexico is illiquid and the banks are weak spells opportunity for investment

## II. THE BASIC CHALLENGES OF LENDING IN MEXICO

### A. *Antiquated Commerce Code*

Lenders primary concern in providing financing is taking a security interest in collateral. Anybody can lend money, however assuring the repayment of the funds is the challenge. Most banks are driven by this concern. Their real interest is obtaining a security interest in collateral that they can rely on. In this country, we have the Uniform Commercial Code. In Mexico, there is no similar commercial code. There is a Commerce Code (*Código de Comercio*), but that code bears little resemblance to the UCC or to modernized commercial codes of other countries. The Commerce Code in Mexico dates back to the 1800's. This code functioned effectively at the time of the American Civil War, but its applicability to modern commercial transactions is questionable. There is a lot of talk about replacing it with something more modern that conforms to international standards, but these changes have not occurred yet. For over twenty years numerous practitioners and commentators have addressed the paramount necessity of reforming Mexico's secured financing laws. Many of these articles compare and contrast the Mexican system to Article 9 of the Uniform Commercial Code and to similarly modeled provisions in other countries. Commentary has increased during the past several years and the need for modernization of Mexico's secured financing system has also increased. However, the reality right now is that if you want to do business in Mexico today, you have to accept that you must operate and make decisions without a modernized uniform commercial code. Essentially that means there are no simple filings to protect yourself, no standard forms, and no fast remedies for getting things done.

### *B. No Non-Possessory Security Interest*

An additional challenge is that generally there is no non-possessory security interest. In other words, if you are not retaining the collateral in your pocket—you don't have a perfected security interest. Therein lies the key problem with the Mexican secured financing system. In the U.S., if you sell inventory or anything else, you can take a security interest in whatever it is irrespective of whether it's here, there, or across the country; you still have a perfected security interest. In Mexico, if you sell somebody a couple of containers full of keyboards, for example, you can take a security interest in the item, and as long as you file your paperwork in the right state, you are protected. If your buyer doesn't pay you, you can go take your keyboards back. The process is very simple and inexpensive. In Mexico, if you do not maintain possession of the keyboards, you cannot take them back. Of course, if you have the items in your possession, you would not need to take them back. However, if the items are in your possession it is difficult for the purchaser of the goods to sell them. Thus, the lack of a non-possessory security interest creates a very challenging situation and dissuades people from participating in this type of a lending scenario, thereby chilling the expansion of business.

### *C. Limited Non-Judicial Foreclosure*

In Mexico, non-judicial foreclosure is limited and not as available as in the U.S. In the U.S., even when you need to utilize the court system, it moves relatively fast. In Mexico, the process is lengthy and expensive. In the real estate context, in California for example, non-judicial foreclosure is used often. There is some protection for homeowners, but even with these protections the process is much faster than in Mexico. In Mexico, there is a constitutional prohibition against using certain non-judicial proceedings because these proceedings are viewed as "doing justice by your own hand." Thus there is more limited access to non-judicial foreclosure.

## III. PRELIMINARY CONSIDERATIONS FOR SELECTING THE PROPER SECURITY DEVICE

The key to a successful cross-border lending transaction is to understand the different security devices in Mexico. To determine

which security mechanisms are available and most effective in a given situation depends first on whether the transaction is a commercial transaction between merchants or a civil transaction, which is one between ordinary folks. The type of security device you use can and does depend on the type of collateral offered as security in the lending transaction. Whether the borrower is still in possession, and whether he or she needs to be in possession, will determine further the type of security device to use. Sometimes if an asset is being pledged to secure an obligation, but the asset isn't what the borrower needs to acquire sufficient funds to repay the lender, the lender can maintain possession of the asset while the borrower goes about his business. Once the borrower makes the money and repays you then you can release the asset. Also, the purpose of the loan effects the determination of which security device should be used in a given transaction. Interestingly, in contrast to the requirements for creating and perfecting a security interest in the U.S., there are certain types of security devices available in Mexico that are only usable if the loan is for a specific purpose. Thus, to determine which type of security you need to use and which security device is available, a practitioner preliminarily must consider whether the transaction is commercial or civil in nature, the type of collateral offered, whether taking and maintaining possession of the collateral is practical with respect to the goals of the lending transaction, and the purpose of the loan.

Another important consideration that is of paramount concern to practitioners is what law applies in a cross-border lending transaction. Professor Jorge A. Vargas, at the University of San Diego wrote an article approximately 2 years ago on the new Mexican law on conflicts of law. Of course the real question is which country's or state's law is going to govern the agreement. In most countries, and Mexico is no exception, parties can agree and contract between themselves as to what law applies. Mexico will respect that agreement. Mexico will also respect a contract which is formed in another country as long as it is legally formed in that other country. Yet, in reference to secured lending under the Mexican law on conflict of laws, the creation of a security interest, is an interest in a piece of property, irrespective of whether the property is movable or immovable. This interest is governed under Mexican law by where the property is located. Thus if we continue with the container of keyboards example, you think you are clever as a practitioner because you determine that you are going to sell the container of keyboards here in the U.S. You may sell the keyboards FOB, which means title passes in Otay Mesa, within the State of California. If you take a security interest under U.S. law, but you no longer have them, the problem is that as soon as the container goes to



Mexico, the Mexican law on conflict of laws will direct a different law to be applied and you have spent a lot of money securing the goods for nothing.

#### IV. OVERVIEW OF TYPES OF SECURITY DEVICES

##### A. *Guarantee Trust*

Numerous security devices are available in Mexico. The guarantee trust and the trust system that is utilized to secure real property is also used to secure obligations. A guarantee trust is a very flexible device in Mexico. You can put almost anything into a trust. For example, you can place contract rights into a trust and then have the purpose of that trust be to secure an obligation. This type of trust is expensive, but flexible.

If you loan a Mexican party or an American party money, but the collateral that you need to secure the loan if something goes wrong is in Mexico, the title of the collateral can be placed into a trust. If you are talking about a real estate transaction, the land can be placed in a trust. Title of the collateral must actually pass to the trust. To create a guarantee trust: (i) you need a bank; (ii) you need the borrower; (iii) the borrower must put title to the assets into the trust, and then (iv) you need a beneficiary that is generally the lender. You can use any type of collateral to create a guarantee trust (contract rights, the family dog, etc.). The guarantee trust is a very flexible mechanism to secure a loan. Only the creativity of the lawyer and the size of your pocketbook determines what you can do with a trust agreement. A lender obtains some sense of security because the debtor no longer has title to or ownership rights in the property. The bank owns the property. There has been and currently is a debate here in Tijuana among trust officers about whether transferring property into a trust actually transfers the title and the ownership, the *rem*, into the trust. The general feeling in Tijuana now, at least along the border here, is that transferring property into the trust does actually transfer the title. This should give lenders some comfort. The drawback of utilizing a guarantee trust is that it can be prohibitively expensive. If you are doing a lot of lending and you can strike a deal, you may negotiate the trustee fees down under \$1,000 per trust. However, most businesses are not engaging in substantial lending. For smaller deals, this mechanism is not particularly useful because of

the expense. To create a guarantee trust you need a public deed which must be notarized and registered in the public registry of property. Because a guarantee trust requires a notary's deed, the notarial process is time consuming and time translates into greater expense.

### *B. Mortgages*

In addition, a lender can use a mortgage to secure an obligation. A mortgage is utilized particularly in situations where a lender is dealing with a privately owned business in Mexico in which the owners are wealthy but the business is poor. A lender who loans to a poor business and does not want the owners to get wealthy at his expense, can take a mortgage on the owner's house. This type of mortgage is well understood, easily enforceable and actually does form a very good type of security in Mexico. Another type of mortgage, industrial mortgages, are effective but available only to banks. An industrial mortgage allows a borrower to provide a bank with a lien over all of the assets of a business. Although this mechanism is a powerful one for banks, there is no equivalent for private commercial lenders.

Mortgages can be created and attached not only to real property, but also to personal property. To effectuate a mortgage, the mortgage document must be properly notarized and filed in a specified location. The real problems in foreclosing on property in Mexico are related to residential property and the challenges of removing the inhabitants from the property. The benefit of using non-residential property such as a machine as security is that the borrower and his family probably do not live in the machine. Thus, if you are not dealing with residential property, foreclosure can be quick. Again, completely non-judicial foreclosure is very limited. The industrial mortgage, which is a very powerful security mechanism, unfortunately is only available to Mexican banks. The conventional mortgage, however, can successfully secure all real and personal property. You can include other assets, but if you are not a Mexican bank entitled to use an industrial mortgage, you are out of luck.

### *C. Commercial Pledges*

Commercial pledges are also available in Mexico and are utilized in situations in which a lender wants to make a loan to someone and the lender does not want to take a security interest in the items that the borrower is selling. A lender can take a pledge of any valuable asset that is available. If there is something valuable somewhere, for example company stock, a lender can take a pledge of the stock.

A lender can require a pledge to secure a loan. Just like you can put anything into a trust, you can pledge anything. Both tangible and intangible things can be pledged. Money, stock, receivables, the right to sue somebody, rights to receive anything, or anything else can be pledged. You do have to deliver the pledged item to the lender. In some cases the delivery process may not be easy. You can have, essentially, a constructive delivery by placing the collateral in some location which is not legally under the control of the borrower. Sometimes, we see this security mechanism being utilized in factories, especially in cross-border situations in which the U.S. seller is providing component parts to a Mexican factory and wants to assure payment for the parts. The lender can set up a chain link cage on the factory floor and require the borrower to place the component parts of something that they are pledging into the cage. The lender then locks the cage and a guardian sits in a chair in front of the lock. Every time they need component parts, the guardian opens the cage and removes a specific item. This process works successfully. The items are no longer the property of the U.S. seller, they no longer have title over the item; however, the U.S. seller does have a perfected security interest in the item, because he/she still has legal possession. This process can be cumbersome in some situations but it is generally useful. The pledge, furthermore, should be notarized. As most of you know, a notary public in Mexico is nothing like a notary public in the U.S. Notary publics must be very experienced lawyers and obtain a license from the federal government in Mexico. A notary public is an extremely prestigious position in Mexico. Today there are only about 5,000 notary publics in all of Mexico.

#### *D. Pledges of Stock*

A stock pledge is something that I find that American lenders, whether banks or businesses financing transactions between themselves or with a Mexican party, fail to take as much advantage of as they should. A stock pledge can be a very powerful tool. The basic idea behind a stock pledge is that if you are selling to a business, most businesses are privately held in Mexico. The primary benefit of taking a pledge of stock is if the person doesn't pay you, you take the company. This tends to focus the borrower's attention on their obligations.

Thus, a practitioner is well advised to remember the possibility of utilizing the pledge of stock. It's a fairly easy transaction: the borrower endorses the stock on the back and the lender takes possession of the

physical stock certificates themselves. Remember that you must take possession in order to perfect the security interest in Mexico. You should also make a notation in the stock register. Each of these steps will take a little time, but they are not difficult to do. If you are not a Mexican, you can have an interest in that stock, but you don't necessarily own it yet. If you own some stock as a non-Mexican in a Mexican corporation, you need to register in the national registry. Therefore, as a safety proposition, a registration with the national registry should always be made. The main drawback of a pledge of stock is that by the time you finish with this process, if you are trying to secure \$50,000, you may spend \$5,000 in legal fees, which is why lenders often opt for other security measures.

#### *E. Operating Credits*

Operating Credits are good for obtaining working capital. Essentially the borrower signs a loan agreement and pledges the items as collateral. Automatically a lien is created over the items. Delivery of the collateral is not required. In the right situation, this type of loan is very useful. It is mostly utilized in the manufacturing sector, which is a big sector here along the border. The only problem is that this mechanism may be somewhat difficult to document which inhibits lenders.

#### *F. Equipment Credits*

Equipment Credits are similar but are useful for capital equipment rather than for working capital. An equipment credit generates an automatic lien over real estate, machinery, and other assets. This security device can apply to after-acquired property and it can secure future advances. You can assign accounts receivable which is something we do frequently in this country. The problem in Mexico, however, and this is what limits the utility of this device, is you cannot pledge your accounts receivable. In the U.S., if you are a borrower, you can pledge your accounts receivable. If you have 100 accounts receivable, this can be a lot of money. Because the accounts receivable is generally one of the largest assets of most companies, companies commonly pledge their accounts receivable. Five years later, if the borrower defaults, then the lender notifies the accounts who owe this bad borrower the money and advises the customers of the borrower to send their money to the lender instead of to the borrower. In Mexico, this structure does not function. The account debtors (i.e. the customers of the borrower) have to be notified up front at the time of the original loan. Since the borrower does not default very often, most borrowers in

Mexico think that this puts them in a bad light and they don't want the bank running around talking to all their customers either about obtaining consent to pledge the accounts receivable or about how much the company is borrowing. So this mechanism tends not to be used very much.

### G. *Promissory Notes*

Promissory notes are a very useful mechanism. A promissory note in Mexico is a negotiable instrument and really ought to be referred to as a *pagaré*. Because it is a negotiable instrument, it gives you access to certain expedited remedies but there are very strict requirements. A *pagaré* has to be for something certain. It has to be due at a particular time. You cannot have installment payments or it is not a true *pagaré*. So, if a vendor is selling somebody \$1,000,000 worth of goods and the customer is going to pay the vendor X dollars a month, they cannot use a true *pagaré*. If there are 36 payments, they can use 36 *pagarés*. Alternatively, they can use one big one, but the customer is not going to be that happy about giving the vendor a \$1,000,000 note and then when he gets to month 35 and defaults, having the vendor say, "thanks, I'll take the \$1,000,000." If you sell to a corporation, take the *pagaré* from the corporation.

However, I reiterate that creditors should remember rich owner-poor business. What a creditor really wants is the short hairs of the owner, not the business. The owner of the business can essentially co-sign and the lender can proceed first against the owner without having to exhaust remedies against the business. You can use guarantees. You can use a guarantee, like that used in California, which is completely separate from the obligation. The problem is you have to go after the first debtor first. You have to go after the poor business before you can go after the rich owner. In which case, as I said, if the lender requires the owner to cosign, then you may proceed first against the wealthy owner.

Lent collateral is a way of saying that, I give you a right to come after my stuff to guarantee the obligations of my brother. Which you can imagine doesn't happen very often. You can bond in Mexico against defaults. It's not that unusual. It's expensive. Letters of credit—they work terrific, terrific. You take a letter, you sell something in Mexico—or anywhere—and you get a letter of credit. All you need to do is show the bill of lading and the bank pays you the money. The problem is, if you are a buyer in Mexico and you ask a person for a \$500,000 letter of

credit, generally the bank issues the letter of credit, and insists that the buyer in Mexico put \$500,000 in the bank to back up the letter of credit. Of course if the buyer had \$500,000 they wouldn't need the letter of credit. Although they work well, here along the border we don't see them that much because generally if you can afford them, you don't need them.

#### *H. Cross-Border Promissory Notes*

Dual jurisdiction promissory notes are perhaps one of the most useful devices. A lender can issue a promissory note with English on the left and Spanish on the right. Dual jurisdiction works. You can get cross-border guarantees. This works great for wealthy owners of Mexican businesses, where the businesses are poor, but the owners are rich. Where do you think the really expensive house is? It's in Veil, it's not in Ensenada. In Veil, you can foreclose on a ski condo in Veil—like that. It's very easy. Also, the house in Rancho Santa Fe or in La Jolla—they are easy to foreclose on. If you can find the asset and if you can convince the borrower in Mexico to give you a mortgage, or here it would be a deed of trust on a house, then I think you really have a secure mechanism to catch someone's attention if there is a repayment problem. It is not required that the documentation be in Spanish unless you want to record them, which is something you should do. It's not required that you notarize documents, but to have a viable secured interest you need to do so. In the U.S., practitioners are careful to be aware of issues of corporate authority. In the U.S., a person can be authorized to bind a corporation by a board resolution. In Mexico, a borrowing party must have to have a power of attorney and although it does not need to be specific, it has to cover what the person is doing. It can be a general power of attorney or it can be a specific power of attorney, but it must be present and authorize the action. Generally the power of attorney should be notarized. Additionally, the due diligence of making sure that the person who is binding the corporation has the right to bind the corporation is much more difficult in Mexico than it is here.

### V. REMEDIES

#### *A. Private Foreclosures*

Let me say a word about private foreclosures. One of the reasons people use trusts in Mexico, even in commercial transactions, before other security devices is the availability of private foreclosures. Most banks and trust officers will tell you, almost without exception, that if

you create the trust and pay them a couple of thousands of dollars for the transaction, the trust officer and the bank will foreclose on the assets. The lender avoids having to go through the lengthy process that you may face in Mexican courts. The main reason the banks can represent this, in my experience, is because Mexican banks generally can get away with it. The default rate, at least until recently, has been fairly low in Mexico on all kinds of loans. Thus, there are not that many situations in which the bank is going to foreclose anyway. When they do foreclose, generally the borrower is little and the bank is big, and therefore the matter rarely goes to court. Moreover, Mexicans are not as litigious as Americans, so even if they foreclose and the borrower doesn't like it, the chances they go to court are low. When I say the default rate is low, I am referring to a one to five percent default rate. Only so many of them go to court. Of the matters that go to court, the bank probably wins between eighty and ninety percent. So the lender only has to preoccupy themselves with a very small percentage of foreclosure matters.

#### *B. A Judicial Dispute Resolution Mechanism*

The 1993 arbitration law in Mexico made it possible to contract for a judicial dispute resolution mechanism. Whether it is a real estate deal or a commercial transaction with an arbitration clause, the international arbitration norms adopted by Mexico even provide for arbitration in the U.S. if agreed by the parties. As long as the essential elements of the judicial process are maintained, alternative dispute mechanisms can be used. Naturally, Mexico does have some wonderful law. The thing I like the best about Mexican laws is the size of the text and that you can put them all in your pocket. In California, you have to have a whole library to hold the statutes. In Mexico they are very short. Actually this is true in all civil law countries. The arbitration law is very helpful in pointing out that as long as you maintain the essential elements of judicial process, you can agree to whatever dispute resolution mechanism you want. However, the statute fails to define or indicate what is meant specifically by "essential elements" of the judicial process. The advice we have given to our clients is that as long as process is served judicially, that probably is enough to satisfy the essential elements of the judicial process. What really is behind the essential elements of the judicial process language is a due process notion. So if you do use an arbitration mechanism, the notice of arbitration, which could under AAA rules be served by mail, should be

served through the Mexican court system. After you serve the notice in this manner, you can have a private foreclosure mechanism and comport with the essential elements of the judicial process.

### C. Availability of Penal Statutes

Another way to focus people's attention on a payment problem is by utilizing penal statutes. Many things which in the U.S. are civil wrongs, such as civil frauds for example, in Mexico, although not criminal offenses, are easily criminalizable. Furthermore, law enforcement authorities in Mexico will prosecute these types of offenses. In the U.S., if somebody gives you a bad check and you go to the police, they usually respond by saying, "well, how many zeros, 6, 8? Go file a lawsuit?" But in Mexico, whether the problem is removing property such as equipment from a building where there is a dispute over the title to the property, or whether it's a commercial situation in which you have an individual or entity who basically fails to repay what they owe, these are actionable claims which can be made criminal. There have been several widely publicized criminalized situations like these in Tijuana, Mexico, during the past two years.

### D. Enforcement Proceedings

If you get the right paperwork, like a *pagaré*, instead of just a loan agreement, you have access to executive proceedings which can move very fast and the assets of the debtor can be attached, prejudgment, which again tends to focus people's attention.

## VI. OTHER CONCERNS

### A. Immigration Status

It is important to be aware of the issues that can arise relating to immigration status. For example, I had a client the other day who accepted a *pagaré*. The client made a loan to a Mexican borrower, got a *pagaré* signed by someone who was an officer of the Mexican corporation who had the right power of attorney. The transaction seemed very nice and neat. However, it resulted that the person signing the *pagaré* did not have the right visa to be engaging in the business that was involved in signing the *pagaré* in Mexico. The consequence was that the *pagaré* was invalid.



*B. Notary Fees*

You will notice that notaries fees are a recurring theme in Mexico. There are also filing fees and transfer taxes. If a lender uses a trust system and transfers title to certain assets into the trust, technically that is a transfer of title. I have heard people try to argue that if the transaction is essentially just pledging something, like your house, and you put it into a guarantee trust, you're really not transferring title, all you're doing is pledging it. However, because the title transfers to the trustee, you are required to pay the 2% tax, which is what makes the use of a trust mechanism so expensive and cuts down on the use of it.

VII. CONCLUSION

So, basically, what I want to leave you with is that secured lending in Mexico is possible. There are many devices that can be used and they work. The legal system is not as transparent as it is in the U.S., but Mexican security devices have been used for decades and they work just fine. Enforcement in Mexico is possible. It's a little more difficult, but it is possible. There is opportunity in Mexico in this area as in many other areas. I think we are going to see a lot more secured financing which means a lot more business across the border in the coming years, and I hope all of you are part of and have a good time doing it. Thank you very much.

