SECURED LENDING REFORM IN LATIN AMERICA: A PRACTITIONER'S POINT OF VIEW ON MEXICO

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Secured lending reforms are rippling through Latin America and other parts of the world. Underlying these reforms we find, among other things, the desire to stimulate economic growth in under-developed nations by making commercial lending simpler and cheaper, more transparent and reliable, and widely available. I will not delve into the obvious economic implications of improved commercial lending systems. Nor will I retrace the historical development of asset-based lending in the United States, Mexico, Honduras, or Guatemala.

Instead, this brief note gives a practicing lawyer's view of the significance of commercial financing reforms taking place around the world, with specific emphasis on reforms underway in Mexico.[1] My practice is concentrated in the NAFTA region and focuses principally on U.S.-Mexico trade. The real experts in this field are those who, like Dr. Boris Kozolchyk, Professor Dale Beck Furnish, the OAS's John Wilson, and Marek Dubovec, are monitoring and, in several cases, guiding the reform process in Latin America. I will not try to keep pace with them. Instead, let me briefly describe what is important to practitioners who, like me, try to make sense of the legal regimes available to protect our clients. I hope simply to outline our needs and comment briefly on the practical challenges that will face us following the profound changes underway.

A. What Is Important for Practitioners?

Secured lending in the United States is a fairly straightforward proposition: a client is asked to lend money to a business. Perhaps the loan is to acquire materials for production of finished goods. Maybe the financing is for seed, fertilizer, herbicides, materials, and payroll to raise, harvest, and sell a crop. Or the loan might enable the borrower to stock an inventory with finished goods

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1. For a more detailed overview of how Mexico's secured lending laws have evolved during the last twelve years, see Dale Beck Furnish, *Mexico's Emergent New Law of Secured Transactions: Recent Developments 2000-2010*, 28 ARIZ. J. INT'L & COMP. L. 143 (2011).

to be sold at wholesale or retail. Whatever the objective of the loan, the putative lender has various concerns, among them:

- Who is the borrower?
- What is its borrowing history?
- What collateral can be used to secure repayment of the loan?
- Does the borrower owe money to prior lenders?
- Does the prior lender have a lien, and if so, would it have priority over the proposed new lender?

Generally these questions are answered by making credit checks, speaking and negotiating carefully with borrowers, analyzing financial statements, and investigating available public records in search of pre-existing debts. Research for a lending decision raises, among many others, the following issues:

- What public records must be inspected?
- Can public records be inspected with relative ease and minimal expense?
- Is the information contained in the public records complete?
- Is the information contained in the public records reliable?
- Can a lending decision safely be based on what is found or not found in the public record?
- Once the decision to lend has been made, how does the creditor structure the arrangement for the best protection possible?
- What documents will be signed and by whom?
- What public recordings may or must be used to protect the lender?
- Where can or must the recordings be made?
- In the event of default, what relief is available to the lender and where may it be obtained?

These questions are not terribly difficult to answer when the collateral, debtor, and creditor are located in the United States. However, when the debtor is located in a foreign country and the collateral is found both within and outside of the United States, the issues can cloud up quickly. The purpose of this article is to illustrate how recent reforms of Mexico's secured financing laws may change the game.

B. Creation and Perfection of Security Interests—The Usual Rules

The Uniform Commercial Code (UCC) provides relatively simple rules for the use of various kinds of personal property to secure repayment of a debt: a

security interest is "an interest in personal property . . . that secures payment or performance of an obligation."[2] A "security agreement" is—not surprisingly—"an agreement that creates or provides for a security interest."[3] In broad terms, the security agreement describes the debt incurred and grants the holder of the security interest the right to take certain collateral and apply it to the satisfaction of the underlying debt. A security interest becomes enforceable against a debtor and third parties with respect to the collateral when: 1) value has been given; 2) "the debtor has rights in the collateral or the power to transfer rights in the collateral to third parties"; and 3) the debtor signs "a security agreement that provides a description of the collateral . . . ."[4] Once the security interest becomes enforceable, it "attaches to the collateral."[5] Collateral can include all manner of things, including tangible and intangible personal property such as perishable agricultural commodities and the accounts generated by their sale.[6]

"Perfection" of a security interest is the "validation of a security interest as against other creditors" or third parties.[7] "[A] security interest is perfected if it has *attached* and all of the applicable requirements for perfection . . . have been satisfied."[8] In general, with some exceptions, "a financing statement must be filed to perfect all security interests."[9] Each of our fifty states maintains an electronic registry in which financing statements must be filed to perfect security interests in such things as equipment, inventory, and accounts receivable.[10]

The purpose of filing a financing statement is "to provide notice to those who may subsequently deal with the debtor or the collateral of the existence of prior outstanding interests or encumbrances."[11] Notice ensures that the prior recorded interest will "gain priority over almost all creditors besides the holders of prior perfected interests."[12] The recording creditor gains priority "because he has

2. U.C.C. § 1-201(b)(35) (2011).

3. *Id.* § 9-102(a)(74).

4. *Id.* § 9-203(b)(1)–(3). As for the enforcement of the security interest against third parties who also hold security interests in the same collateral, while it is true that such other creditors are subject to the terms of a competing lien, the rules of perfection and priority come into play. *See* discussion *infra.* Part I.

5. *Id.* § 9-203(a).

6. The Code defines "collateral" broadly to include any "property subject to a security interest," including accounts, chattel paper, goods subject to a consignment, proceeds of other collateral, payment intangibles, and promissory notes. *See* U.C.C. § 9-102(12).

7. BLACK'S LAW DICTIONARY 1252 (9th ed. 2009).

8. U.C.C. § 9-308(a) (2011) (emphasis added).

9. *Id.* § 9-310(a).

10. *See, e.g.*, Elizabeth Springsteen, *Forms and Filing Information: U.C.C. Filings* (2009), NAT'L AGRIC. LAW CENTER, http://www.nationalaglawcenter.org/assets/articles/springsteen_UCCforms.pdf.

11. Landon v. Stroud, 709 P.2d 565, 568 (Ariz. Ct. App. 1985) (citing JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 23-5 at 919 (2d ed. 1980)).

12. *Id.*

taken action which would put a diligent searcher on notice of his claim."[13] Filing a financing statement is the principal means of acquiring priority and, in general, the first to file has priority over later filings.[14]

What law governs the validity and perfection of security interests? In general, "while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection and the priority of a security interest in collateral."[15] Where a debtor resides in one of the United States (or is incorporated or organized under that state's laws), that state is the "location of the debtor" for purposes of this rule,[16] which is also the location at which financing statements must be filed.[17]

These basic rules, as well as the modernization of recordings systems from state to state, have made it relatively easy and inexpensive to create and give notice of UCC security interests. The same laws and recording systems have also made it easier and cheaper to check for prior UCC security interests to provide the lender reasonably certain proof that prior consensual liens were or were not found.[18]

C. What About Foreign Debtors?

What happens when a U.S. lender is considering whether to provide financing to a borrower located outside of the United States? If a U.S.-style security agreement is contemplated, i) can the agreement be used to *create* a lien? And, if so, ii) how and where must that security interest be perfected? Let us assume that parties to a commercial loan are free to use a lien with the attributes of a UCC lien.[19] How and where must that security interest be perfected in order for it to bind other lienholders and third parties? The UCC includes a special

13. *Id.*

14. U.C.C. § 9-322(a)(1) (2011) (conflicting perfected security interests in the same collateral rank according to time of filing, or time of perfection, if not perfected by filing).

15. *Id.* § 9-301(1).

16. *Id.* § 9-307(b) ("A debtor who is an individual is located at the individual's principal residence.").

17. *Id.* §§ 9-307(b)(1), 9-501(a)(2).

18. This brief note does not address nonconsensual liens that may arise by operation of law. There are many such nonconsensual liens under state law, such as those applicable to various aspects of the business of agriculture. Some of these liens require notice or recording; others do not. For instance, a catalogue of state law agricultural liens is maintained by the National Agricultural Law Center at http://www.nationalaglaw center.org/assets/agliens/index.html.

19. This is not necessarily a valid assumption, especially with respect to such things as floating liens on inventory, security interests in after-acquired property, self-help repossession, and enforcement of security interests against proceeds. However, to simplify this note, the writer assumes the UCC lien can be created by agreement between a U.S. lender and a foreign borrower.

choice-of-law rule for perfection of nonpossessory liens against debtors located in other countries: the rule contemplates perfection of a lien in (or according to the laws of) the debtor's country, but *only if* the country is:

> [A] jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.[20]

Conversely, if the foreign debtor's place of residence "does not *generally require* notice in a filing or registration system, the debtor is [deemed to be] located in the District of Columbia."[21] This means that D.C. law governs perfection, and that recording must be made in the Office of the Recorder of Deeds in Washington, D.C.[22] Although there are no published judicial decisions interpreting UCC Section 9-307(c), an unpublished decision says this rule governs perfection of a lien against a foreign debtor by requiring filing in the District of Columbia, a filing that, "from the perspective of U.S. law, would likely be considered to be effective world-wide."[23] The Official Comments to the UCC make a circular effort to explain the rule of Section 9-307(c), invoking this useless tautology: "The phrase '*generally requires*' is meant to include legal regimes that *generally require* notice in a filing or recording as a condition of perfecting nonpossessory security interests, but which permit exceptions (e.g., control, automatic perfection, temporary perfection) in limited circumstances."[24]

So, if the "generally requires" rubric is satisfied, perfection and the effects of perfection or nonperfection are determined by the law under which the debtor is organized or of the state in which he or she resides. To determine whether this "standard" has been satisfied, the Code and its comments compel analysis of foreign law to determine: i) where, how and with what effects security interests can be perfected, and ii) the effects of a failure to perfect.

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20. U.C.C. § 9-307(c). It is also possible to perfect a security interest by taking possession of the collateral, such as goods, negotiable documents, money, instruments, and certificated securities. *See id.* § 9-313(a).

21. *Id.* § 9-307(c).

22. *See* D.C. CODE §§ 28:9-301(1), 28:9-501(a)(2) (2011).

23. *In re* Flag Telecom Holdings Ltd., 2006 WL 3053075, at *3 n.2 (Bankr. S.D.N.Y. 2006) (discussing Washington, D.C., filing against a Taiwanese debtor).

24. U.C.C. § 9-307 cmt. 3 (emphasis added).

D. The Relationship Between UCC Section 9-307(c) and the OAS Model Law on Secured Transactions

Some UCC scholars argue that foreign country recording is required *only if* "the foreign legal system is equivalent [to UCC Article 9] with respect to public information about nonpossessory security interests."[25] In 2002, the Organization of American States approved the Model Inter-American Law on Secured Transactions (OAS Model Law).[26] By requiring the filing of all "security interests" in a single, central registry, the OAS Model Law certainly provides the sort of "equivalency" spoken of by the commentators.

The purpose of the OAS Model Law is to regulate all security interests in "movable property" that secure "the performance of any obligations whatsoever."[27] Regulation is to be accomplished by requiring countries adopting the law to create a "unitary and uniform registration system applicable to *all existing movable property security devices.*"[28]

The key aspect of secured lending is perfection of the creditor's rights, i.e., taking the steps that are necessary for the security interest to be binding upon third parties. Under the OAS Model Law, a security interest binds third parties only when "publicized," which may be accomplished either by recording or, with regard to certain types of property, by delivering possession or control of the collateral to the secured party or its agent.[29] Recording must be made in the "uniform registration system," which is, in turn, required to be electronic, public, and automated.[30] Priority among recorded security interests is generally based on the order of recording in the registry.[31]

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25. Hans Kuhn, *Multi-State and International Secured Transactions Under Revised Article 9 of the Uniform Commercial Code*, 40 VA. J. INT'L L. 1009, 1049–50 (2000); *accord* Arnold S. Rosenberg, *Where to File Against Non-U.S. Debtors: Applying U.C.C. § 9-307(c) [Rev] to Foreign Filing, Recording and Registration Systems*, 39 UCC L.J. 109 (2006) (analyzing the secured lending systems of a wide array of countries in an effort to determine whether the requirements of § 9-307(c) were satisfied by the legal regimes of each and finding that most countries fall short).

26. ORG. OF AM. STATES (OAS), MODEL INTER-AMERICAN LAW ON SECURED TRANSACTIONS (2002), http://www.oas.org/dil/esp/cidip-vi-garantiasmobiliarias.htm [hereinafter OAS MODEL LAW].

27. *Id.* art. 1.

28. *Id*. (emphasis added).

29. *Id.* art. 10.

30. *Id.* art. 43.

31. OAS MODEL LAW art. 48. One exception is for what the OAS Model Law calls an "acquisition security interest," which the UCC calls a "purchase money security interest." The acquisition security interest has priority over all previous security interests granted by the debtor in the same type of collateral. In order to gain priority, the acquisition creditor must: i) file a registration form that specifically describes the lien as an acquisition security interest, and ii) notify holders of prior liens that the creditor has or expects to acquire a purchase money lien. *Id.* art. 40(I)–(II).

The OAS concept of a security interest includes all types of personal property, including accounts receivable and other intangible property, inventory held for sale or further processing, manufactured goods, proceeds of sale, products of collateral, after-acquired property, and property that presently exists or may exist in the future. Because registration of an OAS security interest is usually necessary to perfect a nonpossessory lien, any state that adopts the OAS Model Law and creates a uniform registry must necessarily satisfy UCC section 9-307(c). Thus, the adopting jurisdiction would be the "location of the debtor" and its law would govern perfection, the effect of perfection or nonperfection, and the location for filing the equivalent of a financing statement. [32]

Variants of the OAS Model Law have now been enacted in Guatemala and Honduras, spurring hope that these countries can now offer wider availability of commercial credit to small- and medium-sized borrowers.[33]

E. Mexico's Pre-2009 System of Commercial Lending

Mexico did not elect adoption of the OAS Model Law, but the evolution of its secured financing laws during the last eleven years appears to have achieved essentially the same result.

Many practitioners believed that Mexico's secured lending system—at least until amendments to Mexico's Commercial Code and related laws in 2009 and 2010—did not satisfy the standard of UCC Section 9-307(c), thus mandating perfection by filing in the District of Columbia.[34] Several commentators have reviewed Mexican secured financing laws in recent years, and all have reached essentially the same conclusion, whether explicitly or implicitly: prior to 2009, Mexico's tools for protecting secured commercial lenders had not advanced enough to satisfy Section 9-307(C). What was the problem?

While the United States has one "security interest" under Article 9, Mexico has typically had a plethora of security devices, many of which are not "generally required" to be recorded in any registry in order to be enforced against third parties.[35] Mexico's array of security devices and recording rules prompted this suggestion from Professor Todd Nelson in 1998:

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32. *See* U.C.C. § 9-307(c) (stating that the law of the location of the debtor governs perfection if that law generally requires publication or registration of a security interest as a condition to gaining "priority over the rights of a lien creditor with respect to the collateral").

33. *See infra* note 51.

34. This statement is based upon my experience as counsel in the agricultural lending field, including frequent interaction with various attorneys around the country who are involved in the same business.

35. *See* Todd C. Nelson, *Receivables Financing to Mexican Borrowers: Perfection of Article 9 Security Interests in Cross-Border Accounts*, 29 U. MIAMI INTER-AM. L. REV. 525, 550–51 (1998); Kuhn, *supra* note 25, at 1057–58 (stating that Mexico "recognizes a

> Beginning with the ideal, Mexico should junk its plethora of legal mechanisms in favor of a single security device which, with respect to non-documentary accounts, would be perfected by public registration. In addition, an assignee of open accounts . . . should be treated as a secured party for the purpose of perfection and should be required to publicly register its interest. If, for whatever reason, Mexico cannot let go of its existing law, at the very least each code should be amended to make the use of a uniform registry system the exclusive method for publicizing all liens in and assignments of accounts receivable.[36]

In 2000 and 2003, Mexico made partial attempts to modernize its secured financing system but retained what has been called a "crazy quilt" pattern of security devices, many of which "create secret liens, making it difficult for a secured party to determine if potential debtor's assets are encumbered."[37] The possibility of significant unrecorded liens in Mexico is real, as unrecorded creditor rights have historically included these common and important security devices:

- Assignments of accounts,[38]
- Factoring of accounts,[39]
- Financial leases,[40]
- Certain types of pledges,[41]
- Title retention arrangements,[42]
- Certain conditional sale contracts, and[43]
- Consignments of goods.[44]

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confusing array of devices that are based on different legal concepts and governed by different statutes").

36. Nelson, *supra* note 35, at 550–51.

37. A. Lopez-Velarde & J.M. Wilson, *A Practical Point-by-Point Comparison of Secured Transactions Law in the United States and Mexico*, 36 UCC L.J. 3, 12–16 (2004).

38. Nelson, *supra* note 35, at 544; Kuhn, *supra* note 25, at 1062.

39. Lopez-Velarde & Wilson, *supra* note 37, at 12–16. Factoring is a process by which accounts receivable are sold by the account holder to a "factor" at a discount from the face value of the accounts, providing needed cash flow to the account holder. *See In re* Straightline Investments, Inc., 525 F.3d 870, 876 n.1 (9th Cir. 2008). In a true factoring arrangement, the factor buys the accounts and assumes the default risk. Where the creditor retains the risk of loss, however, the factoring arrangement is really a security interest governed by usual rules of perfection and priority. *See In re* De-Pen Line, Inc., 215 B.R. 947, 950–51 (Bankr. E.D. Pa. 1997) (factoring agreement was actually an assignment of accounts made for security and was required to be perfected by filing; because factor failed to file financing statement, its unperfected interest was defeated by bankruptcy trustee).

40. Lopez-Velarde & Wilson, *supra* note 37, at 9–12.

41. *Id.*

42. *Id.*

43. *Id.*

Although recording of these interests might not have been required in every instance by Mexican law for the interest to be superior to a later creditor, in the United States, each must generally be perfected under the UCC by recording a financing statement.[45] Because of these gaps in Mexican commercial lending and recording laws, it was impossible to say that Mexican law "generally required" recording as a condition of priority. A "piecemeal system of multiple competing devices used for secured financing"[46] simply cannot satisfy the requirements of UCC Section 9-307(c).

In 2006, Professor Arnold Rosenberg analyzed Mexico's 2000 and 2003 legal reforms and found that Mexico's system was not equivalent to the UCC.[47] His reasons included that Mexico does not recognize a single "security interest," such as we have in UCC Article 9. Instead, Mexican law continues to a wide array of nonpossessory security devices, many of which "do not require registration yet may still take priority over lien creditors and [recorded] nonpossessory pledges."[48] Beyond the risk of secret liens, Professor Rosenberg cites an equally fundamental problem: security interests—as a generalized category of nonpossessory lien that includes all manner of security devices—did not exist under Mexican law. According to Rosenberg, because the concept of a UCC security interest did not exist under Mexican law, a U.S. lien could not be registered in Mexico, even after the reforms of 2000 and 2003:

> In order for a Mexican court to enforce a security interest created in movables located in Mexico, the form of security used must be a security device recognized and governed by

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44. *Id.*

45. *See, e.g.*, *In re* Piknik Prods. Co., 346 B.R. 863, 866 (Bankr. M.D. Ala. 2006) (retention of title to goods is "limited in effect to a reservation of a security interest" that must be perfected by filing to gain priority over other lien creditors); *In re* De-Pen Line, Inc., 215 B.R. at 950–51 (Bankr. E.D. Pa. 1997) (factoring agreement was actually an assignment of accounts made for security and required to be perfected by filing; because factor failed to file financing statement, its unperfected security interest was defeated by bankruptcy trustee); *In re* Eagle Enterps., Inc., 237 B.R. 269, 274 (Bankr. E.D. Pa. 1999) (leases intended for security are "textbook examples of when filing a financing statement is required to perfect a security interest"); Fariba v. Dealer Servs. Corp., 100 Cal. Rptr. 3d 219, 226-27 (App. 2009) (absent proof of creditors' knowledge that goods are held "on consignment," consignor of goods must perfect security interest by filing financing statement, applying UCC § 9-319); Excel Bank v. Nat'l Bank, 290 S.W.3d 801, 803, 809 (Mo. Ct. App. 2009) (alleged bailment was actually a consignment and must be recorded to perfect).

46. Lopez-Velarde & Wilson, *supra* note 37, at 12–13.

47. Rosenberg, *supra* note 25, at 210–14.

48. *See id.* Mexico's system has also been called a "confusing array of security devices that are based on different legal concepts and governed by different statutes," with equally varied means of perfection *other than* recording. *See* Kuhn, *supra* note 25, at 1057–58.

> Mexican law. A secured party seeking to foreclose on assets located in Mexico that are described as collateral in an American security agreement that uses revised Article 9 terminology probably would be unsuccessful, because the secured party's security interest in the Mexican assets would not be recognized by a Mexican court.[49]

F. Mexico's 2009 Legislation and its 2010 Regulatory Reforms Create Equivalence with the Requirements of UCC Section 9-307

The days of unrecorded liens in Mexico are coming to an end: on August 27, 2009, amendments to Mexico's Commercial Code[50] created the *Registro Único de Garantias Mobiliarias* (Single Registry of Security Interests, referred to here as RUG). The purpose of the RUG is to facilitate the use of *bienes muebles*, literally "movable property," as collateral so that micro- , small, and medium-sized business can obtain financing under more favorable conditions, and thereby "stimulate investment, growth and competitiveness" in the economy.[51] Use of the RUG for recording *garantías mobiliarias* is mandatory.[52] What is a *garantía mobiliaria* under Mexican law? The 2009 amendments to Mexico's Code of Commerce vaguely described *garantía mobiliaria* as "legal commercial acts by

49. Rosenberg, *supra* note 25, at 210–14. This is a debatable point. Many practitioners, including the author and some Mexican colleagues, believe that there has been no legal impediment to the perfection or enforcement of a U.S. security interest in Mexico, other than a reluctance on the part of U.S. lawyers and creditors to expend the money and effort to learn and comply with both U.S. and Mexican legal rules. There may be certain remedies that are not available under Mexican law—such as self-help repossession. There may be requirements that a U.S. security agreement be translated into Spanish before being recordable in a public registry, but a U.S.-based consensual lien is not necessarily prohibited. Other practitioners have agreed with Professor Rosenberg. In light of 2009 and 2010 reforms, however, this discussion has largely become academic. *See* discussion *infra* Part F.

50. Código de Comercio [CCo.] [Code of Commerce], arts. 32 bis 1–9, *as amended*, Diario Oficial de la Federación [DO], 27 de Agosto de 2009, *available at* http://www.diputados.gob.mx/LeyesBiblio/ref/ccom.htm.

51. *See* REGISTRO ÚNICO DE GARANTÍAS MOBILIARIAS, http://www.rug.gob.mx/Rug/home/inicio.do (last visited Dec. 30, 2011) [hereinafter RUG]. The registry was created by the Mexican government to regulate online investigation and recording of security interests. Similar registries have been established in Honduras and Guatemala, and these countries share the same objectives stated by Mexico. *See* REGISTRO DE GARANTÍAS MOBILIARIAS (Hon.), http://www.garantiasmobiliarias.hn/ (last visited Dec. 30, 2011); REGISTRO DE GARANTÍAS MOBILIARIAS (Guat.), http://www.rgm.gob.gt/index.php?id=7 (last visited Dec. 30, 2011).

52. CCo. art. 32 bis 2.

which a special privilege over or right of retention of personal property on behalf of third parties is created, modified, transmitted, or canceled."[53]

The 2009 legislation did not define this so-called "special privilege" or spell out the details of its right to possession of personal property, leaving too much to the imagination.[54] Two points were made clear, however. First, "[a]ll security interests . . . of a commercial nature, their modification, transmission or cancellation, as well as any legal act performed in relation to them"[55] are "subject to recording . . . only in accordance with the terms of"[56] the RUG legislation. Second, recording in the RUG will now constitute "public notice" for purposes of the RUG legislation and "other legal regimes."[57]

Ambiguities in the 2009 law reforms were largely eliminated by the issuance of an implementing regulation in 2010:[58] the definition of "security interest" was clarified to include any "guaranty or special privilege or a right to possession of personal property in order to secure performance of an obligation."[59] Specific categories of security interests that must be recorded in the RUG to be effective against third parties now include:

- Nonpossessory pledges;
- Rights arising under production credit agreements and industrial mortgages;
- Rights to airplanes or vessels;
- Rights arising under financial leases;
- Reservations of title under commercial buy-sell agreements covering identifiable goods; and
- Rights existing under guaranty trust agreements, possession retention agreements and—just to leave at least a little uncertainty in the field—"other special privileges according to the Code of Commerce and other commercial laws," whatever that means.[60]

All types of property appear to be covered by these "special privileges," including machinery, equipment, inventory, motor vehicles, agricultural products, consumer goods, stocks, shares, debts, bonds, option and futures contracts, and

53. *Id.* art. 32 bis 1.
54. *Id.*
55. *Id.*
56. *Id.*
57. CCo., art. 32 bis 2.
58. Decreto por el que Se Reforman y Adicionan Diversas Disposiciones del Reglamento del Registro Público de Comercio [Decree that Amends and Adds Various Provisions of the Regulations of the Public Commercial Registry], arts. 1, 10–24, 30–35, DO, 23 de Septiembre de 2010 [hereinafter Regulations].
59. *Id.* art. 1(II).
60. *Id.* art. 32(A)(I)–(VII).

other rights, including collection and payment rights.[61] Priorities among holders of security interests will be determined by the order of their recording in the RUG. Mexico recently launched its RUG, and access to it is now available online for research and recording of security interests.[62] Since the law now requires recording of *all* security interests in the RUG, it seems absolutely clear that U.S. creditors must now comply with Mexican recording laws in order to perfect and establish priority in the property of Mexican debtors.[63]

G. How Will Mexico's New System Affect Daily Practice?

Attorneys investigating possible loans to Mexican commercial borrowers will now have to check *at least* two registries—one in Washington, D.C., and the other in Mexico. Why? Because:

> One of the purposes of the filing requirements of the Uniform Commercial Code, like that of any recording statute, is to provide notice to those who may subsequently deal with the debtor or the collateral of the existence of prior outstanding interests or encumbrances. A concomitant purpose is to enable the creditor to perfect a security interest, and thereby to gain priority over almost all creditors besides the holders of prior perfected interests, because he has taken action which would put a diligent searcher on notice of his claim.[64]

What happens if a creditor fails to consult available registries? A creditor that makes a loan, ignorant of pre-existing, perfected liens, will generally suffer the effects of being in line behind a senior lender. This is so because a lender is normally charged with knowledge of what a diligent search of public records would reveal.[65] One consequence of being a junior lien holder is that taking the proceeds of collateral subject to a prior perfected security interest can

61. *Id.* art. 32(B)(I)–(IX).

62. *See* RUG, *supra* note 51.

63. Are there any remaining gaps in the new RUG legislation? Perhaps. The new law makes no specific mention of accounts, assignment of accounts, or factoring agreements as "special privileges." However, the law does apply to "payment rights." *See* Regulations, art. 32(B)(I)–(IX). The assignment or factoring of accounts are, of course, transfers of "payment rights" to secure payment of a debt.

64. *See* Landon, 709 P.2d at 568.

65. *See* South Shore Bank v. Int'l Jet Interiors, Inc., 721 F. Supp. 29, 32 (E.D.N.Y. 1989) (deciding that a company that refurbished airplane without encouragement by prior lien holder could not recover on unjust enrichment theory; had the company "properly searched the Airplane's title, it would have become aware of the Bank's lien prior to agreeing to refurbish the Airplane").

result in a judgment for conversion damages.[66] Because liability for conversion does not generally require actual knowledge of the secured party's lien, it is especially important that counsel conduct a careful investigation of a potential borrower.[67]

Careless creditors sometimes seek relief from a senior creditor by asking courts to subordinate the interest of the prior lien holder. Subordination—"[t]he act or an instance of moving something (such as a right or claim) to a lower rank, class, or position [such as] subordination of a first lien to a second lien"[68]—when imposed by court decree is often called "equitable subordination."[69] The circumstances where equitable subordination is appropriate are "few and far between,"[70] as the holder of a prior perfected security interest cannot be subordinated to a junior creditor unless the senior creditor agrees, or engages in inequitable conduct that is "so inequitable it 'shocks one's good conscience,'" and "defrauds other creditors."[71] This is because a court of equity "is not free to adjust

66. *See, e.g.*, Farmers State Bank v. FFP Operating Partners, L.P., 935 P.2d 233, 235–36 (Kan. Ct. App. 1997) (holding junior unperfected secured creditor liable for conversion of security interest of senior secured creditor and upholding award of actual and punitive damages); Case Corp. v. Gehrke, 91 P.3d 362, 368 (Ariz. Ct. App. 2004) (finding "a viable claim for conversion of its secured proceeds of the inventory"); Lafayette Prod. Credit Ass'n v. Wilson Foods Corp., 687 F. Supp. 1267, 1274–75 (N.D. Ind. 1987) (upholding compensatory damages, measured as value of goods at time of conversion, against meat packer who converted security interests in hogs); State Bank of Independence v. Equity Livestock Auction Mkt., 417 N.W.2d 32, 34 (Wis. Ct. App. 1987) (claim for conversion lies against auctioneer who facilitates sale of secured party's interest despite lack of knowledge and good faith); United States v. Tugwell, 779 F.2d 5, 6–8 (4th Cir. 1985) (finding purchaser of combine converted security interest of secured party and the "measure of damages for conversion is fair market value of the converted property at the time of conversion plus interest"); *see also* RESTATEMENT (SECOND) OF TORTS §§ 229, 243 (1965).

67. *See* Agrilliance, LLC v. Runnells Grain Elevator, Inc., 272 F.Supp.2d 800, 803–07 (S.D. Iowa 2003) (grain broker was liable for conversion where, after receipt of FSA notice, a broker paid sale proceeds to borrower's landlord instead of to secured lender); ITT Indus. Credit Co. v. H&K Mach. Serv. Co., 525 F.Supp. 170, 172 (D. Mo. 1981) ("lack of knowledge of the security interest . . . and the so-called good faith disposition by [the seller] are not relevant to an action in conversion"); Food Servs. of Am. v. Royal Heights, Inc., 871 P.2d 590, 596 (Wash. 1994) (if a "commission merchant additionally wishe[s] to lend money to the farmer and take a security interest in the farm product, then, like any other secured lender, the commission merchant should check the appropriate records").

68. BLACK'S LAW DICTIONARY 1563 (9th ed. 2009). Subordination can occur by agreement of the parties to a subordination agreement, as permitted by the Uniform Commercial Code. *See* U.C.C. § 9-339 (2011).

69. *See, e.g.*, World Help v. Leisure Lifestyles, Inc., 977 S.W.2d 662, 673 (Tex. App. 1998) (reversing summary judgment subordinating mortgage lien due to fact questions about whether lien holder defrauded material suppliers).

70. *In re* First Alliance Mortg. Corp., 471 F.3d 977, 1006 (9th Cir. 2006).

71. World Help, 977 S.W.2d at 668, 669; *accord In re* Hedged Inv. Assocs., 380 F.3d 1292, 1301–02 (10th Cir. 2004) (noninsider creditor was not subject to equitable

the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result [would otherwise be] inequitable."[72]

So, if a secured creditor merely asserts its lien against a junior creditor as permitted by law or contract, a court must enforce the senior lien and cannot rank it below a later lien.[73] "To do otherwise would render the secured creditor status useless."[74] Careful research to identify possible prior liens *in Mexico* is now mandatory, but is it difficult?

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subordination absent "gross misconduct tantamount to fraud, misrepresentation, overreaching or spoliation"); Knox v. Phx. Leasing, Inc., 35 Cal. Rptr. 2d 141 (App. 1994) (equitable subrogation requires either conduct that at "one end of the scale is fraud" or other inequitable conduct; the "mere fact of augmenting or enhancing the collateral's value is by itself insufficiently notable to justify special equitable protection"); Daniels-Sherridan Fed. Credit Union v. Bellanger, 36 P.3d 397, 404 (Mont. 2001) (finding no equitable subrogation where secured party "remained uninvolved in the . . . transaction" and there "was no evidence that the Credit Union encouraged" the sale); Farm Credit Bank v. Ogden, 886 S.W.2d 305, 313 (Tex. App. 1994) (equitable subordination not available because lien holder did nothing inequitable); *see also* 1 GERALD L. BLANCHARD, LENDER LIABILITY: PRACTICE AND PREVENTION § 9.9 (2d ed. 2008) (collecting cases).

72. United States v. Noland, 517 U.S. 535, 539 (1996) (quoting Andrew DeNatale & Prudence B. Abram, *The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors*, 40 BUS. LAW 417, 428 (1985)); *accord* Commerce Bank, NA v. Tifton Aluminum Co., 217 B.R. 798, 802 (W.D. Mo. 1997) (unsecured creditor cannot use "unjust enrichment" principles to circumvent a perfected Article 9 security interest "absent a showing of fraud on the part of the secured creditor"); Peerless Packing Co. v. Malone & Hyde, Inc., 376 S.E.2d 161, 164 n.4 (W. Va. 1988) (denying unjust enrichment recovery against holder of perfected security interest due to lack of evidence of fraud).

73. *See, e.g.*, *In re* Castletons, Inc., 990 F.2d 551, 558–60 (5th Cir. 1993) (equitable subordination properly refused where secured creditor was "simply exercising the contract rights it had, and there's nothing wrong with that"); *In re* Pacific Express, 69 B.R. 112, 116–18 (9th Cir. BAP 1986) (reversing bankruptcy court's equitable subordination order in part because junior creditors "conceded . . . they did not 'know of any inequity or inequitable conduct'"); Hilo Crane Serv., Inc. v. Ho, 693 P.2d 412, 424 (Haw. Ct. App. 1984) (appellate court reversed trial court's equitable subordination award because trial court had also refused specific findings that creditor's conduct was inequitable); City of Parkesburg v. Carpenter, 507 S.E.2d 120, 123 (W. Va. 1998) (liens not subject to equitable subordination where lienholders did nothing "contrary to the law[] . . . [and took no] action other than that provided for by the law governing the perfection of liens").

74. SMP Sales Mgmt., Inc. v Fleet Credit Corp., 960 F.2d 557, 560 (5th Cir. 1992); *see, e.g.*, Nat'l Bank & Trust Co. v. Moody Ford, Inc., 273 N.E.2d 757, 760 (Ind. Ct. App. 1971) (giving unsecured creditor priority over a prior perfected security interest "would be little more than a judicial erasure of" the perfection and priority rules of the UCC); Evans Prods. Co. v. Jorgensen, 421 P.2d 978, 983 (Or. 1966) ("The purpose and effectiveness of the U.C.C. would be substantially impaired if interests created in compliance with U.C.C. procedures could be defeated by application of the equitable doctrine of unjust enrichment"; reversing trial court's refusal to enforce perfected lien against a later, unperfected material supplier).

H. Checking Mexico's Online Security Interest Registry

How does it work? Simple:

- Enter the website, http://www.rug.gob.mx/Rug/home/inicio.do.
- Sign up as a user.
- Create a password.
- Go to the search page, http://www.rug.gob.mx/Rug/home/busqueda.do.
- Input the requested information.
- Read the results.
- Evaluate the information that is found in the public record.

There will, of course, be a time of transition; lawyers inside and outside of Mexico will have to learn of: i) the new law, ii) the new registry, and iii) the ease of its use. It appears, however, that the system is readily accessible to lenders, borrowers, and their attorneys. Transparency will become the rule, not the exception, as unrecorded liens should largely become a thing of the past. Use of the registry should also greatly ease the anxiety of deciding whether to lend money to Mexican commercial borrowers. In the long run, this should stimulate lending, growth, increased competition, and greater economic welfare.

I. Enforcing the Creditors' Rights Perfected in the Security Interest Registry

Much of the concern about lending to Mexican debtors relates to enforcement of the creditors' rights. Many creditors fear long delays in Mexican courts, fraught with uncertainty about its reputed inefficiency and with negative assumptions about its integrity.[75] How does the new RUG affect what happens when the honeymoon between borrower and lender has ended?

75. These opinions are largely anecdotal and frequently wrong. Moreover, the courts of the United States do not generally presume that Mexico's courts are inadequate. *See, e.g.*, DTEX, LLC v. BBVA Bancomer, S.A., 508 F.3d 785, 796-97 (5th Cir. 2007) (Mexican courts offered adequate alternative forum for suit arising from alleged tortuous interference with a contract "despite differences in Mexican and American substantive and procedural law"). Indeed, one court observed that cases decided in the Fifth Circuit Court of Appeals establish a "nearly airtight assumption" that Mexico's courts are an adequate alternative to U.S. tribunals. *In re* Ford Motor Co., 591 F.3d 406, 412 (5th Cir. 2009). That is not to say that Mexico's courts are always fair in their operation. *See, e.g.*, Transportes Aereos Pegaso, S.A. de C.V. v. Bell Helicopter Textron, Inc., 623 F. Supp. 2d 518, 537–38 (D. Del. 2009) (enforcement of Mexican money judgment was refused because the Delaware court was not "satisfied" that the judgment "was not obtained by fraud" in the procurement of expert opinions supporting judgment creditor's damages award).

The secured transaction reforms to the Mexican Commercial Code address remedial issues to a limited extent, but the enforcement of a creditor's rights in Mexico still will be governed largely by existing judicial procedures. Judicial enforcement before Mexico's courts will continue to be the norm, unless: 1) the parties choose to litigate before the courts of another country; or 2) the parties choose to resolve their disputes by binding arbitration.

In addition, provisional remedies will continue to be available according to the agreement of the parties and the procedural laws applicable where collateral can be found. This will enable disputed assets to be seized or attached while the parties adjudicate their dispute, whether by arbitration or otherwise. That the new laws are not designed to affect available remedies means only that the parties negotiating commercial lending transactions need to consider these issues carefully before making their deal. Resolution of commercial lending disputes will be greatly simplified if the parties give careful thought ahead of time to these practical enforcement issues.