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The Treatment of "Inversion Units" under Mexico's Law of Commercial Insolvency ¹

Introduction

Since the publication of the Law of Commercial Insolvency in Mexico's Federal Register ² on May 12, 2000, diverse forums have challenged the constitutionality of its provisions, which make reference to the Inversion Units ³ ("UDIs"). The UDIs were adopted pursuant to the Executive Order published on the Federal Register on April 1, 1995, which specifies the financial obligations that can be converted to UDIs and amends the relevant provisions of Mexico's Federal Income Tax and Fiscal Code. ⁴ Further, the same forums have identified certain contradictions between the Law of Commercial Insolvency ⁵ and Mexico's Federal Monetary Law, thus requiring examination of the subject.

I. Applicable Provisions Under the Law of Commercial Insolvency

A. The relevant provisions of the Law of Commercial Insolvency for purposes of this article are as follows:

1. Article 4– For the purposes of the Law of Commercial

Insolvency:

IV. UDIs shall reference is made in the mean the Investment Units to which executive order published on the Federal Register on April 1, 1995. ⁶

2. Article 5– Small businesses may declare bankruptcy if they agree voluntarily and in writing to submit to the application of the Law of Commercial Insolvency. For the purposes of the Law of Commercial Insolvency, a small business shall be deemed to be any business whose aggregate current and past due liabilities do not exceed the equivalent of 400,000 UDIs upon the date on which the bankruptcy petition is filed (the "petition date"). ⁷

3. Article 89– On the date on which the order granting the petition for bankruptcy (the "order for relief") ⁸ is issued:

I. The unpaid principal and related financial charges of any

unsecured debts denominated in Mexican currency (pesos), shall cease accruing interest and will be converted to UDIs using the exchange rate published by the [Central] Bank of Mexico. Any debts originally denominated in UDIs shall also cease accruing interest;

II. The unpaid principal and related financial charges of any unsecured debt or obligation denominated in foreign currency, regardless of which jurisdiction the parties agreed that such obligation shall be paid, shall cease accruing interest and shall be converted to pesos at the exchange rate determined by the Bank of Mexico for the payment of foreign currency–denominated obligations payable in Mexico. The amount shall, in turn, be converted to UDIs as provided in section I above; and any secured debts, regardless of whether the parties agreed that they would be repaid in Mexico or overseas, shall remain in the currency or unit in which they were originally denominated, and will only accrue regular interest at the rate set forth in the contract, up to the value of the collateral. ⁹

In order to determine the voting rights of secured creditors in a case subject to the Law of Commercial Insolvency, the amount of their claims as of the petition date shall be converted to UDIs as provided in sections I and II of the Article with respect to unsecured debts. Secured creditors shall thus retain their secured status to the extent of such amount, regardless of the value of their collateral, unless they elect application of the next paragraph.

If a secured creditor believes that the value of its collateral is less than the amount of its pre-petition claim, the creditor may request that the court allow its secured claim to the extent of the value which he assigns to its collateral, and classify the remaining deficiency as an unsecured claim. The value that the creditor ascribes to its collateral will be converted to UDIs utilizing the rate in effect on the petition date. In such case, the creditor must surrender, expressly in favor of the Estate, any excess amount between the price obtained from the foreclosure sale of the collateral and the value that the secured creditor assigned to the collateral, based on the value of the UDIs as of the date of the foreclosure. ¹⁰

4. Article 128– In the preliminary list of claims, the conciliator must include the following information as to each claim:

II. The amount of the claim that he believes should be allowed, pursuant to Article 89 of the Law of Commercial Insolvency. . . . ¹¹

5. Article 158– The [reorganization] plan shall be deemed approved by any general unsecured creditor holding an allowed claim, without the need to vote, if the plan:

- I. Provides for the payment of each unsecured claim in the amount due and payable as of the effective date of the petition date, converted to UDIs at the rate in effect on the date in which the order for relief is issued;
- II. Provides for the payment of all amounts and charges due under the contract, from the date the order for relief is issued to the date in which the reorganization plan is approved, as if a bankruptcy had not been filed, and as if the claim had been paid on the date the order for relief was issued. These amounts will be converted into UDIs based on the rate in effect on the date each payment was due; and
- III. The payments to which Sections I and II of the Article refer must be made within thirty business days following approval of the plan, taking into account the value of the UDIs on the payment date. ¹²

6. Article 214– During the first thirty calendar days of a bankruptcy liquidation case, the trustee may avoid the separate enforcement of a secured creditor's lien whenever he determines that it is in the best interests of the Estate to dispose of the collateral in conjunction with the other assets of the Estate.

In any such cases, prior to the disposition of the secured creditor's collateral, the trustee shall determine the value of the collateral.

If the creditor exercised its election rights under paragraph II of Article 89 of the Law of Commercial Insolvency, the following shall apply:

II. For the purposes of the comparisons and the payments to which the Article refers, the value assigned by a secured creditor to its collateral shall be converted to pesos, using, for that purpose, the value of the UDIs as of the day before the creditor's claim was paid.

B. The relevant Transition Articles under the Law of Commercial Insolvency

1. Second– The old Bankruptcy and Suspension of Payments Law published in the Federal Register on April 20, 1943 is repealed, and all other statutes which are inconsistent with the provisions of the Law of Commercial Insolvency are repealed or amended.

2. Ninth– Within five years following its effective date, the Law of Commercial Insolvency shall not apply to any Merchants who, as of the effective date of the Law of Commercial Insolvency, have liabilities that, computed as the

sum of the nominal value of each claim as of the contract date, do not exceed the equivalent of 500,000 UDIs unless they voluntarily agree in writing to submit to the application of the Law of Commercial Insolvency.

C. The executive order establishing the obligations which may be converted to UDIs and various dispositions of the Federal Income Tax and Fiscal Code in its first three articles defines a UDI and how to determine and adjust its equivalence in pesos for the payment of business or financial obligations:

1. First Article– The payment of liabilities denominated in pesos by the mutual agreement of the parties to a contract evidenced by any credit instrument, except checks and, in general liabilities, under a business contract or other business acts, can be denominated in an accounting unit as a standard of value or exchange, called an Inversion Unit, whose equivalent value in pesos shall be determined daily by the Bank of Mexico and published in the Federal Register. The obligations denominated in UDIs shall be deemed liquidated.

2. Second Article– The obligations denominated in UDIs shall be satisfied in their equivalent amount in pesos. Accordingly, the amount of the obligation expressed in UDIs shall be multiplied by the applicable rate of said unit on the date the payment is made.

3. Third Article– Fluctuations in the value of the UDI shall be tied to the National Consumer Price Index determined by the Bank of Mexico and published in the Federal Register.

The Bank of Mexico shall determine the value of the UDIs pursuant to the foregoing procedure, and should adjust according to the provisions of Article 20 Bis of the Fiscal Code. Article 20 defines the basis for determining the Consumer Price Index, with the goal of establishing the average price increase in the national economy.

D. The legislative history of the executive order that created the UDIs provides the basis for understanding the concept, use and advantages of the UDI as an accounting unit, as follows:

The UDI should be an accounting unit, not a monetary unit, and its use should be voluntary. This means that, in any business dealings, the parties can opt to denominate their financial obligations in pesos or UDIs. In the latter case, the debtor satisfies his debt in the equivalent sum in pesos, determined based on the value of the UDI on the date the payment is made.

Further, the legislative history to the executive order provides in pertinent part:

It is evident that the use of the UDIs would benefit borrowers and lenders. Thus, borrowers will probably pay a lower rate of interest due to the avoidance of any risk of inflation . . . however, the greatest benefit conferred to borrowers will be the anticipated elimination of debt payments.

This would alleviate the financial burden of enterprises, thus contributing to the preservation of their viability while reducing their marginal costs and thereby increasing production.

E. Relevant provisions of the Monetary Law of the United States of Mexico.

The Federal Monetary Law provides, in pertinent part:

1. Article 1– The unit of the monetary system of the United States of Mexico is the "peso", with the equivalence subsequently indicated.

2. Article 7– The payment of obligations in any amount in Mexican currency shall be denominated in pesos and, if necessary, in fractions of pesos. Such obligations shall be paid through tender, in nominal value, of bills or coined metal furnished by the Bank of Mexico as set forth in Article 2 hereof.

3. Article 9– The provisions of the two preceding articles are mandatory and any stipulation to the contrary shall be null and void.

II. Overview

The unconstitutionality argument with respect to the use of UDIs in the Commercial Law of Insolvency is premised on the fact that the applicable provisions of the Commercial Law of Insolvency are unconstitutional because they contravene certain well established principles such as legal certainty, equality, and validity under pre-existing Mexican laws. Similarly, some argue that these provisions are also unconstitutional because they are in direct contravention of the Federal Monetary Law.

However, a different point of view would indicate that pursuant to the express language of the Second Transition Article of the Commercial Law of Insolvency, there is no contradiction at all to the extent that the Commercial Law of Insolvency abrogates any pre-existing law, including the provisions of the Federal Monetary Law that contradict the Law of Commercial Insolvency.

III. Analysis

The following must be considered with respect to the foregoing debate:

Pursuant to the Executive Order of April 1, 1995, it is clear that the UDI is not a substitute for Mexico's national currency denominated the "peso," to the extent that: (i) it is a unit of accounting used to make calculations; (ii) its use is optional and subject to the objection of either party to a contract; (iii) it is applicable only in connection with business or financial transactions in general; (iv) it protects the payment of a liquidated obligation against currency devaluation due to inflation; (v) its value fluctuation is determined in relation to the National Consumer Price Index; and (vi) it is monitored and its value is determined exclusively by the [Central] Bank of Mexico through its publication in the Federal Register. ¹³

Furthermore, the Law of Commercial Insolvency attributes the following uses and characteristics to the UDI: (i) its use is mandatory, without contravening the principle of equality of rights between the debtor and its creditors ¹⁴ (set forth in Article 13 of the Federal Constitution); (ii) it standardizes the valuation of unsecured claims, to the extent that it is applied equally among the members of a class of unsecured creditors; ¹⁵ (iii) it standardizes the valuation of secured claims, to the extent that it is applied equally among members of a class of secured creditors, for the purpose of establishing the voting rights of secured creditors with respect to matters that must be decided based on the amount of each creditor's secured claim, not the value or types of the secured claims or liens; ¹⁶ (iv) it is used to liquidate (to establish the amount of) an allowed claim; ¹⁷ (v) it is used to establish the value of a secured creditor's collateral if the secured creditor elects to foreclose its interest in its collateral, since any remaining surplus from the foreclosure sale must be turned over to the estate and any remaining deficiency in the amount of the secured creditor's allowed claim will be treated as an unsecured claim; ¹⁸ (vi) it is used to establish the value of a secured creditor's collateral whenever a party in interest or creditor opposes a secured creditor's election to foreclose on its collateral and thereby reduce the assets of the estate otherwise available for distribution to all the creditors; ¹⁹ and (vii) it is used to determine whether certain debtors are eligible to file for bankruptcy protection. ²⁰

In addition, the adoption of the UDI under the Law of Commercial Insolvency does not violate the constitutional guaranties provided by Article 16 of the Federal Constitution to the detriment of any interested party inasmuch as the UDI is based, in its use and application, on the valid rule of law that created it. This is similar to the "Executive Order, which establishes the obligations that can be denominated in inversion units and amends the relevant provisions of the Federal Income Tax and Fiscal Code." Therefore, the adoption of the UDI, under the Law of Commercial Insolvency, is valid and constitutional because the aforementioned executive order preceded the Law of Commercial Insolvency and the latter does not contradict the former's text.

Likewise, the principles of legal certainty and equality of rights between the debtor and the creditors are not contravened to the extent that, as set forth in Article 89 of Law of Commercial Insolvency in standardizing the valuation of all allowed claims against the debtor, none of the creditors will have an economic advantage over the others. This is consistent with the concept of equal treatment of creditors embodied in the Law of Commercial Insolvency. Similarly, the equality principle is not affected by the provision of Article 89(III) of the Law of Commercial Insolvency, which permits the denomination of secured claims either in pesos or UDIs according to their

original denomination in the loan documents. It must be remembered that the principle of equality applies in the context of each class of similarly situated creditors based on the classification and priority of those classes.

In addition, the Law of Commercial Insolvency does not contravene the Federal Monetary Law by adopting the UDI as a unit of accounting inasmuch as the Federal Monetary Law establishes the "peso" as the unit of the national monetary system, but does not prohibit the denomination of financial obligations in a unit of accounting.²¹ It only requires that the payment of the obligation be made in pesos, since the peso is the currency of legal tender in Mexico.²² This viewpoint is confirmed by the following language from the Federal Monetary Law which, in parallel with the language found in the Law of Commercial Insolvency, justifies the denomination of obligations in UDIs while equating such inversion unit to the peso for the purpose of valuing the obligation that is to be paid, as follows:

Inversion Units: Even When The Obligation Is Denominated in UDIs, It Will Always Be Valued In Pesos. A correct interpretation of Article 7 of the Federal Monetary Law and Article 1 of the Executive Order of April 1, 1995, respectively, would indicate that the intent of the legislature, in providing that payment of a debt or obligation in Mexican currency must be made in pesos, was to avoid having the debtor satisfy his obligation in any type of currency other than the peso. Accordingly, the Federal Monetary Law authorizes in connection with business or financial transactions, that the amount of a debt or obligation can be established in units of accounting commonly known as inversion units, since these will always be valued in pesos based on the conversion rate published daily by the [Central] Bank of Mexico in the Federal Register. Therefore, the court of appeals correctly ruled that, independently of how the debt or obligation of the appellant was denominated in the contract, the parties agreed that the payment of such obligation would be made in pesos because the documents submitted to the court as evidence show that the inversion units into which the obligation was denominated would be paid based on their equivalent value in pesos as established by the [Central] Bank of Mexico.²³

Further, consistent with the foregoing interpretation, Article 4 of the Law of Commercial Insolvency, which defines the UDIs, expressly incorporates the inversion units referenced in the executive order published in the Federal Register of April 1, 1995, verbatim.²⁴ Nowhere in the Law of Commercial Insolvency did the drafter intend to substitute the inversion units in place of the peso as the lawfully acceptable money for payment of a debt or obligation. By incorporating Article 2 of the Federal Monetary Law into the statute, the provisions of such Article 2 apply, thus directing that any obligation denominated in inversion units must be paid in its equivalent value calculated in pesos.

With respect to the alleged contradiction between the Law of Commercial Insolvency and the Federal Monetary Law based on the Second Transition Article of the Law of Commercial Insolvency, which overrules any pre-existing provisions of the Federal Monetary Law that contradicts the provisions of the Law of Commercial Insolvency, clearly such a contradiction does not exist. The latter does not alter the text of the Federal Monetary Law, but rather, supplements it stating, "independently of whether an obligation is denominated in UDIs, it is reiterated that, such denomination is not prohibited, but all obligations must be paid in their equivalent value in pesos, the only money of legal tender in the United States of Mexico."²⁵

Conclusion

Based on the foregoing, the adoption of the UDI as an accounting unit under the Law of Commercial Insolvency is not unconstitutional. The inclusion of the UDIs in the Law of Commercial Insolvency to denominate the debtor's debts or obligations follows applicable nonbankruptcy federal law. Under the Law of Commercial Insolvency the UDIs are intended for use as units of accounting, that is they are used to calculate or estimate the amount of an obligation if originally denominated in pesos to UDIs, so long as the parties to the business or financial transaction agree, and without implying that the UDIs will substitute the peso as the acceptable form of payment of such obligations or debts.

Footnote:

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Comments by Josefina Fernandez McEvoy, Esq. [Back To Text](#)

² Translated by authors as "Diario Oficial de la Federacion." [Back To Text](#)

³ Translated by authors as "Unidades de Inversion (plural); unidad de inversion (singular)." [Back To Text](#)

⁴ Translated by authors as "Codigo Fiscal de la Federacion y de la Ley de Impuesto Sobre la Renta." [Back To Text](#)

⁵ Translated by authors as "Ley de Concursos Mercantiles." [Back To Text](#)

⁶ See "Ley de Concursos Mercantiles," art. 4, D.O., May 12, 2000 (Mex.), translated by authors [hereinafter "Ley de Concursos Mercantiles"]. "UDI" stands for "Unidades de Inversion." [Back To Text](#)

⁷ See id., art. 5 (stating, additionally, any state-owned enterprise formed as a business association may be declared in a business reorganization) [Back To Text](#)

⁸ Under the Law of Commercial Insolvency the filing of a voluntary or involuntary bankruptcy petition does not trigger an automatic stay of bankruptcy. Rather, shortly after the petition filing, the court, after notice and a hearing, decides whether the petition should be granted. See generally "Ley de Concursos Mercantiles," supra note 5., arts. 17–28 (describing procedure for granting order for relief). [Back To Text](#)

⁹ See "Ley de Concursos Mercantiles," supra note 5, art. 89, § III. [Back To Text](#)

¹⁰ "Decreto por el que se aprueba la Ley de Concursos Mercantiles reforma el articulo ochenta y ocho de la Ley Organica del Poder Judicial de la Federacion," art. 89, D.O., May 12, 2000 (Mex.) [hereinafter Mexican Insolvency Law]. [Back To Text](#)

¹¹ See id. [Back To Text](#)

¹² See id., art. 158. [Back To Text](#)

¹³ See id., art. 89. [Back To Text](#)

¹⁴ See id. [Back To Text](#)

¹⁵ See id. [Back To Text](#)

¹⁶ See Mexican Insolvency Law, supra note 9. [Back To Text](#)

¹⁷ See id. [Back To Text](#)

¹⁸ See supra note 8. [Back To Text](#)

¹⁹ See id. (noting specifically "the amount of their claims . . . shall be converted to UDIs . . . with respect to unsecured creditors."). [Back To Text](#)

²⁰ See supra note 5 (requiring, inter alia, that business aggregate liabilities do not exceed 400,000 units). [Back To Text](#)

²¹ See "Ley Monetaria de los Estado Unidos Mexicanos," D.O., art. 1, July 27, 1931 (Mex.), translated by author (declaring unit of monetary system only). [Back To Text](#)

²² See id., art. 7 (denominating peso as currency by which obligations are to be paid). [Back To Text](#)

²³ Quinto Tribunal Colegiado en Materia Civil del Primer Circuito [Fifth Civil Court of the First Circuit], 7 S.J.F. 790 (9a época 1998) (case number 7555/97; opinion recorded as number 196,493). [Back To Text](#)

²⁴ See supra note 4 and accompanying text (referring explicitly to decree published in Federal Register dated April 1, 1995). [Back To Text](#)

²⁵ See generally "Ley de Concursos Mercantiles," supra note 5. [Back To Text](#)