How to Avoid Uncollectibles on International Credit Sales

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Essential guidelines for making sure we have a strategic advantage in Court, should our "creditworthy" customers default payment and litigation becomes necessary in Mexico. [*Educational brochure for "Effective Pre-Shipment and Post-Shipment Strategies for Collecting on Overdue Accounts"*]

I. INTRODUCTION

Securing payment out of a credit sale heading into Mexico takes more than running a credit report for your prospective customer and making sure he is "creditworthy". In order for us to have the best possibilities of collecting on an overdue account, we have to make sure that our sale is conducted in a way that anticipates legal action should our debtor fail to honor his payment commitment.

From a litigation standpoint, it is not only necessary to have sufficient proof of your sale; it is crucial that we have the kind of evidence and tools that will allow us for a cheaper, faster and more secure remedy.

The following article will try to provide and explain therefore, a game plan that exporters should follow when selling goods into Mexico on credit, in order to guarantee the most favorable scenario should legal action be required for collection.

Practical advice will be given in summary fashion on the recommended legal remedies available, as well as the essential documents, information and security devices that will give way to these remedies. We will also asses the possibility of substituting litigation in Mexico for arbitration or court proceedings overseas, according to the difficulty in enforcing judgments and awards in Mexico.

II. LEGAL REMEDIES AVAILABLE IN MEXICO

Our game plan will begin by anticipating litigation. If we knew in anticipation that we were going to have to resort to a courtroom to get paid, where would we want to sue our debtor and what type of proceeding or other legal remedy should we seek as creditors?

We will have to do it in a place and in a way that will benefit us most by guaranteeing legal certainty and a strategic advantage over the debtor and over other creditors.

Knowing the types of proceedings available in Mexico and the advantages that each one of them presents will help us better asses whether to file suit directly in Mexico or turn to arbitration or litigation overseas.

The remedies that you will find in Mexico (relevant to our discussion) are the following:

I. **Commercial *executive* proceeding**. This would be the ideal scenario for a creditor if there is no possibility of creating a security interest on the debtor's property (mortgage or pledge).

First of all, the special title document (*título ejecutivo*) on which the proceeding is based creates a presumption that the claim exists and that it's legally valid, therefore, turning the burden of proof to the defendant (he basically has to probe that he paid).

Secondly, the same title gives a preliminary certitude of the plaintiff's claims, allowing therefore, an immediate *ex parte* prejudgment attachment order without placing bond.

Thirdly, it is rather a summary proceeding in which evidence admission and proposals are limited to the initial stages through complaint and answer's briefs. This makes for a shorter and faster proceeding in which a final resolution is usually going to be rendered in less time.

TIMEFRAME: Approximately one to two years to get a judgment [in a contested lawsuit]. This will depend on the venue and the amount involved.

TO FILE THIS WE NEED: A special title document (*título ejecutivo*) which could be a promissory note, a check or a bill of exchange.

II. **Commercial *"special"* proceeding**. This is a new regulated type of proceeding to allow a creditor to execute or foreclose on a movable asset or real property placed as collateral to secure a debt through a non-possessory pledge or a guaranty trust.

The new proceeding has made an enormous effort at last, to provide creditors for a fast and secure relief.

First, the creditor is allowed to repossess the collateral immediately after filing his complaint.

Second, if no objection is made by the debtor to account statements provided by the creditor, the court will presume that the debt exists and that it is legally valid. Also, payments made by the debtor will waive any defense based on the contracts validity (or nullity).

Third, debtors are allowed only specific limited defenses based on documentary evidence. This will limit debtor arguments in Court and will give more certainty to creditors.

TIMEFRAME: Should be a shorter proceeding than the executive. It should take around one year or less.

TO FILE THIS WE NEED: A non-possessory pledge agreement or a guaranty trust executed in writing before a Notary.

III. **Civil *summary* proceeding**. This is the mandatory proceeding to begin foreclosure on any real property serving as a mortgage.

It is a relatively short proceeding that has a track proven record of certainty and security for creditors, provided that the mortgage has been well executed and that it has priority over other encumbrances, if any.

TIMEFRAME: Approximately one to two years to begin foreclosure (in a contested lawsuit). This will also depend on the amount involved and State where the case is filed.

TO FILE THIS WE NEED: A mortgage agreement executed in writing before a Notary and filed at the Public Registry.

IV. **Commercial *ordinary* proceedings**. These proceedings accommodate for most of the cases where an international business transaction is disputed because they do not rely on a *título ejecutivo* and therefore, do not allow for immediate interim measures to secure proper execution of a final judgment.

Some of the most important features include the fact that it is a relatively longer proceeding and the plaintiff has the entire burden of proof to support his claim.

TIMEFRAME: From two to four years, depending on different factors: venue, amount involved, nature of our claim, supporting documents, etc.

TO FILE THIS WE NEED: Nothing; just a statement of facts. Of course, it will be difficult to probe your case under these conditions. Ideally you should account for a credit application, purchase orders, invoices, and delivery receipts.

Other options

There are two other options that must be considered before commencing proceedings in Mexico. These are:

1. Arbitration overseas and further enforcement of the arbitral award in Mexico

2. Court proceedings overseas and enforcement of the foreign judgment in Mexico

Many factors come into play when making a decision as to whether pursue legal action directly in Mexico or litigate or arbitrate overseas. These might include: 1) reliability of the specific State Courts that will hear our case [knowledgeable of international commercial disputes, corruption-free, etc.]; 2) the costs involved for filing suit, getting a judgment and executing upon debtor; 3) approximate timeframe for finishing our case and getting paid; and 4) the type of proceeding to be filed and the security that comes along with a temporary relief measure, if provided.

The options of suing abroad should be immediately discarded whenever you have real property or other collateral from the debtor as security for your debt. It is always much faster, more secure (because of interim relief measures) and less expensive to file suite directly in Mexico through a *special* or *summary* proceeding.

If you have no collateral and no promissory notes to allow you for an *executive* proceeding, you should be thinking arbitration or court proceedings abroad.

However, when you have a note that allows you to file for an *executive* proceeding, the scenario is not that clear. Ideally, you should always seek relief directly in Mexico, but should really ponder whether to follow that rule when you anticipate that sales will surpass $100,000.00 US dollars. In this case you should take a closer look at the State where your debtor is located and investigate how reliable are the Courts in that jurisdiction.

The National Banker's Association of Mexico prepared a study which aimed at ranking Judicial Authorities of all 31 Mexican States (published in the national newspaper "El Financiero" on April 15, 2002), based on 1) professionalism, 2) quick outcomes, 3) staffing resources, and 4) the quality of actual enforcement action. The study came out as follows:

Ratings by State			
Aguascalientes	**EC1**	Morelos	EC4+
Baja California	**EC2+**	Nayarit	EC4+
Baja California Sur	EC3	**Nuevo Leon**	**EC1**
Campeche	EC4+	Oaxaca	EC3
Coahuila	**EC2**	Puebla	EC5
Colima	**EC2+**	**Queretaro**	**EC1**
Chiapas	EC3	**Quintana Roo**	**EC1**
Chihuahua	EC5	**San Luis Potosi**	**EC2**
Mexico City (DF)	**EC3+**	Sinaloa	EC3
Durango	EC4+	Sonora	EC5
Guanajuato	**EC3+**	**Tabasco**	**EC2**
Guerrero	EC5	**Tamaulipas**	**EC2+**
Hidalgo	EC4+	Tlaxcala	EC5
Jalisco	**EC2**	Veracruz	EC5
Mexico State	**EC2**	Yucatan	EC4+
Michoacán	EC5	Zacatecas	EC4

EC1 Highest rating
EC2 Superior rating
EC3 Average rating
EC4 Below average rating
EC5 Worst rating possible

* A "+" or "promising rating" within EC2, EC3 and EC4 denotes a higher or more promising standing within the rank.

So, back to our previous question as part of the first step in our game plan: what type of suit should we look for and what jurisdiction should we choose?

Final recommendations

Although you should seek specific legal advice for all particular situations, some general guidelines could be followed:

1. **Get collateral.** Try to get any type of security from your customer, either a mortgage (preferably), a non-possessory pledge, or a guaranty trust. This will allow for a summary or special proceeding, both very reliable and highly recommended.
2. **Get secured.** If your customer will not provide collateral as security, get him to sign a promissory note as a security guaranty. However, on accounts that will surpass more than $100,000.00 US dollars choose suing overseas when the debtor's jurisdiction is not reliable.
3. **Choose wisely.** If you can't get any security from your buyer or the account will surpass $100,000.00 US dollars and the buyer's jurisdiction is not reliable, choose a jurisdiction overseas or arbitration. (More on enforcement of arbitration awards and foreign judgments will be discussed ahead.)

III. WHAT DO WE "ALWAYS" HAVE TO PROBE IN COURT?

Every time we sell goods to someone we are actually entering into a contract. Even if there is nothing in writing, only verbal or electronic communications, a contract is actually formed.

Therefore, every time we turn to a Court and request a Judge to compel our debtors to pay, we essentially have to probe that we have a binding contract for the sale of goods (or services), that specific terms and conditions apply, and that we met our part of the deal. (A contract is basically formed when there is an offer [for buying or selling] and an acceptance to that offer.)

Consequently, it is imperative that we ALWAYS probe the following:

1) That our buyer offered to buy some goods or that we offer to sell them;
2) That we accepted the buyer's offer or that he accepted ours;
3) Our specific terms & conditions for the sale of goods (or services) to the buyer; and
4) Delivery of goods (or rendering of services) according to our contract (terms & conditions).

IV. HOW DO WE PROBE OUR CONTRACT AND WHAT DOCUMENTS ARE IMPORTANT TO SUPPORT THE SALE?

Our contract for the sale of goods can be probed by any kind of proof or evidence available: testimony by witnesses, depositions of parties, expert witnesses, government reports, inspections, original documents, fax, copies, emails, etc.

The important question to ask is: which evidence will be considered strong evidence which is persuasive to the Court and easier for us to provide during a case?

The answer might be already known: original signed documents.

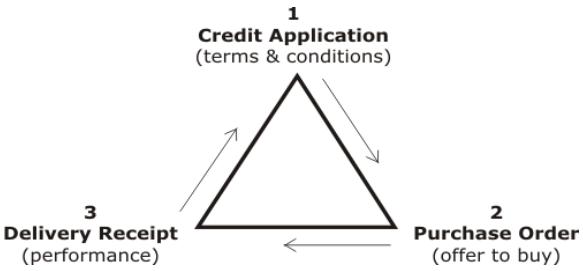
An original signed document will probe against the defendant who signed it immediately; unless he denies the authority of the signature. On most cases, it will be easy to probe (by an expert witness) that the signature is in fact the defendant's, and could result in the defendant's criminal responsibility for false statements before a Court (perjury).

So, originals are still the way to go.

If you cannot get original signed forms to support your sale, you should at least try to get copies that reinforce every commitment between you and your debtor, as well as the fulfillment of your obligations.

From a litigation standpoint, it is much better to have a copy (or email printout) to which a witness can refer to and testify, than having him memorize specifics of your transaction (including terms and conditions) and have him recite them in Court. A Judge may just find him unreliable or untrustworthy.

Either way, originals or copies, it is essential that you implement and keep at least: 1) a credit application; 2) purchase orders; and 3) delivery receipts. The relationship between them is best shown in the following expression:



Let's look at a greater detail at each one of them, as well as other documents that might come in handy.

— CREDIT APPLICATION —

This will serve as the foundation for all of your sales transactions. Despite serving as a credit reference to asses the granting of credit, you can and should use it as your main contract for the sale of goods, where you will be able to provide for the following:

1. Terms & Conditions of Sale. This could be done by adding a part that contains the specific terms & conditions for your sale of goods, and committing the customer to such terms upon his signature. (More on convenient terms will be discussed ahead.)

2. Personal Guarantee. The credit application can also help you establish a personal guarantee by a main shareholder (the owner in reality), a parent company (or the appropriate subsidiary company that IS capitalized), or a third party that will avail payment from your customer.

3. Non-Possessory Pledge. Moreover, it can even help you establish a lean over the client's property for accounts that will not exceed 250,000 Mexican *investment units –UDIS–* (which roughly represented $75,000.00 US dollars during December of 2003), by

adding a clause for the creation of a non-possessory pledge.

4. Promissory Note. When no collateral is granted as security, you should request your client to furnish a *pagaré* payable upon demand (for an amount equal to the credit authorized), to serve only as a guaranty device. Your credit application should make precise reference to this *pagaré* (which must be identifiable by a reference number inside the note) and point out under which conditions will you be allowed to enforce it.

Things to look out for

I. CORPORATE GROUP. Check if your customer is part of a larger corporate group. Make sure you ask them that information in your application. Usually a buyer will use a company that is undercapitalized. In these cases it is CRUCIAL that you ask for additional security. (An example is the *maquiladora* company in Mexico. These are usually off-shore subsidiaries of foreign companies that have no ownership over the assets they hold.)

II. SEVERAL COMPANIES IN THE SAME ADDRESS. Same situation as above: an undercapitalized buyer might be the one requesting credit. These are legal schemes to help debtors secure their assets from all sorts of claims: labor, tax, and commercial.

III. SPECIFIC INDUSTRIES. Some industries carry more risk than others and therefore, it is common to see undercapitalized companies within these sectors. The construction industry carries great risks, so often they will undertake operations with undercapitalized companies. In our experience, agriculture companies and service companies also pose a treat. Look more into your customer's industry, and if you have doubt, ask for additional security.

Additional recommendations

I. ORIGINAL SIGNATURE. At least with the credit application you should make a strong effort to get it originally signed (handwritten). Only this way you will be allowed to enforce any non-possessory pledge that might have been included in the contract.

Besides this, consider that it will be the foundation for your transactions, where its terms and conditions will allow future use (and reinforce legal effects) of faxes and electronic means (emails) for sending and receiving purchase orders, delivery confirmations, or acknowledgments from your debtor; and may give express authorization to specific personnel within the company.

With the debtor's original handwritten signature in the application, his commitment and obligations will be irrefutable in a Mexican Court.

II. ALL PAGES SIGNED. Although you will make an effort to keep it short and simple (ideally), it might go beyond one page. If you have to use two or more pages make sure that all of them are signed.

III. LEGAL OFFICER SIGNATURE. The granting of authority or legal representation to act on behalf of a Mexican company (capacity) requires a formal power of attorney through a Notary Public. Make sure that the individual signing on behalf of the client company has sufficient powers as an officer of the company according to the articles of incorporation (known as *acta constitutiva*) or in a separate power of attorney.

THIS PROCESS SHOULD NEVER BE OVERLOOKED. LACK OF CAPACITY OF THE INDIVIDUAL SIGNING THE ARBITRATION CLAUSE IS ONE OF THE VERY FEW REASONS WHY A MEXICAN COURT WILL NOT GRANT ENFORCEMENT OF AN ARBITRATION AWARD!

IV. DOUBLE-CHECK SIGNATURE. Make sure that the signature is actually from the individual who is supposed to be signing the application. Get a copy of a photo ID with his signature stamped on it, or have a sales representative from your company do this for you (in person).

V. FINAL STATEMENT. Just above the applicant's signature (at the end of the application) should be a statement certifying that the information provided in the application form is true and correct and that the purpose for it is to get credit. This will give way for criminal responsibility should you be mislead into a financial status of the customer which is not real. The

following statement might be placed just above the applicant's signature:

"I do hereby certify and attest that the above information is true and correct, and that the same is provided for the purpose of obtaining credit from the SELLER (name your company here). I am aware of the terms and conditions set forth above and agree to them entirely; understanding that they will apply to all future transactions entered into with the SELLER."

VI. ENGLISH-SPANISH VERSION. Whenever you can, provide a form that includes a Spanish version with it. At least the main terms and conditions (with pledge agreement, reference to promissory note or personal guarantee) as well as the final statement should be provided in Spanish also. Error in an individual's consent is also a valid reason to be alleged against the enforcement of an arbitral award. You shouldn't give the debtor the slightest possibility of bringing those arguments in Court.

— PURCHASE ORDER —

Some companies think that a payment history from the debtor after a delivery of goods, along with the invoices will be sufficient evidence for a Court to rule against the debtor. Wrong.

Even if the creditor has an acknowledgement of the debt in writing, incredible as it may sound, there is a need to probe where and how did the debt originated from.

As a result, we have to probe in Court that the buyer actually offered to buy specific goods at a fixed price, and according to certain terms. We can only probe our performance of obligations when we have probed what we committed to (what was requested through the purchase order).

It is highly recommended therefore, that we request purchase orders from our customers every time they want to place an order from us, or even when it has been already placed by phone or directly through our office or through a sales representative. The orders can be sent to you by fax, and they must include the following essential information:

1. FULL DESCRIPTION OF GOODS. You need your customers to describe the requested merchandise in full detail. Codes of parts or materials will not probe anything to a Court, and you will have to resort to a witness and additional documents to clarify what all those codes mean. Abbreviations create a similar problem also. Avoid them.

2. PRICE AND PAYMENT. Tell them to include the price per unit and the grand total to be paid. Terms of payment should also be included (even tough it may already appear in the application): 15 days, 30 days, etc.

3. PLACE AND TIME OF DELIVERY. Your customers must tell you when and where you should deliver the goods. *INCOTERMS* (international commercial terms) could also be of use to arrange specifics of delivery not already convened in the application (freight, insurance, risk, title, etc.).

4. SENDER INFORMATION. The order should be sent in the buyer's letterhead paper and contain the date and place of signature. IT SHOULD ALWAYS BE SIGNED BY AN AUTHORIZED EMPLOYEE. Besides the signature, the full name of the individual signing the order should also appear clearly.

5. ADDRESSED AT US. Needless to say, the order should be addressed to our company.

Additional recommendations

I. REQUEST AS MANY ORDERS AS YOU LIKE. Make sure that every piece of information and condition requested is included, and that you agree and will be able to comply with the terms stated in there. If there is an error in price, delivery date, quantity of the goods or any other thing that would legally affect the transaction, request the buyer to correct it and send it again.

— DELIVERY RECEIPT —

The delivery receipt, along with the credit application and purchase order completes our triangular expression for security on credit sales. The delivery receipt probes our performance, our fulfillment of obligations.

When we have performed according to what the buyer requested (through a purchase order), and by satisfying contract terms and conditions (through the credit application), we will be allowed to get paid in Court.

The delivery receipt could be obtained by way of a signed BILL OF LADING, a signed PACKING SLIP, or a custom-made DELIVERY RECEIPT. Whenever you can, especially in cases where a delivery company uses its own forms, request that they also use your own packing slip or your custom-made delivery receipt. This will have to include the special essential features that follow:

1. STATEMENT OF RECEIPT. The individual who is in charge of receiving the merchandise and the bill of lading should acknowledge receiving such goods, and should also confirm that he has personally checked or inspected that the goods received are in exact quantity and quality as the ones that appear in the bill of lading, packing slip or delivery receipt that he is signing. This could be included as a statement just above his signature.

2. FULL DESCRIPTION OF GOODS. Just as with your purchase orders and invoices, your customers should acknowledge in full detail what specific goods they are receiving. Codes of parts or materials will not help us. Abbreviations create the same problem also. Try to get a full description.

3. DATE, TIME AND PLACE OF RECEIPT. This will help us probe that the delivery was made according to the contract terms.

4. ORIGINAL SIGNATURE. Just as with the credit application, you should get an original handwritten signature of receipt on the bill of lading, packing slip or delivery receipt, or all. This can be requested to the freight or delivery company, or you should do it yourself if the delivery was EXW (Ex-Works).

5. FULL NAME OF RECEIPIENT. The individual signing the delivery receipt should write his full name clearly, and whenever possible, state his position with the company. This will allow us to identify the individual receiving each shipment and summoned him as a witness to recognize his signature in Court, should the debtor deny receiving the goods (more common that you would think).

— ADDITIONAL DOCUMENTS —

The following are documents that are also important to support your transaction. It is recommended that you use them also and keep them on file.

▪ **INVOICE.** For obvious reasons, the invoice will help probe that a sale was actually made for a specific product and for a specific price. Therefore, try to include date of issuance, full description of goods sold (no codes or abbreviations), price per unit and grand total, payment terms, accurate shipping and billing addresses, etc. THIS INFORMATION SHOULD MATCH THE ONE IN THE PURCHASE ORDER!

▪ **ORDER CONFIRMATION.** The order confirmation will probe essential when the buyer has placed an order but then changes his mind and rejects the goods being delivered or tries to cancel his order unfairly.

If you have already started manufacture of the goods or lost another sale based on the debtor's order (now cancelled), you should be allowed relief (compensation) for this loss. This will only happen when we can probe that there was an acceptance to his offer to buy goods (purchase order).

▪ **STATEMENT ACKNOWLEDGMENT.** You should make it a custom policy to regularly provide your clients with account statements and request their approval of the balance shown. This will bring to our case an important element of acknowledgment of debt, which will reinforce other evidence.

Moreover, article 1414 bis 8 of the Commercial Code (for Mexico) provides that an account statement sent to and received by the debtor will be considered as accepted by him if not refuted within 10 working days after receipt or when payments have followed. (This will only be applicable in *special* proceedings since the regulation is for that proceeding only).

▪ **SHIPPER IMPORTS.** A shipper import (*pedimento de importación*) reinforces our sale by probing that the

debtor actually imported and acquired our sold goods. Since this can be confirmed through an official report by government officials, it carries a great weight in a courtroom as a public document. Whenever possible you should request your client to send you a copy of his shipper import document or at least details from such operation (import date or reference number from the form).

TERMS AND CONDITIONS OF SALE
(What clauses and provisions are we looking to include in our credit application)

We've said before that the main reason of having a credit application is to allow proper documentation of your contract terms and conditions, that is, how are you going to sell and how are disputes going to be settled.

The following are just few essential issues that your contract should cover. Your aim should be of keeping your credit application as short, plain, and simple as possible. In a short and simple way, your application should cover the following issues to your advantage:

1. GOVERNING LAW. This is a very delicate issue from a litigation standpoint. WORD OF ADVICE: YOU SHOULD NEVER INCLUDE A GOVERNING LAW CLAUSE IF YOU DON'T KNOW FIRST WHAT YOUR STRATEGY IS IN REGARDS TO JURISDICTION OR ARBITRATION. Many Courts in Mexico will interpret a governing law clause as a jurisdiction clause and you can be denied legal action in Mexico if a foreign law was selected to govern your contract.

SECOND: If you are going to include a governing law clause, CHOOSE THE LAW OF THE STATE WHERE YOU ARE SURE TO FILE SUIT. A lot of attorneys tend to include governing law from their State of practice just because they are familiar and more comfortable with said laws. Choosing a governing law should not be based on these reasons.

Important reasons could include: 1) which law gives a strategic advantage to you as a creditor; and 2) which laws will be easier to be applied by the Court that is going to hear your case.

Supposed for instance that you have chosen the law of the State of California to govern your contract but have given proper jurisdiction to Mexican Courts. The plaintiff will have to prove before the Mexican Court what does California Law provides in regards to your transaction. This will have to be done through expert witnesses or government official reports, something that will only add considerable time and expense.

So our recommendation is to seek a common ground by specifically providing for the Vienna Convention on Contracts for the International Sale of Goods (the Vienna Convention) to govern your contract.

If you want more certainty to your transaction as to an underlying law for issues not covered by the Vienna Convention, choose the law of the State that will be selected to resolve any dispute, and also try to provide for specifics terms and conditions (in your credit application) that will give you an edge on the transaction.

2. VENUE AND JURISDICTION OR ABITRATION. We have already emphasized the importance of choosing the ground for your battles. One word of CAUTION: IF YOU DO DECIDE TO GIVE JURISDICTION TO A FOREIGN COURT, MAKE SURE THAT YOU FOLLOW THE STEPS PROVIDED FOR UNDER MEXICAN LAW FOR CHOOSING JURISDICTION SO THAT YOUR CONTRACT WILL BE ENFORCEABLE IN MEXICO.

The Mexican Commercial Code provides under article 1093 that in order to choose a jurisdiction clause the parties have to give clear and express renunciation to the venue given already by Mexican Law, and also must choose between the place where any of the parties have their addresses, or the place where the obligations were to be discharged according to the contract.

Another word of CAUTION: AVOID CLAUSES THAT GIVE EXCLUSIVE OPTION OF CHOOSING VENUE AND JURISDICTION TO ONE PARTY (SELLER). This clause will be considered null and void by the Federal Code of Civil Procedure (article 567), and thus, will make a judgment unenforceable in Mexico.

Both these two words of caution will not apply to an arbitration clause and therefore, an option clause for arbitration could be used, and there will be no need to include the former statement of renunciation.

If no jurisdiction clause is chosen, Mexican case law (*jurisprudencia*) has established that Mexican Courts will be considered to have proper jurisdiction to hear a case out of an international commercial dispute if the defendant is located in Mexico.

3. TIMEFRAME FOR BUYER TO RAISE CLAIMS. The Vienna Convention provides under article 39 that the buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller within a "*reasonable*" time. The Mexican Commercial Code gives a buyer only five days (after delivery) to raise claims to the seller in regards to lack of quality or quantity of the goods sold.

Provide certainty to your transaction by establishing a specific timeframe for the buyer to raise claims on this regard. If he does not give you notice of these claims within that timeframe he will not be able to raise those questions in Court.

4. PAYMENT TERMS (WHEN, WHERE, HOW). You can and should provide for a general scenario on when and how will the buyer pay. The general rule should be that the buyer will pay in 30 (or 45, or 60) days upon delivery and receipt of the goods. Provide that the payment will have to be made directly to the seller through wire transfer without any need of a formal demand of payment. (Mexican Law provides for this formal demand under some scenarios. You can waive this right by expressly providing so.)

5. TOLERANCE IN SHIPMENT. Some companies sell in bulks or large production units and therefore are unable to send exact quantities as ordered by buyers. Provide that the seller will be authorized a 5% deficit or surplus in the order placed and that the buyer will be obligated to accept that 5% deficit or surplus.

6. INTEREST. Article 78 of the Vienna Convention provides that interest should be paid upon default, but gives no figures or ways of determining one. The Mexican Commercial Code provides for a 6% (annual) late interest fee. If you don't provide specifically for one you will be only allowed to charge 6% per year.

7. REINFORCE USE OF FAX AND EMAIL. Provide that the buyer will be authorized to place orders through fax or email. This will reinforce the presumption that these mediums were common practice and a general rule.

8. NON-POSSESSORY PLEDGE. Because of the new characteristics and regulation of the non-possessory pledge in Mexico, it's possible to establish a lien over the debtor's movable property in generic fashion, that is, we do not have to point out specifically what assets are being encumbered.

Moreover, a pledge for transactions below 250,000 Mexican *Udis* (roughly $75,000.00 US dollars on December of 2003) will be valid when executed in writing, even though it is not executed before a Notary Public. This allows you to create a pledge with your credit application, and you should really take advantage of that.

V. WHAT HAPPENS WHEN I DON'T HAVE WRITTEN DOCUMENTS?

A commercial transaction that is done verbally or through the use of fax or email is a valid one. Article 78 of the Mexican Commercial Code provides that no commercial transaction will be subject to specific formalities or prerequisites for its validity.

Furthermore, recent amendments to the Commercial Code (May 2000 and August 2003) now specifically provide (under articles 89 through 114) for electronic messages and electronic signatures (along with regulation on certifying authorities) as a valid mean to create a legal and binding contract or agreement, considering such transaction as if it was executed in writing (under certain generally known conditions of authenticity and integrity).

In addition, the Vienna Convention on Contracts for the International Sale of Goods (Vienna Convention) provides under article 11 that a contract of sale needs not to be concluded or evidence in writing and is not

subject to any other requirement as to form. Article 13 further provides that for the purposes of the Convention "writing" includes telegram and telex.

So, if a commercial transaction by phone, email or fax is considered valid and enforceable by law, why is it so hard to enforce in Court?

The problem lies not in the validity issue, but in our strict Legal System derived from Civil-Roman Law and in even more rigid rules on evidence procedure. Furthermore, the way in which data messages have to be conserved and presented in Court as evidence posses a great challenge not just to Mexico but to any other country.

First, evidence procedure rules on the Commercial Code provide that a private document —as opposed to a public document which is given total credit as either a public record or a document signed before a Notary Public— can only be legally recognized by the party who signed it. That means that only original signed documents by the defendant or his employees can be recognized in Court through deposition. And that's the rationale behind requesting original signed documents all the time.

A fax or an e-mail printout sheet presented in Court by the plaintiff are documents produced by the same creditor-plaintiff, not signed by the debtor-defendant, and therefore not allowed for recognition through a deposition. The defendant will simply just object to them saying that those documents were produced by the plaintiff alone and could have been altered or falsely created.

The fax and email, although considered "writings" to satisfy a writing condition which carries authenticity, are both mediums of communication of so intangible nature that a Court will just not allow for that data to be attributable to a defendant, if objected.

Under these conditions (objection), proving by way of a fax printout alone would be impossible. Proving by way of e-mail messages would required for us to prove how the data is stored in our computer system in order to confirm integrity (that it contains all the content or text and in the way that we are asserting) and authenticity (that is real and that it was actually originated and sent by the defendant). Still, this will prove even more difficult than it sounds.

Answer

So, what happens when we lack written or originally signed documents and have only copies or email and fax printouts? The answer is simple: you provide the Court these copies and printouts and support them with reliable witnesses. Each witness will reinforce the fact that the data contained in such documents is real and that it originated from the defendant.

Mexican Courts will request at least two witnesses to prove each fact, and will give less credit to testimony from employees of the party who is offering them in Court. Despite this, full credit should be given when there are other elements supporting our claim such as fax, email printouts and other copies to which the witnesses can refer to.

With copies and proper witnesses you should be able to prove and support your claim.

Still, we cannot stress out enough the need of having at least a credit application and the delivery receipts originally signed. Besides this, everything else can be requested and kept in copies.

VI. ADDING ADDITIONAL SECURITY TO YOUR TRANSACTION THE EASY WAY

There are three documents considered in Mexico an executive title (*título ejecutivo*): 1) the check; 2) the letter of exchange [*letra de cambio*]; and 3) the promissory note [known as a *pagaré* in Mexico]. All these will allow for filing an *executive* proceeding in Mexico and thus, serve as a great security device.

However, the most important security device today is the *pagaré*. The bill of exchange is outmoded (not used anymore), and checks are harder to use as a security device and have a shorter life period for enforcement (six months). For that reason, we will address the *pagaré* as your ideal device to easily secure any credit sale.

— PROMISSORY NOTE —

An ideal situation is for you to have a *pagaré* signed for each shipment sent and received by your buyer. Because this is very difficult to achieve in practice, you should aim at having at least one promissory note signed at the beginning of your relationship to serve as a guaranty for your future sales.

This is achieved by creating a *pagaré* payable "upon demand", and then linking it to your contract (credit application) with a reference number and providing a general rule of use in said contract.

Although many customers will be reluctant to sign them, the reference to your credit application should give them security for the risk of improper use. So there is no reason why your customer should refuse to sign it.

The word of caution however is to draft your *pagaré* making sure it meets all requirements provided for under Mexican Law for proper enforcement.

According to article 170 of Mexico's General Law of Commercial Paper and Credit Transactions (LCPCT), a promissory note that's compliant with Mexican Law must contain the following:

1. The express statement that the document is a *pagaré*, contained within the note itself.
2. The unconditional promise to pay a certain amount of money (*pagaré incondicionalmente*).
3. The name of the company or individual to whom the payment is to be made.
4. The time and place where the payment is to be made.
5. The time and place where the note is subscribed (essential for the validity of the note).
6. The original signature of the issuer of the note.

Additional recommendations

The following recommendations should also not be overlooked since they could carry the nullity of the note and make it unenforceable:

1. When the issuer/debtor is a corporation, make sure that the individual signing the note has full powers to sign or issue credit instruments (*títulos de crédito*) on behalf of said corporation.
2. When the issuer/debtor is a corporation, make sure that the act of signing promissory notes or credit instruments is provided for specifically under its corporate purpose in the articles of incorporation.
3. Make sure that the signature is genuine and from the individual who is actually supposed to be signing the note.
4. When seeking enforcement of a promissory note, make sure that you file suit within three years of the date of maturity (statute of limitations is 3 years).
5. A co-signer (*aval*) is a great way to reinforce your guarantee of payment by the primary debtor. Get a co-signer.

(For further details on how to draft *pagarés* that will be enforceable in Mexico please visit our website at http://www.hmhlegal.com/pagaresinmexico.)

VII. OTHER VALUABLE SECURITY DEVICES AVAILABLE IN MEXICO

There are several good security devices available in Mexico today. With the recent amendments to our Commercial Code and to the Negotiable Instruments and Credit Transactions Law on May 2000 and June 2003, our government has taken colossal steps in an effort to create a modern secured financing system.

The recent amendments create a new regulation for the commercial pledge, creating in fact a new non-possessory commercial pledge, and adding valuable features not even dreamed about four years ago with traditional pledge. The amendments also addresses and regulates the guaranty trust (*fideicomiso de garantía*), correcting a situation of non-transfer of property rights to trustees that for years created many problems in court for creditors to the extent of making it unenforceable.

For this reason, we will only briefly address the new security devices available, as well as others which still have wide use and have proved to be valuable as well as cost-effective. Other valuable options such as the letter of credit, bonds, and insurance will not be covered on this topic.

— NON-POSSESSORY PLEDGE —

The commercial pledge is a device that helps secure a loan by creating a security interest on the debtor's personal or movable property (such as goods recently acquired out of an international sale).

For years, Mexican Law had followed traditional *Roman Law* principals which required that goods securing a loan be delivered to the creditor (seller). Not anymore.

Recent amendments to the Negotiable Instruments and Credit Transactions Law on May, 2000 have made it possible for lenders to retain an interest in the pledged property while debtors retain possession.

Another main feature of this new pledge is the possibility of creating a security interest in present and future collateral, as well as to secure present and future obligations. (Future collateral includes after-acquired property, account receivables, proceeds, etc.)

BEAUTY OF IT: Although not put so much to the test due to its recent regulation, we believe that the new pledge will allow for the fastest and less expensive proceeding of all. Also, you are able to create a valid pledge contract just by executing it in writing without the need of a Notary Public (for accounts worth less than 250,000 Mexican Udis, which accrued to around $75,000.00 US dollars on December 2003).

DOWNSIDE: It only creates legal effects against third parties (other creditors) upon filing at the City Public Registry. Labor and tax claims have preference and priority over a pledge.

— GUARANTY TRUST —

By means of a guaranty trust the debtor conveys certain assets to an institution (mostly banks) duly authorized by Federal authorities to act as a trustee, with the purpose of securing payment and priority on an obligation. The guaranty assets can be any real or personal property, tangible or intangible.

Upon default, the trustee is entitled to execute on the guaranty assets either through court or through an out-of-court foreclosure procedure in order to pay the creditor.

BEAUTY OF IT: The trustee acquires real ownership rights of the assets transferred. Therefore, there will be no labor or tax claims that will have preference or priority over your credit. It also provides for an out-of-court foreclosure procedure that is supposed to be fast and cost-effective.

DOWNSIDE: Very expensive to use on your everyday transaction. It is recommended only on sales worth $400,000.00 US dollars or more.

— MORTGAGE —

The mortgage agreement allows a creditor to establish a security interest in the debtor's real property (real estate) to secure payment of any loan with priority over other creditors.

Upon default of the obligation secured, the creditor has the right to request the foreclosure of the mortgage before a judicial court and pay indebtedness with the proceeds derived from the foreclosure.

BEAUTY OF IT: It has a proven reliable procedure to foreclose on the property. Very affordable and widely known by most attorneys in Mexico.

DOWNSIDE: Has no preference or priority over labor or tax claims.

— CONDITIONAL SALE —

Through this device seller reserves title to the goods sold until buyer completes full payment. This method has proven very effective when the goods sold can be identified and can also be recorder in the City's Public Registry of Commerce (in buyer's place of business). Proper recording allows a seller immediate

repossession of the goods sold should buyer default payment, even in bankruptcy or strike proceedings.

Highly recommended for selling heavy machinery or equipment because you get to keep ownership rights to the goods sold until paid in full.

BEAUTY OF IT: Very affordable and easy to execute. By far the least expensive of all security devices explained here. As an owner there will be no labor or tax claim that will have preference over your credit.

DOWNSIDE: You still have to file it at the City Public Registry to have legal effects against third parties, and thus, must first execute it before a Notary Public. Legal action has to be pursued through an ordinary action, unless otherwise provided through a binding arbitration or jurisdiction clause.

VIII. SHOULD WE RESORT TO ARBITRATION OR COURT PROCEEDINGS OVERSEAS?

We have already said that we should definitely resort to court proceedings overseas or arbitration when we don't have any security for our debt. Even when we do have a promissory note as security but our debt will grow to more than $100,000.00 US dollars and the debtor's jurisdiction is not reliable we should be thinking of this option also.

The question is which of these two options should we choose? You answer will be based on two factors: 1) the easiness and cost effectiveness of getting a quick judgment or award; and 2) the easiness, availability and cost effectiveness of enforcing such judgment or award in Mexico.

In assessing this situation we will only speak about the second factor. The first factor will have to be assessed through your local counsel overseas where you are seeking relief.

It would be a total disappointment (with the waste of time, money and effort invested) getting a judgment overseas only to figure out that it cannot and will not be enforceable in Mexico.

Therefore, the requirements and procedures for the enforcement of foreign judgments and arbitration awards will be addressed in this part. Our further recommendation for choosing either option will be assessed solely based upon this information.

— ENFORCEMENT OF FOREIGN JUDGMENTS —

The enforcement of a foreign judgment creates great challenges for litigation attorneys. The process for enforcement goes through another parallel process called *homologación*, which brings recognition of full legal binding effects in Mexico to a judgment from a Court of a different jurisdiction.

As we will see, this will be a very formalistic process which will carry unenforcement if not complied with rigorously.

In regards to the enforcement of foreign judgments Mexico has signed only two Treaties: 1) The Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards [Montevideo]; and 2) Inter-American Convention on Jurisdiction in the International Sphere for the Extraterritorial Validity of Foreign Judgments [La Paz].

As of this date, the Montevideo Convention as really not been supported by any country but Mexico, so it is not in effect yet. The La Paz Convention has been signed by several Latin American countries only, with the absence of Canada and the United States.

Consequently, we will have to rely on Mexican Law to figure out the specific requirements and procedure for enforcement, namely, the Commercial Code and the Federal Code of Civil Procedure (FCCP).

Requirements

According to article 571 of FCCP, the recognition and enforcement of a foreign judgment will take place only when the following conditions are met:

I. All formalities for letters rogatory are satisfied. According to the FCCP letters rogatory should comply with the following:

1) The letter rogatory should be certified or authenticated.

2) The documents must be legalized.

3) The documents must be translated.

4) The request must include a statement that helps satisfy the comity condition.

5) The request must include a statement that helps prove that the judgment is final.

6) Full and express powers are to be given to the requested court.

7) Counsel in Mexico should be appointed and an address must be designated.

II. Judgment is not the result of an *In Rem* right. (A mortgage and a pledge are *In Rem* rights over real and personal property.)

III. The court rendering the judgment had proper jurisdiction to try the matter and to pass judgment on it. Mexican rules on Jurisdiction should be totally complied with.

IV. Service of process has been completed upon defendant in due legal form. This "due legal form" has to be strictly compliant with Mexican Law. It can either be done according to the OAS Inter-American Convention on Letters Rogatory, or the UN Hague Convention on the Obtainment of Evidence Abroad on Civil and Commercial Cases. Either way, Mexican Procedure Law should be strictly followed.

V. The judgment must be final and have the force of *res judicata*. (Not subject to an appeal process for further review.)

VI. There must be no case tried by a Mexican court that is a result of the same legal actions.

VII. The judgment must not be contrary to Mexican public policy (*ordre public*).

Procedure for enforcement

The process for *homologación* can be considered a summary proceeding. This process provided for under article 574 of the FCCP, requests that parties involved are given a nine day period —after filing documents for enforcement— to defend themselves through allegations or requesting the presentation of evidence in court.

After the court has decided which evidence proposals are admitted a hearing date will be set for disclosure. Once the evidence is rendered the court will be ready to issue a judgment either granting the enforcement or denying it. An appeal process is also available to both parties for which a five day period is granted for filing.

(For additional and full information on enforcement of US judgments in Mexico please logon to our web: http://www.hmhlegal.com/enforcementofjudgments)

— ENFORCEMENT OF ARBITRAL AWARDS —

The process for enforcement of an arbitral award is a rather simple one; less troublesome, less expensive and far more secure in contrast to the enforcement of a foreign judgment as explained above. That is why it should be your best option. Here's why.

First, defenses and arguments will be limited to the debtor as Mexican Courts (according to article 1462 of the Commercial Code) will only be allowed to deny enforcement in the following cases:

I. When debtor (upon whom the execution is sought) proves to the enforcing Court that either

a) The parties in the arbitration clause (either one) had no legal capacity to enter into the contract and commit to the arbitration clause or that the contract is considered null and void by the law governing such contract or the law of the State where the award was issued (if nothing was agreed in regard to governing law);

b) No legal and proper notice was given for the appointment of an arbitrator or any of the arbitration proceedings;

c) The award deals with differences (issues) not contemplated by or exceeding within the terms of the arbitration clause;

d) The composition of the arbitral tribunal or the arbitration procedure was not done according to the parties agreement, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

e) The award has not yet become binding on the parties, or has been set aside or suspended by a Judicial Court of the country under the law of which that award was made.

II. When the Court finds out that the subject matter of the controversy is not capable of settlement in arbitration according to Mexican Law or when the recognition & enforcement is contrary to public policy.

Second, there is no need to comply with the formal petition requirement set forth for foreign judgments, therefore having no need of complying with strict rules on letters rogatory and no sacramental rules of procedure for service of process in Mexico. A simple formal petition (called a *demanda incidental*) drafted by your attorney in Mexico and signed by your legal representative, along with the requested supporting documents will be sufficient to request enforcement of an award.

Third, requirements are few and easy to comply with. Therefore, the debtor will be left with limited grounds for raising arguments in Court. The requirements are as follows.

Requirements

I. Original or certified copy of the arbitration award duly authenticated (with the appropriate *apostille*);

II. Original or certified copy of the arbitration clause or contract that contains such clause; and

III. A full translation in Spanish language of the above referenced supporting documents.

Procedure for enforcement

The process for enforcement of an award is much the same than the one provided for judgments with one big exception: debtors have limited arguments and Courts are forced to deny any relief to the defendant based on these arguments. This alone will make your process for enforcement much easier, more secure, faster, and more reliable overall.

The process (provided for under article 360 of FCCP) can be considered a summary proceeding (*incidente*). It requests that parties involved are given a three day period —after filing a petition for enforcement— to contest or to request the presentation of evidence in court.

After the court has decided which evidence proposals are admitted a hearing date will be set for disclosure and to make final allegations in the following three days. Ten days are given for discovery. Once the evidence is rendered the Court must resolve within five days. An appeal process is also available to both parties and five days are granted for filing.

Final recommendations

Because we want to limit all of debtor's arguments in court against enforcement, whenever you are going to choose arbitration and in proceeding with this step you should always do the following:

I. Because legal capacity is one of the few allowed arguments in court, make sure that upon signing the credit application that includes the arbitration clause, the individual signing has actual legal representation for his principal. This is done by requesting a copy of the articles of incorporation (*acta constitutiva*) or a specific power of attorney signed before a Notary Public.

II. Another ground for unenforcement is lack of proper notice. Don't take risks into having your award put aside because —according to the court's criteria— the defendant was not properly served (notified). Before commencing the arbitration proceedings hire an attorney in Mexico to serve debtor personally and with the help of a Notary Public. If you cannot serve him personally, follow Mexican local procedure rules for leaving notice on his place of business or with his employees.

IX. SUMMARY GUIDELINES

Whenever you are selling goods into Mexico on credit apply the following guidelines:

1. Think strategically. If you knew that you were going to have to sue your customer, how would you want to proceed and in which jurisdiction?

2. Get secured. Based on the preceding question, choose a security device that will allow for a fast, inexpensive, and reliable proceeding in Mexico.

3. Choose wisely. If your customer will not provide security or when the amount of your transaction exceeds $100,000.00 US dollars and the debtor's jurisdiction is not reliable, choose arbitration to resolve any dispute.

4. Leave evidence of your sale to prove your case. Always request an originally signed ***credit application*** that includes terms and conditions of sale. Also request ***purchase orders*** (at least by fax), and get delivery receipts signed (***bills of lading***) for each shipment.

X. CONCLUSION

An international credit sale presents always the risk of turning uncollectible. There are too many legal factors involved to properly collect in Court. You have to reduce that risk to a minimum.

Besides following the preceding guidelines make sure you have insight and specific advice from your local attorney overseas, as well your attorney in Mexico.

These guidelines are provided for general scenarios. You should always seek approval and advice for your specific and delicate transactions. ■

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