

The Daily Transcript

San Diego's Business Daily

Thursday, May 4, 2006 | Vol. 121, No. 89 | www.sddt.com

Secured financing of U.S.-based loans in Mexican transactions enhanced by use of Mexican trust



Rebeca Perez-Serrano

By REBECA PEREZ-SERRANO
Sheppard, Mullin, Richter & Hampton LLP

U.S. lenders financing Mexican transactions are increasingly using Mexican trust agreements to enhance secured financing.

Enforcement issues — including expensive litigation, the complexity created by the interplay of Mexican and U.S. remedies, where the exercise of a remedy in Mexico may affect a remedy in the United States or vice-versa, and the enforcement of Mexican judgments in the United States or the enforcement of U.S. judgments in Mexico — arising from more traditional secured financing mechanisms in México have brought about this trend.

Examples of such mechanisms include mortgage, pledge, personal guaranty and the guaranty trust agreement, which is a trust where the debtor/settlor transfers the ownership of certain property to a Mexican bank, which acts as trustee or fiduciary, in order to secure compliance with an obligation owing to the creditor/beneficiary. In the event of default on the underlying obligation, the trustee will proceed with the sale of the trust property in an auction and apply the proceeds to the payment of the secured obligations, as provided in the trust agreement. This article gives an overview of two variations of the guaranty trust agreement that provide enhanced protection and control over the collateral.

Trust agreement where the lender is designated as the "first beneficiary" of the trust: "lender's trust"

In a lender's trust, the settlor transfers title to the collateral, either real or personal property (the "property"), to the Mexican trust (the "trust"). The trustee or fiduciary is a Mexican bank. The first beneficiary of the trust is a U.S. lender/creditor and the second beneficiary of the trust is a

borrower/debtor subject to a credit agreement governed by U.S. law. Note that a second beneficiary often is the same entity as the settlor.

While the parties to a lender's trust can contractually set forth any rights and obligations permissible under applicable Mexican law, a lender's trust may include some of the following terms:

1) Rights of the first beneficiary

- Authorize the second beneficiary to use and possess the property until such authorization is revoked pursuant to an event of default under the U.S. Credit Agreement.

- Pay or instruct the trustee to pay any property taxes or expenses to maintain the property in the event that the second beneficiary fails to do so.

- Keep control over the property until all the obligations under the U.S. Credit Agreement have been paid in full.

- Instruct the trustee to sell the property in a private sale in the event of default by the second beneficiary under the U.S. Credit Agreement.

- Appoint a substitute first beneficiary. This may be used to syndicate the underlying loan.

2) Rights and obligations of the second beneficiary.

- Possess and use the property subject to the first beneficiary's rights to revoke such possession and use in the event of default under the U.S. Credit Agreement.

- Pay applicable taxes, utilities and any other costs or expenses associated with the possession and use of the property.

- Receive proceeds from the operation of the property.

- Appoint, with the consent of the first beneficiary, a substitute second beneficiary.

3) Rights and obligations of the trustee

- Act upon instructions of the beneficiaries consistent with the terms of the lender's trust.

- Receive a fee for its services, as set forth in the lender's agreement.

- Be indemnified and held harmless by the beneficiaries in connection with the performance of instructions given by them.

Trust agreement for the development of real estate in Mexico ("developer's trust")

A developer's trust is a trust agreement typically used to develop residential real estate (the "real property") located in México's restricted zone, which covers 100 kilometers inward from international borders and 50 kilometers inward from the coastline. Mexico's Foreign Investment Law restricts

direct ownership of land for residential purposes in these areas by non-Mexican nationals. In a developer's trust, the seller acting as "settlor" transfers title to the real property to the Mexican trust (the "trust"). The "trustee" or "fiduciary" is a Mexican bank. The "first beneficiary" of the trust is the buyer/developer. The "second beneficiary" of the trust may also be the seller of the real property or another party designated by the settlor.

Again, while the parties to a developer's trust can contractually set forth any rights and obligations permissible under applicable Mexican law, a developer's trust may include some of the following terms:

1) Rights of the first beneficiary

- Use and develop the real property; e.g., subdivide the property, submit the real property to a condominium regime.

- Pay applicable taxes, utilities and any other costs or expenses associated from the possession and development of the real property or instruct the trustee to do the same.

- Instruct the trustee to sell certain parcels to third-party buyers. Note that this right may be limited by the rights remaining with the second beneficiary.

- Appoint a substitute first beneficiary, with the consent of the second beneficiary.

2) Rights and obligations of the second beneficiary

- Allow the first beneficiary to possess, develop and subdivide the real property, reserving the right to revoke the same upon default in the payment of the purchase price.

- Procure and provide utilities for the property, such as road access, energy, water and sewage.

- Set forth transfer restrictions on the subdivided real property, pending payment of the purchase price.

- Instruct the trustee to sell the property in a private sale if the first beneficiary defaults on its obligations under the underlying purchase and sale agreement.

3) Rights and obligations of the trustee

- Act upon instructions of the beneficiaries consistent with the terms of the developer's trust.

- Constitute a condominium regime on the real property following the first beneficiary's instructions.

- Allow the first beneficiary to subdivide the property, market and sell individual lots. This right may also be limited by the right of the second beneficiary.

- Transfer title to individual lots

to third-party purchasers following the first beneficiary's instructions.

- Receive a fee for its services, as set forth in the developer's trust.

- Be indemnified and held harmless by beneficiaries in connection with the performance of instructions given by them.

Final considerations applicable to the lender's trust and the developer's trust

- The trust agreement must be executed in the presence of a Mexican notary public in the form of a public deed and recorded with the public registry where the property transferred to the trust is located.

- The tax effects relating to the transfer of the property to the trust must be carefully analyzed and reviewed by tax advisers familiar with both U.S. and Mexican tax laws. Some tax issues for consideration may include whether the creation of a Mexican trust by a U.S. corporation creates a permanent establishment in México, thus subjecting the U.S. settlor to Mexican taxes, settlor's ability to depreciate property transferred to the trust and tax incentives available for certain trusts that meet requirements of Mexican tax laws.

- The rights and obligations of the first and second beneficiaries in the event of default of the main agreement, whether it is a purchase and sale or a credit agreement, should be carefully drafted and properly reflected in the trust agreement.

- The trust agreement should contain governing law, conflicts of law provisions and jurisdiction and dispute resolution provisions, whether the parties choose mediation and arbitration or binding final arbitration.

- Because Mexican law governs Mexican trusts, the beneficiaries in a Mexican trust frequently choose to enter into a beneficiary rights agreement, which is usually governed by U.S. law. These agreements establish certain provisions with respect to the trust, the ownership, construction or development, administration and maintenance of the property transferred to the trust and the resolution of disputes between the parties.

Luis Rubio provided information on the structure of the lender's trust. Perez-Serrano is a senior associate in the corporate practice group in the firm's Del Mar Heights office. She can be reached at (858) 720-8900 or rperez-serrano@sheppard-mullin.com.

Source Code: 20060503cre