

# Mexico

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**M**exico (officially known as the United Mexican States) is a federal republic with 31 states and a federal district. The country has a total population of around 105 million. The Mexican economy is 14th in the world by size and according to the World Bank, the per-capita income in nominal market exchange rates is the highest in Latin America, at \$7,310, positioning Mexico firmly as an upper middle-income country.

The country has changed profoundly in the last few decades. Protectionist legislation has been amended to open the economy up to foreign investment and to position the country within the international community. Particularly significant was Mexico's adoption of the General Agreement on Tariffs and Trade (and accession to the World Trade Organisation), and the North American Free Trade Agreement. Mexico has also joined the Organisation for Economic Cooperation and Development.

Mexico, as the world leader in free trade agreements, has an extensive network of such agreements covering most of Latin America, North America, the European Union, the European Free Trade Area and Japan in representation of the Asian region. Mexico is now focused on advancing its commercial relations with these partners.

President Calderón's administration had obtained approval of an important reform to the federal tax laws, as well as new legislation applicable to the pension system for public officers. Nevertheless, many reforms are also being undertaken, such as in regard to the electoral and energy legislation, and numerous proposals have been submitted to Congress for further reforms to modernise the country.

Mexico is a civil law country. In accordance with the Mexican Constitution, the federal government has jurisdiction over commercial law (including business reorganisation and bankruptcy laws). However, local governments have jurisdiction over civil law, which includes property and civil rights. Therefore, the insolvency of an individual is governed by the local civil procedure code of the state in which he or she is resident.

Accordingly, the General Business Corporations Law and the Business Reorganisation and Bankruptcy Law are federal acts. The former regulates the ordinary liquidation of a Mexican corporation, while the latter addresses personal and corporate insolvency processes and sets forth the legal regime for business reorganisations and bankruptcy.

## **1. The legal framework and the effectiveness of court processes/legal remedies**

### **1.1 Describe the nature and the effectiveness of the following:**

#### **(a) Debt recovery remedies where the debtor has no security**

Mexican law recognises that all legitimate debts are valid obligations and are enforceable against the debtor. Such debtor shall comply with its obligations,

using all its assets where necessary.

If the debt is incurred in the ordinary course of business and is unsecured, the creditor shall file a judicial action payment through an ordinary commercial procedure. In such procedure the creditor must prove the existence and maturity of the debt. Only after a definitive award is reached (usually upon review by a higher court) will the court order the debtor to pay. If payment is not made, the court will use its authority to oblige the debtor to pay. However, the judicial process can be very slow.

### **(b) The enforcement of security**

This procedure varies depending on the nature of the security.

**Trust arrangement:** At the time the debtor incurs the debt, it transfers certain assets to a third party (a trustee), which is usually a bank, with irrevocable instructions.

These instructions provide that if payment is not made, the trustee can liquidate the assets and make the payment. It is preferable for the trustee to hold assets that can be easily sold so as to facilitate payment. This mechanism has proved to be quite successful, although in some cases the courts have issued injunctions to trustees to prevent them from liquidating assets until the court has reviewed the fairness of the arrangement.

**Mortgage:** There is a separate court procedure for mortgages. The court verifies that payment is due and authorises the sale of the asset. The sale is through a public auction carried out by the court itself. Payment is made from the proceeds of sale. If the proceeds are insufficient to pay off the entire debt, the balance will constitute an unsecured debt.

The real estate mortgage is perhaps the most widely used form of security for transactions involving immovable property. A debtor or third party executes a mortgage instrument, naming the creditor as the mortgagee and giving the creditor the right, in a default situation, to be paid out of the proceeds of sale of such property, subject to the order of priority set out by law.

A standard real estate mortgage applies to the immovable property identified in the mortgage instrument.

Certain industrial mortgages are available to Mexican banks (and, in some states, to other Mexican foreign lenders as well). This provides the lender with security over all assets of a business (including immovable property).

**Lien:** Mexican law allows for a pledge on movable goods or assets in two ways.

In the first case, possession of the goods is transferred from the debtor to a third party or, under certain circumstances, to the creditor. The law provides certain reasonable rules for the custody and proper storage and maintenance of the goods.

In the event of default, the creditor may ask the court to approve the sale of the goods under a lien. In such case, the judge notifies the debtor and gives it a final term of 15 days either to make payment, to show evidence of payment or to show evidence of any defence it considers appropriate to submit before the court. The judge has 10 days to decide on the matter. If no evidence is produced to show that payment has been made or no good reason is given to avoid payment, the judge will approve the sale. The corresponding consideration or price will be kept under lien until the judge approves the payment.

If the proceeds are insufficient to pay off the entire debt, the balance will constitute an unsecured debt.

In the second case, where a lien is granted without the transfer of goods either to a third party or to the creditor, the debtor can continue to enjoy the possession and use of the goods.

The debtor is thus able to continue its business operations, while simultaneously being able to grant a security to its creditors.

### **(c) Corporate bankruptcy/liquidation processes**

**Regular dissolution and liquidation process or voluntary liquidation:** If a company is not insolvent but certain dissolution events (eg, expiration of its corporate term, agreement of the shareholders) are triggered, then a regular liquidation process should take place in accordance with the provisions of the General Business Corporations Law.

In this case, the shareholders of the company appoint the liquidator, who is responsible for controlling the liquidation process. The appointment of the liquidator is provided for by public deed. Control of the process remains with the appointed liquidator.

**Formal corporate bankruptcy:** If a company defaults on payment of its obligations and is insolvent (as defined in the Business Reorganisation and Bankruptcy Law), and a reorganisation plan is not achievable, the company shall be declared bankrupt. Such bankruptcy could be voluntary (requested by management) or

involuntary (requested by a creditor or by the district attorney).

The formal bankruptcy process is controlled by a judge assisted by a trustee in bankruptcy appointed by the *Instituto Federal de Concursos Mercantiles* (IFECOM), an agency of the federal courts which supports judges in bankruptcy procedures and keeps a register of the officers and specialised persons that act in business reorganisations and bankruptcies under the Business Reorganisation and Bankruptcy Law.

#### **(d) Formal corporate rescue processes**

In accordance with the Business Reorganisation and Bankruptcy Law, a Mexican company can enter into a formal corporate rescue or reorganisation process. The reorganisation should be achieved within a six-month period and can be extended for up to one year by agreement of a majority of the creditors.

The corporate rescue process is handled by a professional conciliator, who is also appointed by and registered with IFECOM. Day-to-day operations continue under the direction and responsibility of company management.

The reorganisation plan is submitted by the conciliator and requires approval by the majority of the creditors and the court.

#### **(e) Informal corporate rescue procedures**

As in many other jurisdictions, informal processes may be negotiated to rescue a company or to liquidate it. Where an informal process proves unsuccessful, the different parties related to a failing company can then initiate a formal procedure. The great majority of restructuring processes actually take place out of court. Usually, the interested parties organise themselves into a committee. The committee works among the different creditors in order to negotiate effectively with the debtor.

Such informal negotiations may be implemented only insofar as no bankruptcy procedure is filed.

The proposed reorganisation plan is submitted by company management.

### **1.2 What are the formal processes to effect a liquidation of the company's assets?**

**Regular dissolution and liquidation process:** A voluntary liquidation or winding-up under the General Business Corporations Law should be entrusted to one or more liquidators, who are the

legal representatives of the company. In the absence of special provisions in the company bylaws, the liquidator should be appointed by the shareholders at the same time as the dissolution is agreed. The liquidator shall have the authority to wind up all unfinished business of the company, collect the outstanding accounts and pay the company's debts, as well as sell company property.

In addition, the liquidators shall pay to the shareholders the corresponding share of the remaining assets and draw up a final balance sheet for the shareholders' approval and registration in the Public Registry of Commerce.

Liquidation of the assets should be at market prices. Appraisals of the assets are advisable prior to liquidation.

**Voluntary or involuntary bankruptcy:** If a reorganisation plan is not viable, the second phase is bankruptcy; this is usually declared only when the debtor has been unable to reach an agreement with its creditors during the conciliation phase.

Bankruptcy is declared only if one of the following events occurs:

- The debtor requests it and the mercantile insolvency proceedings judgment pursuant to the Business Reorganisation and Bankruptcy Law has been pronounced;
- The time limit for the conciliation has expired and the parties have not reached agreement; or
- The conciliator has requested it because it considers that there is no possibility of an agreement.

A declaration of bankruptcy implies that from that moment, the company is managed by a trustee in bankruptcy. The judge will make orders for the occupation of the property and place of business of the debtor and for the drafting of an inventory. The conciliator may be approved further by IFECOM in a formal procedure in order to act as the trustee in bankruptcy.

Even if the recognition of claims has not been concluded, the trustee in bankruptcy will proceed with the alienation of the property and rights that make up the assets. With certain exceptions in which the trustee may proceed to a private sale of the property, such alienation must be made through public auction. Assets that represent security to secured creditors are used to repay those claims.

A partial liquidation may be conducted. Usually creditors will agree to approve it if the company can pay certain debts, as agreed with the creditors' committee, with the proceeds of sale of

the assets sold. An example would be where a business division is sold and the proceeds are used to pay some debt, usually at a discount.

In a formal procedure, the liquidation must be approved by the court.

The trustee must submit a report to the court at least every two months. This report includes:

- a record of all sales of goods;
- the condition of all other assets still owned by the company; and
- the list of creditors which will receive payments.

Both the report and the list may be reviewed by all creditors, which have three days to comment on them.

After three days the court determines any distribution of cash.

### **1.3 What is the effect on debt collection and the enforcement of security of:**

#### **(a) An adjudication of corporate bankruptcy/liquidation?**

Under the Business Reorganisation and Bankruptcy Law, secured creditors are paid with the proceeds of sale of the assets provided as security. To be considered as a secured creditor, the securities must be legally registered.

Unsecured creditors are stayed from pursuing individual actions against the debtor.

Unencumbered assets of the debtor will vest in the trustee in bankruptcy who, after managing the bankruptcy estate, will distribute such assets to the unsecured creditors on a *pro rata* basis.

#### **(b) The commencement of a formal corporate rescue process?**

The Business Reorganisation and Bankruptcy Law provides for a stay of proceedings against secured and unsecured creditors, as well as third parties, to prevent them from terminating or otherwise exercising their rights under contracts with the debtor. The purpose of such stay is to maintain the public interest protected by the Business Reorganisation and Bankruptcy Law, as well as to prevent jeopardising the feasibility of the company's business.

#### **(c) The initiation of an informal corporate rescue process?**

When an informal process takes place, the members

of the negotiating committee will usually conclude a standstill agreement with all creditors. Under this agreement, no creditor is under any legal obligation to execute a standstill covenant. As such, any creditor may initiate a trial to recover debts or enforce security.

A creditor which has executed a standstill covenant must comply with its terms.

### **1.4 Are insolvency procedures started in another jurisdiction in respect of a corporation incorporated in your jurisdiction recognised? In particular, what would be the impact of US bankruptcy proceedings being commenced?**

According to general laws on reciprocity, a Mexican court will recognise the effects of proceedings initiated in a foreign jurisdiction if that foreign jurisdiction recognises proceedings initiated in Mexico. The foreign court or the foreign trustee of the foreign proceedings, as appointed according to the foreign law, should request recognition and assistance from the Mexican courts in any proceedings.

Specifically, the Business Reorganisation and Bankruptcy Law includes several provisions for cooperation in international proceedings, the access of foreign representative and creditors to Mexican courts, the recognition of a foreign insolvency procedure and remedies that may be granted.

Cooperation is based on the understanding that in any case, the Mexican courts will not honour any request that would violate Mexican public order. The Bill of Rights is considered to be a matter of public order in Mexico. Thus, for example, the proper opportunity to defend oneself must be given in the foreign jurisdiction.

US bankruptcy proceedings are recognised in Mexico according to these principles.

### **1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential liability for continuing to trade? In practice, are any such provisions actually enforced?**

Upon a declaration of bankruptcy, control of the debtor must be transferred to the appointed trustee. Directors are removed from their positions in the company, but may work in other companies and act as directors in those companies.

A director or officer may be liable for continuing to trade if certain conduct (eg, fraud, mismanagement) punishable under Mexican criminal law occurs. If the failure of the company during the business reorganisation process is not

the result of any criminal act, the court may not issue a legal order preventing directors or officers from trading.

## **2. What are the advantages and disadvantages of triggering a formal insolvency or corporate rescue procedure?**

Formal procedures are complex and involve many different parties: the creditors, the debtor, the judge, IFECOM (which handles the procedure) and the conciliator or trustee in bankruptcy. Thus, a formal procedure is more expensive and is usually initiated when the creditors are unable to agree among themselves or with the debtor.

One of the main advantages of a formal procedure is that the process is controlled by an independent judge who has no economic interest in the company. In addition, a formal procedure provides protection against legal actions by creditors – for example, any attachments on assets are suspended to allow for a reorganisation of the business.

A formal procedure may also be initiated if the financial condition of the debtor has deteriorated significantly, as a formal procedure has several tax benefits, protects shareholders against new actions of the creditors and establishes a professional and controlled business reorganisation process.

In addition, if the debtor's management has lost credibility, the formal procedure may be initiated to facilitate negotiations with the conciliator or the trustee in bankruptcy. Management can react more efficiently and creatively in proposing solutions.

## **3. What are the practical options for out-of-court restructuring?**

Any chosen procedure must be handled in good faith. Both the creditors and the debtor need to understand that to preserve the value of the company, each side needs to have consideration for the other.

A prudent and wise adviser or negotiator can be of great help in the negotiating process.

The final agreement can include:

- partial debt forgiveness;
- additional terms in the payment schedules;
- the capitalisation of the company;
- the admission of new partners; and/or
- the granting of additional security from the company or from third parties.

Mexico was badly affected by the peso financial

crisis in 1994. After the crisis, the majority of important work-outs took place through out-of-court negotiation rather than in court.

This proves that the best security is the debtor's willingness to make payment.

## **4. What is the effect on the management of a company of:**

### **4.1 An adjudication of corporate bankruptcy/liquidation?**

Once bankruptcy is finally adjudicated, the judge and the trustee in bankruptcy take control over the assets and management is no longer responsible for running its operations.

### **4.2 The commencement of a formal corporate rescue process?**

In a formal corporate rescue, the day-to-day operations are carried out by the management of the company. The conciliator is responsible for working with management to prepare and submit a formal reorganisation plan for approval by a majority of the creditors.

In certain specific cases, as provided by law, a conciliator can request the judge to remove management of a company.

The purpose of the conciliation phase is to provide the basis for the debtor to attempt to reach a restructuring agreement with its creditors.

Any specific agreement between the debtor and any of its creditors outside the process will be null and void. A creditor which enters into such specific agreement may lose its rights in the insolvency proceedings. The only exception is that the debtor may enter into agreements with its employees. In turn, the conciliator may negotiate tax credit remissions.

The conciliator may request the anticipated termination of the conciliation or reorganisation phase and commencement of the bankruptcy phase if he or she considers that the debtor or its creditors are reluctant to reach agreement.

For the agreement to be effective, it is sufficient that it is approved by the debtor and by recognised creditors representing more than 50 per cent of the value of the recognised common credits and the recognised claims with collateral or special privilege.

The recognised creditors, whether common or secured, may not veto an agreement if it fulfils the requirements mentioned above and payment in *unidades de inversión* (UDIs) is established, together with the accessories generated contractually on the

date of the agreement, according to the value of the UDIs on the date of payment. (A UDI is a non-monetary unit that is adjusted by inflation as determined every day by the Mexican Central Bank. Any obligation or debt denominated in UDIs can immediately and automatically be converted into pesos of equal purchasing power.)

If extensions of the repayment period and reductions in the payment amount are provided for in the agreement, but it is not approved by all common recognised creditors, the agreement provides them with an extension of time with capitalisation of ordinary interest and/or a reduction in the amount of the principal balance and interest, equal to the lesser amount accepted by those common recognised creditors which did approve it, in both cases where the approving recognised creditors of the agreement represent at least 35 per cent of the total claims in their class.

Once the agreement has been submitted, the judge will verify whether the legal requirements have been complied with; if so, he will approve the agreement.

#### **4.3 The initiation of an informal corporate rescue process?**

See section 1.3(c).

### **5. Parties in interest/key players**

#### **5.1 Who is responsible for the 'case management' control and administration of a corporate bankruptcy/liquidation, a formal rescue and an informal rescue?**

In a formal bankruptcy and a formal rescue, the process is ruled by a judge, assisted in a reorganisation by a conciliator or in a bankruptcy by a trustee in bankruptcy; both shall be appointed by IFECOM.

In an informal rescue, case management control is entrusted to the debtor or to those persons or entities appointed by the debtor and its creditors by means of a formal agreement.

Nevertheless, the following parties play important roles in the case management.

**Visitor:** Once an action for mercantile insolvency proceedings has been filed, the judge will notify IFECOM so that it can appoint a visitor to determine whether the company has triggered one of the insolvency events set out in the Business Reorganisation and Bankruptcy Law.

**Conciliator:** Once the mercantile insolvency proceedings judgment has been issued, the judge will request IFECOM to appoint a conciliator to review and regulate the company's management and accounting. In addition, the conciliator shall be provided with creditors' requests so that he or she can file a preliminary list of creditors with the court. The conciliator will also propose the options for the agreement.

**Trustee in bankruptcy:** If bankruptcy is declared, the judge will request IFECOM to appoint a trustee in bankruptcy or, if necessary, to confirm the conciliator as such, for the appraisal and sale of the company's assets and to make payments to creditors as appropriate.

**Interveners:** Any individual may be appointed by the creditors as an intervener. Among its powers, the intervener must supervise the actions of the conciliator and the trustee. Creditors representing at least 10 per cent of the claims may appoint an intervener.

#### **5.2 Who is responsible for preparing the restructuring plan in a formal or informal rescue?**

In a formal rescue the conciliator is responsible for preparing the restructuring plan.

In an informal rescue the parties to the restructuring agreement agree on its terms and conditions, as well as appointing the person responsible for preparing the restructuring plan.

In practice, in both processes the legal, financial, accounting and tax advisers bear the main responsibility for preparing the documents that will be finally approved by the conciliators and the parties.

#### **5.3 Who are the key players? What are their roles and responsibilities?**

See section 5.1.

#### **6. What financial information is available to creditors?**

In bankruptcy, liquidation and formal rescue cases, the debtor's financial information must be contained in the visitor's report.

In an informal rescue the financial information to be made available depends on the agreement reached between the debtor and its creditors.

In the case of a voluntary request for a

mercantile insolvency proceedings judgment, the available financial information must include:

- financial statements of the company for the last three years, which must be audited where the law so provides;
- a memorandum containing the reasons for the events that brought about the breaches;
- a schedule of company creditors and debtors, including:
  - their names and domiciles;
  - the date on which each claim will fall due; and
  - the estimated grade for their recognition, including the particular issues of those claims, as well as of personal or real guarantees that the company has granted to cover personal debts and third-party debts; and
- an inventory of all of the company's real estate, goods, securities, mercantile paper and any other rights.

## 7. Common questions

### 7.1 Funding and the priority given to new money

#### **(a) If an insolvent corporation requires urgent working capital funding, what difficulties are likely to be encountered in the provision of such funding?**

With regard to new financing agreements entered into by an insolvent company, if a formal procedure has started and management continues to manage the company, the conciliator shall monitor accounting and any transactions carried out by the company.

The conciliator shall decide on the rescission of outstanding contracts and approve – on the basis of the intervener's prior opinion, if any – the assumption of new credit, the creation or replacement of collateral and the sale of assets not in the regular course of business. The conciliator must report these activities to the judge. Any objections will be dealt with through ancillary proceedings.

In case of the replacement of security, the conciliator must have the affected creditor's prior written consent. For these purposes, the conciliator must submit to the creditors the details of the transaction, according to the terms established by IFECOM.

The creditors must render their written opinion to the conciliator within five days of the date on which the conciliator submits the proposal for approval. If the creditors fail to answer on a timely basis, they will be deemed to have accepted the proposal.

The conciliator has discretion not to seek the creditors' opinion on the disposal of goods in cases where such goods are perishable, or where he or she believes that the price of such goods may be adversely affected or that their conservation may cost more than any profit which they may yield for the estate. If he or she exercises this discretion, he or she must advise the judge within three days of the transaction. Any objections will be dealt with through ancillary proceedings.

If the conciliator is entrusted with the management of the insolvent company, he or she must take the necessary steps to identify any goods owned by the company but in the possession of third parties, during the declaration of business reorganisation.

Once the new claims are approved, and if an increase in capital is also approved during the proposal formal procedure, the conciliator must inform the judge to notify the shareholders of their preferential rights of subscription to such increase within 15 days of the notification. If the shareholders fail to exercise their rights by then, the judge may authorise the capital increase on the terms and conditions established in the agreement proposed by the conciliator.

The agreement can be entered into by all recognised creditors of the company, except creditors of fiscal or labour claims according to Article 23, Paragraph A, Section XXIII of the Constitution.

#### **(b) Are lenders providing new money, or debtor-in-possession financing, given any statutory priority?**

The following claims are paid before any of the claims set out in section 7.2 below:

- claims listed in Article 123, Paragraph A, Section XXIII of the Constitution and its regulating provisions, taking into consideration wages owed for the two years preceding the company's declaration of business reorganisation;
- claims incurred by the company in its management of the estate with the conciliator's or receiver's authorisation, or those incurred by the conciliator, if any;
- regular expenses incurred in the protection, repair, preservation and management of the properties of the estate;
- claims resulting from judicial or extrajudicial proceedings for the benefit of the estate; and
- the fees of inspectors, the conciliator and the receiver, and expenses incurred by them which were strictly necessary in the performance of their duties and which are duly supported by the provisions issued by IFECOM.

## 7.2 Ranking of creditors

### ***In what order are creditors paid in a corporate bankruptcy/liquidation?***

Creditors are classified by the following grades, according to the nature of their claims:

- singularly privileged creditors (funeral expenses and claiming for illness expenses);
- secured creditors (eg, mortgagees and creditors holding specific pledge warranties);
- special privilege creditors (as set out in the Code of Commerce and corresponding laws); and
- common creditors (ie, all other creditors not previously mentioned).

## 7.3 Avoidance of antecedent transactions

### ***Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?***

Any agreement entered into by the insolvent company after formal proceedings have been triggered is void.

A director of a business which has been declared subject to business reorganisation pursuant to a standing judgment shall be liable to imprisonment for between one and nine years if he has acted in a malicious manner so as to cause or worsen the default of his or her payment obligations.

There is a rebuttable presumption that the default of payment obligations was maliciously caused or worsened by preparing the accounts in such a manner that does not reflect the company's true financial condition or by altering, falsifying or destroying accounts.

The judge will consider the extent of the loss caused to creditors in deciding the penalty.

## 7.4 'Cram-downs'

### ***What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or informal rescue plan?***

In an informal plan the parties are free to negotiate favourable terms for themselves, and as such creditors which do not agree are not bound by agreements which other creditors have entered into, unless they so agree.

In a formal plan, once the conciliator takes into

consideration the views of the insolvent company and the majority of recognised creditors necessary for the approval of the proposed agreement, the recognised creditors have 10 days to subscribe to it or comment thereon.

The conciliator must attach to the proposal a summary which clearly expresses the principal issues raised. The proposal of the agreement and the summary must be filed according to the terms and conditions set out by IFECOM.

At the end of seven days following this 10-day period, the conciliator presents the proposal which has been agreed by the insolvent company and the requisite majority of creditors to the judge.

After the judge receives the proposal, he or she must allow the creditors five days to:

- object to it on the grounds that they had not in fact consented; or
- exercise their veto right.

The agreement affects common recognised creditors which have not entered into it only in the following ways:

- an extension of time, with capitalisation of ordinary interest, of a maximum duration equal to such minimum duration assumed by the recognised creditors that subscribed to the agreement and that represent at least 30 per cent of the total claims;
- a release from the principal balance and interest due and unpaid, equal to the minimum assumed by the common recognised creditors that subscribed to the agreement and that represent at least 30 per cent of total claims; or
- a combination of the extension and release, if the terms are identical to those accepted by at least 30 per cent of the recognised amount due to the common recognised creditors that subscribed to the agreement.

## 7.5 Creditor protection

### ***What action can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?***

Common recognised creditors that have not executed the creditors' agreement cannot veto the agreement.

The agreement can be vetoed by simple majority of the common recognised creditors or by any one of them whose recognised claims (jointly) represent at least 50 per cent of the total claims, both secured and unsecured.