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# Banking & Finance

## Mexico

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# MEXICO

## Law and Practice

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## 1. Loan Market Panorama

### 1.1 Impact of Regulatory Environment and Economic Cycles

Mexico is now in the second year of the administration of President Andrés Manuel López Obrador, who has brought about a climate of political, social and economic unrest.

As a result of this and the COVID-19 pandemic, the Mexican economy is in a serious recession. For instance, Mexico's GDP fell at a record rate in over a decade in Q1 2020, and this trend is expected to continue, with experts estimating a 10-12% recession for 2020. Another element to bear in mind is the increasing inflation resulting from the loss of value of the Mexican Peso versus the US Dollar, among other factors.

It is also worth mentioning the large cutbacks in public spending and the stubborn implementation of infrastructure projects like the Santa Lucía Airport, the "Dos Bocas" refinery and the "Tren Maya," the financial and technical viability of which is questionable, to say the least.

Also, the three major rating agencies (Moody's, Standard & Poor's, and Fitch) have downgraded Mexico's sovereign debt grade this year.

On the other hand, there are – or at least could be – indicators of optimism in certain sectors that are beginning to gain momentum as a result of the US-China commercial conflicts and the enactment of the new United States – Mexico – Canada Agreement (USMCA), such as manufacturing, industrial and agricultural production.

Other positive notes include significant actions taken against alleged corrupt individuals from previous administrations, such as Rosario Robles, Juan Collado, Genaro García Luna and Emilio Lozoya. However, long-term and effective convictions are yet to be seen, and many political experts have questioned these moves as being political in the context of the mid-term elections that will happen in Mexico in July 2021.

On the international front, the eyes of the world are turned to the upcoming presidential elections in the USA, the results of which will certainly have a strong impact on the Mexican economic and financial situation, given the tight-knit and symbiotic relationship between both countries and the fact that the USA is Mexico's largest trade partner.

Considering the above, reasonable activity is expected in Mexico's loan market in light of the material amount of resources that will need to be injected into the economy in order to overcome its current adverse situation and the low interest rates that are

and will continue to be available both locally and internationally. Also, in this context, profitable opportunities will become available for foreign and local investors with liquid assets, and many debtors will need to seek refinancing.

### 1.2 Impact of the COVID-19 Pandemic

Mexico has been struck particularly hard by the COVID-19 pandemic and is currently among the top ten countries for number of cases. As a result, the USA has closed its southern border for land travel (except for essential travellers), and a significant drop in tourism (which accounts for approximately 9% of the Mexican economy) has caused this industry to dwindle at a faster rate.

Moreover, the federal government has been completely passive towards the pandemic and has offered little to no assistance to either corporations or individuals.

Paired with the fact that the pandemic has hit an already weakening economy, this all leads to a grim and uncertain outlook for the country.

That said, and as previously explained, the disruption in the supply chain between China and the USA could provide an opportunity for Mexico to get its foot in the door and increase its manufacturing and export activity – especially since Mexico is a key source of medical device imports to the USA. Also, the enactment of the USMCA is expected to boost the industrial, manufacturing and agricultural sectors in Mexico.

As for the impact on the loan market, and as mentioned before, banks have had no choice but to refinance credits across the market as payment capacity has diminished. Also, in the context of an adverse economic situation, a material amount of resources will need to be injected into the economy and profitable opportunities will become available for investors, so loans will be required, and the loan market is expected to see a reasonable amount of activity.

Likewise, the Mexican Central Bank (*Banco de México*) has taken a more active role in fighting the pandemic and has, among other actions, injected MXN750 million into the market so that banks and other entities can continue to lend to small and medium-sized businesses.

As with the rest of the world, the true and long-term effects of the pandemic are yet to be seen.

### 1.3 The High-Yield Market

Mexican bonds have traditionally been considered competitive in both emerging and developed countries, and bond issuances have continued to take place despite the pandemic, with the last

ones happening in April for international bonds for an accumulated USD6 billion with 5%, 4.75% and 3.9% coupons each, maturing in 2051, 2032 and 2025 respectively.

That said, the recent downgrades to Mexico's sovereign debt made by all three major credit ratings agencies (Moody's, Standard & Poor's and Fitch) and the possibility of Mexico losing its investment grade status in 2021, paired with significant exits of capital from Latin America and the effects of the COVID-19 pandemic, will likely affect the market for these instruments and shift investors' appetite towards that of mid to high risk.

## 1.4 Alternative Credit Providers

Mexico is one of the most underbanked countries in Latin America, with approximately 42 million unbanked consumers, according to different sources. This has prompted regulators to put financial inclusion at the top of their agenda, as evidenced by the passing into law of the Law to Regulate Financial Institutions (*Ley para Regular las Instituciones de Tecnología Financiera*), informally known as the "Fintech Law". The purpose of this law is, generally, to regulate crowdfunding, cryptocurrencies, "digital wallets" and other innovative models. While it was enacted back in 2018, secondary regulation is still being put in place by the regulator, and authorisations for most companies to be organised under such law are currently yet to be completed.

Other experts forecast that Mexico will be a prime market for neobanks (ie, banks that offer banking services via digital means exclusively), and several players have taken the stage. One example is the recent joint venture between Rappi (a Colombian powerhouse in the online retail sector) and Banorte (Mexico's third largest bank), which will ultimately result in a purely digital bank. Also, large banks have come to realise the potential of this hugely untapped market and are implementing digital and consumer-friendly alternatives so as not to fall behind these new up-and-comers.

## 1.5 Banking and Finance Techniques

One trend worth mentioning is that joint venture or co-investment structures are being put in place by banks with entities in other sectors. The strategic alliance between Rappi and Banorte has already been mentioned, but other examples include "Mercado Pago" – the digital branch of Mercado Libre (one of Latin America's first "unicorn" startups) – or the joint venture between Amazon México and Nubank, which will offer credit alternatives to the former's customers.

As mentioned before, both new players and traditional banks are focused on creating efficient and cost-friendly digital onboarding strategies that enable them to reach a broader client base and close on banking products in as little time as possible.

Moreover, the so-called "new normal" resulting from COVID-19 is expected to accelerate these digitalisation trends, given that traditional banking services – which in several cases imply an actual visit to a branch – are currently out of reach for a large section of the population.

## 1.6 Legal, Tax, Regulatory or Other Developments

On the financial and regulatory side, except for the reforms indicated below, the last reforms were passed by the Mexican Congress back in 2014 under the administration of Enrique Peña Nieto; the legal framework has mostly remained unchanged since then. Certain Senators from the MORENA party (Andrés Manuel López Obrador's party) have expressed interest in pushing for a reform to eliminate and restrict banking fees and commissions. Such alternative received heavy pushback and a new formulation has not yet been presented to Congress.

Regarding tax developments, a new tax reform was approved by the Mexican Congress at the end of last year, and began implementation this year. Also, a new framework that will provide for more flexibility to pension funds (AFOREs) to invest in debt and capital instruments is underway, with a bill being proposed to Congress by Andrés Manuel López Obrador in July.

As mentioned before, a large part of the secondary regulation of the Fintech Law is currently being implemented by the regulator.

## 2. Authorisation

### 2.1 Authorisation to Provide Financing to a Company

Generally, the granting of credit in Mexico is not a regulated activity and can be carried out by any person within Mexican territory without requiring authorisation from the federal government for such purpose.

However, some financing activities are regulated by Mexican financial laws and regulations, implying the need for registration and/or authorisation from Mexican financial regulators. Entities that carry out such activities will be subject to the supervision of these regulators and will need to meet certain requirements, such as minimum capitalisation, corporate governance controls, and disclosure of information. The financial entities that can carry out reserved financial activities include the following:

- *instituciones de crédito* (banks), which are entities that (among many other things) may receive deposits from the general public and in turn use them to carry out lending activities. These are traditional banking institutions and

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they can either be “full service” (offering financial products across the board) or “niche” (focusing on specific financial products only – eg, credit card issuance). The capitalisation requirements will vary depending on such activities;

- *sociedades financieras de objeto múltiple* (SOFOMs), which are entities that have access to legal and tax benefits in their financial activities;
- *instituciones de tecnología financiera* (ITFs), which are the entities created by the Mexican Fintech Law for the rendering of crowdfunding and payment fund activities; and
- issuers of securities, which are entities that offer equity, debt or hybrid securities to the general investing public through a Mexican stock exchange.

The lead banking regulator in Mexico is the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores* – CNBV), which is an agency ascribed to the Mexican Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*). Within its several functions, the CNBV is in charge of overseeing and regulating the organisation and operation of banks, SOFOMs and ITFs. Another important player in Mexico’s financial regulation is the Mexican Central Bank (*Banco de México*).

## 3. Structuring and Documentation Considerations

### 3.1 Restrictions on Foreign Lenders Granting Loans

Foreign lenders are not restricted in any way from granting loans in Mexico. That said, charters or licences to operate as a regulated Mexican financial entity can only be granted to Mexican entities, in the understanding that these entities can have up to 100% foreign investments, subject to certain limitations set out in the corresponding statutes.

### 3.2 Restrictions on Foreign Lenders Granting Security

The granting of security or guarantees to foreign lenders is not generally restricted or prohibited. However, in the event of a foreclosure procedure, foreign lenders may be restricted from owning certain regulated assets or assets in general because of limitations on foreign investment in a particular sector. In these types of restricted cases, lenders can structure their guarantees in such a way that allows for a foreclosure on Mexican collateral and the consequent sell-off of the underlying assets to a third party without becoming the legal holder (owner) thereof.

### 3.3 Restrictions and Controls on Foreign Currency Exchange

There are no such restrictions or controls under Mexican law.

### 3.4 Restrictions on the Borrower’s Use of Proceeds

There are no restrictions on the borrower’s use of proceeds from loans or debt securities, as long as the use is for legal activities.

### 3.5 Agent and Trust Concepts

Such concepts are recognised in Mexico.

In the financial context, trusts are commonly used as collateral structures (security trusts), and as debt service or payment mechanisms. Naturally, there are other alternatives to secure lending obligations; these basically refer to personal guarantees, pledges (over intangible and movable assets, including stock) and mortgages (over real estate). It is worth noting that, contrary to other jurisdictions, only certain entities may act as trustees pursuant to Mexican law, such as authorised banks, SOFOMs, brokerage houses and authorised insurance or sureties companies.

Although not expressly recognised by Mexican law, the concept of an agent is not opposed in the legal system and can be implemented within its context.

### 3.6 Loan Transfer Mechanisms

The assignment of creditor rights is possible under Mexican law, and is widely and frequently used. The specific requirements that need to be met depend on the type of creditor rights being assigned and the specific terms agreed in the credit agreement, but they generally consist of the execution of an agreement setting forth the terms governing the assignment, a notice to the debtors, and additional formalities to those necessary for the creation of the relevant rights.

For the assignment of a security package stapled to a loan, in certain cases the same formalities met for its granting will need to be complied with for its assignment. For example, in the case of a pledge agreement, its assignment will need to be filed before the Sole Registry of Movable Securities (*Registro Único de Garantías Mobiliarias* – RUG).

### 3.7 Debt Buy-Back

Debt buy-back by a borrower or sponsor is possible under Mexican law, subject to certain “claw-back” provisions under the bankruptcy statute in Mexico – the *Ley de Concursos Mercantiles*. Such claw-back period is generally 270 days prior to a declaration of the *concurso mercantil* (bankruptcy), and applies to any transfer of assets (including buy-backs) in detriment of creditors under a bankruptcy or reorganisation proceeding. Note that debt acquired by an affiliate of a borrower has a different voting treatment and ranking for purposes of a *concurso mercantil*.

## 3.8 Public Acquisition Finance

Under Mexican law and in the context of a public acquisition – which must be carried out through a public and authorised public tender – an acquirer must disclose the amount and source of the resources that it will use in the transaction, specifying if any of such will come from financings. In this case, it must also disclose a summary of the terms and conditions of the relevant financings, pointing out the direct and indirect consequences that such financings may have for the relevant issuer (target). These provisions are common in public acquisition finance transactions, given the fact that the above disclosure requirements are set forth in the statute.

This disclosure is made by the purchaser under the offering memorandum of the public tender, which is publicly filed. The offering memorandum has to be drafted based on the guidelines provided by the CNBV (as the principal Mexican securities regulator) in the corresponding regulations.

## 4. Tax

### 4.1 Withholding Tax

Generally, amounts for interest paid and proceeds that result from the enforcement of collateral that was specifically intended to be used for the payment of interests or other fees by a Mexican lender to a foreign lender will be subject to withholding taxes. Withholding tax rates will vary, depending on the specific transaction or scenario, and double-tax treaties will come into play in determining them.

### 4.2 Other Taxes, Duties, Charges or Tax Considerations

Mexican banking institutions are not subject to withholding taxes, and are taxed as provided for under Mexican law. Furthermore, loans to certain Mexican financial entities may qualify for a preferential withholding tax rate.

### 4.3 Usury Laws

The Mexican Supreme Court has issued several precedents and criteria restricting disproportionate interest rates (ie, rates that are lucrative for one party and excessively burdensome for the other). Courts will conduct a case-by-case analysis to establish whether an interest rate is disproportionate and thus if an equitable reduction is appropriate. Generally, to determine whether a rate is disproportionate, courts will take the specific circumstances of the case into consideration and will not determine disproportionality when the parties involved are finance and/or commercial experts, merchants or other commercial entities.

Furthermore, the payment of interest on accrued interest is not enforceable in Mexico.

## 5. Guarantees and Security

### 5.1 Assets and Forms of Security

Under Mexican law, collateral can be created over rights and all types of privately owned assets, including real estate and movable assets such as property and goods, shares/partnership interests, receivables, intellectual property, and/or cash deposited in bank accounts.

The following structures and related formalities are generally used in financing transactions.

#### *Pledge over equity interests*

The equity interests – including shares – of a Mexican corporation or limited liability company can be granted as collateral to guarantee payment obligations, including those of a third party if expressly provided as such in the grantor's bylaws. In order for a pledge over equity interests to be duly granted, a pledge agreement must be executed, the pledge must be registered in the applicable corporate book of the grantor of the security and, depending on whether the specific case requires priority over tax credits, the pledge agreement must be ratified before a Mexican public attester (*fedatario público*) and registered before the RUG.

Also, in the case of corporations, the stock certificates representing the pledged shares must be delivered and endorsed (*endosados*) in favour of the pledgee.

Finally, a recommended practice in this type of collateral is for a power of attorney to be granted to the pledgee to exercise the voting powers and economic rights of the pledged equity interests in the event of a default (stock power).

#### *Pledge over movable assets*

There are two ways of creating pledges over movable assets: a regular pledge (possession of the pledged assets is transferred to the pledgee as a depository thereof) or a floating/non-possessionary pledge (possession of the pledged assets remains with the pledgor).

In both cases, a pledge agreement must be executed and then ratified before a Mexican public attester, and finally registered before the RUG. Other consents or registrations may also be required, depending on the specific assets being granted as collateral and/or the nature of the grantor. For example, a pledge over IP will also need to be filed for registration before the Mexican Institute of Industrial Property.

#### *Security trust*

This structure is one of the most flexible collateral structures, as it allows for collateral to be granted over different kinds of assets

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and may encompass all (or most) of the assets of the borrower or guarantor. Specifically, the security trust works when the guarantor transfers title of the collateral to a trust (to be managed by a Mexican institution as trustee) for the benefit of the secured party. In other words, it has the purpose of securing the relevant payment obligations with the trust assets, and can also serve as a servicing mechanism for the relevant debt.

The formalities required to put a security trust in place depend on the nature of the collateral. In general, these include ratifying the agreement before a Mexican public attestor and registering it with the applicable public registry – RUG if the collateral is comprised of movable assets, or local property registries if the collateral is comprised of real property.

The main benefit of having a security trust structure vis-à-vis a combination of pledges and mortgages is that the collateral effectively becomes bankruptcy remote, given that the corresponding assets are no longer formally owned by the grantor of the security but by the trust itself. This protects the secured party in the event of the grantor's bankruptcy or insolvency, allows for a more efficient foreclosure on the collateral, and implies that the secured parties can exert a higher degree of control. Also, in these types of trusts, the trust estate may be foreclosed through an extrajudicial proceeding, which may bring efficiency to the enforcement procedure.

The main disadvantages of such structure are that it is more costly as it implies payment of the fees that will be charged by the trustee for acting in such capacity and may also be intrusive in the day-to-day operations of the grantor.

This collateral structure is commonly seen in the context of project finance transactions.

## *Mortgage*

Mortgages are used to create collateral over real estate (land or building) and must be executed in a public instrument before a Mexican notary public. In order to produce effects vis-à-vis third-parties, a mortgage must be duly registered in the public registry of property corresponding to the collateral's location. The registration fees for this may be material depending on the secured amount and the Mexican state in which the relevant real estate is located.

## **5.2 Floating Charges or Other Universal or Similar Security Interests**

The granting of universal liens is permitted under Mexican law and must be structured through either non-possessory pledge or a security trust. In this type of structure, it is important to contractually agree the terms and conditions under which

future assets will automatically become part of the corresponding collateral.

Another structure that can be used for such purposes is the industrial mortgage, which allows the grantor to collateralise all the assets of a company as a commercial unit. However, this structure is only available for Mexican financial institutions.

## **5.3 Downstream, Upstream and Cross-Stream Guarantees**

It is possible for entities in Mexico to give downstream, upstream and cross-stream guarantees. However, as per common practice (and to avoid interpretation controversies), the authority to guarantee third-party obligations must be contemplated in the relevant grantor's (parent, affiliate or subsidiary) bylaws (as part of its corporate purpose) when such grantor is a Mexican entity.

## **5.4 Restrictions on Target**

There are no restrictions on a target granting guarantees, security or financial assistance for the acquisition of its own shares, except that the security would be subject to claw-back provisions if the acquisition was carried out at the detriment of creditors within 270 days prior to a declaration of a *concurso mercantil*.

## **5.5 Other Restrictions**

Security over publicly owned Mexican assets cannot be created in Mexico.

The enforcement of security in Mexico would be limited by insolvency, *concurso mercantil*, bankruptcy, moratorium, labour, tax and other laws of general application generally affecting the obligations of debtors and the rights of creditors.

Additional contractual requirements may apply, depending on the by-laws of the grantor of Mexican security.

Generally, security over Mexican assets or assets located in Mexico can only be created through Mexican law-governed documents.

In the case of a security trust, these instruments may not hold 100% of the equity interests of a Mexican corporation or limited liability company, given that such entities must have at least two shareholders/partners. A common work-around is to contribute all but one of the equity interests to the trust, and have a pledge put in place for the excluded equity interest.

## **5.6 Release of Typical Forms of Security**

Security is typically released when the secured obligations are duly paid or discharged in full, or are otherwise terminated (whether by mutual consent of the parties, novation, set-off,

or another method), and normally requires compliance with the formalities that were used for its creation (eg, notarisation and registration), provided that the terms agreed in the collateral agreements dictate whether any additional formalities are necessary.

## 5.7 Rules Governing the Priority of Competing Security Interests

Creditor priority under Mexican law is regulated by the *Ley de Concursos Mercantiles* and, generally, is as follows:

- labour claims for salaries and severance for the year prior to the declaration of *concurso mercantil*;
- DIP financing creditors approved by the mediator and relevant court;
- liabilities related to the conservation of the insolvent state;
- costs and expenses for judicial processes benefitting the insolvent state;
- liabilities for secured creditors;
- labour (other than as described above) and tax claims;
- liabilities for privileged creditors;
- liabilities for unsecured creditors; and
- liabilities for subordinated creditors and parties related to the insolvent entity.

Contractual subordination provisions for credits of secured creditors and unsecured creditors would be recognised in Mexico.

## 6. Enforcement

### 6.1 Enforcement of Collateral by Secured Lenders

Secured lenders can enforce secured collateral if and when the secured obligations become due and are not paid, provided that other scenarios of enforcement can be agreed upon contractually.

Such enforcement will involve a judicial proceeding in order for the secured lender to validly foreclose on the collateral. However, under certain circumstances, the parties may agree on an extra-judicial foreclosure procedure which, among other things, is more efficient as it prescribes shorter times and pre-agreed valuation mechanisms.

As mentioned before, the enforcement of collateral is limited by insolvency, *concurso mercantil*, bankruptcy, moratorium, and labour, tax and other laws of general application affecting the obligations of debtors and the rights of creditors, and will be subject to compliance with foreign investment regulations.

### 6.2 Foreign Law and Jurisdiction

A choice of governing law will be upheld in Mexico as long as the parties to the corresponding financing documents expressly submit to the applicable jurisdiction and waive any other jurisdiction to which they may be entitled for whatever reason.

### 6.3 A Judgment Given by a Foreign Court

A judgment issued by a foreign court is enforceable in Mexico subject to compliance with the requirements of Article 1347-A and other applicable articles of the Mexican Commerce Code (*Código de Comercio*) and Articles 569 and 571 of the Mexican Federal Code of Civil Procedure (*Código Federal de Procedimientos Civiles*). Generally, these requirements are that:

- the relevant judgment should be final and obtained in compliance with the legal requirements of the jurisdiction of the court rendering such judgment;
- the relevant judgment is strictly for the payment of a sum of money (in personam action, as opposed to an in rem action);
- service of process should be carried out personally on the defendant or a duly appointed agent;
- the judgment should not contravene Mexican law, public policy, international treaties, or agreements binding upon Mexico, nor generally accepted principles of international law;
- the procedure under the laws of Mexico with respect to the enforcement of foreign judgments (including the issuance of a rogatory letter by a competent authority of such foreign jurisdiction, requesting enforcement of such judgment and the certification of such judgment as authentic by the corresponding authorities of such jurisdiction, in accordance with the laws thereof) should be observed;
- the court issuing the final judgment should be considered competent under internationally accepted rules that are compatible with Mexican procedural laws;
- the action in respect of which such judgment is rendered should not be the subject matter of a pending lawsuit or final judgment among the same parties before a Mexican court;
- the judgment should not contravene a final judgment of a Mexican court considered as “*cosa juzgada*” (final and non-appealable) under Mexican law on the same subject matter between the parties thereto; and
- the relevant foreign courts should recognise the principles of reciprocity and, thus, would enforce a final judgment issued by a federal or state court of Mexico as a matter of reciprocity.

### 6.4 A Foreign Lender’s Ability to Enforce Its Rights

As mentioned before, the enforcement of collateral is limited by insolvency, *concurso mercantil*, bankruptcy, moratorium,

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and labour, tax and other laws of general application affecting the obligations of debtors and the rights of creditors. Also, foreign investment regulations and regulated assets may limit the ability of a lender to enforce its rights under a loan or security agreement.

## 7. Bankruptcy and Insolvency

### 7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency

Extra-judicial reorganisation procedures are not expressly recognised by Mexican insolvency laws but are available prior to the commencement of insolvency procedures. In these extra-judicial processes, the voting requirements are contractually agreed by the creditors and the company.

Also, in terms of Mexican law, a restructuring plan can be agreed by the company and a simple majority of its creditors, provided that such plan is filed as part of a *concurso mercantil* procedure.

### 7.2 Impact of Insolvency Processes

Bankruptcy and reorganisation proceedings will strongly affect a lender's right to enforce a loan and related collateral; however, the extent thereof will vary significantly depending on the specific collateral structure put in place.

Generally, lenders that have received security such as a pledge or mortgage (if duly filed before the corresponding registry) will have priority ranking over other creditors (except for tax and labour credits). Other benefits of being treated as a secured creditor include continued accrual of ordinary interest, loan currency protection, and the ability to participate in the eventual creditor agreement that puts an end to the reorganisation or bankruptcy proceedings.

As mentioned above, security trusts are treated as "bankruptcy remote", given that title to the collateral assets has already been transferred to the trust.

Even if security trusts tend to be on the more robust side of collateral structures in Mexico, in recent years some courts have issued preliminary injunctions and temporarily suspended the enforcement and foreclosure of assets secured under a security trust on the basis that the company being reorganised might need such assets for its survival.

### 7.3 The Order Creditors Are Paid on Insolvency

Creditor priority under Mexican law is regulated by the *Ley de Concursos Mercantiles* and, generally, is as follows:

- labour claims for salaries and severance for the year prior to the declaration of *concurso mercantil*;
- DIP financing creditors approved by the mediator and relevant court;
- liabilities related to the conservation of the insolvent state;
- costs and expenses for judicial processes benefitting the insolvent state;
- liabilities for secured creditors;
- labour (other than as described above) and tax claims;
- liabilities for privileged creditors;
- liabilities for unsecured creditors; and
- liabilities for subordinated creditors and parties related to the insolvent entity.

### 7.4 Concept of Equitable Subordination

The concept of equitable subordination is recognised by Mexican legislation, and the parties related to the insolvent entity will be subordinated as indicated above.

### 7.5 Risk Areas for Lenders

If a lender is treated as a secured creditor, it will have priority over other general creditors. If no agreement is reached to conclude the reorganisation, such secured creditors will have the right to foreclose on their security. However, the bankruptcy estate (*masa concursal*) could only be sufficient to cover tax and labour credits in detriment to the rest of the creditors in line.

## 8. Project Finance

### 8.1 Introduction to Project Finance

Mexico has been an attractive destination for project finance for more than a decade, with infrastructure projects spanning several sectors. To that end, the current administration has expressed its intention to devote a large part of its attention to infrastructure projects – some of which are questionable (see **1.1 Impact of Regulatory Environment and Economic Cycles**).

Likewise, the energy sector – particularly with regards to renewable energy – has seen a significant halt as the federal government has dealt strong blows to the industry. Mexico's current administration is betting on traditional fossil fuels and has turned away from renewables, leaving developers and sponsors with no choice but to begin legal actions against the government for the enactment of certain regulations.

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Additionally, there are some positive forecasts that construction and infrastructure activity will pick up; if that is the case, deals will spark in these sectors.

Please see the following sections for an overview of the legal framework.

## 8.2 Overview of Public-Private Partnership Transactions

Public-private transactions (APP) are widely used in Mexico's long-term investment projects and have the purpose of providing services to the public sector by developing infrastructure built and operated by the private sector.

APP transactions are regulated by both federal and local authorities (depending on the jurisdiction of the entity executing the relevant APP). At a federal level, the main regulations are provided under the *Ley de Asociaciones Público Privadas* and its regulations; local regulations may be set forth in different laws (which are in most cases consistent with federal regulations). This regulatory scheme seeks the development of infrastructure in Mexico by allowing joint ventures, partnerships and other forms of associations between the public and private sectors, without major restrictions or obstacles.

## 8.3 Government Approvals, Taxes, Fees or Other Charges

While the financing component of project finance transactions does not require any sort of governmental approval, the investments themselves could require the authorisation of different government agencies, depending on the scope of the transaction and the specific industry or sector the project falls into.

Agencies like the Federal Antitrust Commission (*Comisión Federal de Competencia Económica*) or the Federal Telecommunications Institute (*Instituto Federal de Telecomunicaciones*) may need to approve the transaction from an antitrust standpoint, or authorities like the Ministry of Energy (*Secretaría de Energía*), the Energy Regulatory Commission (*Comisión Reguladora de Energía*), the National Hydrocarbons Commission (*Comisión Nacional de Hidrocarburos*), the Ministry of Environment and Natural Resources (*Secretaría de Medio Ambiente y Recursos Naturales*), the National Water Commission (*Comisión Nacional del Agua*), the Ministry of Economy (*Secretaría de Economía*) or the Communications and Transportation Ministry (*Secretaría de Comunicaciones y Transportes*), among others, may need to authorise the investment (through the granting of concessions, licences and other permits).

Also, there may be limitations on granting certain rights as collateral, such as rights related to permits or concessions.

Generally, project finance transactions are not subject to taxes, fees or charges, although general tax obligations would apply.

Other than specific formalities to be followed depending on the specific project at hand, project finance transaction documents are subject to the jurisdiction considerations, fees, formalities and registrations outlined above, specifically with regards to the implementation of financing structures and related collateral.

## 8.4 The Responsible Government Body

The main governmental agency responsible for the energy sector (encompassing oil and gas) is the Ministry of Energy (*Secretaría de Energía*), which sets forth Mexico's public policy regarding energy resources.

Two agencies also play a significant role in this sector:

- the Energy Regulatory Commission (*Comisión Reguladora de Energía*), which is generally in charge of supervising and promoting the efficient performance of the transportation, storage and distribution of oil and gas, refined products and petrochemicals, as well as power generation, supply and transmission activities; and
- the National Hydrocarbons Commission (*Comisión Nacional de Hidrocarburos*), which is responsible for supervising the exploration and extraction of hydrocarbons, among other things.

It is worth mentioning that, during this administration, these two Commissions have seen important changes in the composition of their government bodies, which have had important effects on these industries, including material delays in the issuance of authorisations and permits.

Other agencies also come into play in the energy sector, including the Ministry of Environment and Natural Resources (*Secretaría de Medio Ambiente y Recursos Naturales*) and the National Water Commission (*Comisión Nacional del Agua*), among others.

The main authority in charge of supervision in the mining sector, and of granting the necessary authorisations, is the Ministry of the Economy (*Secretaría de Economía*).

The primary laws and regulations range from federal to municipal statutes and will depend on the specific project or investment. That being said, the general framework applicable to project finance transactions in Mexico includes the Federal Civil Code (*Código Civil Federal*), the Commerce Code (*Código de Comercio*), the General Law of Business Organisations (*Ley General de Sociedades Mercantiles*) and the General Law of

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Negotiable Instruments and Credit Transactions (*Ley General de Títulos y Operaciones de Crédito*).

Specific statutes to keep in mind for the energy and mining industries are the Mining Law (*Ley Minera*), the Hydrocarbons Law (*Ley de Hidrocarburos*), the Power Industry Law (*Ley de la Industria Eléctrica*), the Energy Transition Law (*Ley de Transición Energética*), the Geothermal Energy Law (*Ley de Energía Geotérmica*), the National Waters Law (*Ley de Aguas Nacionales*) and the General Law on Ecological Equilibrium and Environmental Protection (*Ley General de Equilibrio Ecológico y la Protección al Ambiente*). The application of secondary regulations will depend greatly on the specific transaction.

## 8.5 The Main Issues When Structuring Deals

The main issues that need to be considered when structuring a project finance deal arise from the terms and conditions under the project's main agreements, and from the nature of the project's assets. These issues mainly have to do with the limitations that they may bring from a financing perspective (social and environmental impact, land matters, risks and collateralisation) and how to overcome them. Furthermore, the current political environment in Mexico has created additional risks for the different players in the industry, which need to be sorted on a case-by-case basis.

The most commonly used legal forms for a project company in Mexico are corporations (*sociedades anónimas*) and investment corporations (*sociedades anónimas promotoras de inversión*), both of which shield their shareholders from the liabilities of the project company (unless agreed to). These companies are mainly regulated by the General Law of Business Organisations (*Ley General de Sociedades Mercantiles*) and the Securities Market Law (*Ley del Mercado de Valores*), respectively. However, limited liability companies (known as *sociedades de responsabilidad limitada*) are sometimes used as well, mainly due to tax (pass-through) considerations.

Generally, foreigners can participate in Mexican projects without significant restrictions. That said, limitations apply to strategic activities, with foreign investment being restricted or not permitted at all. Such limitations are contained in the Foreign Investment Law (*Ley de Inversión Extranjera*) and basically entail the following:

- certain activities are exclusively reserved for the state, including control of the national energy grid and management of radioactive materials, among other things;
- certain activities may only be carried out by Mexican entities (with a foreigner's exclusion clause), including the transportation of passengers via land, and development banking;

- subject to certain investment amount thresholds, foreign investment is limited in activities like port management, firearm fabrication, fuel supply to airplanes and trains, and national air transportation; and
- the National Foreign Investment Commission (*Comisión Nacional de Inversión Extranjera*) must authorise certain transactions where foreign investment represents more than 49% of the capital stock of the company carrying out the corresponding activity – such transactions include the construction and operation of railroad systems, education services, legal services, etc.

Likewise, Mexico is party to several international treaties that protect foreign investment by providing alternative dispute resolution mechanisms, protection from expropriation, free transfer of funds, etc.

## 8.6 Typical Financing Sources and Structures for Project Financings

The typical source of project financing in Mexico is bank financing paired with export credit agency financing – this financing comes from both international banking institutions and Mexican banks (commercial and development). That said, the use of project bonds and other structured securities is on the increase, taking its place in the Mexican project financing market. These have proved to be attractive investments for Mexican pension funds (AFORES), which have taken advantage of relevant tax benefits.

However, financing these types of investments with equity is a useful alternative in some scenarios.

The typical structure for project financing involves a credit agreement, letters of credit (guaranteeing the risk capital), promissory notes, customary conditions precedent, the contracting of relevant insurance, financing models, pledges, a security, management and source of payment trust to which all the assets of the project are transferred (including collection rights and financing proceeds) to serve as the funding vehicle of the project (subject to work progress), its collateral, and the source of payment of the different financings, and direct agreements.

## 8.7 The Acquisition and Export of Natural Resources

Under Mexican law, title to natural resources belongs to the state, so the exploitation of natural resources typically requires an authorisation from the relevant government agency in the form of a concession or permit, which is usually only granted to Mexican entities. Likewise, and depending on the specific resources, there are restrictions on private players participating in activities across the spectrum (extraction, transporta-

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tion, distribution, export, etc). In other words, certain activities related to the exploitation of natural resources are reserved exclusively for the state.

The payment of certain fees may also be required, depending on the specific activity or natural resource being exploited. For example, private entities engaged in upstream activities are required to pay/receive a percentage (either in cash or in kind, depending on the specific contract) of the gross value/amount of the hydrocarbons produced.

## **8.8 Environmental, Health and Safety Laws**

There is a robust and vast body of laws regulating the environment, as well as health and safety. On the environmental end, these laws seek to protect the ecological balance and address comprehensive waste management, biodiversity preservation and climate change. As for health and safety, the General Health Law (*Ley General de Salud*) sets forth the primary framework that, together with secondary regulations and official standards, seeks to guarantee workers' health and safety.

# MEXICO LAW AND PRACTICE

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**Gonzalez Calvillo** provides comprehensive legal and regulatory solutions to domestic and foreign clients in relation to all aspects of the banking and financial sector, across regulated and unregulated industries. The Banking and Finance Practice Group is one of the largest practices of the firm. The team represents lenders and borrowers in domestic and cross-border transactions, including several major national and foreign banking and finance institutions, investment banks, underwriters, private investment funds, foreign asset management companies, agencies and representation offices of foreign

banks, which it assists in complying with all Mexican regulatory aspects and all sorts of transactions. The team has developed expertise in the design and implementation of innovative financing structures, including syndicated credit facility/bond offering schemes. As a solution-centred firm, Gonzalez Calvillo has a broad commercial practice with relevant experience in the negotiation and implementation of refinancing transactions and workouts, as well as local and cross-border restructurings.

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