

Chambers

GLOBAL PRACTICE GUIDE

Definitive global law guides offering
comparative analysis from top ranked lawyers

Banking & Finance

Mexico
Gonzalez Calvillo, S.C.

[chambers.com](https://www.chambers.com)

2019

MEXICO

LAW AND PRACTICE:

p.3

Contributed by Gonzalez Calvillo, S.C.

The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

Contributed by Gonzalez Calvillo, S.C.

Contents

1. Loan Market Panorama	p.4	6. Enforcement	p.8
1.1 The Impact of Recent Economic Cycles and the Regulatory Environment	p.4	6.1 Circumstances in Which a Secured Lender Can Enforce Its Collateral	p.8
1.2 The High-yield Market	p.4	6.2 Foreign Law and Jurisdiction	p.8
1.3 Alternative Credit Providers	p.4	6.3 A Judgment Given by a Foreign Court	p.8
1.4 Evolution of Banking and Finance Techniques	p.5	6.4 A Foreign Lender's Ability to Enforce Its Rights	p.8
1.5 Recent or Expected Legal, Tax, Regulatory or Other Developments	p.5	7. Bankruptcy and Insolvency	p.8
2. Authorisation	p.5	7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency	p.8
2.1 Requirements for Authorisation to Provide Financing to a Company	p.5	7.2 Impact of Insolvency Processes	p.8
3. Structuring and Documentation Considerations	p.5	7.3 The Order Creditors Are Paid on Insolvency	p.9
3.1 Restrictions on Foreign Lenders Granting Loans	p.5	7.4 Concept of Equitable Subordination	p.9
3.2 Restrictions on Foreign Lenders Granting Security	p.5	7.5 Risk Areas for Lenders	p.9
3.3 Restrictions and Controls on Foreign Currency Exchange	p.5	8. Project Finance	p.9
3.4 Restrictions on the Borrower's Use of Proceeds	p.5	8.1 Introduction to Project Finance	p.9
3.5 Agent and Trust Concepts	p.5	8.2 Overview of Public-private Partnership Transactions	p.9
3.6 Loan Transfer Mechanisms	p.6	8.3 Government Approvals, Taxes, Fees or Other Charges	p.9
3.7 Debt Buy-back	p.6	8.4 The Responsible Government Body	p.10
3.8 Public Acquisition Finance	p.6	8.5 The Main Issues When Structuring Deals	p.10
4. Tax	p.6	8.6 Typical Financing Sources and Structures for Project Financings	p.10
4.1 Withholding Tax	p.6	8.7 The Acquisition and Export of Natural Resources	p.11
4.2 Other Taxes, Duties, Charges or Tax Considerations	p.6	8.8 Environmental, Health and Safety Laws	p.11
4.3 Usury Laws	p.6	9. Islamic Finance	p.11
5. Guarantees and Security	p.6	9.1 Overview of the Development of Islamic Finance	p.11
5.1 Assets Typically Available and Forms of Security	p.6	9.2 Regulatory and Tax Framework for the Provision of Islamic Finance	p.11
5.2 Floating Charges or Other Universal or Similar Security Interests	p.7	9.3 Main Shari'a-compliant Products	p.11
5.3 Downstream, Upstream and Cross-stream Guarantees	p.7	9.4 Claims of Sukuk Holders in Insolvency or Restructuring Proceedings	p.11
5.4 Restrictions on Target	p.7	9.5 Recent Notable Cases	p.11
5.5 Other Restrictions	p.7		
5.6 Release of Typical Forms of Security	p.7		
5.7 Rules Governing the Priority of Competing Security Interests	p.7		

Gonzalez Calvillo, S.C. provides cross-disciplinary teams in the most challenging and sophisticated transactions, and has experience providing legal, business and regulatory advice to multinational and domestic companies in a broad range of practice areas. The Banking and Finance Practice Group is composed of ten partners and more than 40 pro-

fessionals, providing comprehensive legal and regulatory advice to domestic and foreign clients in relation to all aspects of the banking and financial sector, across regulated and unregulated industries. Clients include high-profile names such as BANORTE, BANCOMEXT and NAFIN.

Authors



José Ignacio Rivero Andere is a partner at Gonzalez Calvillo and a member of the International Bar Association (IBA) and the Asociación Nacional de Abogados de Empresa (ANADE). He specialises in banking & finance, M&A, capital markets

and private equity, and has authored several articles and chapters related to banking & finance. He actively represents individuals and companies from a wide range of sectors in multimillion-dollar domestic and cross-border transactions.



Jacinto Avalos Capin is a senior associate who is actively involved in counselling Mexican and international clients in cross-border transactions. He has experience in banking & finance, M&A, capital markets and private equity matters.

He is a member of the Barra Mexicana de Abogados (BMA) and the Asociación Nacional de Abogados de Empresa (ANADE).

1. Loan Market Panorama

1.1 The Impact of Recent Economic Cycles and the Regulatory Environment

Mexico continues to reap the benefits of structural reforms passed during Enrique Peña Nieto's tenure as president. Specifically, previously restricted sectors such as infrastructure, energy and telecoms (which are years behind those of developed countries and thus potential recipients of multi-billion investments) are now open and beginning to generate jobs and economic growth in the country. Likewise, Mexico recently passed the Fintech Law, which regulates the rendering of financial services through technological platforms such as crowdfunding and cryptocurrencies and, as the first Latin-American country to regulate this sector, expects substantial economic growth in it.

Notwithstanding the foregoing, Mexico's entire economic and political environment is at a crossroads. More than a year after President Trump's inauguration, US–Mexico relations maintain stability amidst the imposition of commercial tariffs between these countries, NAFTA renegotiations, and what has been an aggressive immigration policy by the Trump administration; however, how these crucial points will ultimately play out is yet to be seen.

Another important factor is Mexico's recent presidential election where left-wing candidate Andrés Manuel López Obrador (known as AMLO) was elected as Mexico's new president. So far, AMLO's speech has been one of conciliation with, and appeasement of, Mexico's commercial, financial, infrastructure and energy sectors – contrary to his pro-

posals as candidate, which included the reversal of structural reforms, and protectionist policies; however, AMLO will not take office until December 2018, and a return to his policy of protectionism and to his speech of reversing structural reforms is not yet discarded.

In summary, Mexico has maintained a sustained economic growth with reasonable economic and financial activity generated by the structural reforms implemented during Enrique Peña Nieto's tenure; however, there is substantial uncertainty on how U.S.–Mexico relations and the AMLO administration will ultimately play out and whether they will push forward the Mexican economy or slow it down.

1.2 The High-yield Market

The high-yield market in Mexico has been stable, with Mexican bonds being among the most profitable in both emerging and developed countries. However, the Mexican banking sector continues to show sustained growth with its total loan portfolio increasing by 9.4% in 2017. Likewise, default rates are stable on the lower end of the spectrum and have been so for the past five years. Thus, both the high-yield market and the banking sector co-exist with good outcomes for both.

1.3 Alternative Credit Providers

Even though Mexico's banking sector has continued to grow, there is still a large part of the population (mainly the lower and middle classes) that cannot access banking services and thus has had little to no access to banking credit. There are several reasons for this: clients are too expensive to serve, perceived as risky, or simply do not/cannot meet the strict borrowing requirements set forth by banks.

Considering that Mexico has one of the largest lower and middle-class populations in Latin America, new financing alternatives tailored to such sectors have arisen. Similarly, new borrowing opportunities focused on small businesses have also come into play. Examples of such alternatives include payday and asset-backed loan mechanisms, crowdfunding, and online lending. As a result, some traditional banks have come to understand the size of this unattended market; they feel the pressure from these small yet new and innovative players, and have started to offer similar products, mainly through non-banking SPVs.

1.4 Evolution of Banking and Finance Techniques

Banking and financial techniques are mainly evolving in relation to financial technology, including digitalisation trends, alternative financing methods, new and innovative players, and evolution of traditional banks, with all of these looking to meet a broader borrower base more efficiently as well as giving all people access to the financial system.

In this sense, Mexico is the first Latin American country to regulate financial technology, including crowdfunding, cryptocurrencies and a regulatory sandbox for innovative technologies in the financial sector.

1.5 Recent or Expected Legal, Tax, Regulatory or Other Developments

The last tax and regulatory (finance) reforms were passed in the Mexican Congress over four years ago and had mostly positive results. As for the future, AMLO's administration is likely to propose a new tax reform which could imply, among other things, increases in tax rates, but the impact this reform will have is yet to be seen.

On legal and regulatory, last March Mexico enacted the Fintech Law, which mainly regulates the rendering of legal services through technological platforms and innovative financial instruments such as crowdfunding, cryptocurrencies, and a regulatory sandbox for innovative technologies in the financial sector.

2. Authorisation

2.1 Requirements for 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 the Mexican territory.

Notwithstanding the foregoing, certain financing activities are regulated by Mexican financial laws and regulations; the performance of these activities requires a registry and/or authorisation from Mexican financial regulators, and the entities that perform them are subject to the supervision of these regulators and need to meet certain requirements such as minimum capitalisation, corporate governance con-

trols, and disclosure of information. Among the financial entities that can carry out reserved financial activities, there are: (i) *instituciones de crédito* banks, which are entities that (among many other things) receive deposits from the public and place such deposits through the granting of credit; (ii) *sociedades financieras de objeto multiple* (SOFOMs), which are entities that have access to legal and tax benefits in their financial activities; (iii) *instituciones de tecnología financiera*, which are the entities created by the Mexican Fintech Law for the rendering of crowdfunding and payment fund activities; and (iv) issuers of securities, which are entities that offer equity, debt or hybrid securities among the public.

3. Structuring and Documentation Considerations

3.1 Restrictions on Foreign Lenders Granting Loans

Foreign lenders are not restricted in any way from granting loans.

3.2 Restrictions on Foreign Lenders Granting Security

The granting of security or guarantees to foreign lenders is not generally restricted or impeded. However, in the event of a foreclosure procedure, foreign lenders may be restricted from owning certain assets (including stock) because of limitations on foreign investment, or in the case of regulated assets. Notwithstanding, lenders may foreclose on Mexican collateral and sell off the underlying asset to a third party without ever becoming the legal holder (owner) thereof.

3.3 Restrictions and Controls on Foreign Currency Exchange

Under Mexican law there are no such restrictions or controls.

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 licit activities.

3.5 Agent and Trust Concepts

The agent and trust concepts are both recognised in Mexico. In the financial context, trusts are commonly used as collateral structures (security trusts) and as debt-service mechanisms. Other alternatives exist to secure obligations; these basically refer to pledges (over intangible or movable assets, including stock) and mortgages (over real estate).

As for agents, although not expressly recognised by Mexican law, the concept is not antagonistic to the legal system and can be accommodated within it.

3.6 Loan Transfer Mechanisms

The assignment of creditor rights is contemplated and possible under Mexican law. The specific requirements that will need to be complied with will depend on the type of creditor rights being assigned, but they generally consist of, in addition to any applicable contractual requirements, the execution of an agreement setting forth the terms governing the assignment, a notice to the debtors, and analogue formalities to those necessary for the creation of the relevant rights.

3.7 Debt Buy-back

Debt buy-back by the borrower or sponsor is possible under Mexican law subject to “claw-back” provisions if debt is bought back within 270 days prior to a declaration of *concurso mercantil* in detriment to creditors under a bankruptcy or reorganisation proceeding.

3.8 Public Acquisition Finance

Under Mexican law and in the context of a public acquisition finance transaction, an acquiror must disclose the amount and the source of the resources that it will use in the transaction, as well as whether all or part of these resources will come from financings, in which case it must also disclose a summary of the terms and conditions of the relevant financings, pointing out the direct and indirect consequences in the relevant issuer. These provisions are common in other acquisition finance transactions.

The aforementioned disclosure is made by the acquiror in the offering memorandum, which is publicly filed. The offering memorandum has to be drafted based on the form provided by the Mexican securities regulator in the relevant Mexican 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 taxes rates will vary depending on the specific transaction or scenario, and double-tax treaties will come into play to determine 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 in 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 exorbitant or usurious interest rates. Courts will use a case-by-case analysis to establish whether

an interest rate is usurious and thus if an equitable reduction is appropriate. Generally, courts will take into consideration the specific circumstances of the scenario and whether the interest rate is disproportionate (lucrative for one party and excessively burdensome for the other). Likewise, the payment of interest on accrued interest will not be enforceable in Mexico.

Also note that generally and under the above judicial criteria, interest will not be deemed exorbitant or usurious when contracted among commercial entities, notwithstanding the rate at which it is accrued.

5. Guarantees and Security

5.1 Assets Typically Available and Forms of Security

Under Mexican law, collateral can be created over 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.

As for the typical structures and related formalities, the following are generally used in financing transactions:

Pledge over equity interests. The equity interests of a Mexican corporation or limited liability company can be granted as collateral to guarantee payment obligations. For a pledge over equity interests to be duly granted, a pledge agreement must be executed and the pledge must be registered in the corresponding corporate book and, depending on whether the specific case requires priority over tax credits, the pledge agreement must be ratified before a Mexican notary public and registered before the *Registro Único de Garantías Mobiliarias*. In the case of corporations, the pledged stock certificates must also be delivered and endorsed in favour of the pledgee. Finally, a recommended practice is for a power of attorney to be granted to the pledgee to exercise the voting powers of the pledged equity interests in the event of a default.

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 depository) or a floating/non-possessionary pledge (possession of the pledged assets remains with the pledgor). In both cases, a pledge agreement must be executed, then ratified before a Mexican notary public and finally registered before the *Registro Único de Garantías Mobiliarias*. Bear in mind that other consents or registrations may be required depending on the specific collateral and/or grantor.

Security trust. This structure is one of the most flexible as it allows for collateral to be granted over different kinds of assets and may encompass all (or most) of the assets of the bor-

rower or guarantor. Specifically, the security trust basically works when the guarantor transfers title of the collateralised assets 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 of providing a servicing mechanism for the relevant debt.

The formalities required to put in place a security trust depend on the nature of the collateralised assets. In general, these include ratifying the agreement before a Mexican notary public and registering it with the applicable public registry.

The main benefits of having a security trust structure vis-à-vis a combination of pledges and mortgages are: (i) that the collateralised assets will be bankruptcy remote, thus protecting the secured party in the event of the grantor's bankruptcy or insolvency; and (ii) that the secured parties can exert a higher degree of control over the collateralised assets.

The main drawbacks of this structure vis-à-vis a combination of pledges and mortgages are: (i) that it is more costly as it may need to consider additional notarial and registration fees, as well as trustee fees; and (ii) that it can be somewhat intrusive in the day-to-day operations of the borrower.

Mortgage. Mortgages are used to create collateral over real estate (land or building). Mortgages must be executed in a public instrument before a Mexican notary public. Likewise, for a mortgage to produce effects vis-à-vis third-parties it must be duly registered in the public registry of property corresponding to the collateralised asset's location; the registration fees for this registration 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 either under a non-possessory pledge or a security trust. 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 to 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) corporate purpose, when such guarantor 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 carried out in detriment to creditors within 270 days prior to a declaration of *concurso mercantil*.

5.5 Other Restrictions

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

Certain types of regulated assets such as concessions, aeroplanes or vessels would be subject to additional perfection requirements.

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

5.6 Release of Typical Forms of Security

Security is typically released when the secured obligation is duly paid, discharged or otherwise terminated (whether by mutual consent, novation, set-off, or other), and normally requires the reversal of the formalities that were used for its creation, provided that the terms agreed in the collateral agreements may dictate whether any additional formalities are necessary.

5.7 Rules Governing the Priority of Competing Security Interests

The priority of credits under Mexican law is regulated by the *Ley de Concursos Mercantiles* and, generally, is as follows: (i) labour claims for salaries and severance for the year prior to the declaration of *concurso mercantil*; (ii) DIP financing creditors approved by the mediator and relevant court; (iii) liabilities related to the conservation of the insolvent state; (iv) costs and expenses for judicial processes benefiting the insolvent state; (v) liabilities for secured creditors; (vi) labour (other than as described above) and tax claims; (vii) liabilities for privileged creditors; (viii) liabilities for unsecured creditors; and (ix) liabilities for subordinated creditors and related parties to the insolvent entity.

In Mexico the subordination of credits is as provided above. Contractual subordination provisions for credits of secured creditors and unsecured creditors would be recognised in Mexico.

6. Enforcement

6.1 Circumstances in Which a Secured Lender Can Enforce Its Collateral

Secured lenders can enforce secured collateral if and when the principal obligor of the secured obligations is subject to a corresponding event of default as contractually agreed in the relevant financing documents. 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 thereto may agree on an extra-judicial foreclosure procedure which, among other things, entails less time.

As for restrictions, enforcement of collateral is limited by insolvency, *concurso mercantil*, bankruptcy, moratorium, labour, tax and other laws of general application affecting the obligations of debtors and the rights of creditors.

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 (i) submit to the applicable jurisdiction, and (ii) 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 would be 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: (i) the relevant judgment should be final and obtained in compliance with the legal requirements of the jurisdiction of the court rendering such judgment; (ii) the relevant judgment is strictly for the payment of a sum of money (*in personam* action, as opposed to an *in rem* action); (iii) service of process should be carried out personally on the defendant or a duly appointed agent; (iv) the judgment should not contravene Mexican law, public policy, international treaties, or agreements binding upon Mexico or generally accepted principles of international law; (v) the procedure under the laws of Mexico with respect to the enforcement of foreign judgments (including 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; (vi) the court issuing

the final judgment should be considered competent under internationally accepted rules that are compatible with Mexican procedural laws; (vii) 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; (viii) 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 (ix) 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

Enforcement of collateral is limited by insolvency, *concurso mercantil*, bankruptcy, moratorium, labour, tax and other laws of general application affecting the obligations of debtors and the rights of creditors.

Also, in the event of a foreclosure procedure, foreign lenders may be restricted from owning certain assets (including stock) because of limitations on foreign investment, or in the case of regulated assets. Notwithstanding this, lenders may foreclose on Mexican collateral and sell off the underlying asset to a third party without ever becoming the legal holder (owner) thereof.

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 this plan is filed as part of a *concurso mercantil* procedure.

7.2 Impact of Insolvency Processes

Bankruptcy and reorganisation proceedings will strongly impact 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 of commerce or property, as applicable) will have priority ranking over other creditors (except for tax and labour credits). Other benefits of being treated as a secured creditor include, among others, 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.

If referring to security trusts, as referred to above, these are treated as “bankruptcy remote” given that title to the collateralised 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 enforcement and foreclosure of assets collateralised under a security trust on the idea that the company being reorganised might need such assets for its survival.

7.3 The Order Creditors Are Paid on Insolvency

Generally, the order in which creditors are paid on a company’s insolvency is as follows: (i) labour claims for salaries and severance for the year prior to the declaration of *concurso mercantil*; (ii) DIP financing creditors approved by the mediator and relevant court; (iii) liabilities related to the conservation of the insolvent state; (iv) costs and expenses for judicial processes benefiting the insolvent state; (v) liabilities for secured creditors; (vi) labour (other than as described above) and tax claims; (vii) liabilities for privileged creditors; (viii) liabilities for unsecured creditors; and (ix) liabilities for subordinated creditors and related parties to the insolvent entity.

7.4 Concept of Equitable Subordination

The concept of equitable subordination is recognised by Mexican legislation, and the related parties 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, as mentioned before, 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. Notwithstanding the foregoing, 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 over a decade, with infrastructure projects spanning several sectors. However, recent structural reforms have had an important boosting effect on the project finance sector, specifically with respect to energy, telecoms and infrastructure. This can be seen in the increasing activity in the construction and operation of infrastructure projects.

For an overview of the legal framework, please refer to the sections below.

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, main regulations are provided under the *Ley de Asociaciones Público Privadas*, and its regulations. On the other hand, 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 the 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. On one hand, 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. On the other, 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*), 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).

Generally, project finance transactions are not *per se* subject to taxes, fees or charges. However, 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 (particularly Section 5), 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. In this sector, there are also two agencies that play a significant role; these are the Energy Regulatory Commission (*Comisión Reguladora de Energía*), generally in charge of surveilling 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*), responsible for, among other things, surveilling the exploration and extraction of hydrocarbons. Other agencies come into play in the energy sector and include the Ministry of Environment and Natural Resources (*Secretaría de Medio Ambiente y Recursos Naturales*), the National Water Commission (*Comisión Nacional del Agua*), etc.

As for the mining sector, the main authority in charge of surveilling, as well as granting the necessary authorisations, is the Ministry of Economy (*Secretaría de Economía*).

The primary laws and regulations range from federal to municipal statutes and will apply depending 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*), General Law of Business Organisations (*Ley General de Sociedades Mercantiles*), and the General Law of 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*), Hydrocarbons Law (*Ley de Hidrocarburos*), Power Industry Law (*Ley de la Industria Eléctrica*), Energy Transition Law (*Ley de Transición Energética*), Geothermal Energy Law (*Ley de Energía Geotérmica*) National Waters Law (*Ley de Aguas Nacionales*), the General Law on Ecological Equilibrium and Environmental Protection (*Ley General de Equilibrio Ecológico y la Protección al Ambiente*). Relevant secondary regulations would highly depend 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 the nature of the project assets. These issues mainly have to do with the limitations that these may bring from a financing perspective (social and environmental impact, risks and collateralisation) and how to overcome them.

The most commonly used legal form for a project company is a corporation (known as *sociedad anónima*), which shields its shareholders from the liabilities of the project company. 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*). However, limited liability companies (known as *sociedades de responsabilidad limitada*) are sometimes used as well – the foregoing 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: (a) certain activities are exclusively reserved for the state and include the control of the national energy grid and management of radioactive materials, among other things; (b) certain activities may only be carried out by Mexican entities (with a foreigner's exclusion clause) and include, among other things, transportation of passengers via land, and development banking; (c) subject to certain investment amount thresholds, foreign investment is limited to activities like port management, firearm fabrication, fuel supply to aeroplanes and trains, and national air transportation; and (d) 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 – these include, among others, construction and operation of railroad systems, education services, legal services, etc.

Likewise, Mexico is party to several international treaties that protect foreign investment by, among other things, 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 financings in Mexico is bank financing paired with export credit agency financing – this financing comes from both international banking institutions as well as from Mexican banks (commercial and development). That said, the use of project bonds and other structured securities is beginning to make noise and take a place in the Mexican project financing market (eg in CDMX's new airport). These have proved to be attractive investments for Mexican pension funds (AFORES), which have taken advantage of relevant tax benefits.

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

The typical structure for project financings involves a credit agreement, guarantees from third parties, letters of credit (guaranteeing the risk capital), promissory notes, customary conditions precedent, the EPC/CPS, the contracting of relevant insurance, financing models, and a guarantee, man-

agement 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.

8.7 The Acquisition and Export of Natural Resources

Under Mexican law, title to natural resources belongs to the state. To that end, the exploitation of natural resources typically requires an authorisation from the relevant government agency in the form of a concession or permit. Generally, the latter is usually only granted to Mexican entities. Likewise, and depending on the specific resources, there are restrictions for private players to participate in activities across the spectrum (extraction, transportation, 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) on 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 ecological balance, comprehensive waste management, biodiversity preservation and climate change. As per 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 worker's health and safety.

Gonzalez Calvillo, S.C.

Montes Urales 632
Lomas de Chapultepec
Mexico City 11000
Mexico

gonzalez calvillo
meet new standards

Tel: +(52 55) 5202-7622
Email: info@gcsc.com.mx
Web: www.gcsc.com.mx

9. Islamic Finance

9.1 Overview of the Development of Islamic Finance

As of today, Islamic finance instruments have not been structured in Mexico. There have recently been discussions about issuing a Shari'a-compliant bond but nothing has ever materialised – this could very well be because of other versatile structures currently emerging in Mexico.

9.2 Regulatory and Tax Framework for the Provision of Islamic Finance

As mentioned above, this is not an issue in Mexico yet.

9.3 Main Shari'a-compliant Products

As of today, there are no Shari'a-compliant products used in Mexico.

9.4 Claims of Sukuk Holders in Insolvency or Restructuring Proceedings

As mentioned above, this is not an issue in Mexico yet.

9.5 Recent Notable Cases

As mentioned above, this is not an issue in Mexico yet.

Chambers

The cover features several large, dark green leaf-like shapes scattered across the background, creating a natural, organic feel. The leaves vary in size and orientation, with some pointing upwards and others downwards.

GLOBAL PRACTICE GUIDE

Definitive global law guides offering
comparative analysis from top ranked lawyers

Banking & Finance

Second Edition

Mexico
Gonzalez Calvillo, S.C.

chambers.com

2019

Law and Practice

Contributed by Gonzalez Calvillo, S.C.

Contents

1. Loan Market Panorama	p.4	6. Enforcement	p.8
1.1 Impact of Regulatory Environment and Economic Cycles	p.4	6.1 Enforcement of Collateral by Secured Lenders	p.8
1.2 The High-yield Market	p.4	6.2 Foreign Law and Jurisdiction	p.8
1.3 Alternative Credit Providers	p.4	6.3 A Judgment Given by a Foreign Court	p.8
1.4 Banking and Finance Techniques	p.4	6.4 A Foreign Lender's Ability to Enforce Its Rights	p.8
1.5 Legal, Tax, Regulatory or Other Developments	p.4	7. Bankruptcy and Insolvency	p.8
2. Authorisation	p.5	7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency	p.8
2.1 Authorisation to Provide Financing to a Company	p.5	7.2 Impact of Insolvency Processes	p.8
3. Structuring and Documentation Considerations	p.5	7.3 The Order Creditors Are Paid on Insolvency	p.9
3.1 Restrictions on Foreign Lenders Granting Loans	p.5	7.4 Concept of Equitable Subordination	p.9
3.2 Restrictions on Granting Security to Foreign Lenders	p.5	7.5 Risk Areas for Lenders	p.9
3.3 Restrictions and Controls on Foreign Currency Exchange	p.5	8. Project Finance	p.9
3.4 Restrictions on the Borrower's Use of Proceeds	p.5	8.1 Introduction to Project Finance	p.9
3.5 Agent and Trust Concepts	p.5	8.2 Overview of Public-Private Partnership Transactions	p.9
3.6 Loan Transfer Mechanisms	p.5	8.3 Government Approvals, Taxes, Fees or Other Charges	p.9
3.7 Debt Buy-back	p.5	8.4 The Responsible Government Body	p.10
3.8 Public Acquisition Finance	p.6	8.5 The Main Issues When Structuring Deals	p.10
4. Tax	p.6	8.6 Typical Financing Sources and Structures for Project Financings	p.10
4.1 Withholding Tax	p.6	8.7 The Acquisition and Export of Natural Resources	p.11
4.2 Other Taxes, Duties, Charges or Tax Considerations	p.6	8.8 Environmental, Health and Safety Laws	p.11
4.3 Usury Laws	p.6	9. Islamic Finance	p.11
5. Guarantees and Security	p.6	9.1 The Development of Islamic Finance	p.11
5.1 Assets and Forms of Security	p.6	9.2 Regulatory and Tax Framework	p.11
5.2 Floating Charges or Other Universal or Similar Security Interests	p.7	9.3 Main Shari'a-compliant Products	p.11
5.3 Downstream, Upstream and Cross-stream Guarantees	p.7	9.4 Claims of Sukuk Holders in Insolvency or Restructuring Proceedings	p.11
5.4 Restrictions on Target	p.7	9.5 Recent Notable Cases	p.11
5.5 Other Restrictions	p.7		
5.6 Release of Typical Forms of Security	p.7		
5.7 Rules Governing the Priority of Competing Security Interests	p.7		

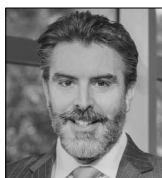
Gonzalez Calvillo, S.C. has a Banking and Finance Practice Group that provides comprehensive legal and regulatory solutions to domestic and foreign clients in relation to all aspects of the banking and financial sector, across regulated and unregulated industries. The firm represents lenders and borrowers in domestic and cross-border transactions, in-

cluding 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, assisting them to comply with all Mexican regulatory aspects in all sorts of transactions.

Authors



José Ignacio Rivero Andere has more than 15 years' experience in providing legal and business advice to domestic and foreign clients in multimillion-dollar, cross-border transactions involving M&A, banking and financing, corporate law, capital markets and private equity. He is a member of the International Bar Association (IBA) and the National Corporate Counsel Association (ANADE), and has contributed articles to several publications.



José Víctor Torres Gómez is a seasoned financial lawyer with extensive experience as counsel in complex cross-border transactions, financings, securities and acquisitions. His experiences includes transnational financings, syndicated loans and leasing, as well as rendering legal opinions required for public offerings in local and foreign capital markets. He has represented companies from both highly regulated and non-regulated sectors, including private equity firms, investment funds and companies in the telecommunication and real estate industry.



Hernando Becerra has more than 15 years' professional experience, and has focused on cross-border M&A, private equity and financing transactions. His practice includes advising developers and banks in infrastructure financing transactions. He has also participated in M&A, advising local or foreign investors in their investments in Mexico. His experience includes representing initial purchasers and issuers in international and domestic securities offerings, with an emphasis on cross-border transactions in a variety of industries, including energy, banking, agriculture and infrastructure. He is admitted to practice in both Mexico and New York.

1. Loan Market Panorama

1.1 Impact of Regulatory Environment and Economic Cycles

After being in office for nearly a year, and as a consequence of the adoption of what has widely been seen as a series of poor decisions by President Lopez Obrador's administration, a slowdown of Mexico's economy is now well underway (to the level of stagnation), generating increasing market uncertainty and raising significant concerns for local and foreign investors.

The cancellation of key infrastructure projects, including the new Mexico City airport and the pending rounds for oil blocks in the Gulf of Mexico, combined with the replacement of these projects with new ones with (in the best of cases) questionable technical, social and economic feasibility (eg, Santa Lucia airport, the Dos Bocas Refinery, and the so-called Maya train), have caused local and international investors to become concerned about the government's ability to generate the economic growth levels promised during the 2018 political campaigns. Furthermore, significant reductions in government salaries and a threatened relocation and decentralisation of several of the main government agencies have instigated lifetime public servants with relevant career expertise to leave key governmental positions, undermining the administration's capacity to properly manage the country's public affairs.

In an attempt to counter the foregoing, among other strategies, the administration is seeking to reform the Mexican pension system by providing greater flexibility to allow for the investment of pension fund flows in different financial instruments. AMLO (as the President is known in Mexico) has also issued a number of tax incentives for certain transactions carried out in Mexican stock exchanges, in a measure that seeks to incentivise corporations to use the securities markets in Mexico. Finally, AMLO recently heralded a government-spending programme that some expect to generate additional economic activity.

On the international front, Mexico's ties and business relationship with the US, its largest commercial partner, have maintained a positive sense of stability. A strong US economy trend has benefited Mexico with, among others, all-time highs in remittance payments from Mexican immigrants into the country, and a growing demand for Mexican products, services and tourism. Also, Mexico has profited from trade wars between the US, China and Europe, which benefit looks set to continue due to the successful renegotiation of NAFTA in the form of the USMCA/T-MEC/CUSMA, although this is still waiting to be ratified by the US congress.

In summary, economic and financial activity in Mexico has shown a slowdown as a result of AMLO's policies; however, international conditions have bolstered some sectors of the

economy, thereby partially offsetting some of the administration's missteps.

1.2 The High-yield Market

Mexican bonds remain among the most competitive in both emerging and developed countries. However, risks associated with the country and negative outlooks from rating agencies have affected the high-yield market and investors' appetite for it. On the other hand, the Mexican banking sector continues to show sustained growth while default rates are stable, as they have been for the past few years.

1.3 Alternative Credit Providers

Even though Mexico's banking sector has continued to grow, there is still a large part of the population (mainly the lower and middle classes) that have been unable to access banking services, and thus have had little or no access to banking credit. There are several reasons for this: clients are too costly to serve, they might be perceived as risky, or they simply do not or cannot meet the strict borrowing requirements and thresholds set by banks.

Considering that Mexico has one of the largest lower and middle-class populations in Latin America, new financing alternatives tailored to such sectors have arisen slowly but steadily. Similarly, new borrowing opportunities focused on small businesses have also come into play, such as payday and asset-backed loan mechanisms, crowdfunding, and online lending. As a result, some traditional banks have come to understand the size of this unattended market, and are already noticing the success of these small-yet-new and innovative players, and have started to offer similar products, mainly through non-banking SPVs.

1.4 Banking and Finance Techniques

Banking and financial techniques are mainly evolving in relation to financial technology, including digitalisation trends, alternative financing methods, new and innovative players, and the evolution of traditional banks, with all of these looking to meet a broader borrower base more efficiently, as well as giving more people access to the financial system.

In this sense, Mexico is the first Latin-American country to regulate financial technology, including crowdfunding, cryptocurrencies and a regulatory sandbox for innovative technologies in the financial sector.

1.5 Legal, Tax, Regulatory or Other Developments

The last tax reforms were passed in the Mexican Congress more than four years ago, and expert impressions are that they carried mostly positive results. As for the future, AMLO's administration has pledged not to create or increase existing taxes and, as stated above, has even created some tax incentives for certain transactions carried out in Mexican stock exchanges.

On the regulatory side, AMLO is seeking to reform the Mexican pensions system by providing flexibility towards the investment of pension funds in different types of financial instruments. Due to the significant size of the system, this legislation could have important implications in generating economic activity in financial markets.

Also on the legal and regulatory side, the recently enacted Fintech Law – which mainly regulates the rendering of legal services through technological platforms and innovative financial instruments such as crowdfunding, cryptocurrencies, and a regulatory sandbox for innovative technologies in the financial sector – is also expected to generate a significant amount of activity in the financial sector.

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 the Mexican territory.

However, certain financing activities are regulated by Mexican financial laws and regulations; the performance of these activities requires a registration and/or authorisation from Mexican financial regulators, and the entities that perform them are subject to the supervision of these regulators and 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) receive deposits from the public and place such deposits through the granting of credit;
- *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*, 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 public.

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.

3.2 Restrictions on Granting Security to Foreign Lenders

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 assets (including stock) because of limitations on foreign investment, or in the case of some regulated assets. Notwithstanding, 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

Under Mexican law, there are currently no such restrictions or controls.

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

The concepts of agent and trust are both recognised in Mexico. In the financial context, trusts are commonly used as collateral structures (security trusts), and as debt-service or payment mechanisms. Other alternatives exist to secure 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 banking entities.

Although not expressly recognised by Mexican law, the concept of 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, but they generally consist of – in addition to any applicable contractually agreed requirements – 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.

3.7 Debt Buy-back

Debt buy-back by a borrower or sponsor is possible under Mexican law, subject to certain “claw-back” provisions (generally, 270 days prior to a declaration of *concurso mercantil* 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 finance transaction, an acquirer must disclose the amount and the source of the resources that it will use in the transaction, as well as whether all or part of these resources will come from financings, in which 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. These provisions are common in other acquisition finance transactions.

This disclosure is made by the acquirer in an offering memorandum, which is publicly filed. The offering memorandum has to be drafted based on the form provided by the Mexican securities regulator in the relevant Mexican 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 taxes rates will vary, depending on the specific transaction or scenario, and double-tax treaties will come into play to determine 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 in 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 use 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 commercial entities.

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 of a Mexican corporation or limited liability company can be granted as collateral to guarantee payment obligations. 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 issuer and, depending on whether the specific case requires priority over tax credits, the pledge agreement must be ratified before a Mexican notary public and registered before the *Registro Único de Garantías Mobiliarias*. Also, in the case of corporations, the pledged stock certificates must be delivered and endorsed 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 depository) 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 notary public, and finally registered before the *Registro Único de Garantías Mobiliarias*. Other consents or registrations may also be required, depending on the specific assets being granted as collateral and/or the nature of the grantor.

Security trust

This structure is one of the most flexible, as it allows for collateral to be granted over different kinds of assets and may encompass all (or most) of the assets of the borrower or guarantor. Specifically, the security trust basically works when the guarantor transfers title of the collateralised assets to a trust (to be managed by a Mexican financial 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 collateralised assets. In general, these include ratifying the agreement before a Mexican

notary public and registering it with the applicable public registry.

The principal benefits of having a security trust structure vis-à-vis a combination of pledges and mortgages are that the collateralised assets become bankruptcy remote, thus protecting the secured party in the event of the grantor's bankruptcy or insolvency, and that the secured parties can exert a higher degree of control over the collateralised assets.

The main cons of this structure vis-à-vis a combination of pledges and mortgages are that it is more costly as it may incur additional notarial and registration fees, as well as trustee fees, and that it can be intrusive in the day-to-day operations of the borrower and/or interfere with them.

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 for a mortgage to produce effects vis-à-vis third-parties it must be duly registered in the public registry of property corresponding to the collateralised asset's location; the registration fees for this registration 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 under either a 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) 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 *concurso mercantil*.

5.5 Other Restrictions

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

Certain types of regulated assets would be subject to additional perfection requirements, such as concession rights, airplanes or vessels.

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.

5.6 Release of Typical Forms of Security

Security is typically released when the secured obligation is duly paid, discharged or otherwise terminated (whether by mutual consent, novation, set-off, or another method), and normally requires the reversal of the formalities that were used for its creation, provided that the terms agreed in the collateral agreements may dictate whether any additional formalities are necessary.

5.7 Rules Governing the Priority of Competing Security Interests

The priority of credits 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.

In Mexico, the subordination of credits is as provided above. 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 principal obligor of the secured obligations is subject to a corresponding event of default, as contractually agreed in the relevant financing documents. 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, entails less time.

As for restrictions, 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.

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 would be 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, or 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

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.

Also, in the event of a foreclosure procedure, foreign lenders may be restricted from owning certain assets (including stock) because of limitations on foreign investment, or in the case of regulated assets. However, lenders may foreclose on Mexican collateral and sell off the underlying asset to a third party without ever becoming the legal holder (owner) thereof.

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 of commerce or property, as applicable) 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.

Security trusts, as referred to above, are treated as “bankruptcy remote”, given that title to the collateralised 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 collateralised 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

Generally, the order in which creditors are paid in a company’s insolvency 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, as mentioned before, 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. However, recent structural reforms have had an important boosting effect on the project finance sector, specifically with respect to energy, telecoms and infrastructure. This can be seen in the increasing activity in the construction and operation of infrastructure projects.

For an overview of the legal framework, please refer to the sections below.

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).

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 (particularly in **5. Guarantees and Security**), 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*) 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*) is responsible for supervising the exploration and extraction of hydrocarbons, among other things. 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*), the National Water Commission (*Comisión Nacional del Agua*), etc.

The main authority in charge of supervision in the mining sector, and of granting the necessary authorisations, is the Ministry of 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 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*). Relevant secondary regulations would 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 the nature of the project 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.

The most commonly used legal form for a project company is a corporation (known as *sociedad anónima*), which shields its shareholders from the liabilities of the project company. These companies are mainly regulated by the General Law of Business Organisations (*Ley General de Sociedades Mercantiles*). 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 the 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, among other things, 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 a 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, guarantees from third parties, letters of credit (guaranteeing the risk capital), promissory notes, customary conditions precedent, the contracting of relevant insurance, financing models, pledges, and a guarantee, 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.

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, transportation, 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.

9. Islamic Finance

9.1 The Development of Islamic Finance

Islamic finance instruments have not yet been structured in Mexico. There have recently been discussions about issuing a Shari'a-compliant bond but nothing has ever materialised – this could very well be because of other versatile structures currently emerging in Mexico.

9.2 Regulatory and Tax Framework

As mentioned above, this is not yet an issue in Mexico.

9.3 Main Shari'a-compliant Products

There are currently no Shari'a-compliant products used in Mexico.

9.4 Claims of Sukuk Holders in Insolvency or Restructuring Proceedings

There are currently no Shari'a-compliant products used in Mexico.

9.5 Recent Notable Cases

There are currently no Shari'a-compliant products used in Mexico.

Gonzalez Calvillo, S.C.

Montes Urales 632
Lomas de Chapultepec
11000
Mexico City

gonzalez calvillo
meet new standards

Tel: +52 (55) 5202-7622
Email: info@gcsc.com.mx
Web: gcsc.com.mx