Mexico

Treasury Shares Guide
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Contact

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INTRODUCTION

The following guide provides an overview of the Mexican legal framework on the acquisition and sale of treasury shares of Mexican stock corporations (hereinafter "*Sociedad Anónima*" or "*SA*"). It aims to provide general information on treasury shares, on the legal requirements and restrictions of acquisitions and sales of such treasury shares and finally implications of treasury shares under Mexican takeover provisions.

The information in this guide cannot substitute professional legal advice. Therefore, anyone involved and considering any transaction with respect to treasury shares of an SA (including a buy-back program of shares) should not rely on this guide alone and should always seek specialist advice.

GENERAL OVERVIEW

Is the buyback of shares permitted in your jurisdiction?

In Mexico, the legal provisions governing the repurchase of shares needs to be viewed under two general scenarios: **(a)** closely held SA and **(b)** those stock corporations (SA´s) governed by the Securities Markets Law that are all incorporated as or transformed into **(i)** a kind of closely held SA specially designed to serve as target company for, and recipient of private equity capital, known as the investment promotion stock corporation (hereinafter, "SAPI") **(ii)** a SAPI that is a publicly held stock corporation, but with limited corporate governance and reduced investor base (hereinafter, "SAPIB"), or **(iii)** a SA that is publicly held stock corporation (hereinafter "SAB").

The repurchase of shares by a closely held SA is generally prohibited by the General Law of Commercial Companies *(Ley General de Sociedades Mercantiles* – hereinafter, *the "LGSM").* Article 134 of the LGSM expressly sets forth such prohibition and not only provides the sole exception when a SA may repurchase its shares but it also enumerates certain conditions and obligations to management with respect to such repurchased shares (*e.g.*, the obligation to transfer such shares within a 3 month period after the date of the buyback). In a nut shell, the sole exception under which a SA may purchase its shares except is in case of judicial adjudications for the payment of debts owed to it (please refer to the section title "*Acquisition of Treasury Shares*" below).

In addition to Article 134, care should be taken of the provisions in Articles 138 of the LGSM which impose joint and several liability to the management (members of the Board of Directors and executives) of a SA of any damages (direct damages) caused to the SA or to its creditors as a result of any buyback authorized by such directors.

Buyback of shares issued by a SAPI, a SAPIB or a SAB is permitted under applicable law subject to compliance with the provisions set forth in the by-laws of the relevant corporation, the Securities Markets Law (*Ley del Mercado de Valores*) and other legal provisions (please refer to the *Regulatory Framework* section below).

In a nutshell, an SA cannot repurchase its own shares, except: **(i)** where the corporation is publicly traded or otherwise regulated by the Securities Markets Law (a SAPI or a SAPIB) and subject to a number of other limitations; or **(ii)** pursuant to a judicial adjudication for the payment of debts owed to the SA.

What are the characteristics (maximum holdings, voting rights and other rights) of treasury shares?

Treasury shares in Mexico are understood as unsubscribed and payable shares which issuance by the SA has been authorized by the Shareholders' Meeting at any given time so that they may be issued, subscribed and paid by a shareholder or third party at a later date.

As long as the minimum capital requirement is fulfilled (based on past practice, such minimum capital requirement is usually set in the by-laws at $50,000.00 pesos (approximately US$3,900 dollars)), there is no limit to the proportion of authorized capital stock that may be represented at any given time by treasury shares.

Treasury shares held by a SA have no corporate or economic rights.

What are the main reasons to acquire treasury shares?

Treasury shares are commonly used in the context of joint venture or corporate finance transactions where the investor needs to ascertain that it will have access to subscribe and pay for such shares. It is also common to use treasury shares as a mean to assure the funding of additional capital into a company without altering the ownership structure (avoiding dilution) of the shareholders. Within the context of corporate finance transactions, treasury shares are used to properly document the creditor´s rights under convertible securities, because the SA needs to have sufficient treasury shares to comply with the potential convertibility of the securities in question.

Moreover, treasury shares are commonly used in stock option programs that assist in the hiring and retention of key employees.

Finally, bear in mind that in SABs and SAPIBs, buybacks are common when management believes the stock is undervalued.

REGULATORY FRAMEWORK

General Law of Commercial Companies (*(Ley General de Sociedades Mercantiles)*

Securities Market Law (*Ley del Mercado de Valores)*

CNBV Regulations (*Circular Única de Emisoras*)

ACQUISTION OF TREASURY SHARES

How can a company acquire treasury shares?

As stated above, a distinction needs to be made with respect to the kind of SA that issued the relevant treasury shares; however, in the case of a SA or a SAPI their treasury shares are understood as unsubscribed and payable shares which issuance by the SA has been authorized by the Shareholders' Meeting at any given time so that they may be issued, subscribed and paid by a shareholder or third party at a later date,.

In view of the foregoing, treasury shares held by a SA are generally not held by any person and as such they are un-transferable. In any case, the SA (through a Shareholders' Meeting resolution) could resolve on reducing the authorized capital stock and cancelling the subscription rights to subscribe and pay the relevant treasury shares.

A second scenario is that the Shareholders' Meeting that approved the issuance of treasury shares also specified the individual with the exclusive right to subscribe and pay for such shares. In this case, the cancellation of such exclusive subscription rights is also possible, but it would be subject to the provisions set forth in the original resolution of such Shareholders' Meeting together with the terms and conditions of any underlying agreement regulating the subscription (subscription agreement, warrant, etc.). Under this second scenario, the cancellation of such exclusive subscription rights would require another resolution by the Shareholders' Meeting together with, as applicable, the consent subscription right holder, given that such cancellation may entail a default or breach by the issuing SA or its shareholders that could give rise to certain indemnity obligations to the holder of the relevant subscription rights.

In the case of any other shares issued by an SA please note that it is forbidden from acquiring its own shares, except in the case of judicial adjudications for the payment of debts owed to it. Pursuant to the LGSM, upon the judicial adjudication, the SA shall sell the shares within the 3 months following the date on which it can freely dispose of them. Should the SA not achieve the disposition within such term, the shares shall be cancelled and the corresponding capital reduction shall be undertaken. During the time the shares are owned by the SA, they shall not be represented at Shareholders' Meetings.

In the case of the SA's regulated under the Securities Markets Law (a SAPI, a SAPIB or a SAB) please note the following:

(a) SAPI: Unlike the SA, SAPI's are not restricted from repurchasing their own shares, which in terms of liquidity or exit allows the shareholders to put their shares to the SAPI. In addition, shareholders of a SAPI may establish specific registration rights designed to take the SAPI public.

The acquisition of the SAPI's shares may be charged to the company's net worth, in which case, the bought back shares would be maintained by the SAPI without having to reduce its capital stock, or on account of its capital stock, in which case, the shares will be transformed into treasury shares, without the need for a shareholders meeting resolution.

Please refer to the three initial paragraphs of this section that refer to the acquisition of treasury shares.

(b) SAB and SAPIB. The General Shareholders' Meeting of a SAB or SAPIB may approve, on an annual basis, a maximum amount that may be used for purchasing shares representing its corporate capital. This amount cannot exceed the SAB or SAPIB net income, including retained earnings. Pursuant to this authorization, a SAB or SAPIB may acquire shares representing its corporate capital:

- **(i)** through a domestic (Mexican) stock exchange; and
- **(ii)** at market price, except for public offers or through auction processes authorized by the Mexican securities regulator (CNBV).

Are there any restrictions in acquiring treasury shares? (e.g. purpose-wise; accounting-wise?)

As stated above, under Mexican law treasury shares *per-se* are not subject to acquisition given that they have not been issued. Please refer to our answer in the preceding question.

(a) SAPI. None

(b) SAB and SAPIB. Among other things, the acquisition by a SAB or SAPIB of shares representing its own corporate capital is subject to the following restrictions:

(i) no acquisition may result in a violation of the listing maintenance requirements of the relevant Mexican stock exchange (e.g., for a SAB, reducing the number of investors below 100), or of the maximum percentages of non-ordinary shares that, by statute, it may have;

(ii) if SAB's o SAPIB's preferred shares are outstanding, it must have complied with all cumulative dividends;

(iii) if SAB's o SAPIB's debt securities registered in the National Securities Registry (*Registro Nacional de Valores*) are outstanding, it must have complied with all its payment obligations thereunder;

(iv) the acquisition must be made:

1. over fully paid up shares, without distinction regarding the identity of the selling shareholder;

2. through a market order;

3. if involving more than 1% of the outstanding shares, the SAB or SAPIB must disclose the transaction to the market at least 10 minutes in advance;

4. through a public offering, when the number of shares intended to be acquired, in one or more transactions, is equal or greater that 3% of the outstanding shares;

5. through the individual specially appointed by the Chief Executive Officer to that end; and

6. Through the same brokerage house, when made on a single date;

(v) no acquisition may be instructed within the first and last 30 minutes of a trading session or afterhours;

(vi) no bid may remain in effect for more than 1 day;

(vii) the acquisition must be disclosed to the market no later than the next business day;

(viii) no acquisition may be made if the SAB or SAPIB is in possession of material non-public information; and

(ix) no acquisition may be made if a tender offer is in progress.

Which authorization is needed?

(a) SAPI: The SAPI is allowed to repurchase its shares so long as **(i)** it has the approval of the Board of Directors to acquire such shares, and **(ii)** the purchase is charged to the company's net worth, in which case, such shares may be maintained by the SAPI without having to reduce its capital stock, or on account of the SAPI's capital stock, in which case, the shares will be cancelled or transformed into un-paid shares kept in the company's treasury, without the need for a shareholders meeting resolution. Fixed capital companies will transform the shares they acquire pursuant to this rule into un-paid shares kept in their treasury. As is the case with an SA, shares repurchased by a SAPI (including treasury shares) held by it have no corporate or economic rights.

The securities held by the SAPI or, if applicable, the treasury shares, may be placed among the current shareholders of the SAPI without a shareholders' meeting resolution unless otherwise resolved by the Board of Directors that approved the repurchase, in which case the allocation

or distribution of the repurchased shares shall be subject to the resolutions adopted by the Board of Directors to such effect (e.g., sale to any person). In case of such a placement by the SAPI, the shareholders do not necessarily have right of first offer to acquire such securities or a preferential right to subscribe the treasury shares being offered to a third party.

(b) SAB and SAPIB: In addition to the Shareholders' approval described above, the Board of Directors must approve the basis for the acquisition and placement of treasury shares. Additionally, the Board of Directors must approve a buy-back program policy, which must contain, as a minimum:

(i) the authorities and obligations of the individuals involved in the acquisition and placement decisions with respect of treasury shares;

(ii) the procedures to assign treasury shares to vehicles established in connection with share options programs for employees; and

(iii) the terms under which the Board of Directors must report, at least once a year, to the General Shareholders' Meeting, the basis under which it approved the acquisition and placement of treasury shares.

What are the publicity requirements in the event of acquisition of treasury shares?

Following the distinction that has been made throughout this report, please note the following:

(a) SAPI: None.

(b) SAB and SAPIB: As mentioned above, SAB and SAPIB must disclose to the market each acquisition made no later than the next business day and, for those acquisitions involving more than 1% of the outstanding shares, the SAB or SAPIB must disclose the transaction to the market at least 10 minutes in advance.

Put and call options – do they count as acquisition of own shares?

Again, a distinction needs to be made with respect to the kind of SA that issued the relevant shares that are subject matter to the options.

Unless the *put option* is directly from one shareholder against the remaining shareholders of the SA, in the case of the latter, a *put option* by the shareholder to the SA would need to be correctly documented in order for such put option to be valid. Recall that the acquisition of its own shares by an SA is forbidden under the LGSM. The put option conditioned upon the transformation of the SA into a SAPI regulated under the Securities Markets Law could be valid if the necessary corporate preliminary steps are taken by the SA (including shareholder resolutions approving such transformation). Careful analysis of how to document and formalize the put option and the conditions precedent to the shareholder's right to exercise such option would need to be taken.

As to the *call option* exercisable by an SA, given that the acquisition of its own shares by the SA is forbidden under the LGSM, such call option would not be permissible, valid or enforceable unless the SA is transformed to a SAPI (except in the case that the *call option* is directly between shareholders of the SA). As is the case with the *put option* described above, a careful analysis should be made to document a call option conditioned upon the transformation of the SA into a SAPI. For this last scenario, please refer to our comment above with respect to the documentation and implementation of such alternative.

In the case of an SA regulated under the Securities Markets Law (a SAPI, a SAPIB or a SAB) please note the following:

(a) SAPI: SAPI's are not restricted from repurchasing their own shares, which in terms of liquidity or exit allows the shareholders to *put* their shares to the SAPI or the SAPI to exercise a *call* against any of its shareholders. Unless the call or put options are expressly set forth in the by-laws of the SAPI (which would be the advisable approach), en even then; prior to the execution of either option agreement by the SAPI with a shareholder, such execution needs to be previously approved by either the Board of Directors or the Shareholders' Meeting of the SAPI.

(b) SAB and SAPIB: All restrictions applicable to acquiring and re-selling treasury shares are applicable to physically settled derivatives or options in which the underlying assets are shares representing the capital stock of a SAB or SAPIB. However, these derivatives and options do not have to be acquired through a domestic (Mexican) stock exchange; and no specific price is required.

SAB and SAPIB must disclose to the market, on a quarterly basis, the derivatives or options entered into in which the underlying assets are shares representing their capital stock.

UTILIZATION OF TREASURY SHARES

Are there any statutory obligations to resell or redeem treasury shares?

In the case of an SA, it is up to the Shareholders' Meeting to determine any condition applicable to the resale or redemption of treasury shares. Although no statutory obligation to redeem treasury shares exists, the LGSM provides that the shareholders of an SA may not approve a capital increase until the entire treasury shares have been subscribed and paid (or cancelled).

As to the SA regulated by the Securities Market Law, please note the following:

(a) SAPI: The SAPI has no statutory obligation to re-sell or redeem treasury shares. It is up to the Board of Directors of the SAPI or, in its case, the Shareholders' Meeting to determine any specific terms and conditions of resale or redemption of treasury shares. As in the SA, the SAPI may not increase its capital in so far as treasury shares remain unsubscribed and payable.

(b) SAB and SAPIB: There is no statutory obligation to re-sell or redeem treasury shares, and its treatment is similar to a SAPI.

How are treasury shares redeemed?

In the SA it is permissible to redeem treasury shares. Given that such shares are unsubscribed and payable; the redemption only requires an approval of the Shareholders' Meeting cancelling such treasury shares and reducing the authorized capital stock of the company in question. Again, care should be taken as to the provisions of the by-laws of the respective company as well as of the resolutions taken by the Shareholders' Meeting whereby the treasury shares in question were issued.

As to the SA's regulated by the Securities Markets Law, please note the following:

(a) SAPI: The same principle as described above for the SA would apply.

(b) SAB and SAPIB: There is no statutory obligation to re-sell or redeem treasury shares, and its treatment is similar to a SAPI.

SALE OF TREASURY SHARES

How can the company sell treasury shares?

As stated above, treasury shares in Mexico are understood as unsubscribed and payable shares which issuance by the SA has been authorized by the Shareholders' Meeting at any given time so that they may be issued, subscribed and paid by a shareholder or third party at a later date. Consequently, treasury shares issued by a SA are generally not held by any person.

When shareholders of a SA approve the issuance of treasury shares that are to be subscribed and paid by a specific person, they waive their preferential right to subscribe and pay such shares. Thus, if the Shareholders' Meeting that approved the issuance of treasury shares also specified the individual with the exclusive right to subscribe and pay for such shares upon their issuance or on a later date (e.g., pursuant to a subscription agreement), such right to subscribe and pay for such shares may be transferred to another person provided that such assignment is previously approved by the Shareholders' Meeting. Alternatively, the shareholders that approved the capital increase and the issuance of treasury shares may authorize the Board of Directors to tender the shares to any individual in which case they generally give such authorization together with certain guidelines and requirements that the Board of Directors must follow when tendering such treasury shares for their subscription and payment by a third party.

As to the SA's regulated by the Securities Market Law, please note the following:

(a) SAPI: The same principle of the SA applies to the SAPI. However, two important characteristics of the SAPI need to be considered for purposes of the subject matter of this report (including the "*sale of treasury shares*" or for the "*restrictions of selling treasury share*") by the company:

(i) Voting Restrictions. Shareholders of the SAPI may establish voting restrictions otherwise prohibited under Article 198 of the LGSM that provides that any agreement that limits or in any way restricts the rights of the shareholders to vote their shares is null and void" Hence, the LMV allows shareholders to covenant to vote or abstain from voting on certain matters or under certain circumstances (e.g., the assignment to a third party of the subscription right of treasury shares). Another important aspect of the SAPI not available in the SA is that shareholders of SAPI's may assign their voting rights.

(ii) Preemptive Rights. Shareholders of a SAPI may waive or assign their preemptive rights to subscribe and pay capital increases, even prior to the adoption of the shareholders resolution approving the relevant capital increase. The relevant provisions also allow for the implementation of punitive dilution and other remedies for shareholders defaulting on their capital commitments or capital calls.

(b) SAB and SAPIB: Generally speaking, SAB and SAPIBs are free to sell treasury shares, either through a market order, a public offering, or a private negotiation. However, re-sell of treasury shares following its repurchase by the company are subject to the following restrictions:

(i) It must be made at market price, except for public offers or through auction processes authorized by CNBV.

(ii) the sale must be made:

1. over fully paid up shares, without distinction regarding the identity of the buying shareholder;

2. through a market order;

3. if involving more than 1% of the outstanding shares, the SAB or SAPIB must disclose the transaction to the market at least 10 minutes in advance;

4. through a public offering, when the number of shares intended to be sold, in one or more transactions, is equal or greater that 3% of the outstanding shares;

5. through the individual specially appointed by the Chief Executive Officer to that end; and

6. through the same brokerage house, when made on a single date;

(iii) no sale may be instructed within the first and last 30 minutes of a trading session or afterhours;

(iv) no ask may remain in effect for more than 1 day;

(v) the sale must be disclosed to the market no later than the next business day;

(vi) no sale may be made if the SAB or SAPIB is in possession of material non-public information;

(vii) no sale may be made if a tender offer is in progress.

Are there any restrictions for selling treasury shares?

In the SA the restrictions for the subscription and payment of treasury shares are imposed by the Shareholders' Meeting that approved the capital increase and the issuance of such treasury shares. In many instance the resolution that approved the issuance generally sets forth the provisions and requirements to be met at the time the shares are subscribed and paid (including, in many instances, the identity of the third party that will subscribe and pay such treasury shares).

As to the SA's regulated by the Securities Market Law, please note the following:

a) SAPI: The same principle of the SA applies with the exceptions to the provisions of the LGSM that apply to an SA and that would not necessarily apply to the SAPI. Please refer to the section above that refers to the sale of treasury shares".

b) SAB and SAPIB: Other than those mentioned above, there is no additional restriction for selling treasury shares.

Which authorization is needed for selling treasury shares?

Please refer to the two previous subsections. Generally, careful analysis of the by-laws, the shareholders' agreements and the resolutions taken by the Shareholders' Meeting that approved the issuance of the treasury shares must be made to see which requirements, if any, must be met to assign the right to subscribe and pay for the treasury shares.

No approval by the General Shareholders Meeting or the Board of Directors of either a SAB or SAPIB is needed for selling or for re-selling previously acquired treasury shares. However, such re-selling must be made pursuant to the general basis approved by the Board of Directors.

Can treasury shares be sold other than via the stock exchange or by public tender offer?

As to an SA or a SAPI, please refer to the two previous subsections.

Previously acquired treasury shares of a SAPIB or a SAB cannot be sold other than via the stock exchange, public offerings or auction processes authorized by CNBV.

What are the publicity requirements in the event of a sale of treasury shares?

As to an SA or a SAPI, please refer to the two previous subsections.

As mentioned above, SAB and SAPIB must disclose to the market each re-sale made no later than the next business day and, for those re-sales involving more than 1% of the outstanding shares, the SAB or SAPIB must disclose the transaction to the market at least 10 minutes in advance.

What legal restrictions are there in order to avoid market abuse?

None apply to the SA or SAPI as closed corporations.

All insider trading restrictions in the Securities Markets Law and its regulations apply to the acquisition and resale of treasury shares by SAB and SAPIB. For example, insiders (e.g., directors, officers, shareholders representing more than 10% of the voting shares), cannot acquire or sale shares of a SAB or SAPIB other than through a public offering, an auction authorized by CNBV or other limited circumstances.

TREASURY SHARES AND TAKEOVER LAW

What are the general implications of treasury shares under the applicable takeover law regime?

In accordance with Mexican law, any person or group of persons that directly or indirectly intends, through one or more simultaneous or successive transactions, to acquire or reach for any means 30% or more of a SAB, must carry-out a public tender offer to purchase the corresponding shares. One exception to this mandatory public tender offer is when a person or group of persons exceeds the 30% threshold as a result of a capital reduction, which would cover a buy back by the SAB.

Treasury Shares as defense measures?

Under Mexican law, a SAB or SAPIB are legally impeded to acquire or sell shares representing its own capital stock during a tender offer, so that, in principle, treasury shares could not be used as a defense measure.