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Reference

Project Finance 2014 – Mexico

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General

1 How common is project finance in your jurisdiction? In what sectors is project financing most common?

Project finance is very well-established in Mexico, especially in the oil, gas and electricity industries, as well as in the highway and water sectors. Over the past decade, project financing has become the preferred structure to finance large infrastructure in Mexico, especially for projects linked with government concessions and contracts granted by Mexican governmental entities such as the Comisión Federal de Electricidad (CFE) and Petróleos Mexicanos (Pemex).

In recent years, the Mexican government has dramatically increased the amount of budgetary resources to infrastructure development, and set up the National Infrastructure Fund (FONADIN) to provide seed funding for infrastructure projects and encourage the participation of the private sector.

2 What kinds of institutions typically act as sponsors and lenders in your jurisdiction? Why?

From the sponsors' side, Mexican projects have typically attracted the main industry players from Europe, the US and Japan, and we are now seeing important participation from Korean companies although less from China. Often, these foreign companies form consortiums with local companies to ensure local content and knowledge.

From the lenders' side, international commercial banks from the US, Europe (mostly Spain and France) and Asia (ie, Japan and Korea) are joining local commercial and development banks and team up with development banks, import-export agencies and multilaterals (ie, World Bank, Interamerican Development Bank) for financing infrastructure projects in Mexico.

3 What structures are most common?

For years, the build-own-transfer (BOT) and the build-own-operate (BOO) financing structures have been recurrently used to finance infrastructure projects sponsored by Mexican government entities. More recently, public-private partnerships (PPPs) have been used to develop local infrastructure such as hospitals, schools, local roads and water-related projects.

Mexico currently ranks third among all of the developing countries investing in PPPs.

4 Does local law require (or is it advisable) that the project company be organised under the laws of your jurisdiction? What is the typical legal form of a project company and why? Does local law require that any of the project company's equity be held by local investors?

Although Mexican legislation does not impose nationality restrictions, for most infrastructure projects, it is advisable to have the project company organised under Mexican law even if it is controlled by non-Mexican sponsors. In some cases where the project is government-sponsored, the bidding guidelines require that the project company be incorporated in Mexico.

The most commonly used forms are the stock corporation (*sociedad anónima de capital variable*) and the limited liability company (*sociedad de responsabilidad limitada de capital variable*), both of which offer limited liability for the sponsors and can be set up to address any financing structure.

Foreign investment

5 Please describe the foreign investment regime in your jurisdiction.

Under Mexican law, except for certain regulated sectors in which foreign investment is limited to certain thresholds or restricted to Mexican investors or the Mexican government, non-Mexican investors are welcomed in most industries in Mexico. Mexican companies with foreign investment must register before the National Registry of Foreign Investment, but only with the purpose of keeping track of foreign investment and not to impose oversight or control.

6 Are there any restrictions on payments abroad or repatriation of capital by foreign investors?

As a general rule, there are no restrictions on the repatriation of funds by foreign investors to their home jurisdictions. Notwithstanding, repatriation is subject to Mexican corporate and tax laws, which govern the payment of dividends and other distributions, as well as the taxation applicable to distributions.

7 Is it permissible for a project company to maintain offshore foreign currency (eg, US dollar) accounts?

Under Mexican law, there are no restrictions for a project company to maintain offshore foreign currency accounts.

8 What recent measures has your government implemented to make projects in your jurisdiction more attractive to foreign investors? Has this involved making government or other local sources of co-financing more available for projects?

As mentioned above, the Mexican government has set up the National Infrastructure Fund (FONADIN) to provide seed funding for infrastructure projects and encourage the participation of the private sector. In many projects, the FONADIN acts together with the Mexican development bank, Banobras, to provide anchor financing to key projects and entice commercial banks to participate.

Project and financing documents

9 Will any of the financing or project agreements need to be registered or filed with any government authority or otherwise need to comply with local formalities to be valid or enforceable? Even if not necessary for enforceability, is there any special advantage in complying with local formalities?

Under Mexican law, as a general rule, financing and project agreements are not required to be registered or filed with any government authority in order to be valid or enforceable.

Nevertheless, some agreements creating security interests (such as mort-

gages or pledges) do require formalisation before a notary public and registration before the Public Registry of the Property and Commerce in order to perfect the security.

10 Are there any advantages in having the project company issue promissory notes that are governed by local law in addition to the credit agreement governed by New York (or other law)?

The typical financing structure for Mexican projects has the main loan agreements governed by New York law and the governing law for the security package divided between New York and Mexico to ensure all project assets are covered. This structure usually makes having local-law promissory notes unnecessary, although sometimes these are used when the loan is funded by commercial banks through local branches.

The advantage of having the project company issuing promissory notes governed under Mexican law is that lenders have the right to appear before a Mexican court and quickly request an attachment order on the company's assets; however, in most cases the Mexican security package has already isolated the project assets in stand-alone guaranty trusts so an additional attachment should be unnecessary.

11 Must any agreements (finance or project) be governed by local law?

Under Mexican law, there is no restriction as to the governing law of the financing or project agreements, although many contracts in government-sponsored projects will be governed by Mexican law (ie, concession agreement, PPAs etc). Also, some agreements creating security interests over the project assets have to be governed by Mexican law in order to perfect and enforce the security.

Collateral security

12 May a collateral agent act as the sole secured party for the benefit of a group of lenders whose composition may change from time to time?

Under Mexican law, a collateral agent may act as the sole secured party for the benefit of a group of lenders. The collateral agent would be a party in the Mexican security agreements and manage the project assets and take all required actions with the purpose to foreclose such collateral.

13 May a security interest be granted with respect to all of a project company's assets? Are any types of property considered personal in nature (eg, permits that are granted to an entity that has satisfied certain specific requirements) or 'of public interest' such that granting a security interest therein (or foreclosure thereon by the lenders) would not be permissible?

The typical financing structure for Mexican projects includes taking a security interest with respect to all of a project company's assets (including its contract rights, general intangibles, easements and after-acquired property) through guarantee trusts and floating lien pledges. However, there may be certain permits and rights that may only be held by the project company and that may not be transferred or even encumbered, which is addressed by taking a security interest on the project company's equity so that control can be effectively taken by the lenders in the event of a default.

14 What costs are associated with registering collateral security interests in your jurisdiction? Are such costs determined with respect to the obligations secured or the approximate value of the property?

The costs associated with registering collateral security interest in Mexico are mainly:

- filing fees related to the registration of the notarial deeds before the corresponding Public Registry of Property and Commerce; and
- fees charged by the notary public who grants the corresponding deed.

If a guarantee agreement is part of the collateral security package, the trustee fees shall also be considered among the costs associated.

The registration filing fees vary in Mexico depending on the state and may be in the form of a fixed fee, a capped amount or a percentage of the value of the transaction being registered. The notary public fees are determined based on the amount of the transaction, but can usually be negotiated for a fixed fee.

15 Does your jurisdiction require lenders to stipulate the value of their collateral security in the relevant security documents? If so, what happens if at the time of foreclosure the property is worth more? Must such amount be stated in local currency even if the financing is in a foreign currency? If so, what protections may be implemented against devaluation of the local currency?

Mexican collateral security documents, such as a mortgage or a floating lien pledge, include the total amount of the obligations guaranteed by such collateral, but not the value of the collateral itself. If the obligations are stated in a currency other than Mexican pesos, a reference exchange rate is typically included in the security documents.

16 Does each item of collateral (eg, equipment) need to be individually identified (whether by serial number or otherwise) in the security document to grant a valid security interest in that item? Or would a general description of the types of collateral covered be sufficient?

If a guarantee agreement is part of the collateral security package, the specific project assets contributed do have to be individually identified and these typically relate to project contracts and specific core physical assets. If a floating lien pledge is also used, this would cover other movable assets with a more generic description.

17 How do lenders satisfy themselves with respect to the absence of other liens on their collateral? Are liens centrally recorded or searchable? May contractors file mechanic liens? If so, are lien waivers enforceable?

Before the security is perfected on the project's assets, the project company is required to provide evidence that these are free of liens through no-encumbrance certificates issued by the Public Registry of Property and Commerce with jurisdiction, as well as a mercantile folio for the project company itself. Mechanic liens and similar contractor-related encumbrances do not exist in Mexico so lien waivers are not usually required.

Title insurance has become more common in Mexico, although it is not yet a standard requirement in project finance.

18 What steps must a lender take to foreclose on a collateral security interest in your jurisdiction? How does a beneficiary of a guarantee provided by a local entity or granted under local law enforce such guarantee? Are any self-help remedies available? Is a public or private sale permissible or required? Is a judicial sale necessary? May lenders participate as buyers in any such sale, including by bidding the debt owed by the project company to them in lieu of cash? May any such sale (private or public) be for foreign currency? Is foreclosure on a pledge of the ownership interests of the project company more efficient and less time-consuming than a foreclosure on individual assets of the project company?

The common security package in Mexican project finance is composed by a combination of agreements that are meant to ensure the project's continuity even in the event of a material default that requires the lenders to step in, which includes:

- the guaranty trust;
- the commercial pledge;
- the floating lien pledge;
- the mortgage; and
- the industrial mortgage.

A guarantee trust is used to hold the most relevant project assets in a bankruptcy remote form, and typically provides that upon the occurrence of an event of default of the borrower under the financing documents, the beneficiary may take control of the assets and eventually require the trustee to sell the collateral.

A pledge agreement may be enforced through a special judicial procedure set forth in the applicable law. Upon maturity of the secured obligations, the pledgee may request judicial authorisation to sell the pledged assets without any additional judicial intervention. In a floating lien pledge, the pledgee may

seek payment of the secured obligations and pursue the delivery and possession of the pledged assets through an extra-judicial procedure initiated by a formal request of delivery of the pledged assets made to the pledgor before a Mexican notary public or a commercial notary public. Upon delivery to the pledgee of the pledged assets by the pledgor, the pledged assets shall be transferred. The value of the pledged assets shall be calculated by an appraiser or in any other manner specifically agreed upon by the pledgor and the pledgee. However, the extra-judicial foreclosure procedure may be followed only under certain circumstances. The floating lien pledge may also be enforced through the special judicial foreclosure procedure set forth in the Mexican Code of Commerce.

Generally, a mortgage agreement must be enforced through special judicial foreclosure proceeding. Industrial mortgages are typically included as part of Mexican loan agreements by Mexican credit institutions and entitle the mortgagee to enforce the industrial mortgage thorough a summary judicial procedure (juicio ejecutivo mercantil).

If lenders have not taken control of the project through the guarantee trust and/or by foreclosing on the ownership interests of the project company, or for some other reason the project assets are to be sold, the lenders may participate as buyers in any sale of the assets, including by bidding the debt owed by the project company to them in lieu of cash, and such sale may be for foreign currency.

19 What creditors would enjoy a higher statutory priority with respect to the collateral security than the lenders?

Under Mexican law, unsecured credit obligations would rank below tax, social security and labor claims such as the following:

- labour claims related to unpaid wages for the two years prior to the declaration of insolvency;
- unpaid taxes;
- in an insolvency proceeding, administration expenses authorised by the *conciliador* or *síndico*; expenses related to the preservation of the assets of the insolvent debtor; expenses related to judicial or extra-judicial proceedings related to the insolvency procedure; and
- the fees of the visitador, conciliador and síndico and the related expenses, only to the extent such expenses are strictly necessary and duly documented.

20 Would the lenders incur any liabilities upon foreclosure relating to project assets (as opposed to equity)?

Under Mexican law, lenders would not incur any liabilities upon foreclosure relating to the project assets.

21 What legal restrictions exist with respect to the operation of the project post-foreclosure by the lenders or their designee?

In Mexico, the transfer of ownership and/or operation of the project post-foreclosure of the lenders or their designees does not have any statutory restrictions. However, in the case of projects sponsored by governmental entities, it is common to find that any lender step-in must be authorised by the corresponding governmental entity and such authorisation may be subject to the satisfaction of certain conditions such as having the necessary financial and technical capacity to operate the project. There may be some restrictions on foreign ownership or operation of the project, especially for regulated sectors; please refer to question 5 above. If the service provided by the project company is considered a public service, the lenders will not be able to sell the project assets, but the relevant contracts usually stipulate that the title over the project assets be transferred to the corresponding governmental entity for a price determined through a contractual formula.

22 Would the agreement by a project company's equity holders to make capital contributions to the project company (or directly to the lenders in satisfaction of the debt) be enforceable by the lenders (assuming such rights have been collaterally assigned by the project company to the lenders) in bankruptcy proceedings of the project company?

Capital contribution obligations are generally assumed by the project company's equity holders in agreements made with the project lenders, and these should be enforceable in bankruptcy proceedings of the project company, although they would likely require the approval of the bankruptcy trustee as part of a general bankruptcy resolution.

Dispute resolution

23 Can a project company organised under local laws validly submit to the jurisdiction of a foreign court?

Under Mexican law, there is no restriction for a project company organised under local laws to validly submit to the jurisdiction of a foreign court or to an arbitration procedure carried out abroad and under a foreign law, in the understanding that in order to enforce any foreign judicial resolution or arbitration award in Mexico various procedural requirements will have to be satisfied.

24 Is service of process by mail recognised in your jurisdiction or would the project company need to appoint a process agent?

Service of process abroad by mail is not recognised under Mexican law; as a result, the project company does have to appoint a process agent through special power of attorney granted for such purpose.

25 Are foreign judgments and arbitral awards enforceable in your jurisdiction? If so, does any process of ratification or additional review need to be carried out in the local court system as a condition to such enforcement? Do sovereign or quasi-sovereign entities (eg, a counterparty to a major project document to which the project company is a party) have the capacity to arbitrate as a matter of local law?

Mexico is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and any other relevant Conventions. As a result, foreign judgments and arbitral awards are enforceable in Mexico, provided they satisfy certain procedural requirements, including they do not contravene Mexican law, public policy of Mexico, international treaties or agreements binding upon Mexico or generally accepted principles of international law, and that the enforcing parties comply with the applicable procedure under the laws of Mexico with respect to the enforcement of foreign judgments. This includes the issuance of a letter rogatory by the competent authority of such 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.

In spite of the expedited nature of the procedure, the parties may file interlocutory appeals, which in practice can make enforcement more protracted. Also, ministerial procedures conducted by the court (ie, time used to admit the filing, to notify the parties) is in addition to the statutory timeframes.

Miscellaneous

26 Is subordination of debt recognised under the law of your jurisdiction?

Under Mexican law, subordination of debt is recognised. In the event of bankruptcy, the bankruptcy court should give effect to the provisions of an agreement between the senior and subordinated lenders pursuant to which the subordinated lenders agree that they will not be repaid (in whole or in part) until the debt to the senior lenders is paid.

27 Are there laws in your jurisdiction that regulate how tariffs payable to a service provider (eg, a power plant or pipeline company) must be calculated? If so, please describe briefly.

For regulated sectors (ie, gas and power), the competent government authority (regulator) sets the guidelines to determine the tariffs to be charged by a service provider. In other industries, the tariff to be charged will depend on the offer made by the winning bidder in a tender process carried out by the corresponding government authority, where the tariff charged is a function of the project's development and operational costs.

28 Do environmental, tax or other liabilities relating to the project extend beyond the project company to the direct or indirect owners of the project company or to the lenders?

The 'veil piercing' doctrine does not generally apply in Mexican law, and liabilities relating to the project do not extend beyond the project company, except in certain situations relating to tax matters where the Mexican tax authorities may attempt to hold the equity holders liable for unpaid taxes. In general, the shareholders or partners of the project company are only liable to the extent of their contributions on the capital stock of the project company.

29 Are there any limitations (or incentives) with respect to importation of equipment or materials to be used in the project?

Mexican legislation does not limit the importation of equipment or materials to be used in a project. On the contrary, several incentives are granted by the tax authorities to the importation of equipment or materials, such as acceleration of depreciation or a reduction in the tax rates applicable to import duties.

30 What land issues might there be in connection with a project financing in your jurisdiction? Are there any restrictions on foreigners' ownership of land or natural resources? How difficult is it to obtain rights of way (eg, in connection with a pipeline project that traverses many plots of land)?

Under Mexican law, foreigners may acquire real estate properties to the extent they agree before the Mexican Ministry of Foreign Affairs to be considered as Mexican nationals with regard to such goods and not to invoke the protection of their governments. However, article 27 of the Mexican Constitution sets forth a prohibition for foreign nationals to acquire land within a strip of 100km along the borders and 50km along the coastline; however, Mexican entities with foreign investment may acquire direct ownership over real estate as long as it is not intended for residential purposes and they satisfy certain filing requirements. Alternatively, foreign investors and Mexican entities with foreign investment may also acquire and hold real estate through Mexican trusts created for such purpose. Outside the restricted zone, foreign individuals and corporations are allowed to acquire real estate properties.

As for rights of way, the difficulty in obtaining them will depend on:

- the number of rights of way required to develop a project;
- the number of land plots being affected; and
- the type of land, either owned by private parties or by the local or federal government.

For rights of way to be obtained from a governmental authority, generally an authorisation is enough to obtain the right of way (ie, the crossing of a highway). As for rights of way affecting private property, it will be necessary to negotiate and enter into an agreement with the corresponding owner and usually it implies the payment of compensation. Finally, these agreements will have to be formalised before a notary public and the deed will be required to be registered before the corresponding Public Registry of the Property. In some cases, if no negotiation can be achieved, the government may expropriate the corresponding land lot for the benefit of the project.

31 Please describe any other relevant legal considerations relating to project finance in your jurisdiction.

Project finance has become a standard practice in Mexico and the financing structure, along with the collateral security package, is well established and understood by sponsors and lenders.

Public-private partnership (PPP)

32 Has specific PPP-enabling legislation been passed in your jurisdiction? If so, and if applicable, has it been passed at the federal, state or municipal level and is it sector-specific?

The federal Public-Private Partnerships Law (Ley de Asociaciones Público-Privadas) was enacted on 16 January 2012 and it Regulations on 5 November 2012. The Mexican PPP legislation provides a clear and uniform framework for the development of long-term infrastructure project and the provision of related services, promoting greater cooperation between government agencies and the private sector. These projects may be developed through private funds or using federal resources and can be structured to allow long-term financing and development.

33 What legal limitations, if any, are there (whether constitutional or otherwise) on PPP transactions? Are there any limitations on the contracting power of the state, the state's ability to incur long-term fiscal obligations, or the extent to which certain government functions may be performed by the private sector?

The new federal PPP Law is designed to offer much flexibility to the structuring of a project to be developed under the scheme, and provides that the awarding of a contract should not take the lowest cost as the defining criteria and should include an in-depth analysis of the project's viability, technical requirements, structure, social benefits and funding needs. The legislation is not restricted to specific sector or to any type of project structure, allowing the contract to be tailored to the project's needs. The only formal limitation is that those projects requiring federal funding shall be registered with the Ministry of Finance and Public Credit so that it may be included in the Federal Budget and approved by the Chamber of Deputies.

34 What are the most significant PPP transactions that have been completed to date?

There has been limited use of the PPP structure to develop large infrastructure projects in Mexico, and few completed PPP transactions. The most significant ones have been road, hospital and school projects developed by the states of Puebla, Mexico and Nuevo León. Nevertheless, we expect that the great majority of the infrastructure projects in Mexico will now be structured and developed under the PPP legislation.

35 What do you see as the primary impediments and drivers, both legal and commercial, to the development of PPP in your jurisdiction?

The enactment of the federal Public-Private Partnerships Law (Ley de Asociaciones Público-Privadas) should serve as an important driver to launch Mexican PPP projects in a large scale, allowing the government to better attract sponsors and investors to large projects and offer such sponsor and investors significant flexibility in structuring projects and their financing.

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