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Project Finance

Mexico

Ritch, Mueller, Heather y Nicolau, S.C.

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MEXICO

LAW AND PRACTICE:

p.3

Contributed by Ritch, Mueller, Heather y Nicolau, 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

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Ritch, Mueller, Heather y Nicolau, S.C. has five partners and 15 associates in its Energy, Projects and Infrastructure group, which is based in Mexico City and handles project finance transactions in co-ordination with the firm's Environmental, Social and Tax practice groups. Transactions involve a number of sectors and industries, including

power (renewable and conventional), hydrocarbon transport and storage, transportation and water treatment. The team is known for its ability to structure and implement complex structures, and represents a diverse range of players in the infrastructure industry.

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1. Project Finance Panorama

1.1 Recent History and Expected Developments

Limited and non-recourse financing schemes that are commonly referred to as “project finance” have been widely and increasingly used in Mexico over the past few decades to provide financial resources to large-scale infrastructure projects, including in the power, hydrocarbons transport and storage, transportation, health, water treatment and telecommunications industries. Such schemes were first implemented, albeit with much less sophisticated structures, as the Mexican economy started to allow private investment in a number of sectors of the infrastructure space in the 1990s, including in the power generation and transmission, gas transport, toll road and water treatment industries.

As the demand for infrastructure in Mexico has continued to grow, projects that were traditionally built by the Mexican government directly have been the subject of long-term concessions, services contracts and similar arrangements requiring the participation, ownership and operation by private parties. This has resulted in the need for financing for these projects to grow and for more sophisticated schemes to be implemented hand in hand with the development in the underlying contracts and concessions.

The Mexican energy reform that commenced in 2014 has allowed for an even larger number of projects to be awarded in the power and oil and gas sectors in Mexico. The need to expand and upgrade the Mexican electric transmission grid has also given way to recent bidding processes that seek

to award contracts in this space in the near future. A great many of the projects that have been awarded under the new legislation are now seeking financing under a limited or non-recourse scheme which is a key component in the financial model required for sponsors to meet their profitability requirements.

1.2 Institutions Typically Acting as Sponsors and Lenders

As the market for public-private projects has developed in Mexico, the type of sponsors interested in participating in the market has also evolved. Initially, sponsors were largely industrial construction companies and operators of assets with a long-term ownership objective. Currently, those “traditional” sponsors have been joined by other short and long-term investors and developers that are willing to participate in projects at an early stage, as providers of initial development efforts and seed capital, as well as by longer-term equity investors with a view to forming a long-term asset base.

It should be noted that auction processes and guidelines for infrastructure projects in all industries include strict equity, operational and expertise requirements, which are aimed at ensuring that the projects are awarded to entities capable of bringing projects to commercial operation. Therefore, it is not uncommon for projects to be developed by sponsors forming consortiums with parties having different capabilities and expertise. Such novel investors and consortium parties include institutional investors and specialised private equity firms that allow smaller developers and contractors having the necessary construction, technological and op-

erational expertise to compete for projects that they would otherwise not be able to bid for.

The increasing appetite for projects in Mexico has resulted in the appearance of developers and engineering firms that usually have a less robust capital base but sufficient expertise in permitting and pre-development tasks relating to the projects. Such companies commonly bid for projects with expressions of interest or even put options entered into with long-term investors that will allow the developers to exit the projects upon completion of certain milestones. In this scheme, developers undertake the activities necessary to make the project attractive to be sold to a long-term equity investor once the project reaches a “ready to build” or “ready to finance” stage or achieves financial closing.

Initially, as with many other similar jurisdictions, the project finance space was largely reserved to Mexican development banks and multilateral, bilateral and regional financing institutions such as the International Finance Corporation, the Inter-American Development Bank and the North American Development Bank. As the market has evolved, both Mexican and international commercial lenders have been increasingly interested in providing financing to projects.

International lenders currently seem to gravitate towards projects in the power and hydrocarbons sectors since many of these projects allow for payment streams denominated in or indexed to United States dollars. This has resulted in many of the toll road and traditional infrastructure projects being left to the Mexican lenders that are better suited to providing financing in Mexican currency.

The market for project bonds in Mexico is the focus of significant recent attention. Although many toll road projects have issued project bonds, they commonly do so in the Mexican market and in Mexican currency. A few project bonds have been issued in the past few years in relation to projects in the energy industry; however, construction risk continues to be a key issue that needs to be addressed prior to a successful bond issuance. This is typically dealt with by a strong guarantee to the investors that bonds will be repaid as of a certain long-stop date. Therefore, project bonds still seem to be more suitable for a long-term refinancing of projects once commercial operation has been achieved.

In addition to the traditional senior project financing lenders, the industry has seen the development of a market for bridge, mezzanine and back-leveraged financing. Lenders commonly include specialised private equity firms that have a clear understanding of the project and are willing to lend at a higher cost in order to provide the project with additional “quasi-equity” necessary to achieve the ready to finance stage or otherwise monetise dividends payable to sponsors during operation of the project.

Mexican commercial and development banks actively provide financing of VAT costs incurred by the project during construction, which financing is typically a shorter-term financing that is parallel to the senior project finance debt and recourse is limited to the VAT refunds payable by the Mexican Ministry of the Treasury and, in some instances, to excess cash flows once scheduled project finance debt has been repaid.

1.3 Public-private Partnership Transactions

Public-private partnership transactions in Mexico have long been the target for project financing. Considering the budgetary constraints of the Mexican government, at the federal, state and municipal levels, the Mexican government has dedicated significant efforts and resources towards the implementation of these types of projects in order to continue the development of much needed infrastructure projects, particularly in the toll road, air transportation, seaport, water treatment and tourism industries, many of which are developed as concessions for public services and which, in some instances, receive federal funding and guarantees.

Public-private partnerships (PPPs) in Mexico at a federal level are regulated by the Public-Private Partnership Law (*Ley de Asociaciones Público Privadas*) and its regulations. Many states of Mexico also have their own public-private partnership laws, which are applicable to PPPs sponsored by the state governments that do not rely on federal funding in whole or in part and only consider state taxes or federal revenues payable to the Mexican states.

At a federal level, pursuant to the Public-Private Partnership Law and its regulations, any ministry or agency can act as procuring authority. A procuring authority interested in the development of a PPP project must go through a number of studies and analyses in order to determine the viability of the proposed PPP including the social profitability of the project and the economic and financial viability of the project.

Parties may submit unsolicited proposals for PPP projects, which shall be analysed by the procuring entity in a period of three months that can be extended if necessary. The evaluation of an unsolicited proposal will take into consideration, among other aspects, that the project is of public interest and provides social returns consistent with the National Development Plan and sectorial and regional programmes.

As a general rule, all PPP projects that are considered suitable and viable by a procuring authority shall be submitted to a public bidding process. Exceptions to public bidding processes such as direct awards or limited or restricted invitations to bid, are not applicable to unsolicited proposals. Such bidding process is aimed at ensuring that the best terms are available regarding price, quality, financing, timing and other relevant circumstances. Any person or entity, national or foreign, can participate in a public bidding process provided that they comply with the bidding requirements,

terms and provisions, whether individually or as a consortium; however, if awarded with a PPP project participants are required to incorporate a Mexican special purpose vehicle to execute the relevant contract.

Considering the nature of PPP projects, it is not uncommon for the assets subject to such projects to be considered part of a public service or outright owned by the government. As such, lenders financing these projects are often prevented from taking security on such assets and must rely solely on a cash flow based security structure that is implemented by way of an assignment of the rights of the project company to collect under the relevant contract or concession.

1.4 Main Issues Considered When Structuring the Deal

The development of the public-private project space in Mexico has also been influenced in large part by the requirements of project finance lenders. As such, projects suitable for a project financing structure typically require a concession or long-term offtake or services contract that allows for a stable cash flow, payments in hard currency, typically United States dollars, or otherwise payments in Mexican pesos that reflect adjustments to costs incurred by the project in United States dollars, and termination payments that allow for repayment of at least the investment component of the project in the event of a default by the offtaker or concession entity, and occasionally, the project company.

Many of the projects that have been awarded recently in Mexico include the features described above, which ultimately result in such contracts being more attractive to investors and lenders. This is the case, among others, with respect to the contracts awarded in recent long-term electricity auctions called by the Mexican power grid operator, long-term gas transport contracts awarded by Comisión Federal de Electricidad or Petróleos Mexicanos, and a number of water treatment, toll road and healthcare projects that have been awarded by state or federal concession entities under public-private schemes.

Financing structures for projects in Mexico are generally conceived as mid to long-term financings that have limited or no recourse to the project sponsors and that rely solely on the ability of the project company to generate the cash flow necessary to repay the project finance debt. Therefore, it is key to ensure that the project assets are shielded from claims of third parties, which is generally achieved by creating a security package that only benefits the project finance lenders, with limited exceptions.

Project finance transactions in Mexico require sponsors and lenders to navigate through complex regulation that varies depending on the particular industry that they relate to. A large number of these projects require a public bid or other similar administrative process, except in certain instances where unsolicited or direct awards are possible. Depending

on the particular industry that they relate to, projects need to comply in varying degrees with laws and regulations relating to power, hydrocarbons, telecommunications, transportation, health, safety, environmental, social and anti-corruption issues. Such regulations will dictate, among others, the ability of the lenders to take security on certain project assets and the challenges and risks relating to the construction and operation of the project, including as it relates to the acquisition of land rights required for the project.

Finally, it should be noted that, as a result of the Mexican Energy Reform, power, gas transport and hydrocarbon projects now need to comply with additional obligations in relation to environmental and social issues, including the need to conduct social impact assessments and consultations. These regulations are currently being implemented by the Mexican government and have proven to be significant challenges for project developers and lenders.

2. Guarantees and Security

2.1 Assets Typically Available as Collateral to Lenders

As indicated above, project financings are generally structured as limited or non-recourse transactions as it relates to the project sponsors; therefore, it is uncommon for sponsors to grant security in relation to the project financing.

An exception to the non-recourse nature of these financings is the security that project sponsors are expected to create on the shares representing the capital stock of the project company and their rights to collect on shareholder loans granted to the project company by the sponsors, both of which are generally considered part of the collateral package. In certain transactions, the lenders may also require that the sponsors provide additional credit support to the project company by way of a parent company guarantee or letters of credit to secure the contribution by the sponsors of the base equity required by the lenders.

The assets available to project finance lenders as security for the obligations of the project company will vary depending on the nature of the project itself. As a general rule, lenders expect that the project company create security on all of the assets owned by the project company in relation with the project. These assets include real estate rights, collection and contractual rights of the project company under offtake contracts or concessions, construction, operation, management, maintenance and other material project contracts, the right to receive insurance proceeds, and the ownership of project assets, including the facilities, installations and other “hard assets” relating to the projects.

Projects awarded by way of concessions allowing project companies the right to render public services, including, among others, toll roads, transmission lines and certain

telecommunications projects, generally exclude the right of the project company to own the assets used in relation to the project. Therefore, the lenders would not be able to take security on, or foreclose upon, any of such assets, which are considered to be the property of the Mexican nation.

On the other hand, the projects in the power, hydrocarbons and healthcare industries generally allow the project company to be the owner of the assets necessary to perform its obligations under the relevant contracts. Consequently, the lenders typically require that the assets owned by the project company be part of the collateral package, which assets may be subject to foreclosure and enforcement in the event of a default by the project company under the financing documents.

Depending on the nature of the project, the creation of security interests on project assets may be subject to limitations in addition to those described above, including the need to obtain authorisation by the concession authority or regulator prior to creating security on the project assets, the concession or the rights under the contract. However, concession authorities and regulators in Mexico are generally accustomed to these requests for consent since they generally recognise the need to issue such consent as a condition for financial close and commencement of construction of the project.

As a matter of Mexican law, security interests may be created through a variety of forms, the suitability of which will largely depend on the type of assets and particular characteristics of the project. Generally the benefit of the security is held by the lenders directly or, in a more common approach, through a collateral agent named by the lenders that shall act in accordance with the direction of the lenders. A description of the main forms of security interest that are used in project finance transactions and their perfection requirements is included below:

(a) Security Trust

By means of a security trust, the debtor transfers to a Mexican bank (or other financial institution in certain cases), as trustee under a trust, title to assets that are specifically identified to the trustee, to be held by the trustee as security for performance of the obligations of the debtor. The security trust allows flexibility to create security on any kind of real and personal property and is one of the most commonly used security mechanisms in project financing transactions in Mexico. Project finance lenders typically require that the majority of the project assets be contributed into the trust, provided that in relation to assets or rights that the debtor is unable to dispose title of, for example, in relation to permits and licences, the debtor is not required to transfer such rights into the trust and is expected to create security on such assets through other means.

While title to the trust assets is always held by the trustee, the parties may agree for the debtor or any third party to maintain the physical possession thereof, in which case the debtor or the third party shall be considered as depositary of the trust assets. In case of security trusts constituted over personal property, the parties may authorise the debtor to make use of the trust assets, combine or make use of them for the production of other assets, receive and use the proceeds thereof, and instruct the trustee to dispose of and transfer the trust assets in the ordinary course of the debtor's business.

Mexican law allows for the creation of security trusts to secure simultaneously or successively different obligations of the borrower with one or more creditors. In addition, the grantor of the trust may designate one or more beneficiaries to receive the benefits of the trust simultaneously or successively. The proceeds derived from the foreclosure of a security trust will be allocated to the beneficiaries in the priority of their designation as beneficiaries under the trust.

The security trust must be in writing and, subject to the value of the collateral, signatures should be ratified before a notary public. Security trusts created on real estate must be recorded with the Public Registry of Property of the jurisdiction of the place where the assets are located. Registration times and costs vary from registry to registry, and fees are generally calculated on the basis of the secured obligation, although a maximum fee is provided for in the regulations of most registries.

The perfection requirements for security trusts constituted in respect of personal property and contractual rights, vary depending on the underlying assets, but generally require notice to the relevant counterparties and registration before the Sole Registry for Security Interests on Movable Assets (*Registro Único de Garantías Mobiliarias*). Security trusts over receivables require notice to the corresponding debtor. If the trust assets include shares or other securities, the endorsement in favour of the trustee is required in addition to the registration of the security in the share ledger of the company issuing the shares. If the security trust is created in respect of other movable assets physical or virtual delivery thereof to the trustee is required for perfection.

(b) Non-Possessory Pledge

Similar to an English law floating charge, the non-possessory pledge allows the creation of a security interest on a fluctuating pool of assets, and may be created in respect of movable tangible or intangible property and covers the funds that result from the sale of the assets subject to the pledge. The non-possessory pledge may be granted over a specifically designated set of assets or as a generic or floating pledge.

As indicated above, it is not uncommon for project finance lenders to require that all assets not capable of being transferred to a security trust or that may otherwise be subject

to another type of security interest, whether by virtue of the impossibility to identify them individually or by virtue of the impracticality of obtaining authorisations from the governmental authorities that would need to authorise transfer of title to the relevant permits or authorisations pledged in favour of the lenders through a non-possessory pledge.

This blanket pledge on assets does not require that the assets be delivered to the creditor; therefore, the debtor may maintain physical possession of the property being pledged. The debtor is allowed to use the collateral as part of its manufacturing process, or to sell it within the normal course of its business activities, in which case the proceeds of the sale are subject to the pledge, provided that the right to sell collateral within the normal course of business is suspended upon notice that enforcement procedures are initiated, and provided further that collateral which represents more than 80% of the assets of the debtor may only be sold in the ordinary course of business with the prior approval of the judge or the creditor.

If the market value of the collateral drops below the outstanding amount of the secured loan and interest thereon, the creditor is entitled to obtain additional collateral. To the extent the debtor intends to sell collateral to related parties, the prior approval of the creditor is required.

The non-possessory pledge is required to be granted in writing before a Mexican notary public and is required to be recorded with the Sole Registry for Security Interests on Movable Assets (*Registro Único de Garantías Mobiliarias*). If the non-possessory pledge is created on shares, an endorsement of the shares in favour of a collateral agent as pledgee is required in addition to the registration of the pledge in the share ledger of the company issuing the shares. Similarly, any amendment made to the pledge agreement is subject to recording in the Sole Registry for Security Interests on Movable Assets (*Registro Único de Garantías Mobiliarias*) in order to be enforceable vis-à-vis third parties.

(c) Mortgage

In certain instances when it is impossible or impractical to transfer title on real estate to a security trust, security interests on real estate, including usufruct or easement rights, are commonly created through mortgages. Laws applicable to real property are of local jurisdiction, and therefore mortgages are governed by the Civil Code for the state where the mortgaged asset is located; some state laws, in addition to ordinary real estate mortgages, allow for the creation of unilateral mortgages covering real estate and movable property.

The mortgage is defined by law as “a real guarantee created on assets that are not delivered to the creditor but that grant the creditor, in the event of default of a secured obligation, the right to be paid with the value of the assets, with the preference set forth in the law”. Mortgages must be created in respect of real property that is specifically identified, and in

most of the cases, but depending on in which state of Mexico the real estate property is located, the mortgage includes (a) the natural accessions of the mortgaged property, such as the rights to any easements, (b) improvements made thereon by the owner, (c) movable objects permanently affixed to the mortgaged property by the owner and which cannot be removed without damage to such objects or property, and (d) new buildings built on the mortgaged land.

Pursuant to article 2901 of the Federal Civil Code and its correlative articles contained in the Civil Codes of the other states of Mexico, a real estate property that has been mortgaged may be subject to additional mortgages. Priority among mortgages is determined based on the date of recordation of the mortgages with the corresponding Public Registry of Property. The mortgage first recorded with the corresponding Public Registry of Property shall constitute a senior or first priority lien and the mortgages recorded thereafter shall constitute junior or second priority liens and so on.

A mortgage must be granted in writing before a Mexican notary public and recorded in the Public Registry of Property (*Registro Público de la Propiedad*) of the jurisdiction where the mortgaged properties are located. Registration times and costs vary from registry to registry, and fees are generally calculated on the basis of the secured obligation, although a maximum fee is provided for in the regulations of most registries.

The steps that are traditionally taken to grant a mortgage are (i) obtaining a certificate of liens that evidences the existence or lack of existence of liens on the property to be mortgaged, and (ii) giving, where available, a preventive notice (*aviso preventivo*) which assures the creditor (to the extent they perfect the security interest within the time periods during which such notice is effective) preference over any other notation or registration made on the property that does not show up on the certificate of liens to which such notice is attached.

To the extent the creditor taking a security interest thereon perfects the mortgage during the period the preventive notice remains effective, the mortgage will be registered prior to any other sale, mortgage, attachment or other action occurring after the date of the preventive notice. If the preventive notice is allowed to expire, or where such notice is not available, the mortgage will only have preference over registrations occurring after the registration of the mortgage.

2.2 Charge or Interest over All Present and Future Assets of a Company

As indicated in 2.1 **Assets Typically Available as Collateral to Lenders**, Mexican law provides for a non-possessory pledge that, similarly to an English law floating charge, allows the creation of a security interest on a fluctuating pool of assets, and may be created in respect of movable tangi-

ble or intangible property and covers the funds that result from the sale of the assets subject to the pledge. The non-possessory pledge may be granted over a specifically designated set of assets or as a generic or floating pledge.

2.3 Costs Associated with Registering Collateral Security Interests

The cost of creating security interests in Mexico varies on the basis of the form of security and the assets expected to be covered by such security. In many instances, such as documents evidencing security on real estate, including mortgages and security trusts, the security interests need to be formalised by way of a public deed, which needs to be issued before a notary public in Mexico. Certain other security documents, such as non-possessory pledges and security trusts that are not expected to hold real estate, may be issued by a ratification deed, also before a notary public.

The process for obtaining lien certificates, preventive notices and registering security interests in Mexico is ordinarily handled by notaries public participating in the relevant transactions, in coordination with counsel to the borrower and the lenders.

The maximum fees a notary public is authorised to charge vary depending on the state of Mexico where the notary is located and are generally based on the secured obligation; however, the notary is authorised to deviate from such maximums as a matter of negotiation with interested parties.

Security interests may need to be registered with general or specialised registries. The fees of such registries vary depending on the location of such registry and many of them have fixed and maximum fees. In other instances, fees are calculated on the basis of the transaction that is subject to registration, with a maximum amount applicable in certain registries.

2.4 Granting a Valid Security Interest

As indicated in **2.1 Assets Typically Available as Collateral to Lenders**, security interests created by way of mortgages and security trusts require that the relevant assets be specifically identified as a requirement to granting such security. The non-possessory pledge allows the creation of security on specifically identified assets, on all assets of the pledgor or on a specific generic set of unidentified assets.

2.5 Restrictions on the Grant of Security or Guarantees

As indicated in **2.1 Assets Typically Available as Collateral to Lenders**, certain assets and rights may be inconsistent with a certain type of security interest under Mexican law. Generally, assets that the borrower is entitled to dispose of freely would be subject to any security interest freely agreed to among the borrower and its creditors.

Permits and governmental authorisations generally do not allow transfer of title from the original permit-holder without an authorisation from the issuing authority, which is in many instances impractical or impossible. Also, the assignment to a security trustee or creation of security on contract rights may require consent from the relevant counterparty if such restriction is set out in the document governing the relevant contract rights. In these instances, the non-possessory pledge is a suitable alternative to act as a defensive device that prevents such assets from being pledged to another creditor, provided that enforcement thereof may be limited by the need to obtain authorisation as a condition to the sale or foreclosure on such contract rights.

2.6 Absence of Other Liens

In order to verify the existence of liens on companies or assets, lenders may need to conduct searches in a number of registries depending on the relevant assets. A search in the online-based Sole Registry for Security Interests on Movable Assets (*Registro Único de Garantías Mobiliarias*) would identify whether a company has granted security on movable assets owned by that company at a federal level. However, certain security interests are not required to be registered in such registry.

In relation to lien searches relating to real estate, it shall be necessary to conduct a lien search in the public registry of property of the jurisdiction where the real estate is located. Although most registries are being updated to digital files, certain registries continue to conduct a ledger-based registration, which may result in delays in conducting the searches.

2.7 Releasing Typical Forms of Security

Release of security interests is typically conducted by way of the execution of a release agreement which needs to follow the same formalities as those required for the creation of security, including notarisation and registration in the relevant registry. Please note that as a general proposition, security interests are subject to the terms of statute of limitations of the main obligations that they relate to.

3. Enforcement

3.1 Secured Lender Enforcing its Collateral

Prior to enforcement on security in Mexico it is necessary to provide evidence that the secured obligations have been breached. This may be particularly cumbersome in instances where the secured obligations are incurred pursuant to financing documents governed by laws other than Mexican law, since it may be necessary to enforce the relevant foreign judgment in Mexico prior to commencement of the enforcement action on the security interest. A description of the legal provisions and steps for enforcement in relation with the main forms of security interests that are used in project finance transactions in Mexico is included below:

(a) Security Trust

The security trust may be foreclosed through a judicial proceeding that is essentially the same as the judicial foreclosure proceeding set forth with respect to the non-possessory pledge.

Mexican law allows for the parties to agree to a non-judicial enforcement proceeding pursuant to which the trustee will sell the trust collateral to satisfy the secured obligations, provided that the parties should include minimum rules in the procedure, which, among others, include (i) that the non-judicial foreclosure shall begin upon written notice made by the beneficiary to the trustee, (ii) that the trustee shall notify receipt of the foreclosure request to the grantor, and (iii) the ability of the grantor to oppose foreclosure by evidencing payment or the extension of the term for payment.

(b) Non-Possessory Pledge

A non-possessory pledge may be foreclosed by means of a non-judicial proceeding or a judicial proceeding. The judicial proceeding is similar to the mortgage foreclosure proceeding described below in that, once the debtor is found to be liable to pay the secured obligation, the court carries out, through an appraiser, a valuation of the assets subject to the pledge and proceeds to the public sale thereof with a progressive reduction in the price of such assets until definitively sold.

The non-judicial proceeding begins with the formal requirement made by the pledgee requesting delivery by the pledgor of the pledged assets. Following the delivery of the pledged assets, the pledgor may proceed with the sale of the assets, prior notice having been given to the pledgor. It should be noted that the law allows for certain flexibility in relation to the non-judicial proceeding, which is a matter of contract. However, certain minimum requirements must be met in order to prevent challenges from the pledgor in relation to the enforcement proceeding. Such minimum requirements include (i) the designation of an appraiser acceptable to both parties to determine the price of the pledged assets, (ii) the requirement to provide written notice to the pledgor of an event of default, together with a request to deliver possession of the pledged assets in order to continue with the foreclosure proceeding, and (iii) and the ability of the pledgor to oppose foreclosure by evidencing payment or the extension of the term for payment.

It should be noted that an opposition by the pledgor in relation to the delivery of the pledged assets will result in the non-judicial proceeding being abandoned and the right of the pledgee to commence judicial foreclosure proceedings.

(c) Mortgage

Foreclosure under a mortgage requires a judicial proceeding to be followed before the competent courts of the jurisdiction where the mortgaged property is located.

Once the proceeding is initiated on the basis of claim relating to the default of the secured obligation, the court is required to issue a mortgage proceeding statement (*cedula hipotecaria*) which shall be recorded with the corresponding Public Registry of Property as notice to third parties in order to prevent any attachment or sale of the mortgaged property during the proceeding.

Once the court resolves that the mortgage is to be foreclosed upon, the court commences the enforcement procedure which commences with an appraisal by an independent appraiser as to the value of the property. Once such value is determined, the court conducts a public sales process which involves progressive reductions of the appraisal price until the property is sold.

The proceeds of such sale are applied to the payment of the secured obligation. To the extent that the mortgage was created to secure obligations with several creditors, the proceeds from the sale of the mortgaged assets shall be allocated to such secured creditors following the order of priority of their respective mortgages.

3.2 Upholding Foreign Law

As a matter of Mexican law, the choice of foreign law to govern agreements is valid and such choice would be recognised by Mexican courts upon enforcement. However, a choice of foreign law may not be valid if it is selected to avoid the application of Mexican principles of public policy, or if it is chosen for fraudulent purposes. Please note that security documents created on assets located in Mexico or governed by Mexican law, must be created pursuant to Mexican law and a choice of a foreign law to govern such agreement would not be valid.

In addition, except in relation to disputes relating to the Mexican subsoil, airspace and territorial sea, in respect of which the Mexican courts have exclusive jurisdiction, the parties to an agreement may validly submit to the jurisdiction of foreign courts as long as the parties to the relevant agreement clearly and definitely waive the jurisdiction that the law affords them and designate as competent courts any courts of the domicile of the parties, the place where the obligations under the contract are expressed to be performed, or the place where the assets are located. It should be noted that such submission must benefit all parties to the agreement and must be exclusive; therefore, submission clauses that allow a party to seek remedies in any other jurisdiction of its choosing would not be recognised.

3.3 Judgment Without Retrial

A judgment issued by a foreign court will be recognised and enforced by the courts of Mexico, without re-examination on the merits, if the following requirements are fulfilled:

- the judgment is obtained in compliance with the legal requirements of the jurisdiction of the court rendering it, and

in compliance with all the legal requirements set out in the relevant agreement;

- the judgment does not contravene Mexican law, the public policy of Mexico, international treaties binding on Mexico, or generally accepted principles of international law;
- service of process was made personally on the debtor or on a duly appointed process agent;
- the applicable procedure under the laws of Mexico with respect to the enforcement of foreign judgments, including issuing a letter rogatory by the competent authority of the jurisdiction requesting enforcement of the judgment, and the certification of the judgment as authentic by the relevant authorities of the jurisdiction in accordance with their laws, is complied with;
- the judgment is final in the jurisdiction where it is obtained;
- the action in which the final judgment is rendered is not the subject matter of a lawsuit among the same parties pending before a Mexican court; and
- the courts of the non-Mexican jurisdiction contained in the relevant agreement would enforce Mexican judgments as a matter of reciprocity.

Similarly, Mexican courts will recognise and enforce a foreign arbitration award without re-examination on the merits unless:

- a party to the arbitration agreement proves that it was affected by disability, or that the agreement is not valid under the law to which the parties have submitted, or if anything has been expressly addressed in the matter, under the law of the country in which the award was rendered;
- the party against whom enforcement is sought was not duly notified of the appointment of an arbitrator or of the arbitration procedure, or was unable, for any other reason, to protect their rights;
- the award relates to a dispute not covered by the arbitration agreement or contains decisions that exceed the terms of the arbitration agreement;
- the procedure was not followed accurately under the agreement between the parties, or in the absence of an agreement, that they did not follow the law of the country where the arbitration took place;
- the award is not yet binding on the parties or has been cancelled or suspended by the judge of the country where the award was issued; or
- the judge finds that, according to Mexican law, the dispute is not subject to arbitration, or the recognition or enforcement of the award is contrary to public policy.

3.4 Other Matters Impacting a Foreign Lender's Ability

In the event that foreign law financing documents are the subject matter of a dispute before a Mexican court or if enforcement of a foreign judgment thereunder is sought before the courts of Mexico, a Spanish language translation will need to be delivered in the course of such action.

Depending on the type of project and project contracts, it may be necessary for the main offtake contracts to be registered with budgetary or administrative authorities, in particular if such documents are considered to be long-term payment obligations of certain governmental authorities.

Documents evidencing real estate rights and, in certain state jurisdictions in Mexico, leases, require registration in the public registry of property to which each real estate corresponds.

Security documents entered into in relation to project financings must be filed with the corresponding public registries in order for such security interests to be enforceable with respect to third parties and to establish priority and ranking of the security interest. Such registration requirements vary on the basis of the type of security granted and the asset that is intended to be part of the collateral package. Please refer to **2 Guarantees and Security** for a description of such registration requirements.

4. Foreign Investment

4.1 Restrictions on Foreign Lenders Granting Loans

Mexican law does not restrict foreign lenders from granting financing to private parties in Mexico and no foreign exchange controls or restrictions are currently in effect in Mexico. The section **8 Tax** describes the provisions of Mexican law governing payments of interest by Mexican parties to foreign lenders and repatriation of dividends by foreign investors in Mexican companies, as they are relevant to project financing transactions.

It should be noted that the incurrence of debt by government entities and the states and municipalities in Mexico is the subject of specific regulation, including the restriction applicable to the states and municipalities of Mexico to incur debt with foreign lenders. However, project finance transactions are seldom, if ever, structured in a way that requires that the government entities awarding contracts incur debt directly and rather involve granting financing to private entities that are obligated to perform under concessions or contracts awarded to them by government entities.

4.2 Restrictions on Foreign Lenders on Granting of Security or Guarantees

Foreign lenders are generally able to take security on assets located in Mexico, under the forms described in **2 Guarantees and Security**. As such, foreign lenders are commonly named beneficiaries of such security interests, whether directly or, in the more common structure, through a Mexican or foreign collateral agent that acts as directed by a majority of the financing parties.

Notwithstanding the above, please note that pursuant to Mexican law, only Mexican banks are authorised to act as security trustees; however, such security trustees act for the benefit of the beneficiaries of the security trust, who may be foreign lenders. Also, please note that certain specific forms of security are reserved to Mexican banks, such as the industrial mortgage (*hipoteca industrial*), which is not described in this chapter considering that such form of security is not commonly used in project finance transactions involving foreign lenders in Mexico.

4.3 Foreign Investment Regime

The provisions of Mexican law governing foreign investment have been gradually and progressively liberalised from an economy that was largely closed to foreign investment at the end of the 1990s through today. As such, foreign investment has been increasingly allowed to participate freely in the ownership and operation of projects in Mexico, with a few remaining restrictions and regulations.

Currently, the Mexican nation continues to consider as matters reserved for the Mexican nation, the exploration and extraction of hydrocarbons, the generation of nuclear power, mining of radioactive minerals, planning and control of the national electric grid, and electric power distribution and transmission. In addition, certain sectors of the telecommunications industry continue to be reserved to the Mexican nation.

Foreign and private investment has been allowed to participate in sectors reserved to the Mexican nation and to benefit from the rights to concessions and authorisations in relation to natural resources through schemes that protect ownership of certain assets in favour of the Mexican nation and which are supervised and regulated closely by the Mexican government. Such schemes include concessions, licences and services contracts that may be awarded to companies with foreign investment subject to certain restrictions and that allow the ownership, use and disposition of such assets. Such limitations include the agreement by companies having foreign investors that any foreign investor, upon becoming a member of such company, shall agree that it shall be treated as a Mexican national in relation to its investment and shall not invoke protection of its government of origin in the event of disputes with the Mexican nation.

The Mexican Foreign Investment Law also prevents foreign investment from participating in more than 49% of the capital stock of entities conducting certain activities that may be relevant to the infrastructure industry. Particularly, the administration of port facilities, internal navigation and certain port services are the few remaining activities that fall within this category.

Consequently, the vast majority of activities that may be of interest to foreign investors and lenders in the project finance sector are now open to foreign investment. These ac-

tivities include power generation, construction and maintenance of electric transmission lines, hydrocarbons transport, storage, exploration, drilling and related services, toll road construction, operation and maintenance, telecommunications, railways, social rehabilitation and healthcare.

Considering the needs of Mexico in relation to infrastructure generally, the Mexican government has increasingly maintained tax incentive programmes, including customs and trade benefits, that seek to encourage foreign investment in projects located in Mexico. Such programmes enable the importation of foreign equipment with preferential tax rates and also the temporary importation of certain assets.

Following the liberalisation of the Mexican economy and its gradual and progressive opening to foreign investment, Mexico is now a party to a significant number of bilateral treaties governing the mutual protection of investments which include provisions governing the customary investment principles and protections that include most-favoured nation clauses, protections from expropriation and actions tantamount to expropriation, release of limitations to transfers of funds, and dispute resolution mechanisms. Currently, such treaties exist, among others, with Germany, Argentina, Australia, China, Korea, Denmark, Cuba, Spain, Finland, The Netherlands, Panama, Portugal, the Czech Republic, Trinidad and Tobago, Belgium, Uruguay, India, Iceland, Greece, Switzerland, Sweden, Austria, France, Italy, Spain, Slovakia and the United Kingdom of Great Britain and Northern Ireland.

Mexico is also a party to a number of bilateral and regional free trade agreements that provide for preferential treatment in relation to customs and trade issues. These agreements also include provisions governing the protection of investments made in Mexico by foreign entities, similar to the investment treaties described above. Currently, the main examples of these free trade agreements include the North American Free Trade Agreement with the United States of America and Canada, which is currently subject to a renegotiation process and has resulted in the agreement in principle of a new trade agreement between the United States of America and Mexico, and the Free Trade Agreement among Mexico and the Members of the European Union.

4.4 Restrictions on Payments Abroad or Repatriation of Capital by Foreign Investors

There are no restrictions under Mexican law in relation to the transfer of funds abroad or the repatriation of capital by foreign equity investors; however, it should be noted that interest payments under shareholder loans and the repatriation of funds intended to be carried out by way of payments of dividends or capital reductions may be subject to withholding tax, capital gains taxes and tax on dividends pursuant to the Mexican Income Tax Law, in accordance with the provisions of the applicable international treaties for the

avoidance of double taxation entered into by Mexico and the country of residence of the relevant foreign parent company.

4.5 Maintenance of Offshore Foreign Currency Accounts

Mexican companies are permitted to maintain accounts in foreign currency abroad, which is commonly a requirement of project finance lenders particularly as it relates to debt reserve and payment accounts.

5. Structuring and Documentation Considerations

5.1 Registering or Filing Financing or Project Agreements

Financing documents are not required to be filed or registered with a governmental authority in order for such documents to be valid or enforceable. However, in the event that foreign law financing documents are the subject matter of a dispute before a Mexican court or if enforcement of a foreign judgment thereunder is sought before the courts of Mexico, a Spanish language translation will need to be delivered in the course of such action.

Project contracts generally are not required to be filed or registered with governmental authorities in order for them to be enforceable or valid. However, depending on the type of project and project contracts, it may be necessary for the main offtake contracts to be registered with budgetary or administrative authorities, in particular if such documents are considered to be long-term payment obligations of certain governmental authorities.

Documents evidencing real estate rights and, in certain state jurisdictions in Mexico, leases, require registration in the public registry of property to which each real estate corresponds. In addition, following the Mexican Energy Reform, contracts entered into for the use or occupation of real estate for hydrocarbon exploration, production and transport projects and electric power projects that require a specific location due to their technology, such as geothermal or hydro power projects, need to comply, prior to registration with the relevant public registry, with a court validation process that has proven to be time-consuming and challenging. Such court validation process is aimed at ensuring that the provisions in the Mexican Hydrocarbons Law protecting the rights of the owners and communities affected by these projects are complied with. Such provisions include matters of prior consultation, due consideration and information in relation to the intended project.

Security documents entered into in relation to project financings must be filed with the corresponding public registries in order for such security interests to be enforceable with respect to third parties and to establish priority and ranking of the security interest. Such registration require-

ments vary on the basis of the type of security granted and the asset that is intended to be part of the collateral package. Please refer to **2 Guarantees and Security** for a description of such registration requirements.

5.2 Licence Required for Owning Land or Natural Resources

No licences are required in order to hold ownership of land in Mexico, provided that the ownership of land in border regions is limited to Mexican nationals and corporations. According to the Mexican Federal Constitution, natural resources belong to the Mexican nation; therefore, individuals require governmental authorisation, licensing or concessions as a condition for their use, ownership or exploitation. Such authorisations cannot be held directly by foreign entities, but they may be held by corporations having foreign investment subject to the provisions of the Mexican Law on Foreign Investment.

Currently, the Mexican nation continues to consider as matters reserved for the Mexican nation, the exploration and extraction of hydrocarbons, the generation of nuclear power, mining of radioactive minerals, planning and control of the national electric grid, and electric power distribution and transmission. In addition, certain sectors of the telecommunications industry continue to be reserved to the Mexican nation.

Foreign and private investment has been allowed to participate in sectors reserved to the Mexican nation and to benefit from the rights to concessions and authorisations in relation to natural resources through schemes that protect ownership of certain assets in favour of the Mexican nation and which are supervised and regulated closely by the Mexican government. Such schemes include concessions, licences and services contracts that may be awarded to companies with foreign investment subject to certain restrictions and that allow the ownership, use and disposition of such assets. Such limitations include the agreement by companies having foreign investors that any foreign investor, upon becoming a member of such company, shall agree that it shall be treated as a Mexican national in relation to its investment and shall not invoke protection of its government of origin in the event of disputes with the Mexican nation.

5.3 Recognition of Agent and Trust Concepts

The trust concept is widely recognised and utilised in Mexico, as described in more detail in **2 Guarantees and Security**. The agent concept is not applicable pursuant to Mexican law; however, Mexican law includes concepts having similar effects as they relate to the ability of a party to appoint a representative to act on its behalf with limited or general authority.

5.4 Rules Governing the Priority of Competing Security Interests

Pursuant to Mexican law, priority on security interests and recordable rights generally follows the “first come, first served” approach. As such, in case a security interest requiring registration is not recorded in a timely fashion, there is a risk that a competing or prior lien may be recorded. In addition, please note that the tax, labour and social security claims may have a preference on claims except to the extent that such claims have a specific real security, such as a mortgage or a pledge.

Considering the transfer of title that occurs by creation of a security trust, the assets transferred to the security trustee to secure obligations of a project company are generally considered to be beyond the reach of other creditors of the project company, except if such transfer is considered to be fraudulent in the context of an insolvency proceeding. As such, beneficiaries to a trust may freely establish priority among themselves as it relates to the distribution of the trust assets upon enforcement.

In relation to claims that are not secured by a security trust, a real security interest, such as a mortgage or pledge, or that do not otherwise have a specific ranking, such as tax, labour or social security claims and rights of retention on specific assets, Mexican law recognises contractual subordination provisions which are generally upheld by insolvency and bankruptcy courts.

5.5 Requirements of Local Law

Most project finance transactions involve a special purpose company that is typically required to be a company incorporated pursuant to the laws of Mexico with a corporate purpose limited to the execution of the relevant project. This requirement is often embedded in the bid requirements issued by contracting or concession entities and commonly refers solely to the creation of a Mexican mercantile corporation.

The most common forms of mercantile corporations for projects and businesses in Mexico generally is a limited liability company, organised as a *sociedad anónima de capital variable* (“SA”), which is a stock corporation, the interests of which are evidenced by share certificates, or as a *sociedad de responsabilidad limitada* (“SRL”), which is a partnership, the interests of which do not need to be, and are normally not, documented, and may only be transmitted by assignment. A variation of the SA is the *sociedad anónima promotora de inversión* (the “SAPI”) which is also a stock corporation but has a regulation allowing more flexibility in relation to shareholder matters and the creation of preferred shares. The “variable capital” feature is a modality that allows flexibility in the increase and reduction of the variable portion of the corporate capital, as long as the minimum portion remains untouched. All of the forms described above may adopt this feature in order to increase or reduce the variable capital of the company in a more expedited fashion.

All the corporate forms described above are generally suitable to conduct projects and have very similar characteristics from a business and managerial standpoint. The selection of one corporate form over another commonly responds to tax considerations of the sponsors and in some instances the requirements of the bidding guidelines. In particular, in transactions with investors from the United States the SRL has been preferred considering the similarity to a partnership.

6. Bankruptcy and Insolvency

6.1 Availability and Practice of Company Reorganisation Procedures

The Mexican Commercial Insolvency Law (*Ley de Concursos Mercantiles*) provides for a sole insolvency proceeding applicable to mercantile companies in Mexico. Such proceeding is denominated *concurso mercantil* and encompasses two successive phases: a conciliatory phase of mediation among creditors and debtor, and a bankruptcy phase. The objective of the conciliatory phase is to preserve or save the business enterprise through a restructuring or reorganisation agreement. The stated purpose of the bankruptcy phase is to liquidate the business, as a whole or by sale of its individual assets, in order to repay its creditors.

As a general rule, insolvency may be declared if the debtor has ceased to comply with its payment obligations. The petition may be filed by the debtor or by creditors holding at least 35% of obligations payable by the debtor. Unless the debtor proves that it maintains sufficient assets to comply with its payment obligations, a declaration of insolvency would be accepted by the courts if the debtor ceases to pay two or more of its creditors and (a) the debtor ceases to pay its obligations that have been due for at least 30 days and represent 35% or more of all obligations payable by the debtor on the date the insolvency petition is filed, and (b) the debtor has no liquid assets or if there are insufficient assets for purposes of paying at least 80% of the debtor’s obligations that are due and payable on the date the petition is filed.

The key procedural events of a conciliatory stage, in summary, are as follows: (approximate terms being pointed out in parenthesis): (i) filing before a federal court, (ii) acceptance of filing (within day 10), (iii) appointment of a visitor (within day 21), (iv) judgment declaring insolvency (within day 80); (v) appointment of conciliator (within day 85); (vi) judgment recognising creditors and establishing preferences (within day 145); (vi) restructuring agreement (within day 365). If on day 365 a restructuring agreement is not accepted by the creditors or the conciliator, the conciliator shall move into the bankruptcy stage and commence the liquidation of the business. The bankruptcy stage may begin prior to the expiration of the period indicated above if the debtor requests such bankruptcy to commence or if the conciliator determines that a reorganisation or restructuring is not possible. Creditors may also demand that the bankruptcy stage

commence at an earlier time, but considering the nature of the commercial insolvency proceeding, such requests are rarely granted.

Once the judge has made the declaration of insolvency, the judge will appoint a conciliator and issue a judgment recognising creditors and establishing preferences. During the conciliatory stage, the debtor will maintain the administration although the conciliator or mediator may request the court for the removal of the administration. If no restructuring agreement can be reached bankruptcy will be declared.

6.2 Commencement of Insolvency Processes Impacting Lender's Rights

Following the acceptance of the insolvency filing, the court may order measures aimed at conserving or saving the business. Such measures may include a court order preventing the filing of attachments or the enforcement of rights against assets of the debtor. During the conciliatory stage, all obligations of the debtor shall be considered due and payable; however, creditors would generally be prevented from seeking attachment or enforcement of rights against the debtor.

The Commercial Insolvency Law establishes provisions that are designed to protect the monetary value of creditor loans. All peso-denominated obligations are converted into inflation-linked units; foreign currency-denominated obligations are converted into pesos at the prevailing rate of exchange on the date the insolvency judgment is rendered, and then converted into such inflation-linked units. Only claims with a perfected security interest will be maintained in their original currency or unit of account, and will continue to accrue interest, but only to the extent of the value of the collateral.

Considering the transfer of title that occurs by creation of a security trust, the assets transferred to the security trustee to secure obligations of a project company are generally considered to be beyond the reach of other creditors of the project company, except if such transfer is considered to be fraudulent in the context of an insolvency proceeding. As such, beneficiaries to a trust may freely establish priority among themselves as it relates to the distribution of the trust assets upon enforcement.

6.3 Payment Order to Creditors on a Company's Insolvency

If a reorganisation agreement is reached, creditors would be paid in accordance with the provisions of such agreement. Generally, a reorganisation agreement shall require the consent of recognised creditors representing more than 50% of the total recognised amounts corresponding to unsecured and secured or privileged creditors, in addition to agreement by the debtor. Any such agreement, with the prior validation of the insolvency court, shall become binding on all creditors and the insolvency proceeding shall be considered final and concluded.

If a reorganisation agreement is not agreed to within the time periods provided for in the insolvency law, the proceeding shall move to the bankruptcy phase and the court shall order the liquidation of the debtor. Such liquidation may take some time and shall involve the sale of the assets of the debtor to repay its creditors up to the amount of the amounts recovered. The commercial insolvency law provides for the following ranking in relation to payments due by the debtor upon liquidation:

- (1) Privileged creditors:
 - (a) Labour (2 year wages and severance);
 - (b) Applicable to individuals (comprises funerary costs and medical expenses);
- (2) Secured creditors, which includes creditors holding a valid mortgage or pledge interest, up to the amount of the value of the relevant security interests;
- (3) Creditors with a particular privilege:
 - (a) Tax;
 - (b) Labour (other than 1(a) above);
- (4) Unsecured creditors; and
- (5) Subordinated creditors, subject to the contractual provisions in the relevant agreements entered into by such creditors.

6.4 Risk Areas for Lenders

Lenders are exposed to the inherent risks of any commercial insolvency proceeding, including as they relate to procedure and failure to appear in the proceedings within the legal time periods for the recognition of their respective claims. Lenders may also face the risk of recovering less than the full amount owed to them if the assets of the insolvent are insufficient to cover the whole of its obligations, subject to the rankings described in the immediately preceding section. Finally, the lenders would be exposed to the risk of inability to recover the full amount of their debt in case of a foreclosure of any security interests granted to them and being required to recover the balance from the assets of an insolvent entity as unsecured creditors.

In addition, upon a declaration of insolvency, agreements entered into with the debtor prior to the petition could be declared as not effective against the insolvent estate and be set aside if they are determined to constitute acts defrauding creditors (*actos en fraude de acreedores*). Under Mexican law, acts defrauding creditors (*actos en fraude de acreedores*) would include (a) acts carried out by the debtor prior to the declaration of *concurso mercantil*, knowingly defrauding creditors, (b) gratuitous acts carried out within the period when insolvency is presumed to have begun, which as a general rule is a period of 270 calendar days prior to the judgment declaring insolvency (the "retroactive period" (*fecha de retroacción*)), (c) acts and dispositions carried out within the retroactive period, in respect of which the debtor

paid a consideration notoriously higher in value or received a consideration notoriously lower in value when compared with the consideration paid or received by its counterparty, (d) transactions carried out by the debtor within the retroactive period on terms or conditions significantly outside then prevailing market conditions or commercial practices or custom, (e) forbearance of debts carried out by the debtor within the retroactive period, (f) payments by the debtor of unmatured obligations within the retroactive period.

Under Mexican law, acts that would be presumed to constitute acts defrauding creditors (*actos en fraude de acreedores*) would include granting security or increasing existing security within the retroactive period, when the original obligation did not provide for the grant or increase of such security, and transactions against the estate (*masa*) of the insolvent carried out within the retroactive period by specifically listed related parties, in each case unless the creditor can prove that it acted in good faith.

6.5 Entities Excluded from Bankruptcy Proceedings

As a general rule, the Mexican Commercial Insolvency Law applies in relation to the insolvency of mercantile corporations. Such law provides for special proceedings applicable, among others, to Mexican banks that become insolvent.

Generally, the Mexican government and entities thereof are not subject to insolvency; however, certain state-owned enterprises, including Comisión Federal de Electricidad and Petróleos Mexicanos, may be subject to liquidation pursuant to the terms of the laws creating such enterprises.

7. Insurance

7.1 Restrictions, Controls, Fees and/or Taxes on Insurance Policies

Project finance lenders generally require that project companies carry insurance to cover their operations and activities, subject only to the risks that are insurable in the Mexican market. To that end, it should be noted that pursuant to Mexican law, risks within the territory of Mexico may only be insured, through a policy primary, by insurance companies authorised to operate in Mexico, provided that such insurance companies may enter into reinsurance policies with foreign reinsurers. Please note, however, that the validity of cut-through clauses in reinsurance contracts has been strongly debated since such clauses are viewed to be contrary to the underlying principle that risks in Mexico must be insured by Mexican insurers.

The policies that the lenders commonly require in project finance transactions in Mexico include all-risk coverage during construction, property and equipment insurance and loss of revenue insurance during the operation period

of the project. Third party liability coverage is also required during both construction and operation.

It should be noted that non-invalidation clauses contemplated in insurance policies that are issued by Mexican insurers are not valid under Mexican law. Under the Insurance Contract Law (*Ley del Contrato de Seguro*), insurance companies can oppose payment of an insurance claim if it proves that the insurance policy was issued based on false or inaccurate representations made by the insured. Waiver of this provision by the insurer is null and void.

7.2 Payable Insurance Policies over Project Assets to Foreign Creditors

Lenders require that the insurance proceeds under policies other than third party liability insurance form a part of the collateral package created to secure the financing. This is commonly documented by designating the security trustee, if such security mechanism is implemented, as loss payee or additional insured. In instances where a security trust is not part of the collateral package, the insurance policies are commonly pledged in favour of the lenders and the collateral agent and the lenders receive such designation as loss payees or preferred beneficiary. Upon payment of the insurance proceeds, the lenders would have the right to direct the application of such proceeds towards reconstruction, in whole or in part, of the damaged project assets, or towards repayment of the financing obligations.

8. Tax

8.1 Payments to Lenders Subject to Withholding Tax

Pursuant to the Mexican Income Tax Law, foreign creditors and holders of debt securities issued by Mexican residents are subject to tax on interest payments made by debtors resident in Mexico. Such taxes are payable by way of a withholding that is required to be made by the Mexican debtor that results in payment to the Mexican tax authorities directly by the debtor. Debtors incurring debt with foreign lenders are also required to comply with certain information requirements with the Mexican tax authorities, as necessary to determine the applicable withholding rate and the compliance with the tax obligations by the lenders subject to such tax on interest payments.

Withholding tax rates applicable to interest payments made abroad vary from 4.9% to 40% and depend on the identity and tax residence of the relevant lender. In addition, it may be possible that a treaty for the avoidance of double taxation exists between Mexico and the host country of the relevant creditor, which may result in a reduced withholding rate. Interest payments to export credit agencies and certain multilateral and regional development lenders are exempt from withholding taxes.

Considering the above, it is not uncommon for financing documents in international project financing transactions to include provisions requiring the debtor to make payment of increased amounts necessary for the lenders to receive the full amount of interest that they would have received had such withholdings or deductions not have been made. Such provisions are valid under Mexican law; however, the net effect thereof is the cost of financing for a debtor is increased.

8.2 Taxes, Duties, Charges or Tax Considerations Relevant to Lenders

Although there are no restrictions under Mexican law in relation to the transfer of funds abroad or the repatriation of capital by foreign equity investors, it should be noted that interest payments under shareholder loans shall also be subject to the withholding taxes described above. In addition, if the repatriation of funds is intended to be carried out by way of payments of dividends or capital reductions, capital gains taxes and tax on dividends may apply pursuant to the Mexican Income Tax Law, subject to the provisions of the applicable international treaties for the avoidance of double taxation entered into by Mexico and the country of residence of the relevant foreign parent company.

In addition to withholding taxes applicable to interest payments, and capital gains and dividend taxes payable in respect of repatriation of dividends, no significant taxes apply to the activities of foreign lenders of investors in their lending activities. However, please note that state or local taxes have been implemented in relation to projects in a specific industry which may reduce the profitability of such projects.

8.3 Usury Laws or Other Rules Limiting the Amount of Interest Charged

As a general proposition the determination of interest payable by a borrower is not subject to a maximum or minimum limit, since financings are considered to be transactions among sophisticated entities that do not require protection in terms of usury or balancing laws. However, transfer pricing provisions should be considered to the extent interest payments are not in line with market terms and conditions, since failure to set interest rates in line with the market may result in claims from the Mexican tax authorities.

It should be noted that pursuant to Mexican law, the collection of interest on interest is prohibited; therefore, claims in relation to amounts corresponding to ordinary or overdue interest on interest amounts would not be recognised. How-

ever, the parties do have the right to agree to capitalise any amounts corresponding to interest and incorporate them as part of the principal amount on which ordinary interest would accrue.

9. Applicable Law

9.1 Law Typically Governing Project Agreements

Project agreements are generally entered into pursuant to Mexican law. This applies particularly in relation to offtake contracts and concessions granted by Mexican government entities. Security documents in relation to assets located in Mexico and documents relating to land rights and insurance are also required to be governed by the laws of Mexico.

Certain project agreements, such as construction, operation and maintenance, equipment supply and similar project level agreements, may be entered into pursuant to laws of jurisdictions other than Mexico or pursuant to Mexican law. The decision in relation to applicable law in relation to such agreements is a matter of negotiation among the project company and its respective counterparties and the choice of foreign law to govern such agreements is valid and recognised pursuant to Mexican law subject to limited exceptions, including rules relating to transfer of ownership of assets located in Mexico which require that contracts are entered into pursuant to Mexican law.

9.2 Law Typically Governing Financing Agreements

The main financing documents in project finance transactions may be entered into pursuant to Mexican law or foreign law. As indicated previously in this chapter, in projects that allow for payments of currency other than Mexican currency or that are sponsored by international companies, it is not uncommon for documents to be governed by the laws of New York or England; however, certain Mexican and international development and commercial lenders have accepted financing documents pursuant to Mexican law.

9.3 Matters Typically Governed by Domestic Law

Project agreements are generally entered into pursuant to Mexican law. This applies particularly in relation to offtake contracts and concessions granted by Mexican government entities. Security documents in relation to assets located in Mexico and documents relating to land rights and insurance are also required to be governed by the laws of Mexico.

10. Islamic Finance

10.1 Development of Islamic Finance

Currently there are no provisions in Mexico governing Islamic finance.

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