
THE MERGERS & ACQUISITIONS REVIEW

SIXTH EDITION

EDITOR
SIMON ROBINSON

LAW BUSINESS RESEARCH

THE MERGERS & ACQUISITIONS REVIEW

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THE MERGERS & ACQUISITIONS REVIEW

Sixth Edition

Editor
SIMON ROBINSON

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EDITOR'S PREFACE

Deal-making has remained on the agenda in the past year, although the first half of 2011 showed a stronger performance than the second half, which saw a significant fall in transactional activity. In the wake of continuing economic uncertainty, opportunities for acquisitions remain limited to companies and institutions on a stable financial footing. At the same time, corporates are beginning to focus on their core business and looking for ways to return value. Valuations remain favourably low for purchasers, and the prospect of striking a bargain makes cross-border M&A attractive for those who can afford it. While access to the loan market has remained difficult, cash-rich corporations have begun to swing the balance in their favour. Shareholder participation and a desire for control and accountability are on the rise, and an atmosphere of increased regulation, reform and austerity is building. We remain in a state of geopolitical flux, and these factors continue to complicate the global economic scenario. The period of widespread unrest in the Middle East and North Africa seems to be reaching a settled conclusion, although the situation in Syria (and possibly Mali and Sudan) is still volatile. A number of countries have seen fresh elections and a transition of leadership, including France and Russia, and a change of leadership in China is expected following the 18th National People's Congress this autumn, when the US presidential elections will also take place. The sovereign debt crisis and the ongoing uncertainty over the fate of the eurozone are further contributing to the lack of confidence in the markets.

All is not doom and gloom, however, and whereas the global picture remains difficult, there are signs of hope. The emerging markets have shown a persistent growth in outbound investment, spurred on by a desire to build a more prominent global presence and for the purpose of accessing new markets. European targets remain of interest to both US and Middle and Far-Eastern buyers. Inbound investment from the emerging markets into both Africa and Australia is on the rise, and this has strengthened activity in the energy, mining and utilities sector. The technology, media and telecoms sector has also shown signs of promise with some high-profile deals, and must be watched with interest in the coming year. There is hope that, as political and economic factors

stabilise, M&A activity will once more gather pace and momentum, and enter a new era of resurgence. We shall see.

Once again, I would like to thank the contributors for their continued support in producing this book. As you read the following chapters, one hopes the spectre of the years past will provide a basis for understanding, and the prospect of years to come will bring hope and optimism.

Simon Robinson

Slaughter and May

London

August 2012

Chapter 39

MEXICO

Aarón Levet V and Alberto Solís M¹

I OVERVIEW OF M&A ACTIVITY

Mexico continues as a promising market for mergers and acquisitions. Despite the adverse publicity announcing a general lack of security, interest in investing in Mexico by multinational companies has been increasing every year, confirming that publicity is, in some cases, simply a matter of perception. The natural uncertainty of an election year may have an impact on M&A trends during 2012, which will likely stabilise once the results of the election are announced.

Its geographical location, the stability and strength of its financial system, the number of free trade agreements executed with other countries, a favourable legal environment and a stable democracy are some of the main factors that investors have taken into consideration when investing in Mexico. The negotiations for a free trade agreement with Brazil and for a new trading block with Chile, Colombia and Peru, as well as the recent invitation extended to Mexico to become party to the Trans-Pacific Partnership Agreement are clear signs of the confidence that foreign investors have in the Mexican market and its economy.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The Mexican legal regime applicable to M&A transactions is relatively flexible and generally allows the parties to structure transactions according to international custom and practice; however, because of our civil law system, particular formalities should be observed in all M&A transactions.

¹ Aarón Levet V is a partner and Alberto Solís M is a senior associate at Santamarina y Steta S.C.

Mexico does not have a specific M&A statute. The following laws and regulations apply to M&A transactions in general: the Mexican Constitution, the General Law on Business Organisations, ('the Corporations Law'), the Foreign Investment Law ('the LIE'), the Securities Market Law ('the LMV'), the Federal Anti-Trust Law ('the Anti-Trust Law'), the Federal Labour Law ('the LFT'), and the Industrial Property Law, to mention a few. There are other laws that are relevant depending on the specific sector involved.

Notwithstanding the wide variety of laws that may apply, one of the most important considerations for a foreign acquirer is the foreign investment legal regime that applies to the business activity in which the entity to be acquired participates. Under the LIE, the participation of foreign investors and Mexican corporations in which foreign investors participate in certain activities is either forbidden or restricted to a certain percentage or, in some cases, requires prior authorisation from the Mexican government, although the number of activities in which foreign investment is restricted or prohibited has decreased through the years.

The LIE defines foreign investment as the participation of foreign investors or by Mexican companies with a majority of foreign capital, in any proportion, in the capital stock of Mexican companies and participation of foreign investors in activities and acts specified in the LIE. Except as provided in the LIE and its Regulations, foreign investors may participate in any proportion in the capital stock of Mexican companies, acquire fixed assets, participate in new economic activities or in the manufacture of new product lines, open and operate facilities, and expand or relocate those already existing.

On transactions that exceed the assets threshold provided by the LIE (approximately 2.9 billion Mexican pesos in accordance with the threshold published in the Official Gazette of the Federation on 6 July 2011), irrespective of the economic activity, the prior authorisation of the National Commission of Foreign Investments is required if the foreign investor plans to participate, directly or indirectly, in more than 49 per cent of the Mexican company.

The different forms of organisation of business entities in Mexico are governed by the Corporations Law, which is federal in nature and applies throughout the country.

The *Sociedad Anónima* ('SA') and the *Sociedad de Responsabilidad Limitada* ('SRL') are the most common investment vehicles used by domestic and foreign investors, based on the possibility to centralise, in principle, all liabilities in the company, being the liability of the shareholders or partners limited to the amount of their contributions to the corporate capital of the company. The SRL, which is regarded as a US partnership for US tax purposes, has become the most popular vehicle for US investors.

The SA and the SRL may be organised under the modality of 'Variable Capital', allowing for increases or reductions of the corporate capital with more flexibility.

The LMV contemplates a variation to a SA called *Sociedad Anónima Promotora de Inversión* ('SAPI'), which grants to its shareholders broader flexibility in certain business decisions, such as the issuance of shares with no voting or with different voting rights, the possibility to include a different treatment among the shareholders regarding the distribution of dividends or other economic rights, and limitations to the veto or first refusal rights to certain classes of shares.

Subject to any tax structure, this vehicle is highly recommended in transactions with different groups of investors.

In the real estate sector, the *Sociedad de Inversión en Bienes Raíces* ('Sibra') is a vehicle that may offer certain tax benefits, mainly to investors in the commercial real estate industry. Sibras are organised under the Corporations Law (which also can be incorporated as SAPIs). Subject to certain specific rules, practically all of its capital shall be, directly or indirectly, invested in real estate assets in Mexico.

Although rarely used (due to tax and other contractual implications), a branch of a foreign corporation and the joint venture agreements should also be mentioned as investment vehicles available under Mexican law.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

At the three levels of government, Mexico has been making continued efforts aimed at fostering growth and development in the economy and at the same time elevating the standards of behaviour of key players.

On 16 January 2012, the Congress published the Public–Private Associations Law ('the LAPP'), to regulate the participation of the private sector, Mexican or otherwise, in the construction and operation of electricity plants, hospitals, schools, hydraulic facilities and prisons, thus rendering services to the Mexican government. The main purpose of this law is to allow the private sector to finance and operate infrastructure, as opposed to merely constructing it for subsequent operation by the government, helping to reduce governmental budgetary restrictions or limitations that have affected the construction and operation of basic infrastructure. It is anticipated that the LAPP will help to accomplish the objectives of the National Infrastructure Programme 2007–2012, set the basis for the programme to be issued by the next president and, consequently, to expand the number of M&A transactions in Mexico. Other federal laws related to or connected with the subject matter of the LAPP were simultaneously amended.

The amendments to the Anti-Trust Law enacted on April 2011² and correlative amendments to the Federal Criminal Code, the Federal Tax Code and other ancillary legal provisions are of significant relevance for M&A transactions.

The Corporations Law was amended, effective as of 1 January 2012, to expressly allow an indefinite duration for all mercantile corporations and removal of the minimum capital requirements, in an effort to modernise some of the main features of Mexican corporations.

The Regulations to the Federal Law for Protection of Personal Data in Possession of a Person were published on 21 December 2011, thus facilitating the implementation

2 Increasing penalties for violations of the Anti-Trust Law, contemplating that absolute monopolistic practices are considered a criminal offence sanctioned with imprisonment penalties, incorporating the concept of 'joint substantial power in the relevant market' as two or more economic agents that jointly trigger the 'substantial power' concept provided in the Anti-Trust Law, as well as pre-emptive measures, such as the suspension of specific acts are now available in cases where it is considered that irreversible damage could be caused to the competition process.

of the provisions of the law to properly warrant the privacy and the right of self-determination over personal data.

During 2011, *Petróleos Mexicanos* carried out the first bids of the new incentive contracts for the exploration and production of oil by private investors in the Santuario, Magallanes and Carrizo fields, located in the state of Tabasco, which were successfully awarded, the first two to a British consortium and the third to a Mexican company. This new approach will certainly attract new M&A transaction in the energy sector as *Petróleos Mexicanos* publishes new bids.

Structured equity securities ('CKDs') – long-term structured investment instruments issued by a trust (a Mexican bank) and quoted in the Mexican Stock Exchange – constitute an attractive vehicle for Mexican pension funds to accelerate the flow of funds to infrastructure projects, or to private capital funds, real estate and energy projects, and are expected to help increase M&A projects in the years to come.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Preliminary reports for 2011 reflect that foreign direct investment ('FDI') into Mexico amounted to approximately \$19.44 billion. This amount was distributed mainly between five different fields (1) 44 per cent in the manufacturing industry; (2) 18 per cent in financial services and insurance; (3) 9.5 per cent in general commerce; (4) 6.4 per cent in construction industry; and (5) 5.7 per cent in information and media. The remaining 16.3 per cent was split between other different activities and industries, including hotels, restaurants, and professional, technical and personal services.

As a result of the various tax and free trade agreements executed by Mexico, FDI during 2011 coming from the United States was the most represented with 55 per cent of the total, followed by Spain (15 per cent), the Netherlands (6.7 per cent), Switzerland (6.3 per cent), Canada (3.4 per cent), Japan (3.4 per cent) and other countries (12.21 per cent).

Comparing the total FDI that entered Mexico during 2010 (\$18.68 billion) the amount that entered during 2011, there was an insignificant increase; however, it is interesting to notice the changes in the main players (in 2012 the main investor was the Netherlands) and the new players coming into the picture, such as Switzerland and Japan. Eventually, the Trans-Pacific Partnership Agreement may help to increase not only Japanese investments but also the number of players in the Mexican market.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

One of the most representative M&A transactions that concluded in 2011 in Mexico was the merger of two Mexican banks, *Grupo Financiero Banorte SAB de CV* and *IXE Grupo Financiero SAB de CV*. Also, other M&A transactions concluded during 2011 have been of interest due to the impact that they may have on different local and international markets, such as the co-investment agreement between *Mexichem Derivados SA de CV* and *Pemex Petroquímica*, for the development and growth of different plants in south-east Mexico, as well as the acquisition of *Grupo Aeroportuario del Pacífico* by *Grupo México, SAB de CV*.

The first months of 2012 have been active as regards M&A transactions, the most important being the participation of Televisa in the corporate capital of Iusacell, one of the most important cellular phone providers, owned by TVAzteca. Televisa and TV Azteca are the most predominant television networks in Mexico and also in the rest of the Americas.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

There are no special requirements to finance M&A transactions in Mexico, and general requirements apply, such as thin capitalisation rules and arm's-length transactions with related parties. The financing part of an M&A transaction is of the utmost importance and the negotiation of the financing is therefore a key element both with the counterparty and with the creditor. Most likely, the funds that the Mexican pension funds has received from their activities invested through CKDs will constitute an important financing component in M&A transactions.

In most of the M&A transactions carried out in Mexico involving financing, the funds for the acquisition come from foreign sources. Despite the tax effects deriving from contracting a loan with a foreign entity, there is a credit shortage in the Mexican market, in addition to the fact that the interest rates that Mexican banks offer are still high compared with other sources, thus financing from abroad is still prevalent. Interest payments to non-Mexican residents are subject to a reduced tax rate of 4.9 per cent during 2012 for financial institutions complying with certain requirements and registration, or higher rates depending on the nationality and tax residence of the recipient of the interest payment.

VII EMPLOYMENT LAW

When doing business in Mexico, a comprehensive assessment of our labour and social security laws, as well as of the collective and individual labour relationships, compensation requirements and other employment-related contributions and taxes is of the essence. The LFT regulates the relationships between employer and employee, between unions, employees and employers, as well as the activities of the labour authorities. The Social Security Law regulates employer, employee and government participation in the various federal social-benefit programmes through the Mexican Social Security Institute. The Workers' Housing Fund Law regulates employer, employee and government participation in the Institute of the National Fund for Employees' Housing.

There are alternatives to administer and manage the effect of the statutory profit sharing to workers, which need to be evaluated on a case-by-case basis.

An M&A transaction involving the acquisition of shares would not impose any legal obligation *per se* on the acquiring entity as the acquired entity will continue to be primarily responsible for the compliance in terms of labour matters, and employees or unions will not usually have any special rights as a result of the transaction. It is not common to have change-of-control provisions triggering special rights under individual or collective employment agreements, and the LFT certainly does not grant any special rights in this case either.

If the M&A deal is contemplated as an acquisition of assets, the employees may begin working for the acquiring entity either with their prior labour rights in place (e.g., seniority, benefits) or not, in which case a new labour relationship would commence. If the acquiring entity is not expected to assume the labour obligations and contingencies, the existing labour relationship would need to be previously terminated by entering into termination agreements with the employees, which must be ratified before the labour boards to be enforceable. As part of the termination process, the employer would have to grant the employees the statutory severance payments (or the amount that is agreed in lieu) to legally terminate the employment relationship. Thereafter, the acquirer may retain the employees under the conditions agreed with them. If the acquiring entity is expected to assume the labour obligations, the most efficient manner to carry out the transfer of the employees would be through a substitution of employer procedure whereby the acquirer as the new employer only has to notify the employees that, effective as of a certain date, the employees will be employed by the acquirer. The employees do not have to consent to said procedure, and would not be entitled to a severance payment if the new employer respects and recognises their rights and terms of employment. With respect to unionised employees, the union must be notified of any change, which in turn will notify the unionised employees.

In this scenario, the prior employer will be jointly liable with the new employer for compliance with obligations and liabilities that arose prior to the employer substitution for a period of six months.

Aspects related to the participation of labour organisations or unions require adequate 'collective planning' in order to achieve employment stability, a proper labour environment and eventually allow the business to apply its own working principles and practices. In new businesses, the employees' desire to become organised generally as a consequence of the company's exposure to external factors, such as union intervention, which has forced employers to look to preventive solutions. It is always recommendable to have a relationship with a union that shares the labour vision of the employer, regardless of the number of employees in a determined entity.

To avoid baseless union intervention, employers normally approach unions rather than waiting for the union to approach the company. Union selection must be based on several circumstances including: location of the facility, industry sector and level of education of employees required for unionisable positions, size of the work force and experience of other businesses of the same industry, among others. Meetings with the top leadership of the different available organisations to define their interest to participate in the project under the company's standards are highly advisable. In anticipation, it is recommendable to study the target unions.

For many years now, there have been discussions in Congress regarding amendments to the labour legal framework in Mexico; however, no substantial progress has been achieved due to the distinct positions that each political party holds in this respect. Labour legislation in Mexico has a significant political component. In any event, it is not anticipated that any such amendments will change the form in which an employer needs to structure its labour strategy or in which labour issues will be addressed in an M&A transaction, or both.

VIII TAX LAW

Tax planning is essential to the success of any business venture. For most trans-national business planning, federal income tax is first on the list of taxes to consider. Currently, the income tax is at a rate of 30 per cent, a rate that will be reduced to 29 per cent in 2013 and to 28 per cent in 2014. Depending on the nature and needs of a particular business, other taxes may become relevant such as value added tax ('IVA'), import duties, social security and housing contributions, payroll taxes, and real property transfer taxes.

Business planners should also be aware of the flat tax, an alternative minimum tax to the federal income tax, and an excise tax on certain goods and services.

It is generally necessary to consider the following taxes:

- a* IVA at 16 per cent (applicable in general) and 11 per cent (applicable in the border region).
- b* Cash deposits tax ('the IDE') at the rate of 3 per cent applicable to deposits in cash carried out with the same bank institution in excess of 15,000 Mexican pesos during a single month. This tax applies also to deposits made in US dollars or any other currency above the aforesaid amount equivalent to 15,000 Mexican pesos.
- c* A special tax for products and services, at the rate of 3 per cent (with specific exemptions).
- d* Real estate transfer taxes, which, despite varying depending on the location of the property, usually is of an amount equal to 2 per cent of the greatest of (1) the purchase price, (2) the cadastral value of the properties, and (3) its market value as determined in an appraisal.

Mexican commercial banks to freeze bank accounts immediately on receipt of a request from the Tax Administration Service Authority, which is also authorised to request taxpayers' information from the Insurance and Bonds National Commission and the Retirement Savings System Commission.

Tax implications deriving from M&A transactions should be carefully reviewed and evaluated.

The following tax aspects are relevant to non-Mexican acquirers.

i Share transactions

The transfer of shares (or equity participations) issued by a Mexican entity is considered a taxable event, and income arising from such transfer is considered Mexican source income for the transferor. The acquisition of shares of a Mexican entity is not taxed for the acquirer provided the acquisition is carried out at a fair market value. If the acquirer is a foreign entity with no permanent establishment in Mexico, no withholding obligation applies to the acquirer either. There are, of course, tax considerations that apply to the acquisition of a Mexican entity. However, in general terms, a foreign private acquirer of a Mexican entity is not required to make any tax payment or withholding solely due to the acquisition of shares of a Mexican entity.

ii Asset transactions

In the acquisition of moveable items, the acquirer is required to pay IVA, with the exception of export transactions. As for the acquisition of real estate, a municipal tax applies throughout Mexico payable by the acquirer upon the signature of the title documents before a notary public. The applicable tax rate varies depending upon the municipality, but in most parts of Mexico the tax rate is around 2 per cent. Typically, tax is applied upon the highest of the sale price, the appraised value and the cadastral value of the property. The transfer of land is IVA exempted but IVA for the value of the constructions applies.

All real properties must be acquired through a purchase and sale agreement, executed in the form of a public deed and granted before a Mexican notary public and filed for registration with the respective Public Registry of Property. It is customary that all related costs for the acquisition of a real property (notarial and appraiser's fees, registration duties and associated expenses) are paid by the acquirer. In certain specific transactions it is possible to defer the payment of these taxes and transfer them to the final acquirer of the property by the use of a trust agreement.

IX COMPETITION LAW

In 2011, the Federal Antitrust Commission ('the CFC') issued approximately 161 resolutions regarding concentrations, of which 15 were filed in the last months of 2010 and the rest during 2011 and it is expected that 2012 will conclude at least in a similar trend.

As mentioned in Section III, *supra*, amendments were enacted on April 2011 to the applicable legal framework, and during 2011 the CFC has imposed one of the higher fines for not complying with the provisions of the Anti-Trust Law, in the amount of 11.99 billion pesos, imposed on Radiomovil Dipsa (Telcel), one of Carlos Slim's companies.

The Anti-Trust Law requires prior notice to be given to the CFC of any concentration that exceeds any of the following thresholds:

- a* if the price of the overall transaction (regardless of where it occurs, as long as it has a direct or indirect impact in Mexico) is greater than the equivalent of 18 million times the daily wage ('DW');
- b* if the overall transaction entails the accumulation of 35 per cent or more of the assets or shares of an economic agent, the value of whose assets or sales in Mexico is greater than the equivalent of 18 million times the DW; or
- c* if two or more economic agents take part in the transaction, and:
 - whether separately or together, the value of their assets or annual sales volume is greater than the equivalent of 48 million times the DW; and
 - the transaction entails an additional accumulation of assets or capital stock in Mexico greater than the equivalent of 8.4 million times the DW.

The concentration notice must be filed before any of the following events occurs: (1) the legal act is completed under applicable law or, if applicable, the condition precedent to the act is met; (2) an economic agent acquires or exercises *de facto* or *de jure* control, directly or indirectly, over other economic agents or trust interests, equity participations

or shares of other economic agents; (3) the parties sign a merger agreement; or (4) if the concentration involves a succession of acts, the act that, when completed, results in the concentration exceeding the aforementioned threshold amounts.

If any of these events occurs outside Mexico, the economic agent must file the notice before the event has legal or material effects in Mexico.

The CFC has 35 calendar days (plus an additional 40 calendar days in exceptionally complex cases) to examine the concentration and determine whether to approve, conditionally approve or disallow it, based on a duly founded resolution. The aforementioned terms may be reduced to 15 calendar days if it is evident that the transaction will not have a negative effect on competition and this is shown by the parties. If the CFC fails to act within that period, the Anti-Trust Law deems the concentration approved. If the CFC imposes conditions, they must be proportional to and directly linked to correcting the effects of the concentration, and the notifying parties may request the CFC to consider proposals from the parties before rendering its decision.

The general rule is that the agents need not wait for the CFC to issue a resolution to be able to close the transaction. Therefore, the parties may proceed with the closing after the filing has been made unless the CFC issues a 'stop order' within 10 business days. In this case, the transaction may not be closed until the CFC issues its resolution.

Once the CFC has expressly authorised a concentration, third parties cannot challenge the concentration unless they can prove that the CFC based its resolution on false information. For a concentration that does not require prior notice, the CFC or any interested party may raise a challenge within a year of the date the concentration occurred.

The Anti-Trust Law vests the CFC with significant powers to prevent, punish, and deter anti-competitive conduct. With respect to a concentration, in addition to imposing a substantial monetary fine, the CFC may order the total or partial divestiture of the result of a wrongful concentration.

X OUTLOOK

The stability that the Mexican economy has demonstrated during these years of worldwide financial crisis, together with the new legislation on public-private associations, the Pemex 'incentive contracts' and others that are expected to be implemented in the near future, should attract investment into Mexico. Additionally, the turmoil affecting some of the larger world economies in Europe has shifted attention to emerging markets with solid economies.

The uncertainty that presidential campaigns bring are close to an end, so it is anticipated that once the next president is elected, the M&A market will resume its previous trend. The three main candidates have announced the need to expand investment in infrastructure, as well as the need of other structural legal reforms. New competitors in the television industry and other players in the telecommunications sector are also expected.

Another relevant fact that must be considered by investors is that according to their campaigns, all candidates for Mexico's presidency are highly focused on the development of infrastructure in roads, railways, harbours, airports, telecommunications, potable water

and sewerage, irrigation and flood control, electricity, hydrocarbon production, and oil and gas refining; where is an emphasis on the amounts to be allocated on hydrocarbon production, electricity, oil refining, gas and petrochemicals and roads, a situation that should be taken into account by any entity or individual that is interested in carrying out investments in Mexico.

Also, the new global financial situation and the increasing costs in the Asian market, in addition to the transport difficulties, has resulted in a more active US–Mexico border, with some companies that had previously moved their maquila and service production to the east returning to this commercial meeting point, mostly due to the tax and financial incentives offered by many local governments.

Appendix 1

ABOUT THE AUTHORS

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Aarón Levét has been with Santamarina y Steta since 1980, and became a partner of the firm effective 1 January 1990. Mr Levét obtained his law degree (licentiate) in 1983 from the Universidad Nacional Autónoma de México and is licensed and admitted to practise law in México. His professional practice is focused on tourism, hospitality, finance and M&A sectors, representing Mexican and non-Mexican clients in México and abroad with regard to Mexican issues.

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