MEXICO

Law and Practice

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1. Project Finance Panorama

1.1 Recent Trends and Developments

Project finance has been one of the preferred financing methods for large-scale projects in Mexico since the late 1990s. During the past five years, project finance facilities have grown exponentially as a result of the enactment of the Mexican energy reform (2013), which opened the energy industry to private investment. However, since Andrés Manuel López Obrador (AMLO) took office (2018) there has been a significant rollback of this energy policy.

AMLO's new policy seems to somewhat disincentivise new private energy projects in Mexico, making it more difficult for sponsors to have access to non-recourse traditional project finance facilities. Although, this new policy does not seem to include any specific amendments to the existing legal framework applicable to project finance facilities. Notwithstanding the foregoing, by disincentivising private investment in energy projects, growth in other infrastructure non-energy-related projects may be expected.

Sponsors and developers for both energy and non-energy-related projects continue to seek alternative, non-traditional ways in which capital (equity) and debt may be raised from different players in the Mexican and international markets, including Mexican pension funds (*Administradores de Fondos para el Retiro*, or AFORES), Mexican banks, foreign financing entities and even private placements (which are subject to Section 4(a)(2) safe-harbour and 144A bonds placed under the United States Securities Act of 1933).

Other type of schemes would include public and private placements of project or refinancing debt, equity and structured notes (FIBRAS, CKDs and CERPIS), and non or partial recourse project debt, all of which represent significant developments in the projects market in Mexico.

1.2 Sponsors and Lenders

The institutions that typically act as sponsors and lenders are many and include most of the players also involved in project financing in other developed markets and jurisdictions. The specific institutions will vary on a case-by-case basis and according to the specific project finance deal involved, considering – among other matters – the type and industry of the project, and the risks involved, including legal, commercial and political risks.

Sponsors in Mexico can be private and public entities, either Mexican or foreign, including, corporations, funds, and government bodies (ministries and its agencies such as the National Energy Control Centre (CENACE), the National Hydrocarbons Commission (CNH), the Federal Electricity Commission (CFE), and Petróleos Mexicanos (PEMEX)). From a lending perspective, the usual actors are:

- domestic and international commercial banks, participating individually or as a syndicate;
- development banks, both domestic and international;
- import/export agencies and entities; and
- private funds and investors through public and private placements of debt, equity, structured notes and bonds (FIBRAS, CKDs and CERPIS) as well as other schemes.

1.3 Public-Private Partnership Transactions

As a general rule, public-private partnerships are regulated by the Public-Private Partnerships Law (*Ley de Asociaciones Publico Privadas* or PPP Law), enacted in 2012 (note that PEMEX, CFE, CNH and other similar government entities have their own regulatory framework that governs their public-private partnerships). The PPP Law provides structures for the development of public-private partnership projects under the principles of the Mexican Federal Constitution. Such principles include efficiency, effectiveness, economy, transparency and honesty in the satisfaction of the objectives for which the economic resources of Mexican federal entities, municipalities and other agencies are destined under the relevant PPP.

Regulated PPPs are those that aim to establish a long-term contractual relationship between public entities and private actors, for the provision of services to the public sector.

The provisions of the PPP Law are applicable to the PPPs carried out by agencies and entities of the Federal Public Administration, certain federal public trusts, constitutionally autonomous federal entities, and other federal and municipal agencies using federal resources, with certain conditions and exceptions.

PPPs are developed through a PPP contract, which is a long-term agreement, between a public sector institution and a private sector one, through which the latter will provide a public service and build (or improve), finance, equip, operate, maintain and keep, for a certain time, the necessary infrastructure for the provision of that public service, in exchange for a consideration form the public sector. The public sector has the task of specifying the performance standard to be met by the person attached to the public service and/or infrastructure related to that service. The individual person receives a consideration for the provision of the contracted service. The rights of the developer under the PPP contract may be granted or assigned as collateral or under a security interest in favour of lenders and third parties under the terms and conditions indicated in the PPP contract itself, which will include approval from the contracting agency or entity.

It should be noted that the development of federal law-based PPPs may need to consider other laws and regulations (in addition to the PPP Law), by reason of the governmental agency or entity involved and the specific PPP being developed.

Quite a few Mexican states and municipalities have enacted local PPP laws. Such local PPP laws generally follow the same structure and principles of the PPP Law and will apply to PPPs awarded at state and municipal level.

1.4 Structuring the Deal

There are a number of issues that must be considered when considering the structure of a deal:

- the type of project;
- properly understanding and outlining the source of payment for the debt;
- the entities involved in the project; and
- the regulatory framework that applies to the industry of the specific deal or project.

A strong, clearly defined and streamlined source of payment for the debt could be one of the more challenging issues to solve when structuring the deal.

The entities involved (governmental authorities and agencies, sponsors, lenders, contractors, suppliers, among others) have different interests and are willing to assume different risks. Therefore, when structuring a deal, the risk assessment and transfer among the parties is of paramount importance.

Other relevant issues that need to be considered are tax; environmental, social and anthropological matters; health and safety; planning and execution schedules; AML and anti-corruption provisions and compliance; sources of financing; funding alternatives; land and community relations; co-ordination of the external advisors of the project; and social and political risk.

Funding Techniques

The typical funding techniques are:

- the classic project finance structure (ie, loan agreement with usual collateral structure, including a security trust agreement);
- project bond financing;
- equity; and
- a mix of the above, as further described in this document.

Please note that green loans may imply additional requirements.

2. Guarantees and Security

2.1 Assets Available as Collateral to Lenders

Pursuant to Mexican law, different security agreements and structures are available to create a security interest over multiple asset types and classes. The type of asset; its availability and legal form; and other factors such as whether the asset is regulated, requires third-party approval for creating a security interest over it and other characteristics, will typically determine the form and extent of the security instruments that are eventually formalised to secure lenders.

Trusts, Pledges and Mortgages

Typical security instruments to create security over collateral under Mexican law include trusts (*fideicomisos*), non-possessory pledges, (*prendas sin transmisión de posesión*), regular pledges (*prendas*) and mortgages (*hipotecas*).

A *fideicomiso* is generally used when the intention is to create a general security encompassing all or a substantial part of the relevant project assets. However, depending on the relevant project assets, it may be necessary (or advisable) to enter into ancillary security agreements for specific assets (ie, over shares or equity, mortgages over land in certain specific scenarios (ie, tax driven) or other specific assets of the project company or companies). Generally, under a *fideicomiso*, the project companies, sponsors or security providers will transfer title of assets (ie, land, plants, project assets, collection rights, insurance proceeds, contracts, shares or equity) to a trustee, who is a Mexican bank or financial entity authorised to act as trustee, with the purpose of securing payment and performance obligations of the project companies, sponsors and/or obligors towards the relevant lenders, who will be the principal beneficiaries of the *fideicomiso* (directly or through an agent).

Depending on the type of *fideicomiso*, and the assets involved, certain formalities for incorporating, operating and transferring assets to it may apply. The *fideicomiso* is commonly used and regarded as a security control scheme in Mexican project financing because it is generally understood to be a bankruptcy remote vehicle. It is also common to use specific security agreements for specific assets, instead of, or in conjunction with, a *fideicomiso*. This generally happens:

- when using a *fideicomiso* is not viable, advisable or cost-effective from a legal, contractual or business perspective for the particular project being financed;
- where a *fideicomiso* cannot cover all of the assets intended to comprise the security for the project lenders; or
- where a number of different assets or security providers participate in granting the relevant security.

Among these forms of security agreements, the most commonly used are the *hipoteca* over real estate, and *prendas* with or without transfer of possession over movable assets, rights and other benefits, but there can be additional possibilities in specific agreements when structuring type specific asset security.

Perfection Formalities

All of these forms of security arrangements are governed under Mexican law and will require certain formalities to be completed for them to be perfected. Generally, the procedure to create and perfect a typical *fideicomiso* over real property involves designating the relevant assets to be held in trust, appointing a trustee, entering into the relevant *fideicomiso* agreement and formalising it before a Mexican notary public, transferring the relevant assets to the trustee and, finally, registering the *fideicomiso* at the applicable public registry of property and the Sole Registry of Movable Security (*Registro Único de Garantías Mobiliarias* or RUG). Please bear in mind that additional formalities may or may not be required depending on the assets that are to be held in trust (ie, regulatory permits or contractual consents).

The standard procedure to create a mortgage over real property is to enter into a mortgage agreement with the title holder, to formalise it before a Mexican notary public, and to register the mortgage at the applicable public registry of property.

Movable assets (ie, machinery, equipment and other tangible and intangible assets) are typically secured under a *fideicomiso* structure or a *prenda*, with or without transfer of possession structure. The procedure to incorporate and perfect the *fideicomiso* is fundamentally the same as that described above, but please note that because movable assets are involved, the *fideicomiso* would be registered at the RUG. The general procedure to create and perfect a pledge without transfer of possession involves identifying the assets subject to the pledge, entering into a pledge without transfer of possession agreement and formalising such agreement before a Mexican notary public, and electronically registering the pledge at the RUG. As with the *fideicomiso*, additional formalities may or may not be required, depending on the nature or status of the assets that shall be collateralised (ie, regulatory permits or contractual consents). A regular *prenda* is usually incorporated by private contract and, where the asset being pledged requires further formalities for the pledge to be enforceable and perfected (ie, shares of equity interests), it may need to be registered in corporate ledgers, endorsed or else, to complete the applicable formalities. A regular *prenda* would typically not require registration at the RUG as a formality, but there are instances where such registration is sought.

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

As mentioned in **2.1 Assets Available as Collateral to Lenders**, a *fideicomiso* is generally used when the intention is to create a general security agreement encompassing all, or a substantial part, of the relevant project assets. As also mentioned, another form used when either the *fideicomiso* is not available, or when it cannot cover all available assets, or as a matter of securing any future assets of the relevant project companies is the *prenda sin transmisión de posesión* (non-possessory pledge).

2.3 Registering Collateral Security Interests

In most cases where security is granted, the participation of a notary public is required in order to perfect the security interests being created (ie, security over real estate, guarantee trusts and asset pledges without transfer of possession). In other cases, although not legally required for perfection, it may be advisable to ratify security documents with a notary public. Notarial fees are variable and will depend on the type of document or security interest being notarised; these fees are topped out in most cases but can be high (although, in large transactions or when topped fees are high, notaries can, and typically will, grant fee discounts).

Registration fees are associated with security registration at public registries for security over real estate assets. All security over real estate assets must be registered at the local public registry of property for the security to be perfected and opposable to third parties and fees will also vary greatly from state to state. In most cases, registration fees are also topped out by local authorities, but in some cases special discounts may apply when the security is associated with benefits for the locality or state (ie, infrastructure, investment, etc). In cases where the real estate assets are subject to or regulated under agrarian or other specific laws, registration or filing at other specific registries may be necessary.

While registration of security over assets other than real estate, such as receivables, machinery, equipment and similar assets will typically be required (depending on the type of security being created), documents evidencing security over these movable assets are electronically registered at the RUG and there is no fee payable for such a registration (although associated notarial costs may apply).

It should be noted that in addition to the above, in some other cases and in certain local jurisdictions, additional taxes or fees may apply on perfection and/or registration of agreements and of security.

2.4 Granting a Valid Security Interest

Whether each item of collateral needs to be individually identified, or whether a general description will suffice to grant a valid

security interest, will depend on the type of security document being used to create a lien over the relevant asset. In a *fideicomiso*, the assets do need to be precisely identified because they are actually transferred in trust property to the relevant trustee. Under a prenda or a hipoteca if the assets being pledged are specific (ie, equity interests, plots or land) they do need to be individually identified. However, under a *prenda sin transmisión de posesión*, if it is intended that the collateral be formed by all or a substantial part of the assets of the relevant pledgor, they can be generally identified without specific description.

2.5 Restrictions on the Grant of Security or Guarantees

Under Mexican law there are no general restrictions on the creation of security over assets owned by a person. Restrictions derive from either the specific type of asset or right intended to be secured or granted as collateral, from the legal or regulatory limitations that may apply to the person or entity intending to grant such collateral as security, or from contractual or third-party limitations. In project finance transactions, typical limitations on the creation of security over assets of the company involve the need to obtain regulatory approval in connection with creating or granting security over permits, concessions, procurement contracts, licences and other regulated assets (such as pipelines, water treatment plants, power plants, mining properties), or over companies or entities that use, procure, manage and/or operate such assets, or that will normally require prior governmental approval to create security over them (or, at best, prior notice to the relevant authorities).

2.6 Absence of Other Liens

As mentioned in **2.3 Registering Collateral Security Interests**, liens are generally subject to registration at public registries, whether federal or local. Some liens, though, may not require public registration but rather recording in the relevant grantor's books or ledgers. For this reason, to confirm absence of other liens on a typical project finance transaction a lender will typically require that

- a search is performed in all public registries where the collateral would be or should be registered (ie, public registries and RUG); and
- lender's and/or borrowers' counsel perform direct due diligence on the assets and the project companies to confirm any existing or recorded liens that are not publicly available.

2.7 Releasing Forms of Security

The general principle for security interests and granting of liens in Mexico is that the security interests follow the consequences of the secured obligation. This means that if the secured obligation ceases to exist, the security interest and liens over the collateral created to secure that obligation should automatically also cease to exist upon termination of the secured obligation.

However, when a release of collateral is agreed, and even when the secured obligation ceases to exist, the general rule is that the unwinding or release of security is made in the same manner in which the security was created, which will generally be through a full or partial termination and release agreement, and the consequent registration of the termination and release in the applicable public or company registries. Please note, though, that depending on the type of asset or entity, there may be additional actions to be taken prior to, at or upon release of a security interest, including, among other matters, contractual approvals or notices, regulatory clearances and/or notifications, and other potential actions.

3. Enforcement

3.1 Enforcement of Collateral by Secured Lender

Enforcement and foreclosure procedures will depend on the type of security interest and the collateral being enforced. In most of these procedures, there can be injunction procedures that can directly impact the enforcement as well as the timing and cost of enforcement.

Foreclosure of a mortgage or a regular pledge will normally require a summary judicial procedure that would ultimately result in public auctions to sell (or transfer) the collateral as payment to the lenders. For non-possessory pledges and guarantee trusts, it is possible to choose between a judicial or a non-judicial procedure. As for regulatory consents, typically the same consents required for the creation of a security will apply to its foreclosure (especially if the receiver or buyer of the assets is not the same entity as that which requested the original consent), but in many cases the original consent would cover the ability to foreclose on the assets, subject in some cases to prior notice being given to the relevant authorities. Also, enforcement can be significantly affected in the case of a reorganisation or bankruptcy under applicable law.

3.2 Foreign Law

For contracts that do not need to be granted under or governed by Mexican law, a choice of foreign law as the governing law of a contract will be upheld in Mexico.

3.3 Judgments of Foreign Courts

Submission to a foreign jurisdiction is legally binding and enforceable, so long as certain requirements are met when submitting to that foreign jurisdiction (ie, that the matter subject to jurisdiction is not exclusive to the Mexican courts – such as in real estate matters, that the choice of jurisdiction is not solely

for the benefit of one of the parties but, instead, for all of the parties, and that the parties have unequivocally waived their corresponding jurisdiction).

Judgments rendered by foreign courts, pursuant to a legal action instituted before any such court, are enforceable in the competent courts of Mexico, to the extent that the formalities set forth (ie, personal service of process, non-contravention of Mexican law or public policy principles and reciprocity). Mexican courts have the legal obligation to recognise contractual submission of disputes to international arbitration, as well as international arbitral awards, subject to the compliance of procedural and formal requirements under the Mexican Commerce Code and applicable international treaties. Disputes arising from antitrust, bankruptcy, property law, labour and criminal law, tax and administrative law are not arbitrable.

Please note that enforcement of an arbitral award could be denied if, among other reasons:

- one of the parties to the arbitration agreement did not have adequate or sufficient legal capacity to enter into that arrangement, or the arrangement is not valid under the laws chosen by the parties;
- service of process is not correctly and legally completed;
- the award refers to a controversy which, under the terms of the arbitration agreement, was not subject to arbitration or contains a decision that exceeds the terms of that arbitration agreement;
- the subject matter of the arbitration procedure cannot be arbitrated, or the enforcement of the award is contrary to Mexican law, Mexican public policy, international treaties or agreements binding upon Mexico; or
- the award is not final in the jurisdiction where obtained.

3.4 A Foreign Lender's Ability to Enforce

The same restrictions applicable to foreign investors or creditors on owning or operating the project and related companies will apply to foreign investors or creditors in the event of a foreclosure. Please see **4 Foreign Investment** for more information.

4. Foreign Investment

4.1 Restrictions on Foreign Lenders Granting Loans

Financing agreements and documents where the lender or main group of lenders are Mexican financing entities will typically be governed by Mexican law, but loan documents and offshore security documents in which the lender or main group of lenders are offshore entities or are funded through foreign resources will typically be governed and construed under foreign law (such as, in many cases, New York or English law). However, there are a few items that need to be reviewed by foreign lenders when discussing granting a loan for a project in Mexico such as the application of withholding taxes (please see **8.1 Withholding Tax**) and the consequences of foreclosure in connection with the eventual ownership of project assets, permits or rights, which may be limited to foreign investors (please see **4.2 Restrictions on the Granting of Security or Guarantees to Foreign Lenders** and **4.3 Foreign Investment Regime**).

4.2 Restrictions on the Granting of Security or Guarantees to Foreign Lenders

In general terms, the granting of security or guarantees to foreign entities is not restricted. However, the holding or control of entities or assets by foreign lenders or parties as a result of enforcement or foreclosure of security interests may be restricted as a result of foreign investment regulations. Please see **4.3 Foreign Investment Regime** for more information on these restrictions.

4.3 Foreign Investment Regime

Mexico allows 100% foreign ownership of companies and projects in most areas and sectors, and there are multiple bilateral investment treaties and free-trade agreements to which Mexico is a party, which protect foreign investment (ie, the United States–Mexico–Canada Agreement or USMCA). However, there are still a few sectors where foreign investment is partially restricted or totally banned.

Ownership restrictions only apply to restricted sectors, which either:

- reject the participation of foreign investors in specific sectors; or
- merely limit the participation of foreign investors in specific sectors.

Examples of activities reserved exclusively to the Mexican state (except for specific exemptions set forth in secondary laws) are basic petrochemicals, transmission and distribution of electricity as a public service, and nuclear energy. Examples of activities that can be performed exclusively by Mexicans or Mexican entities in which the participation of foreign investment is prohibited are passenger and cargo ground transport (excluding packaging and messaging). Examples of activities that can be performed by foreign investors or Mexican companies with foreign participation, but only up to a certain percentage of participation in the relevant business include, among others, national air transport and companies manufacturing and selling firearms, munitions and fireworks. For activities related to ports and shipping services; private education; and the construction, operation and exploitation of railways, the statutory limit on

the foreign investment percentage may be exceeded with the prior approval of the Mexican Foreign Investment Commission (*Comisión Nacional de Inversión Extranjera*).

Please also note that, except in activities reserved for the Mexican State and subject to prior government approval, foreign investors may participate and exceed statutory limits of investment through "neutral investment" shares, which grant limited corporate and/or voting rights.

No special fees or taxes apply to foreign investment, except for any fees payable to the Mexican authorities for registration or approval of foreign investment.

Pursuant to the Federal Labour Law (*Ley Federal del Trabajo*), 90% of the employees of any given entity must be Mexican nationals. Up to 10% of the employees of any given entity may be foreigners, in the event that certain positions require a given specialty and no Mexican nationals are available to take those positions. This restriction will not apply to administrators, directors and general managers.

4.4 Restrictions on Payments Abroad or Repatriation of Capital

There are no restrictions or controls for remittance and repatriation of investment returns or loan payments to parties in other jurisdictions. However, remittance of investment returns and interest or other fees on loan payments will generally be subject to income tax withholding. Please see **8.1 Withholding Tax** for more detail.

4.5 Offshore Foreign Currency Accounts

There are no restrictions on a project company maintaining an offshore foreign currency account and it is quite common for them to do so, especially as an off-shore restricted account for financings denominated in foreign currency, or to receive foreign-denominated funds or payments in cases where the project off-takers or clients pay in foreign currency.

5. Structuring and Documentation Considerations

5.1 Registering or Filing Financing of Project Agreements

Depending on the type of project, filing or registration of some or all of the relevant financing or project documents may be required.

As for legal formalities, as explained throughout this document, perfection and enforceability requirements such as notarisation, registration, debtor authorisation and similar actions may apply to specific documents or structures for the relevant documents to be valid and enforceable. However, as a general rule, financing and project documents governed by foreign law do not typically require specific formalities to be valid and binding, but procedural, statutory and formal requirements and limits will apply for the effective enforcement of a foreign law governed document in Mexico.

5.2 Licence Requirements

Under Mexico's applicable legal framework, the nation has original and exclusive title to property rights over land, waters and subsoil. Private property over land, however, is recognised. Other rights – different to ownership – over agricultural or *ejido* property may also be recognised as belonging to private entities.

Private entities and individuals are allowed to extract, exploit and use natural resources through concessions and permits, but no concessions are allowed over hydrocarbons, radioactive minerals, or for the provision, transmission and distribution of electricity as a public service. The extraction, exploitation or use of hydrocarbons – such as oil and gas extraction, exploitation and use – can be contracted to private entities in specific cases and under applicable regulations, but these permits and concessions will not grant title over those natural resources, and the rights of holders of concession or permits over such resources are limited by those concessions and permits and by applicable laws and regulations. The right of a foreign party to hold any such concessions or permits is governed and limited by applicable foreign investment regulations, as explained in **4.3 Foreign Investment Regime**.

5.3 Agent and Trust Concepts

Agent and trust concepts are recognised in Mexico. It is valid to appoint agents to act on behalf of financing or secured parties, provided such an appointment is made in writing and contains the specific authorisation, powers and role of the agent by and on behalf of the relevant financing parties. It is also possible to appoint a trustee under a Mexican trust to act as both lender and agent on behalf of third-party lenders, through a *fideicomiso* structure. It is always possible, though not common in syndicated or multi-party loan structures, to avoid the use of an agent and regulate the relationship amongst the lenders and towards the borrower or credit parties through specific agreements (such as an intercreditor agreement).

5.4 Competing Security Interests

Generally, a security interest that creates a *derecho real* (in rem right) will have priority and first ranking over all other security interests and obligations of the relevant grantor or in connection with the applicable collateral. Typical security interest packages that include a security trust (*fideicomiso de garantía*), a *prenda* or a *prenda sin transmisión de posesión* or an *hipoteca* will have

first ranking and priority over all other obligations of the grantor (except for labour and social security obligations) and over the collateral, because they create in rem rights for the beneficiary of such security interests.

Subordination of obligations is available either by operation of law, by contract or through the application of mechanisms such as the *fideicomiso*. Please note though, that the Mexican *Ley de Concursos Mercantiles* (Bankruptcy Law) does have, for the purposes of its application in bankruptcy or reorganisation proceedings, specific criteria as to who may be considered a subordinated creditor or holder of subordinated rights with respect to the company under the relevant bankruptcy or reorganisation proceedings. These subordinated creditors can include entities or companies, not holding in rem security interests, that are considered related parties to, or persons (i) having control over, (ii) controlled by or (iii) under common control by or of, the company under the relevant proceedings (including, in certain cases, equityholders, and subsidiaries).

In a typical project financing, senior lenders will require that all other lenders, including equityholders, are or become subordinated to the senior loans and the relevant security package under the applicable rules (but there are exceptions, such as VAT loans and other figures).

5.5 Local Law Requirements

Project companies will be incorporated under Mexican law in almost all cases. It is not an absolute general legal requirement to do so, but since most projects derive from public bidding processes and/or require governmental permits, authorisations and concessions – which will require the project company to be incorporated under Mexican law – it is unusual that project companies are incorporated under any other law.

Mexican commercial companies are incorporated and governed under the Mexican *Ley General de Sociedades Mercantiles* (Commercial Company Law). The two most common types of commercial entities incorporated under this law, and usually incorporated to create project companies, are the *sociedad anónima* (corporation) and the *sociedad de responsabilidad limitada* (limited liability company or partnership). The *sociedad anónima* can also be incorporated with special regimes available under other Mexican laws, such as the *sociedad anónima promotora de inversion* (or SAPI – investment promotion corporation). Please note, however, that due to the specially regulated nature of most infrastructure projects, the project companies used for such projects may need to meet the requirements of, and include within their organisational documents and thus also be subject to, case-specific laws (eg, the Hydrocarbons Law).

6. Bankruptcy and Insolvency

6.1 Company Reorganisation Procedures

Mexico's *Ley de Concursos Mercantiles* is the general statute governing reorganisation and bankruptcy proceedings throughout Mexico. A reorganisation and/or bankruptcy proceedings will directly affect enforcement of project security for a lender, but the impact will greatly vary depending on the legal robustness of the security received by that lender.

The *Ley de Concursos Mercantiles* will, subject to exemptions and rights, treat a secured lender as a secured creditor. Such treatment grants a secured creditor, among other matters, priority in ranking, loan currency protection, continued accrual of interests and the ability to participate in the eventual creditor agreement (which concludes the reorganisation proceeding). In the event that the aforementioned creditor agreement is not reached, a bankruptcy proceeding will take place and the company's assets will be liquidated to carry out the payment of debts owed to the acknowledged creditors. Unsecured creditors, or creditors without an in rem guarantee, will not have many of the benefits of a secured creditor.

Pursuant to Mexican law, seizing assets outside of court proceedings is not allowed. Acts or actions to seize assets from an individual or company will be approved and carried out by the relevant courts following the procedural rules.

While a bankruptcy procedure is underway, the seizure of assets is forbidden, except for court-approved preventive measures in order to guarantee the payments due in certain cases.

6.2 Impact of Insolvency Process

Creditors that hold an in rem security over assets which may be foreclosed for the payment of the corresponding debt, have a priority position in the bankruptcy proceedings' payment waterfall. However, in cases where multiple secured creditors exist, the date of registration of the security interests will dictate the priority of payment to the relevant creditors, which is highly relevant because when the security interests are not duly registered, the corresponding creditors will be considered as unsecured creditors. As mentioned in **5.4 Competing Security Interests**, creditors who are considered subordinated creditors under the *Ley de Concursos Mercantiles* will rank below unsecured creditors.

Additionally, pursuant to the Ley de Concursos Mercantiles, the issuance of the insolvency resolution entails the acknowledgment and effectiveness of a general retroactive claw-back period of 270 calendar days (which can be extended to 540 days for transactions with affiliates, directors or senior officers of the company, or their relatives) from such issuance in connection

with acts that are, under this law, considered to be fraudulent conveyance. The appointed conciliator for the procedure or acknowledged creditors may request the court to extend the claw-back period if the circumstances justify it, for a period that shall not exceed three years.

6.3 Priority of Creditors

The *Ley de Concursos Mercantiles* sets forth a list, which, subject to exemptions and interpretation, sets forth the following ranking priorities for creditors:

- singularly privileged creditors (ie, burial and sickness expenses);
- secured creditors (those secured with an in rem guarantee, such as the pledges, *fideicomiso* and mortgage agreements described herein);
- specially privileged creditors;
- common (typically unsecured) creditors, and
- subordinated creditors.

However, please note that payments due against the asset mass, such as certain tax or labour payments, debts incurred while in the reorganisation process, asset maintenance and other similar costs, may actually have higher ranking than secured credits and will typically be paid first.

6.4 Risk Areas for Lenders

There are many aspects and risks for lenders to consider in connection with insolvency when either negotiating a financing or when the borrower or guarantor are, or may become, insolvent. Some of the most important of these aspects are set out below:

- Lenders should be careful with pre-insolvency or reorganisation negotiations. Improvements in collateral positions, extensions, waivers, forbearances and similar actions should be carefully analysed as some of these actions may be either questioned by competing creditors or considered acts of fraudulent conveyance subject to claw-back under the *Ley de Concursos Mercantiles*.
- Lenders should be clear on what the actual ranking of their security interests are, both when creating them and upon insolvency of the borrower or restructuring of the loans; as mentioned before, properly documenting and registering such security interests will be key in a bankruptcy or reorganisation proceeding.
- Lenders must be properly aware of the tax and labour situation of the borrower/guarantor; in proceedings under the *Ley de Concursos Mercantiles*, tax and labour payments may continue to accrue.
- Lenders should be aware of cross-default obligations on other secured or unsecured debt; these can be a problem in pre-agreed reorganisations or other proceedings

6.5 Entities Excluded from Bankruptcy Proceedings

Mexican insurance and bonding companies are excluded from bankruptcy or reorganisation proceedings under the *Ley de Concursos Mercantiles*; all other Mexican commercial entities will be subject to bankruptcy or reorganisation proceedings under the *Ley de Concursos Mercantiles*.

With regard to government entities, only commercial entities with government participation may be subject to bankruptcy or reorganisation proceedings under the *Ley de Concursos Mercantiles*, but no other government agencies or public entities may. However, the possibility of having state productive companies, such as Pemex and CFE, subject to bankruptcy proceedings is still questionable. In addition, the assets of government entities may not be seized or interfered with. However, government entities can (and have) implemented trust structures to guaranty debt instrument offerings and other forms of financing, even government procurement, and ensure that assets transferred to such trust are considered to be isolated from the reach of such government entities and therefore subject to the *Ley de Concursos Mercantiles*.

Please also note that because, as explained in **2.1 Assets Available as Collateral to Lenders**, under a *fideicomiso*, title to the assets that form the trust estate is transferred to the relevant trustee and therefore subtracted from the patrimony of the relevant project company, it is generally agreed that lenders secured by or through a *fideicomiso* have, through this agreement, a bankruptcy remote vehicle under applicable law. Lenders should be aware, though, that in recent cases while this remoteness has been generally accepted by Mexican courts, precautionary measures issued by Mexican courts have temporarily frozen enforcement and foreclosure of assets under *fideicomisos* on the basis of, among other things, the need for the project company subject to the reorganisation procedure to use such assets for its survival.

7. Insurances

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

As a general rule, it is prohibited by law for foreign insurance companies to contract and issue insurance policies in Mexico. Policies issued in Mexico by foreign insurers not authorised to do so in Mexico may not be enforceable. Therefore, insurance in Mexico for Mexican projects is normally contracted with insurance companies that are registered in Mexico and authorised in Mexico to grant the specific coverage. Please note, however, that reinsurance activities can be done by foreign insurance companies, and therefore, it is typical that project insurance issued

by a Mexican insurance company will have (and lenders will require it to have) adequate reinsurance agreements backed by respected foreign insurers

7.2 Foreign Creditors

Insurance policies over project assets are payable to foreign creditors, provided the foreign creditor is the beneficiary and/or loss payee of such insurance. Alternatively, an agent (such as a collateral agent) can be named as the beneficiary and loss payee, and the same shall be instructed by the creditors (including foreign creditors) with respect to the relevant insurance policies.

8. Tax

8.1 Withholding Tax

Withholding taxes generally apply to interest payable to foreign lenders, as well as to the proceeds of a claim or an enforcement of security that is destined for payment of interest, commissions or fees (and not principal). The withholding rate will depend on the underlying transaction, the characteristics and nature of the relevant lender or investor, the applicability of international taxation treaties and other related factors, and currently the rates can vary from 4.9% (for foreign financial entities registered in Mexico as such and fulfilling applicable requirements) to 30% and up to 40% when the relevant lender or investor is a resident of, or is subject to, a preferential tax regime (tax heaven). Please note that withholding requirements do not apply to Mexican banks and financial entities, which will calculate and pay their taxes in accordance with applicable Mexican tax laws.

8.2 Other Taxes, Duties, Charges

Security documents under Mexican law are not generally subject to specific taxes but, as explained in **2.3 Registering Collateral Security Interests**, and **4.3 Foreign Investment Regime**, registration fees and other local costs or taxes may apply.

However, lenders should consider the proper assessment, determination and payment of taxes, charges, fees and other duties that may apply to the project company or related parties in connection with the project intended to be financed. Typically, royalties and/or fees will apply to the holder of a concession or permit for extraction of natural resources or infrastructure projects. These royalties or fees are based on applicable regulations and will normally be included and set forth in the relevant concession title and/or permit. No distinction applies to foreign or Mexican parties liable for payment of these royalties or fees.

Export taxes and customs fees for extraction and export of natural resources will generally apply in accordance with the Foreign Trade Law, export tax laws and regulations, customs laws and multiple international trade and tax agreements to which Mexico is a party.

VAT will also typically apply to (and be financed in connection with) a project, mainly as result of construction costs, as well as for operating costs. In some cases, and subject to international trade treaties and Mexican laws and regulations, the Mexican government will apply protective and restrictive measures and fees to the export of merchandise and resources when it is understood that these measures are necessary to protect essential areas of the Mexican economy.

Notwithstanding the fact that foreign investors or creditors are not specifically entitled to incentives, double taxation treaties allow such foreign investors or creditors to obtain benefits for their business in Mexico. As is well known, Mexico is part of a number of double taxation treaties providing benefits to taxpayers and certain industrial sectors (which may be considered as tax-friendly). In addition, several tax abatements, lower tax rates and other tax benefits may be obtained for specific activities.

8.3 Limits to the Amount of Interest Charged

Under Mexican law of general application to commercial transactions, loans and credit between commercial parties do not have a specific limit as to the amount of interest that can be agreed to and charged. However, Mexican law does prohibit the charging interest on interest (but allows the capitalisation of interest).

There are, however, secondary and special application laws and rules that will limit the amount of interest that can be charged on certain types of loans and for certain financial institutions (usually related to individual retail loans to persons and entities). More importantly, court resolutions – which may be mandatory and which determine what is considered usury and even what are the limits for charging interest (ordinary and default) – will protect debtors from it and from excessive charges (and potentially sanction creditors) and will in some cases allow for a court to directly reduce the amount of a claim for payment of interest. Project financings in Mexico, however, usually involve sophisticated lenders and financial institutions as creditors who will offer terms to the borrower that are arms-length and market compliant, so it is not usual that a project financing would need to be vigilant of anti-usury measures.

9. Applicable Law

9.1 Project Agreements

In most cases, project agreements are governed by Mexican law due to, among other factors, such project agreements being the result of public bids or procurement processes or derived or

regulated under Mexican concessions and permits. There are, however, certain cases in which an arrangement that is considered for the purposes of the project financing is regulated by a project document is actually made under, or governed by, foreign laws. An example of this situation can be procurement contracts related to specific assets for the project that are either purchased or developed outside of Mexican territory, or by foreign contractors.

9.2 Financing Agreements

Financing agreements and documents where the lender or main group of lenders are Mexican financing entities will typically be governed by Mexican law. However, loan documents and offshore security documents in which the lender or main group of lenders are offshore entities or are funded through foreign resources will typically be governed and construed under foreign law (such as, in many cases, New York or English law).

9.3 Domestic Laws

Mexican security or guarantee agreements over assets located in Mexico or governed by Mexican law, such as those described in this document, are subject to and governed by Mexican law.

Gonzalez Calvillo, S.C. is a leading firm in project financing in Mexico. The firm represents a broad group of financial institutions, multilateral agencies, suppliers, contractors and sponsors in connection with all kinds of transactions related to the financing of projects and infrastructure in Mexico. Such participation covers a full range of legal issues, including due diligence and legal audit processes, structuring of projects and their financing, and the implementation and negotiation of transactional and financing and security documents to adequately implement the project and to secure any financing related thereto. The firm's project finance practice group team is composed of six partners, three counsels and sixteen associates, and is one of its largest practice groups. Representative clients include Actis, Apollo Management, Avanzia, Banobras/Bancomext/Nacional Financiera, Crédit Agricole, Corporate & Investment Bank, Chevron Corporation, Cemex, Citibank/Citibanamex, Dhamma Energy Management, Ductos El Peninsular, Emerson, Global Infrastructure Partners, Grupo Mexico, Korea Electric Power Corporation, Macquarie Capital, Natixis, Pattern Energy, Sempra Energy/IENova, SENER, Techint and Thermion.

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