
CHAMBERS GLOBAL PRACTICE GUIDES

Project Finance 2022

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comparative analysis from top-ranked lawyers

**Mexico: Law & Practice
and
Mexico: Trends & Developments**

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Law and Practice

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1. Project Finance Panorama

1.1 Sponsors and Lenders

Limited and non-recourse financing schemes that are commonly referred to as “project finance” have been widely used in Mexico over the past few decades as a means to provide financial resources to many large-scale infrastructure projects. As many sectors of the Mexican economy were liberalised over the past few decades, up to and including the implementation in 2013 by the Mexican government of sweeping reforms in the power and hydrocarbons industries, the project financing market in Mexico experienced several years of steady growth and sophistication.

As the market for public-private projects has developed in Mexico, the type of sponsors interested in participating in the market has also evolved. The “traditional” sponsors, such as industrial construction companies and operators of assets with a long-term ownership objective, have now 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.

Auction processes for infrastructure projects in all industries commonly include strict equity, operational and expertise requirements aimed at ensuring that projects reach commercial operation. Therefore, it is not uncommon for projects to be developed by sponsors forming consortiums with parties having those different capabilities and expertise.

On the lending side, 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 have traditionally gravitated towards projects in the power and hydrocarbons sectors, since many of these projects allow for payment streams denominated in or indexed to US 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 and private placement structures is the focus of significant recent attention with respect to the financing or refinancing of Mexican infrastructure assets. 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. Therefore, project bonds and private placement structures still seem to be more suitable for a long-term refinancing of projects once commercial operation has been achieved and the construction risk has been resolved.

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 will-

ing 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 the 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.

1.2 Public-Private Partnership Transactions

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.

Many projects, such as the power and hydrocarbons industries, are not conducted through the public-private partnership legal framework, and rather are developed pursuant to specific rules applicable to those industries, which commonly involve ownership of assets by the private parties, and the operation of those projects pursuant to offtake agreements or concessions that are granted by the federal government.

At a federal level, pursuant to the Public-Private Partnership Law and its regulations, any ministry or agency can act as the procuring authority. A

procuring authority interested in the development of a PPP project must go through a number of studies and analysis 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.

Considering the nature of PPP projects, it is not uncommon for the assets subject to the PPP structure to be considered part of a public service or owned outright by the government. As such, lenders financing these projects are often prevented from taking security over those 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.

1.3 Structuring the Deal

Project finance transactions in Mexico require sponsors and lenders to navigate through complex regulations that vary depending on the particular industry to which they relate. These regulations will dictate the ability of the lenders to take security over 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.

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 US dollars, or otherwise payments in Mexican pesos that reflect adjustments to costs incurred by the project in US 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 in Mexico over many years include the features described above, which ultimately result in such contracts being more attractive to investors and lenders.

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.

1.4 Active Industries and Sectors

On the back of campaign promises aimed at tackling corruption in public procurement, upon entry into office, the current administration cancelled many important infrastructure projects, including the much-needed Mexico City (Texcoco) Airport Project and the long-term power auction programme, which in its first three iterations enabled Mexico to award long-term power purchase agreements at record-setting low prices.

The large-scale infrastructure projects currently under construction have been assigned to be built, in whole or in part, by the Mexican Ministry of Defence, through the Mexican Army Corp of Engineers, with funds from the federal budget.

High demand for the development of infrastructure and related investment in Mexico remains;

however, the policy of the Mexican government following the change of administration in 2018 has shifted and private investment in the infrastructure market has been faced with significant challenges.

Although the initiative of 30 September 2021 to reform the Mexican constitution on power and energy matters proved unsuccessful, the administration has continued its attempt to change policy through a number of secondary legislative and regulatory reforms and decrees that were approved by Congress and continue to be debated before the courts. Private projects have also been faced with revocation, delay or denial of permits by the current administration on the basis of such reformed laws and other grounds that are the subject of challenges before the courts.

In addition, these actions have prompted the opening of a consultation process between the governments of Mexico, the United States and Canada under the United States-Mexico-Canada Agreement (USMCA or T-MEC). The consultation process seeks to analyse whether the actions of the Mexican government within the energy and power industries are in accordance with the treaty. If these disputes are not resolved through the consultation process, the process may move towards a dispute resolution panel that many in Mexico fear could be resolved in a manner adverse to Mexico.

As a consequence of these developments in the political and legislative climate, interest by private investors and project finance lenders across all sectors of the once-dynamic project development and project financing market in Mexico has declined significantly. Instead of seeking new opportunities for investment in Mexico, investors and project finance lenders are monitoring

their current investments closely, with a view to preserving value and defending their investments from government actions such as those described above.

If this trend continues, the main activity in the project financing sector may be in the restructuring space, since it will be likely that projects will need to revisit their base case and repayment profile as a means to adapt to the changes in policy.

In addition, it may be the case that the current shift in policy may result in the creation of opportunities for investors with a higher risk-appetite to acquire projects in Mexico. This may open the possibility for existing project lenders to refinance existing debt with the new project sponsors or propose alternative structures that enable lenders to maintain the value of their investments.

2. Guarantees and Security

2.1 Assets Available as Collateral to 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 will create security over all the assets owned by the project company in relation to the project, including over the shares, equity interests and shareholder loans of the sponsor in the project company.

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,

and the right to receive insurance proceeds. In projects where the project company is entitled to own the project assets in its own name, the lenders also expect security over the project assets, including the facilities, installations and other “hard assets”.

Depending on the nature of the project, the creation of security interests over project assets may be subject to limitations in addition to those previously described, including the need to obtain authorisation by the concession authority or regulator prior to creating security over the project assets, the concession or the rights under the contract.

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. The benefit of the security is usually held by the lenders 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 as follows.

Security Trust

By means of a security trust, the debtor transfers to a Mexican bank, 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 over 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 those rights into the trust and is expected to create security over those 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 the depositary of the trust assets. In the 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 over 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 of those shares or securities 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.

Non-possessory Pledge

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

Project finance lenders typically require debtors to issue a non-possessory pledge to create security over assets not capable of being transferred to a security trust or that may otherwise be subject to another type of security interest. This may be due to the impossibility of identifying the assets subject to the pledge individually or by virtue of the impracticality of obtaining authorisations from the governmental authorities

that would need to authorise transfer of title to permits or authorisations.

This blanket pledge over assets does not require that the assets be delivered to the creditor or otherwise be identified specifically. Under this security structure, the debtor may maintain physical possession of the property being pledged and use the collateral as part of its manufacturing process. Subject to certain restrictions, the debtor may also sell the collateral within the normal course of its business activities, in which case the proceeds of the sale will be automatically subject to the pledge. The right to sell collateral within the normal course of business is suspended upon notice that enforcement procedures are initiated.

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 over 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.

Mortgage

In exceptional instances when it is impossible or impractical for a project company to transfer title on real estate to a security trust, security interests over real estate are commonly created through mortgages. Laws applicable to real property are of the local jurisdiction, and therefore mortgages are governed by the Civil Code for the state in which the mortgaged asset is located.

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, subject to the jurisdiction where the mortgage assets are located, the mortgage may also include the natural accessions of the mortgaged property, such as the rights to any easements, improvements made on the mortgage property by the owner, movable objects permanently affixed to the mortgaged property by the owner and which cannot be removed without damage to the objects or property, and any new buildings built on the mortgaged land.

Real estate property that has been mortgaged may be subject to additional mortgages. Priority among mortgages is determined based on the date of recording 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.

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

See 2.1 Assets Available as Collateral to Lenders, for a description of the non-possessory

pledge provided for under Mexican law, which allows the creation of a security interest over all present and future assets of a company.

2.3 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 that security. In many instances, such as documents evidencing security over 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 maximum fees that notaries public are authorised to charge vary, depending in which state of Mexico the notary is located, and are generally based on the secured obligation; however, the notary is authorised to deviate from those maximums as a matter of negotiation with interested parties.

Security interests may need to be registered with general or specialised registries. The fees of these registries vary, depending on the location of the 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 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 that security. The non-possessory pledge allows the creation of security over specifically identified assets, over all assets of the pledgor or over a specific generic set of unidentified assets.

2.5 Restrictions on the Grant of Security or Guarantees

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

Permits and governmental authorisations generally do not allow transfer of title from the original permit-holder without an authorisation from the issuing authority. Also, the creation of security over contract rights may require consent from the relevant counterparty if that restriction is set out in the relevant contract.

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 over movable assets owned by that company at a federal level. However, certain security interests are not required to be registered in that registry.

In relation to lien searches relating to real estate, it will 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 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. It should be noted that, as a general proposition, security interests are subject to the terms of the statute of limitations of the main obligations to which they relate.

3. Enforcement

3.1 Enforcement of Collateral by a Secured Lender

Prior to enforcement of 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 to the main forms of security interest that are used in project finance transactions in Mexico is as follows.

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 and is described as follows.

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 include minimum rules in the procedure, some of which are (i) that the non-judicial foreclosure shall begin upon written notice made by the beneficiary to the trustee that an event of default has occurred under the financing documents, (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.

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 herein, 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 those 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 pledgee 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 a 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. These 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.

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 a claim relating to the default of the secured obligation, the court is required to issue a mortgage proceeding statement (*cédula 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 that 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 a sale are applied to the payment of the secured obligation. To the extent that the mortgage was created to secure obliga-

tions with several creditors, the proceeds from the sale of the mortgaged assets shall be allocated to those secured creditors following the order of priority of their respective mortgages.

3.2 Foreign Law

As a matter of Mexican law, the choice of foreign law to govern agreements is valid and that choice would be recognised by Mexican courts upon enforcement. 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. Security documents created on assets located in Mexico, or governed by Mexican law, must be created pursuant to Mexican law and the choice of a foreign law to govern that agreement would not be valid.

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 any 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 Judgments of Foreign Courts

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 mat-

ter, 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 A Foreign Lender's Ability to Enforce

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 that 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 those 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 those security interests to be enforceable with respect to third parties and to establish priority and ranking of the security interest. These 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. See **2. Guarantees and Security** for a description of those 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. **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 obliged to perform under concessions or contracts awarded to them by government entities.

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

Foreign lenders are generally able to take security over assets located in Mexico, whether directly or through a collateral agent, under the forms described in **2. Guarantees and Security**.

It should be noted that only Mexican banks are authorised to act as security trustees; however, those security trustees act for the benefit of the beneficiaries of the security trust, who may be foreign lenders.

4.3 Foreign Investment Regime

Currently, the Mexican nation continues to consider 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 as matters reserved for the Mexican nation. In addition, certain sectors of the telecommunications industry continue to be reserved to the Mexican nation. As described in **1.4 Active Industries and Sectors**, the initiative to reform the Mexican Constitution may affect the aforementioned reserved matters and increase the level of state control on a number of activities in the power and mining industry that had previously been liberalised or otherwise made available to foreign investors through concessions.

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. In particu-

lar, the administration of port facilities, internal navigation and certain port services are the few remaining activities that fall within this category.

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

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. These 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 those assets. The limitations include the agreement by companies which have foreign investors that any foreign investor, upon becoming a member of the company, shall agree that it will be treated as a Mexican national in relation to its investment and will not invoke protection of its government of origin in the event of disputes with the Mexican nation.

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 contain most-favoured nation clauses, protections from expropriation and actions tantamount to expropriation, release of limitations to transfers of funds, and dispute resolution mechanisms. Currently, some examples of these treaties include those between Mexico and 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.

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 previously described. Currently, the main examples of these free-trade agreements include the United States-Mexico-Canada Agreement (USMCA or T-MEC, which replaces the North American Free Trade Agreement), and the Free Trade Agreement between Mexico and the member states of the European Union.

4.4 Restrictions on Payments Abroad or Repatriation of Capital

There are no restrictions under Mexican law in relation to the transfer of funds abroad or the repatriation of capital by foreign equity investors. 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 inter-

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

4.5 Offshore Foreign Currency Accounts

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

5. Structuring and Documentation Considerations

5.1 Registering or Filing Financing of Project Agreements

Financing documents are not required to be filed or registered with a governmental authority in order for those 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 that 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 those 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, 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.

See 2. **Guarantees and Security** for a description of the registration requirements applicable to security documents under Mexican law.

5.2 Licence Requirements

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 that have foreign investment, subject to the provisions of the Mexican Law on Foreign Investment, which are further described in 4.3 **Foreign Investment Regime**.

5.3 Agent and Trust Concepts

The trust concept is widely recognised and utilised in Mexico, as described in more detail in 2. **Guarantees and Security**. Mexican law includes concepts, similar to “agency”, that allow a party to appoint a representative to act on its behalf with limited or general authority.

5.4 Competing Security Interests

Priority on security interests and recordable rights generally follows the “first-come, first-served” approach. As such, where 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, it should be noted that the tax, labour and social security claims may have a preference on claims, except where 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 that transfer is considered to be fraudulent in the context of an insolvency proceeding. 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 Local Law Requirements

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 conces-

sion entities and commonly refers solely to the creation of a Mexican mercantile corporation.

The most common forms of mercantile corporations for project companies in Mexico are a limited liability company, organised as a *sociedad anónima de capital variable* (SA), which is a stock corporation, or a *sociedad de responsabilidad limitada* (SRL), which is a partnership. A variation of the SA that is widely used is the *sociedad anónima promotora de inversión* (the SAPI), which allows 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 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 herein 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 corresponds to the tax considerations of the sponsors.

6. Bankruptcy and Insolvency

6.1 Company Reorganisation Procedures

The Mexican Commercial Insolvency Law (*Ley de Concursos Mercantiles*) provides for a sole insolvency proceeding applicable to mercantile companies in Mexico. This 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 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 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.

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 reorganisation agreement can be reached, bankruptcy will be declared.

6.2 Impact of Insolvency Process

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 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.

6.3 Priority of Creditors

If a reorganisation agreement is reached, creditors would be paid in accordance with the provisions of that agreement. Generally, a reorganisation agreement will 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. The liquidation may

take some time and will involve the sale of the assets of the debtor to repay its creditors up to the amount of the sums recovered. The commercial insolvency law provides for the following ranking in relation to payments due by the debtor upon liquidation:

- privileged creditors (which includes certain labour claims);
- secured creditors, which includes creditors holding a valid mortgage or pledge interest, up to the amount of the value of the relevant security interests;
- creditors with a particular privilege (which includes tax obligations and labour and social security quotas);
- unsecured creditors; and
- subordinated creditors, subject to the contractual provisions in the relevant agreements entered into by those 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 previously described. Finally, the lenders would be exposed to the risk of inability to recover the full amount of their debt in the 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 could be

set aside if they are determined to constitute fraudulent conveyance (*actos en fraude de acreedores*). Such acts would include, among others, dispositions (including granting additional security interests not provided for in the initial financing documents) within a period of 270 calendar days prior to the judgment declaring insolvency (the “retroactive period” (*fecha de retroacción*)), transfers of assets not carried out at arm’s length, forbearance of debts within the retroactive period and payments of unmatured obligations within the retroactive period.

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. This law provides for special proceedings that are applicable 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 those enterprises.

7. Insurances

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

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 those insurance companies may enter into reinsurance policies with foreign reinsurers. The validity of cut-through clauses in reinsurance contracts has been strongly debated, since these clauses

are viewed to be contrary to the underlying principle that risks in Mexico must be insured by Mexican insurers.

7.2 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 a security mechanism is implemented, as a 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 that designation as loss payees or preferred beneficiaries. Upon payment of the insurance proceeds, the lenders would have the right to direct the application of those proceeds towards reconstruction, in whole or in part, of the damaged project assets, or towards repayment of the financing obligations.

8. Tax

8.1 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.

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. Tax rates may be affected by the application of one of the many treaties for the avoidance of double taxation to which Mexico is a party. Interest payments to export credit

agencies and certain multilateral and regional development lenders are exempt from withholding taxes.

It is not uncommon for financing documents in international project financing transactions to include tax gross-up provisions that require 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 those withholdings or deductions not been made. These tax gross-up provisions are valid under Mexican law.

8.2 Other Taxes, Duties, Charges

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, interest payments under shareholder loans will also be subject to the withholding taxes previously described. 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.

8.3 Limits to 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 that 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 by the Mexican tax authorities.

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. However, 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 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 the laws of jurisdictions other than Mexico or pursuant to Mexican law. The decision in relation to applicable

law in relation to those 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 be entered into pursuant to Mexican law.

9.2 Financing Agreements

The main financing documents in project finance transactions may be entered into pursuant to Mexican law or foreign law. 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 Domestic Laws

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.

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Trends and Developments

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Background on the Project Financing Industry in Mexico

As many sectors of the Mexican economy were liberalised over the past few decades, up to and including the implementation in 2013 by the Mexican government of sweeping reforms in the power and hydrocarbons industries, the project financing market in Mexico experienced several years of steady growth and sophistication.

The power and midstream sector has been particularly interesting to international project finance lenders over the past many decades. This interest is due, among others, to the large capital requirements and the adequate contractual arrangements in the underlying projects. It is worth noting that the offtake contracts that are used in these projects and which have largely become common industry practice, provide for a steady payment stream denominated in or indexed to US Dollars and include take or pay or similar provisions that are key and attractive features required by lenders in order for international project financings to be successful. This interest by project finance lenders also resulted in the creation of a refinancing market, whether through longer term bank financing or project bond structures, once projects had reached commercial operation and construction risk had been overcome.

Additionally, private equity investors were called upon to bring additional capital to these projects and enable developers to continue their development efforts in an industry that saw steady and progressive growth over many decades. This additional capital was provided through

equity investment as well as through creative mezzanine and “quasi-equity” structures that were tailored to meet the needs of the equity investors and the project companies.

Mexican commercial and development banks supported financing efforts as senior lenders and through the issuance of VAT financing that played a crucial role towards the creation of comprehensive financing structures that were much needed by project developers and investors.

These projects were initially sponsored by the Mexican state-owned power, oil and gas companies; however, the 2013 reforms, along with successful and competitive power auctions that came with them, allowed for an increasing number of privately sponsored projects that would sell products to the fledgling wholesale electricity market.

Recent Changes in Policy Regarding Infrastructure Projects

On the back of campaign promises aimed at tackling corruption, among others, in public procurement activities, upon entry into office, the current administration cancelled many important infrastructure projects, including the much-needed Mexico City (Texcoco) Airport Project and the long-term power auction programme, which in its first three iterations enabled Mexico to award long-term power purchase agreements at record-setting low prices. The administration claimed that the corruption behind these projects was sufficient grounds for the cancellations, which action has been criticised heav-

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ily in the industry considering its breadth and scope, as well as the lack of clear investigation into widespread wrongdoing.

The infrastructure projects announced at the start of the current administration, many of which are still under construction, have not been attractive or made available to investment by private entities or project finance lenders. This is due, among other reasons, to the complexity and scope of those projects or the fact that many have been assigned to be built by the Mexican Ministry of Defence, through the Mexican Army Corp of Engineers, with funds from the federal budget that do not require financing under a project financing structure and rather depend on tax revenues or sovereign debt.

Although there continues to be high demand for the development of infrastructure projects in Mexico, including renewable power projects, the policy of the Mexican government following the change of administration in 2018 has shifted. The decision of the current administration to strengthen the state-owned Mexican power and hydrocarbons companies has resulted in a number of private investors in such markets facing increasing challenges to their business models and their projects.

Recently, the Mexican Congress rejected an initiative to reform the Mexican constitution submitted by the President of Mexico on 30 September 2021. The initiative, which was heavily criticised by and raised great concerns among many private industry participants, sought to increase the level of state control in the Mexican power industry and reduce the involvement of private parties in the power-generation market. The rejection of this initiative by Congress was viewed by many investors in the sector as a step in the right direction towards protecting

the investments of private participants in the liberalised generation and midstream markets that were the subject of significant investment and interest during many years prior to the commencement of the current administration.

In line with the shift in government policy, the current administration has delayed permitting and authorisation processes that are necessary for many private entities to operate in the sector. A number of permits and authorisations held by private parties have been revoked, delayed or denied on the basis of recent changes to secondary legislation and regulations on grounds that have resulted in private investors commencing judicial proceedings aimed at challenging the revocation or inaction of the regulators.

Many of the secondary laws and regulations that have served as grounds for the actions described in the preceding paragraph have been suspended, challenged or overturned by the Mexican courts on a provisional basis, pending final resolution of the court proceedings that are still ongoing on a case-by-case basis. The expectation of the industry and private investors continues to be that the courts will continue to uphold the provisions of the Mexican constitution, and that such provisions will continue to serve as legal basis for the challenges to these regulations and adverse government actions.

As the current administration continues through its fourth out of six years in office, private investors have also continued to contest government actions through commercial arbitration and judicial proceedings against the Mexican state-owned companies involved in the power and hydrocarbons sector. A number of arbitration and judicial rulings have already been issued in terms that are not favourable to the Mexican government entities.

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Finally, these changes in policy have resulted in the commencement of a consultation process between the governments of Mexico, the United States and Canada under the the United States-Mexico-Canada Agreement (USMCA or T-MEC). These consultations are aimed at determining whether the actions of the Mexican government in the energy and power industries are in accordance with the terms of such free trade agreement. If the consultation process is unsuccessful in its attempt to resolve these disputes, it is likely that the process would result in a dispute resolution panel that many in Mexico fear will be resolved in a manner adverse to Mexico.

Consequences of Shift in Policy for the Project Finance Sector

Considering these developments in the political and legislative climate, interest by private investors and project finance lenders across all sectors of the once-dynamic project development and project financing market in Mexico has declined. The previously robust development and financing pipeline has now been reduced to a few acquisition financing transactions with respect to portfolios of operating projects in the power generation space. Interest in financing of greenfield projects has dwindled, considering the uncertainty brought about by the change in policy and the need to preserve rights of existing projects through judicial proceedings.

Instead of seeking new opportunities for investment in Mexico, investors and project finance lenders are monitoring their current investments closely, with a view to preserving value and even preparing to commence claims through the Mexican judiciary or international investment arbitration.

It is likely that many existing and operational projects will continue to rely on project finance to continue their operations. Therefore, the main activity in the project financing sector may be in the restructuring and refinancing space, since it will be likely that projects will need to revisit their base case and repayment profile as a means to adapt to the changes in policy. Also, many project financings originally put in place as short to mid-term construction financings will be approaching maturity and, in line with common industry practice, will likely seek to refinance their debt upon commencement of operations.

In addition, it may be the case that the current shift in policy may result in the creation of opportunities for investors with a higher risk-appetite to acquire projects in Mexico. This may result in many long-term investors requiring project financing to fund their acquisition of portfolios in Mexico, which may be coupled with a move to refinance existing debt with the new project sponsors or propose alternative structures that enable lenders and investors to maintain the value of their investments.

As the current administration draws to a close, the focus in Mexico will start to move towards the presidential election to be held during the summer of 2024. Although it is unlikely that the current government will refrain from its current policy, it is unclear whether the succeeding government will continue with the current policy or take a more moderate view that would enable private participation in the infrastructure space to recover. The latter, naturally, is the expectation of many, including the private participants operating in Mexico, considering the high demand for infrastructure that continues to prevail and the limitations of the federal budget and state-owned enterprises.

MEXICO TRENDS AND DEVELOPMENTS

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