

**GOODRICH'S**  
**BLUEBOOK**  
MEXICO

Business opportunities and legal framework

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Mexico City

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# MEXICO IN THE BICENTENNIAL OF ITS INDEPENDENCE AND THE CENTENNIAL OF ITS REVOLUTION

In 2010, Mexico celebrated 200 years of Independence from Spain, and 100 years since its Revolution. The country has come a long way in achieving stability, as well as institutional and economic growth, positioning it as a prosperous participant in the world economy.

## DEMOCRATIC DEVELOPMENT

Mexico has enjoyed a decade of democracy, following 71 years of hegemonic rule by the Partido Revolucionario Institucional (PRI), a political party which was founded in 1929. In addition, the representation of diverse groups has been accomplished since no political party currently enjoys a majority in Congress. Furthermore, a system of checks and balances has developed marking a change from an all powerful executive branch to a structure where the legislative branch questions, analyzes and at times deviates from executive initiatives. It is worth noting that the judicial branch has experienced the most growth in the last two decades. Indeed, the other two branches, as well as civil society, have often looked to the Supreme Court for policy clarification and for the resolution of controversies amongst different branches of government.

Nationally, the federal system has also gained momentum. Even before there was a change of party in the federal government, state governments had already begun to experience a change in party affiliation. Moreover, these states have achieved a greater level of autonomy thanks to legislative reforms that have returned power and resources to the states. The competition that

has emerged between political parties in their race to achieve electoral gains in state government has also been another factor which has contributed to an increase in state autonomy.

Without a doubt, the road towards democracy in Mexico has been rocky. The presidential election of 2006 was one of the most relevant political events in recent history, and also damaged the country's ability to reach a consensus. A fierce campaign between candidates on the left and the right led to very tight results, with only 244,000 votes out of 30 million votes making the difference. The situation was aggravated because the Mexican electoral system provides for only one round of voting, in which the candidate with the most votes is declared the winner. Thus, the outcome of the election marked an impasse which was ultimately resolved by the Court. The arguments that were presented were not strong enough to avoid the polarization of the electorate. The President Elect faced challenges to his legitimacy, and politicians on the left and other elected officials even refused to recognize Felipe Calderon as the nation's incoming president. In this political context, the damaged legitimacy of President Calderon and his administration has made national consensus difficult. At times, this has even relegated national projects to a second tier, especially when parties are faced with a need for political victories at the polls.

That said, the national elections of 2012 will pose a great challenge to political parties, electoral institutions, and the participation of the electorate. While many predict a return to power of the PRI, a more involved electorate will necessarily demand better practices from players within the system, including political parties, the media, and of course, institutions and electoral courts.

## MACROECONOMIC STATE

One area in which the country has gained ground is in macroeconomics. Mexico has enjoyed over ten years of price and exchange rate stability. Foreign crises, particularly the 2008 economic crisis in the U.S. (an economy with which Mexico is highly integrated), have been overcome relatively well, thanks in large part to economic policies adopted in the 1990s. This stability is also a result of good economic management by the Bank of Mexico and the Ministry of Finance and Public Credit (SHCP).

In order to firmly establish a proper framework for continued economic growth, a number of structural reforms need to be adopted. Some efforts at reform have been undertaken by the President and certain parties in Congress in the fields of energy, taxation, and labor. These reforms are part of a larger project of nationwide reform. However today's political climate—the more democratic nature of the country and the political fractures between parties—has worked to undermine these efforts and has resulted in small and insufficient reforms which simply do not meet the needs of the country. These reforms amount to small agreements which reflect the bare minimum upon which these political parties were willing to compromise.

A clear example of this phenomenon is the energy reform proposed by the President in early 2008 and discussed in Congress for the remainder of the year. While the competition of ideas between various political actors focused on the need to do something about production levels and the future of Mexico's oil industry, proposals for solving the problem were very diverse and contradictory.

In the end, the resulting reform did not offer a solution to the main problems, but did at least reflect the exchange of ideas that the various political parties had sought.

## NATIONAL CHALLENGES

Regrettably, other national problems persist, with the first and foremost being a state of insecurity. For some decades, Mexico has been a transit country for drugs destined for the United States. President Calderon has made it a priority in his agenda to fight both the drug cartels that operate in Mexico and other criminal groups that mainly use kidnappings as their modus operandi. The “war” or “struggle” against organized crime has resulted in the arrests of some notorious drug lords, as well as the seizure of high powered arms, money, and drug shipments. However, it has also caused a surge in violence because of confrontations not only between the government and the cartels, but also between the different cartels in their fight to control important territories, especially in the north. The bloodshed is so high in some states, that some local governments have been unable to control it. Monterrey, formerly the most modern, industrial, and emerging city in the country, has been one of the cities most severely affected by the violence. Extortions carried out by organized crime groups who demand payment in exchange for “security” have placed a burden not only on small and medium-sized businesses, but also on larger, transnational companies. It is natural to expect that the Calderon administration will continue with its current security strategy. It is also foreseeable that the party who wins the presidential election in 2012 will have to redesign the current, widely criticized approach.

Another difficulty that the country has recently encountered is that of natural disasters. A number of devastating earthquakes in the north of the country, hurricanes, and severe rains that caused flooding in Chiapas, Oaxaca, Tabasco and Veracruz, are just some of the adversities that the country has had to endure in recent years. Moreover, the negative effects of climate change also leave the country very vulnerable.

Several sectors have experienced important losses. For example, the agricultural industry has suffered because of flooding and droughts, local governments have suffered damages to infrastructure, the country as a whole has lost habitable zones, and biodiversity has also suffered. The current administration has made efforts to adopt climate change policies, however, most of these measures have simply mitigated the problem and the government’s capacity to adopt significant policies has proved to be difficult. The country’s dependence on oil has also been an obstacle, and no plans are currently in place to reduce emissions from power plants that produce hydrocarbons. It seems that reality is outpacing the country’s ability to adopt solutions. When oil reserves once again began to decline, the legislature passed a law allowing for private capital investment in the production and development of renewable energy. While enforcement and implementation of such provisions is still in its infancy, the market seems to offer good opportunities.

## LOOKING FORWARD

Mexico enters the second decade of the millennium faced with many challenges. The conditions of some of the population demand economic growth –better social conditions and a less violent environment. The foundations for achieving these improved conditions are in place. The country has experienced price stability and good economic management that have allowed it to attain macroeconomic stability in recent years. In 2009, the economy experienced more than 6% recession as a result of the international economic crisis, and now in the second quarter of 2010 the economy has recovered and seen over 7% growth. Though not enough, the government has steadily increased infrastructure spending since 2000 with a significant increase in such spending since 2008– a path that can lead to more attractive investment conditions. Foreign Direct Investment grew in 2010, proving that there is international confidence in the country.

Additionally, NAFTA continues to deliver results. The manufacturing and “maquiladora” sectors have regained strength, as the automotive industry in the United States begins to recover. While some point to Chinese manufacturing as a threat to Mexico’s position as commercial partner with the United States, the reality is that higher wages in China, and an increase in transportation costs has made Mexico a more viable option. Together with the automotive industry, Mexico has developed specialization in production of airplane parts. Government efforts, which make it easier to run a business, have also delivered results. Today it is easier to do business in Mexico than in any other Latin American country, due in part to mechanisms such as online tax payments and fewer requirements for start ups.

Even though the overall framework needs to be completed, structural reforms are in the works, and decision makers, who are trying to gain political capital, will have a reason to push for these reforms after the 2012 election.

We commend Goodrich, Riquelme y Asociados for producing this guidebook on doing business in Mexico, which contains the necessary legal, tax, and governmental information for entrepreneurs.

### **Foreign Affairs Latinoamérica**

Mexico City, January 2011

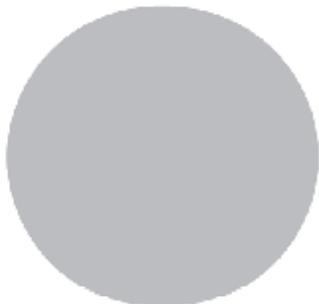
# Introduction

## Our Firm



Goodrich, Riquelme y Asociados is a law firm made up in large part by young professionals with the highest of professional and ethical standards. Our firm was founded in 1934, and according to recent figures published by well-known international legal directories, is one of the five largest and most consolidated firms in Mexico. In addition to our network of partners here in Mexico and abroad, we also have a European office based in Paris. Our legal services are comprehensive and cover virtually all areas that are essential for companies doing business in Mexico. With a solid international reputation, our lawyers have an innovative and robust approach to contemporary legal services, with the goal of helping our clients achieve their commercial objectives.

Our main office is located in the heart of Mexico City, in the political, financial, commercial, and industrial center of Mexico. We are located next door to the Mexican Stock Exchange, and near *el Ángel*, the Monument to Independence, as well as the British, Japanese, and American embassies.



## INTERNATIONAL FOCUS

Goodrich has participated in the economic development of Mexico since the beginning of the country's industrialization in the 1930s, to its continued development into more sophisticated areas such as production of goods and services and international trade in the 21st century. Throughout these decades of progress, there has been an emphasis on attracting foreign companies who want to trade and invest directly in Mexico.

Given our international focus, a significant number of our lawyers speak different languages, and have lived, studied, and are even licensed to practice in different countries. With this background, we can provide assistance to businesspeople regarding how to "do business in Mexico," as well as assist Mexican businesspeople and government officials to understand and evaluate the business objectives of a foreign company.

An illustration of our international focus was the assistance we provided to the World Bank in preparing their report, *Doing Business in Mexico*, in which we coordinated with over 100 law firms in Mexico to gather responses to questionnaires and measure factors of competitiveness.

Goodrich is a founding member of the Bomchil Group, an association of independent law firms in Latin America – recognized by the International Bar Association – with a presence throughout the region. Over the years, our firm has gained the respect and recognition of officials at all levels of government, including local and federal judges, as well as within the legal community here in Mexico. Additionally, some of our partners regularly participate in the preparatory work for new legislation and public policy, at the request of government officials and congressmen.

## OUR ORGANIZATION

Our clients' legal matters are personally handled by one of our partners, who is designated as the head lawyer for an account and who leads a team of professionals assisted by specialists in that particular practice area. The head lawyer works closely with other partners at the firm and with various specialists, including accountants, bankers, economists, engineers, and other consultants. The purpose of this is to provide efficient service without redundancies. The head lawyer is kept informed on matters relevant to the client's case, as well as legislative developments which may affect the client's business.

## OUR PRACTICE AREAS

Our lawyers speak our clients' language, both literally and figuratively. Not only do our lawyers speak various languages, but we also understand the commercial landscape, as well as know and speak the language of business.

Our practice encompasses a broad scope of international, commercial, and civil matters, which include the following areas: corporate law, foreign investment, information technology, foreign trade and import regimes, joint ventures, mergers and acquisitions, privatization, antitrust, international trade, real estate, tourism, environmental law, construction law, public procurement,

tax law, labor law, mining, renewable resources, clean industry and the Kyoto Protocol, oil and gas, insurance, banking and finance, arbitration, immigration, customs, maritime, aviation, and transport law, telecommunications, food and agriculture, patents and trademarks, copyrights, licensing, franchises, wills and estates, trusts, and administrative procedures before authorities at all three levels of government, among other areas. In every practice area, we provide our clients with representation on matters involving both transactions and litigation at all jurisdictional levels, as well as dealings with governmental authorities.

## THE FOURTH EDITION OF OUR BLUE BOOK

With an international focus, and through a multidisciplinary effort, we present the newest edition of our Blue Book. This book has been developed in order to provide information about both the legal framework in Mexico and our firm's practice areas. Our aim is to provide readers with an overview of key issues related to business operations in Mexico, while also providing references throughout the book to additional materials that are available on our website. Our firm has developed our practice into boutique areas involving a high level of specialization. For this reason, we recommend complementing the hardcopy of our Blue Book with legal materials and investment opportunities available on the "boutique" pages on our website.

Globalization and the rapid development of existing business relationships, together with legislative developments and a harmonization of global standards and norms require us to update the content of our Blue Book with greater frequency. Because we are also committed to the environment and the prudent use of natural resources, we have capitalized on the advantages of current technologies, and published this new edition in both a versatile and environmentally friendly format. Clients and readers worldwide who are familiar with the previous editions of our work will find a greater depth of information in these additional materials, which will be frequently updated. With the goal of bring our firm closer to a business community which is increasingly more diverse, we also offer a digital version of our Blue Book in French and German.

We are proud of the role our firm has had in the development of our country, and we are excited to be part of the continued and dynamic development of Mexico.

Last, but not least, we are deeply thankful for the participation of the prestigious publishing firm, Foreign Affairs Latinoamérica, who contributed the prologue to this edition. Their recognized international leadership in geopolitical analysis offers our readers an excellent context for Mexico's state of affairs, as well as the practice of law in our country.

We hope that this book will be both interesting and useful to our clients and friends.

Goodrich, Riquelme y Asociados  
Mexico City, January 2011





# Profile of Mexico

## GEOGRAPHY

Mexico shares a border to the north with the United States of America and to the south with Belize and Guatemala. To the west, Mexico is surrounded by the Pacific Ocean, and to the east, the Gulf of Mexico and the Caribbean.

## POPULATION

- Total population: 112 million people.
- Population growth rate: .99%.
- Average age: 24 years old.
- Density per km<sup>2</sup>: 50 people.
- Average life expectancy: 75 years old.

## LANGUAGE

Spanish is the official language of Mexico. However, there are sixty dialects spoken amongst indigenous communities (approximately 6 million Mexicans) which are generally located in the rural areas in the south of the country. As a result, Mexico is one of the most linguistically diverse countries in the world.

It is important to note that English is widely used in business circles.

## POLITICAL SYSTEM

Mexico is a federal republic with a representative democracy, and is made up of 31 states and a Federal District which are free and sovereign with respect to matters relating to their internal affairs, but are nonetheless united as a federation. Mexico City makes up the Federal District, the seat of the union and the capital of Mexico.

The Federal Government is divided into three branches: legislative, executive, and judicial. Legislative power is vested in the General Congress which is divided into two chambers: the House of Deputies and the Senate.

The House of Deputies is comprised of 500 representatives from throughout the nation, who are elected every three years. Of the 500 deputies, 300 are elected in single-seat constituencies by plurality, and the remaining 200 are elected by proportional representation in 5 multi-state constituencies.

The Senate is comprised of 128 senators who are elected through a mixed system in which some senators are elected through plurality vote and others through a system of proportional representation. Each state elects 3 senators, of which 2 are awarded to the plurality winner and one seat is awarded to the first minority, i.e. the party who obtained the second highest amount of votes.

The remaining 32 senators are elected in a national election through a system of proportional representation.

## LEGAL SYSTEM

The Mexican legal system is based on the Roman law tradition known as civil law or written law, therefore, it is important to keep in mind that the legislative procedure codified in the Mexican Constitution must be complied with in order to enact laws. For this reason, Congress and local legislatures play a leading role because they are responsible for enacting the laws that make up the Mexican legal system. International treaties must be approved by the Senate, and conflicting laws are preempted by the Mexican Constitution. Since the entry into force of NAFTA, the Anglo-Saxon legal tradition has had an important influence upon the Mexican legal system, and today our system can be classified as a hybrid legal system.

Nonetheless, judicial administration takes a secondary role when it comes to lawmaking. This is in contrast to the Anglo-Saxon common law tradition in which law is essentially created by the judiciary through precedent. In our legal system, the judiciary has historically been limited to applying the law enacted by the legislature.

It is equally important to note that under certain conditions, judicial decisions may become binding, thus leading to the creation of jurisprudence and application in future cases. In recent times, the Supreme Court has begun to assume a fundamental role, and is no longer restricted to solely applying laws between individuals and authorities, but rather has begun to fill in the gaps and omissions in legislation. Additionally, the Court arbitrates between conflicting decisions handed down by public bodies, thus helping not only to clarify the content of the law but also assure the proper application of the law.

## ECONOMIC SYSTEM

The Mexican Constitution regulates various matters that affect the country's economic development and foreign investment. The power to enact laws and to implement economic measures is shared between Congress and the President.

The Mexican Government has established and fostered new economic policies which have resulted in the elimination of trade barriers, the reduction of taxes through the implementation of free trade agreements, the privatization of state companies, and the development of new rules governing foreign investment.

## JUDICIAL SYSTEM

The Federal Judiciary is comprised of Mexico's Supreme Court of Justice, the Electoral Court, the Collegiate and Unitary Circuit Courts, and the District Courts.

The Federal Judicial Council is the body responsible for the administration, supervision, and discipline of the Federal Judiciary, with the exception of the Supreme Court.

The Supreme Court is made up of 11 justices who sit either *en banc* or in chambers. Generally, both *en banc* sessions and sessions in chambers are open to the public.



## Chapter 1

# International Trade

## Introduction

The import and export industry is a key sector for economic development in Mexico because it has an impact on generating currency exchange, technological innovation, attracting foreign investment, and job creation. Globalization has increased interaction with international suppliers of raw materials and products, which helps decrease costs associated with marketing goods, developing products, and providing services.

Mexico has signed various free trade agreements with its major trading partners, which encourages the importation of goods, which are exempt from the General Import Tax, making Mexico a more competitive country.

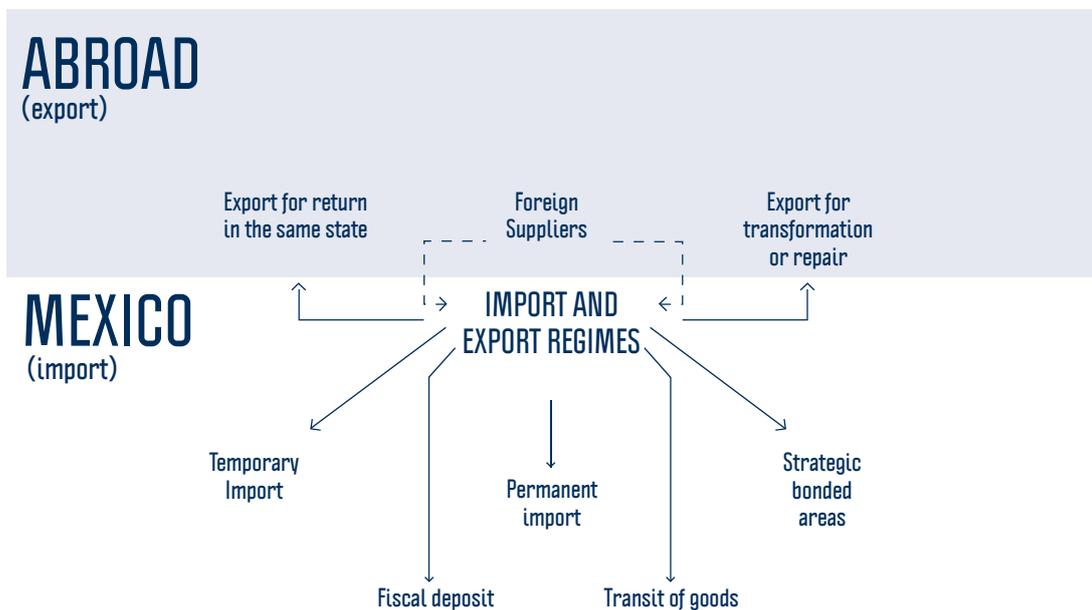
With the goal of encouraging foreign investment, raising capital, and creating jobs, Mexico has created export promotion programs. These programs allow for the temporary or permanent importation of supplies and machinery to produce finished consumer goods, which can be exported or sold domestically. Through the implementation of these programs, Mexico seeks to reduce or exempt the payment of the General Import Tax, Value Added Tax, and Customs Operation Tax.

Another mechanism for promoting foreign trade with other countries is the Strategic Tax Zone Regime, which allows for the entry of goods to be stored, manufactured, or repaired without the payment of taxes.



## KEY POINTS

- For imports, there are customs and tax benefits for companies importing goods originating from countries with which Mexico has concluded a free trade agreement (FTA), provided that they comply with the rules of origin. Among the benefits included are: (i) exemption from paying the Customs Operation Tax (DTA) or making payment under a fixed rate; and (ii) exemption from paying the General Import Tax (IGI).
- A certificate of origin is a declaration produced by an exporter, producer, or member state to an FTA in order to enjoy preferential tariff treatment for the import of their goods.
- The import and export promotion programs are promulgated by the Ministry of Economy to promote the importation to Mexico of supplies and machinery under competitive conditions in order to create jobs and promote foreign investment. Some of these promotion programs include: IMMEX, PROSEC, DRAW BACK, and the Eighth Rule Permit (*Permiso de Regla Octava*).
- The customs regime specifies the status under which goods are imported or domestically produced. There are 6 custom regime statuses: (i) permanent import/export; (ii) temporary import/export; (iii) strategic bonded areas; (iv) fiscal deposit (warehousing); (v) transit of goods; and (vi) manufacture or repair in bonded warehouses.



## QUESTIONS AND ANSWERS

**1- Can you avoid the payment of the IGI and DTA for the permanent importation of goods?**

In principle, all goods must pay the IGI and DTA. One mechanism to avoid payment of the IGI and DTA is to show proof that the goods originated from a country with which Mexico has signed an FTA.

**2- Do you have to pay VAT on the temporary importation of goods under the IMMEX program?**

No. The promotion program IMMEX is a program for producing goods through the temporary importation of supplies and machinery that will eventually be returned abroad.

**3- Do you have to pay VAT on the importation and sale of goods which are subject to the strategic tax zone regime?**

No. Strategic tax zones are federal zones, i.e. they are treated as if the goods are located abroad. However, once the goods are removed from within the tax zone the corresponding taxes must be paid.

**4- Is the importation of clothing manufactured in China still subject to antidumping duties?**

Prior to October 14, 2008, most goods manufactured in China were subject to countervailing duties (imposed to offset the unfair subsidies for goods entering the country). Currently, these antidumping duties have been eliminated. Instead, the Mexican government has implemented a temporary transitional measure that imposes an additional fee to be paid on Chinese goods being imported into the country. This temporary transitional measure will expire in December 2011.

**5- Are taxes paid by the importer of goods when the goods are in bonded storage?**

No. While goods are being warehoused, taxes are only provisionally calculated. When goods are removed from warehousing, taxes on the goods are paid according to the applicable tax regime. This is an attractive tax regime for foreign companies that wish to ship goods into the country but who do not have a subsidiary or affiliate located in the country since the storage and delivery of the goods is not considered permanent for foreign residents.

## CASE STUDY

“Company A” is a foreign company that intends to send machinery, equipment, and supplies to Mexico in order to produce, manufacture and repair automotive parts. These parts will be sold by “Company B,” which is also a foreign company, to “Company C” which is a Mexican automobile manufacturer.

**Can “Company A” send assets and raw materials for the production, manufacture, and repair of said automotive parts and subsequently sell them to “Company B” and “Company C”?**

Yes. “Company A” can do this by establishing a subsidiary or affiliate in Mexico or through a third-party, provided that the subsidiary or affiliate is registered with the Import Registry and participates in an IMMEX Industrial Program.

The temporary import of goods which is carried out through an IMMEX industrial program will not be subject to the payment of IGI, DTA, and VAT, with the exception of machinery, which will be subject to the IGI. The subsidiary company or third-party can transfer the temporarily imported goods to “Company C,” without having to pay taxes provided that the latter participates in an IMMEX program.

It is important to note that the goods must eventually be returned to their country of origin because their import is temporary.

Finally, “Company A” may sell the finished product directly to “Company B,” however, this would require an export license.



## Chapter 2

# Foreign Investment

## Introduction



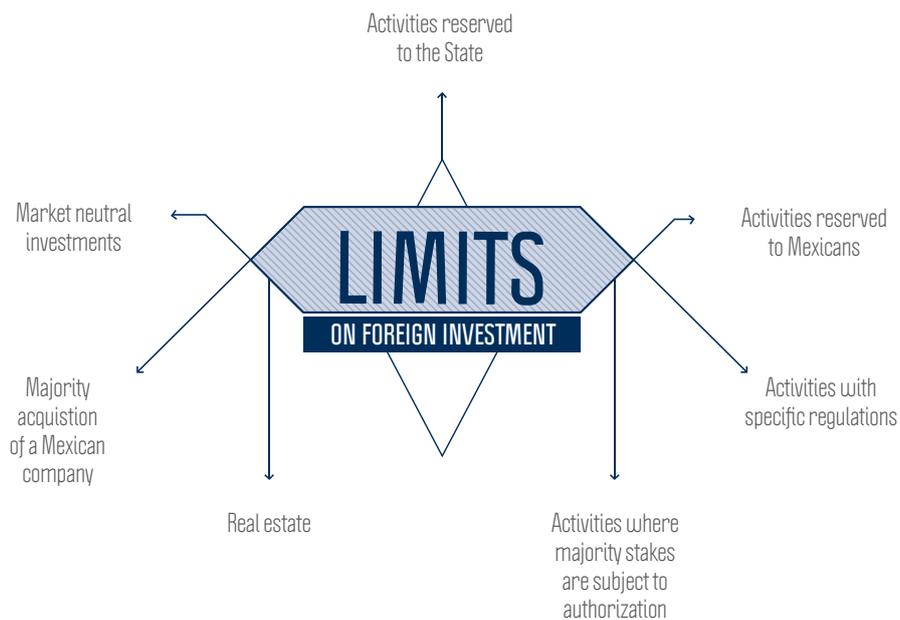
In recent decades, Mexico has established itself as a destination for foreign investment through the implementation of economic liberalization plans set out in the early nineties. Significant trade and investment barriers have been eliminated through the implementation of more flexible laws aimed at attracting foreign capital by allowing foreign access to various economic activities that were previously reserved for Mexicans.

Moreover, Mexico has concluded several trade agreements such as NAFTA and a treaty with the European Union, allowing Mexico to expand its market for goods and services. The governmental authority responsible for implementing and monitoring regulations on foreign investment is the National Commission for Foreign Investment (CNIE), which is a branch of the Ministry of Economy. The CNIE keeps statistical information on foreign investment through the National Registry for Foreign Investment (RNIE).

Foreign investment in Mexico is subject to certain limitations depending on the type of activity. The most politically sensitive economic activities are reserved to the State (oil, electricity, nuclear energy, postal services, production of banknotes and coinage, and airport control, among others). Certain activities are reserved for Mexicans, while other activities allow foreign investment up to a certain percentage.

## KEY POINTS

- Foreign investment is the participation by foreign investors in the capital stock of Mexican companies, regardless of the percentage.
- The Constitution requires foreigners who intend to engage in business in Mexico to be considered as Mexican nationals, and therefore waive their right to seek protection from their government.
- There are several ways to invest in Mexico, with the most common being the formation of a Mexican corporation (see Chapter 4), although it is also common to make investments through joint ventures, distribution agreements, franchises, or directly by opening a branch of the company.



## QUESTIONS AND ANSWERS

### **1- What are the percentage limitations on foreign investment in Mexico?**

Some of the activities in which foreigners can hold up to a 49% stake are: insurance, bonds, currency exchanges, leasing, factoring, investment advising, manufacturing and marketing of firearms and ammunition, newspaper publishing, port management, fuel supply for ships, aircraft and railway equipment, and telecommunications.

Other activities in which foreigners can have more than a 49% stake with the authorization of CNIE are, among others: airports, port services, cellular communications, oil pipeline construction, drilling of oil and natural gas wells, and private education services.

Finally, certain activities are reserved exclusively for Mexicans, such as, land transport of passengers and cargo (with the exception of courier or parcel services), retail sale of gasoline and liquefied petroleum gas, development banks, and certain professional services.

### **2- Can foreign individuals purchase real estate in Mexico?**

Yes, unless the property is located within the restricted zone (50 kilometers from the coast or 100 kilometers from the border). Foreign individuals can use investment trusts or neutral investment schemes to acquire property within the restricted zone, however, this requires government authorization.

### **3- Does Mexico offer incentives for foreign investment?**

Yes. Several states in Mexico offer incentives for foreign investors who want to establish businesses within the state, such as exemptions from certain local taxes and discounts on official registration. Foreign investment in Mexico is also protected by international agreements which allow investors to participate in trade and investment arbitration.

### **4- What are the obligations of foreign investors in Mexico?**

All investments must be registered with the RNIE. If the activity requires the authorization of the CNIE, the investor is required to complete the necessary applications before making an investment. Once the investment is made the investor must submit annual financial reports, and in some cases may be required to submit quarterly reports.

### **5- What is the consequence for failing to register a foreign investment with the RNIE or present obligatory information related to such an investment in a timely manner?**

The RNIE is empowered to impose fines as a consequence for failing to meet these obligations.

## CASE STUDY

“Company A” is a foreign company engaged in the construction and operation of airports around the world. “Company A” is interested in participating in an international public procurement bid for the construction and operation of a new airport being planned in one of Mexico’s world-renowned tourist destinations.

### **Can “Company A” act as an investor and airport operator?**

Subject to the specific provisions of the bidding rules, “Company A” may freely participate in the project provided that their participation does not exceed 49%. In order for the preceding to take place, “Company A” should establish a Mexican corporation that holds title to the concession for the construction and operation of the airport.

### **Can “Company A” have a stockholding interest of more than 49%?**

Yes. The law permits a greater stockholding interest so long as it is authorized by the CNIE. The process for obtaining authorization is relatively fast, but requires the submission of financial information by the applicant, as well as proof of experience and studies demonstrating that the project will benefit the Mexican economy.

### **Should “Company A” be registered with the RNIE?**

During the bidding process it is not necessary to register “Company A” because the investment has not yet taken place. However, in the case that the company wins the bid the Mexican company that will be established for the purpose of this project must register with the RNIE, detailing the percentage share of foreign investment.

## Chapter 3

# Banking, Securities, and Finance

## Introduction



The banking, securities, and **financial industry** is one of the fastest growing sectors in Mexico. It principally regulates and supervises the raising of funds from the general public; the prevention of transactions undertaken with illegally obtained resources; and the protection of information related to financial transactions, which involves the regulation of corporate matters.

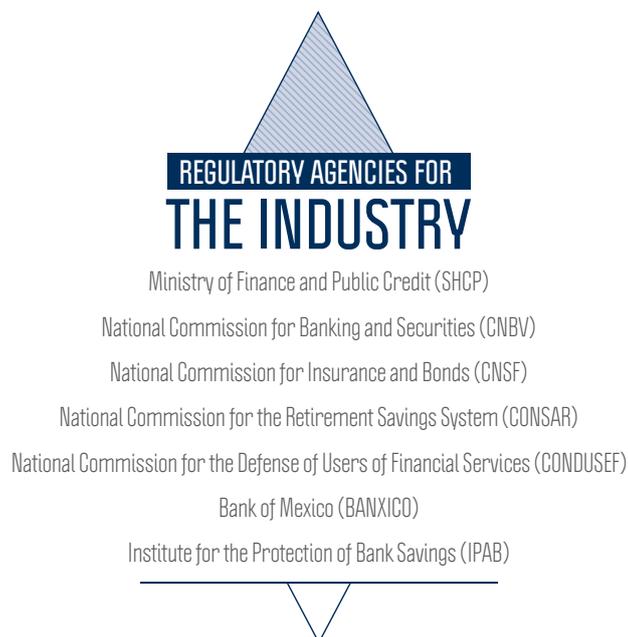
The raising of funds includes activities such as sale of securities, accepting bank deposits, and lending credit. Regarding the latter, however, factoring and capital leasing have been deregulated and do not require a license. These last three are activities engaged in by multipurpose financial companies, or SOFOMEs.

The regulation of the securities industry was reformed in 2005 with the passage of the Securities Market Law, which provides for three new types of joint stock companies: the Investment Promotion Corporations, both those that do and do not issue securities, and Stock Corporations.

The regulatory agencies for this sector are: (i) the Ministry of Finance and Public Credit (SHCP); (ii) the National Commissions: (ii.1) of Banking and Securities, (ii.2) of Insurance and Finance, (ii.3) for the Retirement Savings System, (ii.4) for the Defense of Users of Financial Services; (iii) the Bank of Mexico; and (iv) the Institute for the Protection of Bank Savings.

## KEY POINTS

- All areas of financial activity are open to foreign investment through the establishment of an affiliate.
- These institutions require authorization to operate: (i) banks; (ii) brokerage firms; (iii) stocks and ratings agencies; (iv) institutions for depositing stocks; (v) insurers; (vi) bonding companies; (vii) general depository institutions; (viii) currency exchanges; and (ix) credit information companies.
- SOFOMEs do not require authorization to operate because they are funded by investors in the securities market, and do not attract resources from the general public.
- Money transfer companies do not require the issuance of a license or permit, but are subject to certain obligations to prevent transactions from being undertaken with illegal resources.
- Tender offers can be public or private.



## QUESTIONS AND ANSWERS

**1- Is it possible to offer financial products and services without authorization from the government?**

Only in leasing, factoring, credit, and money transfers.

**2- What relevant laws and regulations should be considered in financial matters?**

The circulars published by the regulatory commissions examine various corporate and administrative requirements. Additionally, the SHCP has rules for preventing transactions from being undertaken with illegal resources. There are also consumer protection laws that provide rules for public information related to mortgage and consumer lending.

**3- Under what circumstances is a securities offering considered public?**

Securities offerings are considered public when the purchase and sale of securities is announced to the general public through mass media communication.

**4- Under what circumstances is a securities offering considered private?**

A securities offering is considered private when it is offered to less than 100 people, conducted pursuant an employee benefits program, carried out amongst members of a private organization, or conducted with an investor of high-net worth or an institutional investor.

**5- Can a foreign insurer insure business conducted in Mexico?**

No, not if the person insured is in Mexico or the insured risk will happen in Mexico. An insurer also cannot insure financial transactions if the transactions to be insured are subject to Mexican law.

## CASE STUDY

A company wants to enter the Mexican market to offer certain financial products and services, namely: (i) credit, debit, and prepaid cards; (ii) electronic payment services; (iii) stock investment advice; and (iv) credit information.

**Do you need a license to provide the services mentioned in the previous paragraph?**

Financing credit and offering securities investment advice does not require authorization, however, electronic payments and credit counseling are subject to the discretionary approval of financial authorities because they involve attracting resources from the general public or brokerage services.

**Why is the granting of credit not subject to approval?**

Credit is deregulated to the extent that the institution's own money is being lent or that it is obtained from investors as a result of prior transactions that were supervised by a regulatory authority, as in the case of negotiable instruments.

**Why is the offering of stock investment advice not subject to prior approval by relevant financial authorities?**

Such activity is considered "self-regulated" and is provided as a professional service. People who are engaged in offering investment advice are not subject to supervision by relevant authorities, but are forbidden from receiving their clients' money in order to invest it, prohibiting them from being intermediaries. Nor may they receive compensation from companies they recommend for investment since they depend on client fees.

## Chapter 4

# Corporate Matters

## Introduction

Foreign investors can establish a presence in Mexico in order to engage in business activities. This can be done directly, through the establishment of a company formed under the laws of Mexico or by acquiring all or part of an existing Mexican company, or indirectly, through a commission agreement or distribution contract.

Investors may also enter into a joint venture agreement, which will give them a share in the losses and profits of a business, in one or more commercial ventures.

There is also the possibility of opening a local office in Mexico or establishing a branch of the foreign company.

If an investor intends to engage in business activities which are non-commercial in nature, investors can form non-profit organizations and associations, including organizations engaged in welfare services.

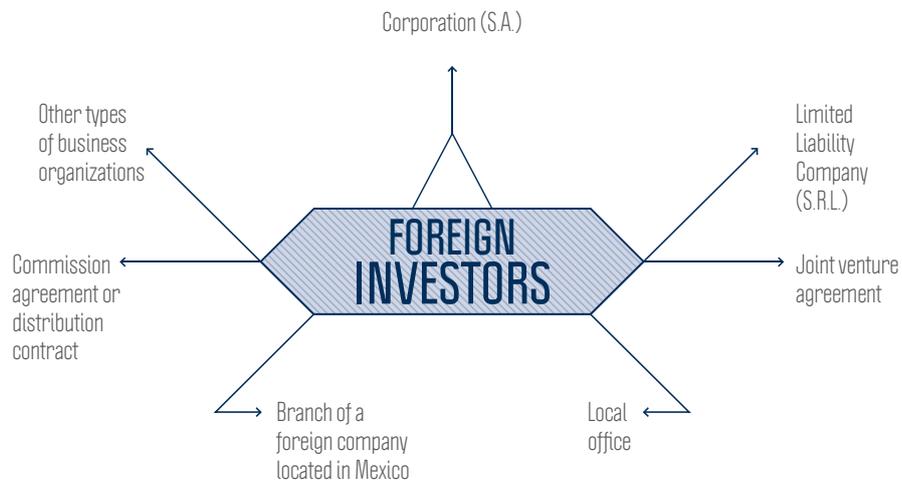
Only in rare cases can foreign investors have a majority stake in a Mexican corporation or partnership (see Chapter 2).



## KEY POINTS

There are several types of business organizations, and from a practical standpoint the preferred options are:

- a) The formation of a corporation (S.A.) (whose capital is represented by shares); or
  - b) the formation of a Limited Liability Company (S.R.L.) (which blends elements of a corporation and a partnership).
- Both business organizations can adopt a variable capital company model, which allows them to increase and decrease capital without the need for a notary public or to register the change with the Public Registry of Commerce.
  - The S.A. is the most flexible option.
  - The S.R.L. can provide certain tax advantages for U.S. investors, as a “flow-through entity.”



## QUESTIONS AND ANSWERS

**1. What is the procedure for forming a company or corporation?**

The requirements are: (i) to obtain a government permit which includes the approval to use a particular name; (ii) that the founding partners grant certain powers to attorneys at our firm; and (iii) to identify the principal activity in which the entity intends to engage, the primary place of business, the names of directors and senior officers, and the responsibilities of those officers in order to grant them sufficient authority.

**2. How long does it take to form a Mexican company or corporation?**

About three weeks, once all relevant information has been submitted and the government permit has been issued.

**3. What is the initial amount of capital needed to start a company or corporation?**

The initial amount needed to start an S.A. is MN\$50,000, and to start an S.R.L. is MN\$3,000, even if the respective company is formed as a variable capital company.

Mexican law does not specify a fixed amount of initial capital needed to start other types of corporations or partnerships.

**4. Is it necessary for the members of the Board of Directors and officers of a Mexican corporation or company to have Mexican citizenship or reside in Mexico?**

No. It is not necessary for the members of the Board of Directors and officers to have Mexican citizenship. Nor is it necessary for members of the board and officers to reside in Mexico. However, board members and officers who will be carrying out obligations and exercising authority in Mexico will need a permit from Mexican immigration authorities.

**5. What is the minimum number of partners that a Mexican company or corporation must have?**

The minimum number of partners is two.

## CASE STUDY

“Shareholder A” seeks to become a minority investor in a corporation by acquiring 20% of its shares. The other shareholders, “Shareholders B and C”, have majority ownership, and own 80% of the shares.

**How can “Shareholder A” be protected so that the value of his shares is not diluted without his consent, or to prevent “Shareholders B and C” from adopting resolutions contrary to the purpose for which “Shareholders A, B, and C” originally associated?**

Since it would be contrary to the basis of the corporate system to establish in the corporate bylaws that any agreement made at a shareholders’ meeting must be approved by an affirmative vote of 81% of shareholders, the following could be established in the bylaws:

- a) Increases and decreases to corporate capital must be approved by 81% of shareholders.
- b) The following issues require the approval of 81% of shareholders: (i) changes to the primary objective of the corporation; (ii) an amendment to the articles of incorporation or the bylaws; (iii) early dissolution of the corporation; (iv) merger; and (v) decisions not to distribute dividends.

The bylaws should also state that the Board of Directors is in charge of administering the corporation, and that any minority shareholder holding at least 20% of shares has the right to name a director.

## Chapter 5

# Labor Law

## Introduction



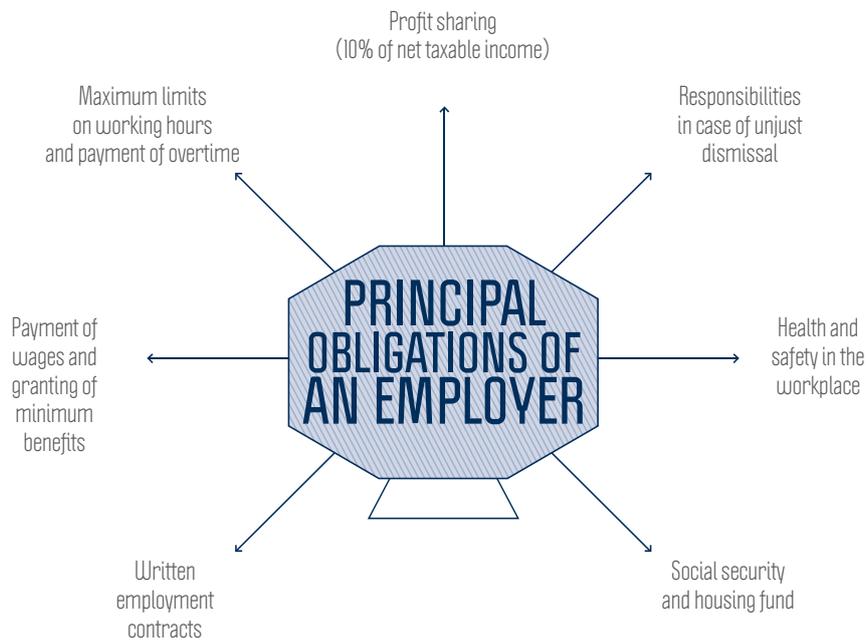
The Federal Labor Law (LFT) regulates all aspects of the relationship between employers and employees, including those related to minimum salary requirements, maximum work hours, overtime rates, minimum benefits for bonuses, holidays and paid vacations, unions, collective bargaining agreements, strikes, and health and safety in the workplace.

The LFT provides rights for employees that go beyond those provided in many industrialized countries. For example, employees are entitled to profit sharing, can only be dismissed in a limited number of cases, and are entitled to seek reinstatement or severance pay if unfairly dismissed.

Employers are required to register with the social security administration and the housing fund. Employers are also required to register all of their employees with these agencies. Employers are obligated to pay tax contributions to these agencies' funds, and lack of payment or untimely payment by an employer will result in surcharges and late payment penalties.

## KEY POINTS

- The fundamental element to determining whether an employment relationship exists is whether a party has agreed to provide subordinate services to another party. This type of relationship can exist even if no written contract, or other formality, has been entered into by the parties.
- Employment contracts must be in writing. If a dispute arises, the employer must provide evidence of the amount and duration of wages paid, benefits, and other working conditions.
- A strike involves the complete suspension of all work at a company worksite. Only the labor authority has the power to decide whether the majority of employees support the strike once work has been suspended at the company.
- The government agencies responsible for administering social security and the housing fund are empowered to collect from the employer unpaid contributions, and to seize company assets to secure payment.



## QUESTIONS AND ANSWERS

**1. Are “at will” employment contracts legal?**

No. The general rule is that an employment contract is of indefinite duration. Temporary employment is permitted when there is a cause that justifies the limited duration of employment, such as a specific work project, extraordinary work, or the temporary replacement of employees that are absent because of leave, holiday, or other similar reason.

**2. Can an agent be considered an employee?**

Yes. An agent can be considered an employee if that individual is a third party who offers subordinate services for the company, or works personally and on permanent basis as a sales agent for the company’s products.

**3. Is it permitted to pay bonuses instead of profit sharing payments?**

No. Profit sharing is mandatory. However, an employer can set up a performance bonus system which forms part of the profit sharing payment, in which case, any difference will be paid through a bonus. For example, if the worker is entitled to \$100 through profit sharing and his overall bonus is \$120, he would receive his \$100 profit sharing payment plus his \$20 bonus.

**4. Is there a minimum number of employees required to form a union?**

While the law requires a minimum of twenty employees to form a union, there is the possibility that regardless of the number of employees at a company, the employees can join another union which is already formed and registered, as a means to allow them to strike, and then request from the company that they enter into a collective bargaining agreement.

**5. Is it possible to avoid registering for and paying contributions to social security by purchasing private life and health insurance for employees?**

No. Participation in the social security system is mandatory and cannot be waived by contracting with private insurers.

## CASE STUDY

An employee who has committed fraud against a company is dismissed without the employer giving written notice. The employee makes a complaint against the employer before the labor court alleging that he was the subject of unfair dismissal and asks for payment of lost wages. Calculation of lost wages begins to accrue from the date of termination until the date the court resolves the matter.

Mexican employment law offers ample protection for employees against employers. Fraud committed by an employee is a legal cause for dismissal. However, in a case like this, even when the employer has provided evidence sufficient to establish fraud the court will generally decide in favor of the worker.

The employer is required to personally hand the employee a notice stating the reason for his or her dismissal. If the employee refuses receipt of that notice, the employer must inform the court of the refusal so that the notice can be delivered to the employee at his or her home address.

Failure to comply with this procedure is grounds for considering the dismissal to be unjust, even though the employer demonstrated that the employee committed an act that would result in a legal cause for termination.



## Chapter 6

# Immigration

## Introduction



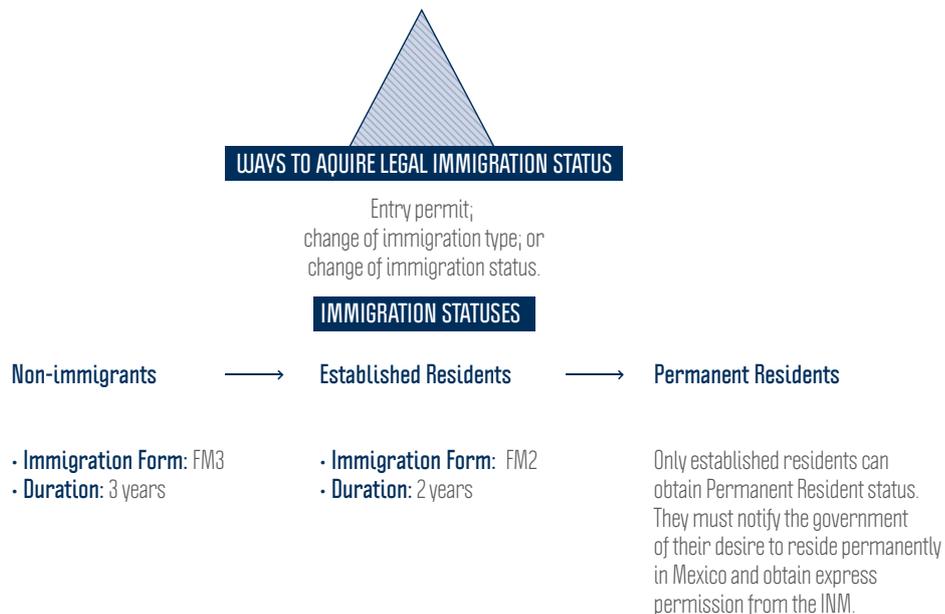
Immigration has become a growing phenomenon in Mexico in recent years. In this context, the legal status of foreigners in Mexico is safeguarded by legal mechanisms enacted by the Ministry of the Interior, through the National Immigration Institute (INM), a body empowered to monitor and regulate the residency of foreigners.

The General Population Law (LGP) establishes the rights and obligations of foreigners, and regulates the different immigration statuses that allow foreigners to enter Mexico in order to achieve their objectives, such as conducting business or engaging in income-generating activities. As a result, individual visas granted by the Ministry of the Interior specify the immigration status, and the rights and obligations of the foreigner while in the country.

The government has recently implemented the use of the Manual for Immigration Standards and Visas (the Manual), as a means of standardizing criteria on a national level with the goal of making the procedures for foreigners more efficient.

## KEY POINTS

- The LGP establishes three general immigration statuses: non-immigrants, established residents, and permanent residents.
- All foreigners who enter the country receive a multi-use immigration form (FMM). This immigration document replaces the tourist immigration visa (FMT), and offers foreigners greater access to the immigration status that they need.
- The FMM has three objectives: (i) documenting foreigners at their port of entry into the country, and authorizing their legal stay in Mexico for up to 180 days; (ii) documenting foreigners with consular visas which are to be replaced with an FM3 or FM2; and (iii) for statistical purposes.



## QUESTIONS AND ANSWERS

1. Are the previously granted FM3s and FM2s issued before the Manual still valid?

FM3 and FM2 immigration documents are still valid for non-immigrants (FM3), and established residents and permanent residents (FM2) until their expiration date in accordance with the provisions of the LGP.

2. When can you change your previously granted FM3 or FM2 for new immigration documents?

The old FM3 and FM2 should be replaced at the normal renewal time by the person named on the immigration document, or in case of loss.

3. Have the criteria for admitting businesspeople into the country changed since the publication of the Manual?

Derived from various international conventions signed by Mexico, the Manual offers the existing criteria for the temporary admission of businesspeople. The objective is to facilitate the movement of foreign individuals who are contributing to economic development. The classification and status for this type of individual is one of a non-immigrant visitor, engaged in lucrative activity, for a maximum period of 180 days.

4. During the process, may a foreigner leave the country?

Foreigners who are in the process of changing their immigration status to one of non-immigrant tourist to non-immigrant visitor, regularization, administrative review, or other status, or those who have had a fine imposed upon them for breach of obligation, cannot apply for an entry and exit permit. These individuals must wait for notification from the Regional Bureau of the National Immigration Institute (DG-INM) that their immigration proceeding has been concluded.

In special cases, it is possible to withdraw from a pending proceeding and obtain permission to exit, terminating the proceeding. In this case, the foreigner would have to initiate a new immigration proceeding once he or she has returned abroad.

## CASE STUDY

A U.S. citizen incorporates a Mexican company as the new CFO. His position as CFO will last for at least 5 years, and his salary will be paid by the Mexican company. “Mr. X” will need to travel both within and outside the country, and does not want to have any problems regarding his travel.

### What is the best way for him to get his FM3 work visa?

In accordance with new immigration policies in Mexico, it is recommended that “Mr. X” obtain a legal entry permit for foreigners, as a non-immigrant visitor engaged in lucrative activities in Mexico.

The first step is to apply for the appropriate documents both with the Mexican company and as a foreign worker. The documents must demonstrate the foreign individual’s ability to perform these activities (along with their respective formalities).

### How long does it take for the FM3 work visa to be issued?

It is necessary to submit an application for a work visa before the DG-INM. After submitting this application, the DG-INM will issue an official notification within 3 or 4 weeks, which will authorize the foreigner to appear at any Mexican Consulate in order to receive his or her visa.

### What is the next step in obtaining legal entry documents?

The foreigner worker will need to go to the Mexican Consulate with a passport and a copy of the official DG-INM notification, and pay the relevant government fees in order for the visa to be issued.

As soon as the foreign worker travels to Mexico, he or she will receive an FMM at the port of entry, and the immigration official at the port of entry in Mexico will check the box on that form that clears the foreign worker for the issuance of an FM3.

Once in Mexico, the foreign worker has 30 days to request the issuance of the FM3 at a local immigration office.

## Chapter 7

# Tax Law

## Introduction

The Mexican State is a federation made up of 31 states and a Federal District. The municipality is the territorial, administrative, and political division of each state. The Mexican tax code provides for three levels of government taxation: federal, state, and local.

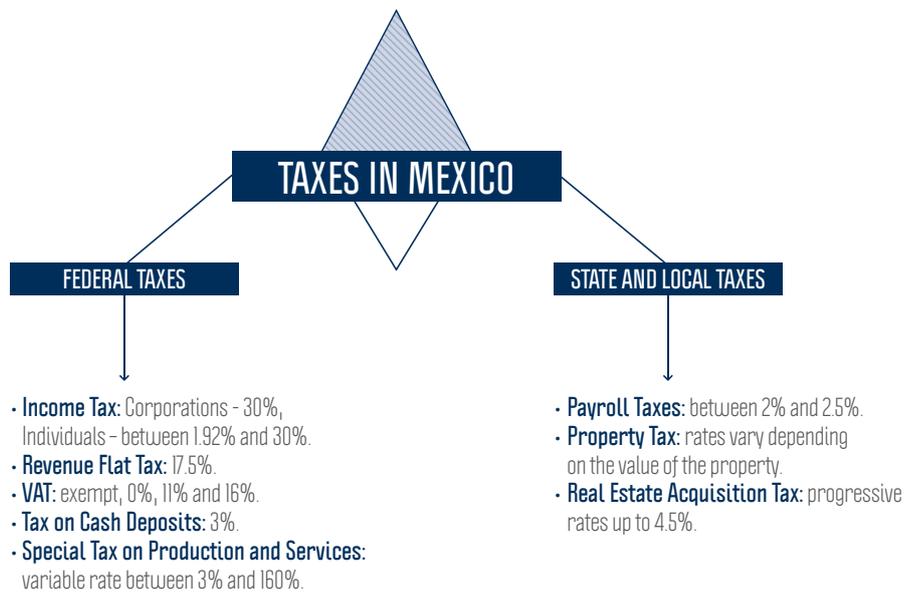
As a result of the divisions between different levels of government, federal taxation is the primary level of taxation and consists of the Federal Income Tax (ISR), a Revenue Flat Tax (IETU), and a Value Added Tax (IVA). State taxes basically consist of a Payroll Tax, Property Tax, and a Real Estate Acquisition Tax, amongst others. The collection of tax revenue for drinking water, drainage, sewage, street lighting, etc. is reserved to local governments by the Mexican Constitution.

The body in charge of calculating and collecting federal income tax is the Tax Administration Service (SAT), while state and local taxes are calculated and collected by their respective treasuries. It is important to keep in mind, however, that there are tax coordination agreements between the federal and state governments, and therefore the states are entitled to audit and collect federal taxes.



## KEY POINTS

- Federal Income Tax is levied on the income of individuals and corporations. Payment is made annually, and interim monthly statements are sent to the taxpayer.
- The Revenue Flat Tax is levied on revenue, and calculated in conjunction with the Federal Income Tax. The taxpayer pays the higher of the two taxes.
- The Value Added Tax is levied whenever a person or entity performs any of the following activities within Mexican territory: (a) sells goods or real estate; (b) renders independent services; (c) grants temporary use or benefits over goods or real estate; or (d) imports goods or services.
- Main state taxes include: property taxes, which are levied upon land and attached buildings, and payroll taxes, which are levied upon salaries or wages.



## QUESTIONS AND ANSWERS

**1. Does the Mexican government provide tax benefits?**

Yes. The tax code provides benefits such as immediate deductions for investment, the hiring of people with disabilities, and investment in real estate developments, amongst others.

**2. Do taxpayers have to pay both Federal Income Tax and the Revenue Flat Tax?**

Yes. However, the payable flat tax is the difference between the amount of this tax and the amount of income tax that has already been withheld. The flat tax is only paid when the amount of the income tax is less than the flat tax amount. For example if the flat tax is calculated at \$500 and the withheld income tax is \$500, then the taxpayer pays \$0. If the flat tax is calculated at \$500 and the withheld income tax is \$400, then taxpayer must pay \$100. Likewise, if the withheld income tax is greater than the flat tax, then the flat tax is not paid.

**3. Are transactions carried out by related parties subject to certain requirements?**

In some cases, it is mandatory to carry out a transfer pricing analysis. In all cases, parties should determine the value of their deductions and revenue as if the transactions were being carried out by independent parties.

**4. Are there mechanisms in Mexico to avoid double taxation?**

Yes. Mexico provides a credit for income taxes paid abroad, and has also concluded a number of international treaties to avoid double taxation. The majority of these treaties have adopted the OECD Model Tax Convention.

**5. Can you recover VAT paid in Mexico?**

Yes. Taxpayers who generate a VAT can receive refunds on the VAT they have paid in Mexico, in accordance with certain rules.

## CASE STUDY

“Company A” which is located in Mexico will distribute dividends to “Shareholder B,” who is a resident of “Country X.” Thereafter, “Shareholder B” intends to sell his shares in “Company A” to “C.” Finally, “C” who is also a resident of “Country X,” wants to market machinery in Mexico which originates from “Country X,” and employs one worker for such ends.

**a) Are dividends distributed to “Shareholder B” by “Company A” taxable?**

The dividends are not subject to withholding and will not be subject to a corporate capital gains tax if income tax (ISR) has already been paid on the dividends in Mexico.

**b) Does “Shareholder B” have to pay income tax, flat tax, or value added tax on the sale of shares of “Company A”?**

The income tax code requires that taxes be paid upon the sale of shares, however, there are some treaties that have been entered into which offer relief from double taxation, and establish benefits such as the reduction or exemption from payment of income taxes for non-residents. The sale of shares is exempt from VAT and IETU taxation.

**c) Do the activities performed by the employee of “C” create a permanent establishment in Mexico?**

No, so long as the employee does not have the authority to enter into contracts in the name of or on behalf of “C” with the intention of conducting business for “C” in Mexico.

## Chapter 8



# Intellectual Property

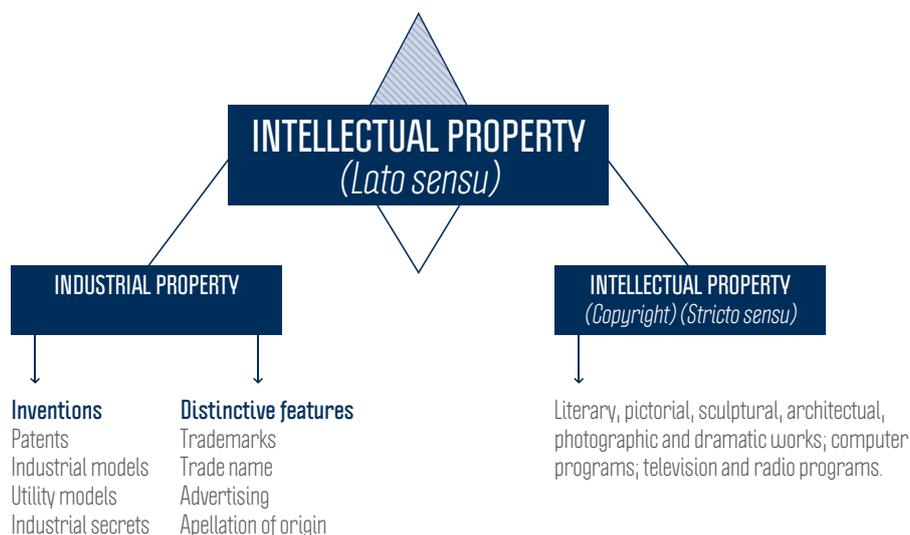
## Introduction

Intellectual property, in a broad sense, aims to promote industrial activity and encourage creativity for the design of new products through the granting of patents for inventions, the registration of utility models, industrial designs, trademarks, advertisements, publication of trade names, appellations of origin, as well as actions aimed at defending intellectual property rights against infringers.

The competent authority in Mexico is the Mexican Institute of Industrial Property (IMPI), whose main purpose is to stimulate the development of technology for the benefit of society.

## KEY POINTS

- Patents are inventions that are new, resulting from an inventive step, and that have an industrial application, with the exception of: (i) processes which are biologically essential for the production, reproduction, and propagation of plants and animals; (ii) biological and genetic materials that are found in nature; (iii) animal breeds; (iv) the human body and its component living parts; and (v) plant varieties.
- Industrial designs include: (i) industrial drawings, which consist of all combinations of images, lines, or colors which are incorporated into an industrial product for decorative purposes, giving it its own, particular aspect; and (ii) industrial models, which consist of three-dimensional shapes or patterns which serve as models for the manufacture of an industrial product, give it a special appearance, and do not involve technical properties.
- A trademark is any visible sign that distinguishes a good or service from similar goods and services that are on the market. Slogans consist of phrases or sentences intended to advertise or publicize establishments, commercial, industrial, or service-based business, or products or services, with the aim of distinguishing them from other similar ones. A trade name grants protection in a geographic zone where a company's actual clientele is established. This can be extended to the entire Republic if it is nationally recognized. It applies only to commercial establishments.
- A license is an authorization granted through an agreement for the use by one or more individuals, with respect to all or some of the products or services to which a trademark is applied. The license must be registered with the IMPI in order to be binding vis-a-vis third parties.
- Copyright refers to those rights derived from the creation of an original work that is capable of being disclosed or reproduced in whichever form or medium. Copyright is the recognition given by the government to all creators of literary and artistic works, and which grants protection so that the author can enjoy personal and economic prerogatives and privileges.
- A domain name is an identifier common to a group of computers or devices connected to a network. It is a simple internet address designed to allow users to easily locate websites. Today abusive domain name registrations exist, so there is a policy in place for the recovery of the .mx domain.



## QUESTIONS AND ANSWERS

### 1. What are the requirements for registering a trademark?

Submit a written request to IMPI containing the following information: name, nationality, and address of the applicant; the distinctive feature of the trademark; the date of the first use; the products or services to which the trademark applies; among others, in accordance with the Law on Intellectual Property.

### 2. What types of trademarks exist?

Nominative, unnamed, mixed, and three-dimensional. Trademarks may be a word, or a combination of words, letters, and/or numbers. They may consist of drawings, symbols, or three-dimensional features such as the shape and packaging of a product.

### 3. For how long are trademarks valid?

Trademarks are valid for 10 years and are renewable for equivalent periods.

### 4. Should the licenses be registered in order for them to be effective?

Yes. When a patent or trademark license exists, it must always be in writing and registered before the IMPI.

### 5. What are the obligations of a trademark holder?

The trademark holder is obligated to use the trademark in the manner for which it was granted. If the trademark is not used for three years, a third party can request the revocation of the use of the trademark.

## CASE STUDY

“Pharmaceutical Company A” is a German company which has decided to distribute its product “Drug X” in Mexico. With this goal in mind, the company contacts “Company B”, a Mexican company with the experience necessary for the sale and distribution of drugs in Mexico. The companies enter into a distribution agreement which includes authorization for the use of “Pharmaceutical Company A’s” leading trademark. Because they are unfamiliar with the law, “Pharmaceutical Company A” fails to register the trademark for its leading product in Mexico.

After 10 years, “Pharmaceutical Company A” decides to set up a subsidiary in Mexico to distribute its products, but it is surprised to find that the trademark has already been registered on behalf of “Company B.”

### **How can “Pharmaceutical Company A” recover its trademark?**

The company should initiate a revocation proceeding with IMPI, claiming prior use in Mexico or abroad, or arguing that a distribution relationship existed between “Pharmaceutical Company A” and “Company B.”

### **What is the statute of limitations for initiating a revocation proceeding for prior use and distribution?**

In the case of prior use, the company has 3 years from date that notice was published that the trademark was granted. In the case of the existence of distribution relationship, there is no limitation.



## Chapter 9

# Environmental Law

## Introduction

In Mexico, like in other countries, environmental regulations are constantly evolving in response to advances in technology and production which directly or indirectly impact the environment. Today, issues such as climate change, waste, biotechnology, and biodiversity are just some of the issues that environmental regulations govern transversally.

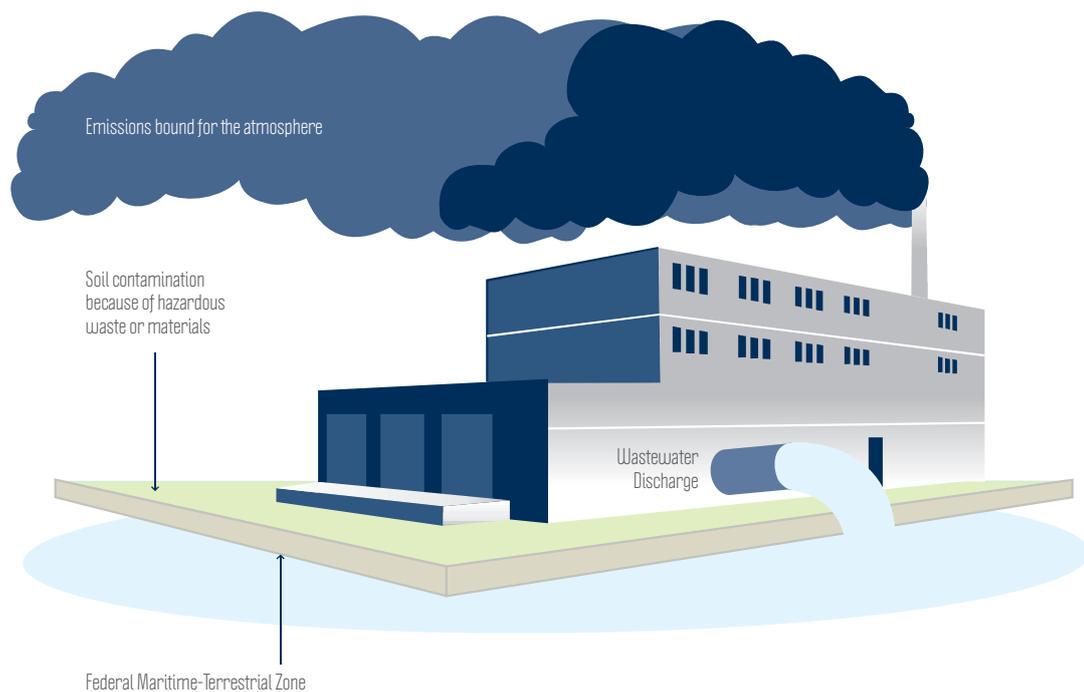
Mexican environmental regulations have been enacted to regulate everyday activities so that they do not compromise the needs of future generations. These laws are intended to regulate the impact that these activities have on the environment, as well as impose liability for those responsible for harming it.

Today, the fight against climate change has become a priority for the Mexican government. Deforestation and the increased use of fossil fuels to generate electricity, and in industry and transport, have contributed to an alarming increase in global warming as a result of greenhouse gas emissions (GHGs).



## KEY POINTS

- Environmental issues are regulated concurrently on federal, state, and local levels, and in the Federal District. Each level of government issues its own environmental legal standards.
- Some environmental issues such as climate change, wildlife preservation, and water pollution require a multi-faceted approach, i.e. they must be analyzed from different points of view by businesses (corporate, tax, administrative, etc).
- There are three types of liability for environmental issues: administrative, civil, or criminal, as applicable.
- Reducing electricity consumption, using renewable energy, and switching to clean fuels are just a few ways to reduce greenhouse gas emissions.
- There are international, regional, and national mechanisms for reducing or capturing greenhouse gas emissions through, for example, cap and trade programs.



This graphic is an example of how an industry can impact the environment through the emission of air pollutants, wastewater discharge, soil contamination because of hazardous waste or materials, and in some cases, the exploitation or use of Federal Maritime-Terrestrial Zone (“Zofemat”) without government authorization or concession. The Federal Maritime-Terrestrial Zone is an area that extends to 20 meters from the mainland, surrounding the coastline, which includes beaches, coastal lagoons, and estuaries.

## QUESTIONS AND ANSWERS

1. Must one obtain authorization before beginning any work or activity that may impact the environment?

Depending upon the type of work or activity planned, one may be required to obtain approval from either federal or state authorities, as appropriate. It is also important to consider whether the planned activity is going to be carried out on land which has land-use restrictions or is located in a protected natural area. Additionally, state and local licenses and permits must be obtained for projects involving environmental matters.

2. In the event that one intends to acquire property where activities involving hazardous waste or materials were carried out, is there a risk for the buyer or lessee of that property?

Yes, there is a risk. When the buyer or lessee acquires possession or ownership of a contaminated site they assume joint and several liability for remedying the contamination on site, in addition to other potential penalties. The purchaser of the contaminated site may have recourse to legal action against the polluter and seek a damages award. It is essential to ensure that the site being considered for purchase or lease is free from environmental liabilities. Moreover, it is prudent to include environmental clauses in contracts for lease or sale which establish responsibility or liability in case of contamination.

3. Is there a risk of losing a water concession awarded by the National Water Commission if it the concession is not exploited, utilized, or exploited in full?

National Water Commission regulations establish that if there is no exploitation of a water concession within a period of two consecutive years, the concession holder will lose the non-exploited volume of water because of an effective declaration of revocation. In the case of the water concession going unexploited for a technical, economic, or natural reason, the concession holder should inform the authorities as soon as possible in order to avoid a revocation of all or part of a concession.

4. What are the risks of developing a project in the Federal Maritime-Terrestrial Zone without authorization or in excess of the permitted limits?

Any work taking place in the Federal Maritime-Terrestrial Zone requires a concession which establishes the terms and conditions under which the work must take place. If an individual carries out a project in this zone without authorization, that individual may be subject to fines, and the project may be suspended and even demolished. In the event that a project causes environmental damage those responsible (i.e. directors, legal representatives) face liability for damages.

5. What are common mechanisms for financing programs for the reduction/capture of greenhouse gases in a country like Mexico where there is no obligation to reduce GHG emissions?

Carbon credits:

Carbon credits are bought by companies in countries where they have an obligation to reduce carbon emissions.

On the other hand, there are also voluntary carbon credit programs. Some companies participate in these carbon credit programs because of their commitment to helping solve climate change and to promote their image as a “green” company. Carbon credits are referred to by different names depending on the mechanism under which they arise. For example, under the Kyoto Protocol, these credits are referred to as certified emission reductions.

Government financing is also available for programs which promote energy efficiency, a switch to cleaner fuels, the acquisition of cleaner technologies, and reforestation.

## CASE STUDY

“Company X” is interested in acquiring “Company Y” which produces organic food and products. As part of its production process, “Company Y” generates a large quantity of water, soil, and air pollutants.

Additionally, “Company Y” consumes a large amount of electricity, generates steam which is not reutilized in production, and also uses diesel fuel to power production - all of which release a large amount of greenhouse gases into the atmosphere.

### **What implications might there be for “Company X” if they acquire “Company Y” given the current condition of “Company Y”?**

Acquiring “Company Y” under present conditions would result in “Company X” having sole responsibility for liabilities arising out of damages caused by environmental pollution. Assuming that responsibility means also assuming responsibility for both remedying the situation and for sanctions imposed by the environmental protection authorities. However, it may be possible to acquire “Company Y” while also stipulating in the acquisition that “Company Y” must rectify the situation in accordance with environmental law.

### **Could “Company X” obtain carbon credits by implementing the use of technology aimed at reducing greenhouse gas emissions?**

“Company X” could obtain certified emission reductions in accordance with the regulations of Kyoto Protocol’s Clean Development Mechanism. Certificates would be issued for the reduction of greenhouse gas emissions resulting from the use of technology which reduces electricity consumption, reintegration of the steam generated through the production process, and the use of natural gas and renewable energy rather than diesel fuel.

## Chapter 10

# Public Procurement

## Introduction

It is the duty of the government to provide basic services for the population, however, many times because of a scarcity of financial resources, that obligation is too great and the increasing demand of the population requires that health, infrastructure, and education needs are met.

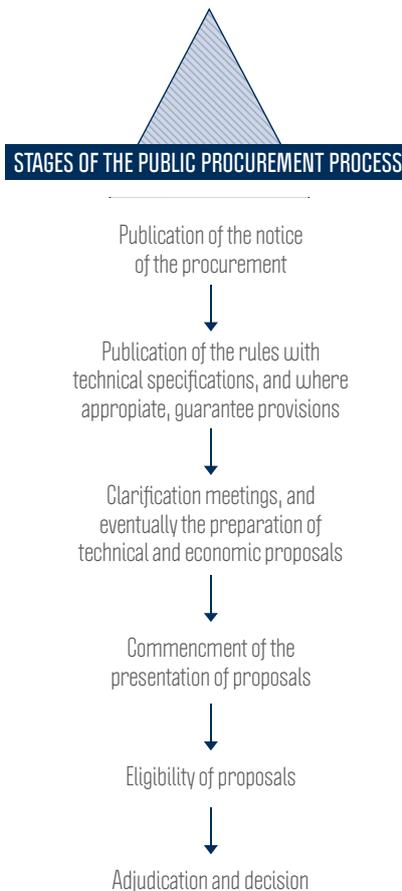
As a result, the government must hire individuals and private entities to collaborate with in order to meet the demands of the population. Some of these public procurements are arranged through a public bidding process, an invitation of at least three people (a private bid), the direct award of a contract, an auction, or through a competition.

There are other mechanisms for public-private partnerships, such as projects to provide services (PPS), which seek to meet collective needs through the joint participation of the private and public sectors, with each party sharing a portion of the risk. Thus, the private sector becomes a government services provider, with obligations to build the necessary infrastructure for the service provided when required.



## KEY POINTS

- The general procedure for public procurement is through a process of public bidding, through which the government seeks to obtain the best price, quality, and financial conditions.
- Public expenditure and the principles that govern public procurement are guided by: efficiency, effectiveness, economy, transparency, and honesty.
- When a public bid is not the most convenient way to contract, procurement can take place through a private bid, involving at least three parties, or through the direct award of a contract.
- A concession is a title issued by the government to a party or a contract entered into by the government with a party which is non-transferable, subject to termination, and revocable, which allows that party to: (i) exploit and take advantage of state-owned assets (a property concession); or (ii) to operate a public service (a services concession).
- Industries in which concessions are granted are: telecommunication, telephone, radio and television, ports, airports, roads, bridges, drinking water, and mines, among others.



## QUESTIONS AND ANSWERS

1. How can companies participate in the process of procurement for goods, services, leases, and public works for the departments and agencies of the Federal Government?

Either through: (i) the website of the Federal Government's Electronic Government Procurement System (COMPRANET); (ii) the websites of the purchase or acquisition departments of states or municipalities; or (iii) notifications which are published periodically in the Federal Official Gazette, and the official gazettes of the states and municipalities.

2. Who can enter into a concession contract with the government?

Any individual or corporation, foreign or domestic, involved in a public procurement proceeding who wins the public bid as a result of meeting all the requirements, and because their proposal presents the best price, quality, and financial conditions, as well as the best opportunity for the Mexican government.

3. How can an individual or corporation, foreign or domestic, contract with the government?

Individuals and corporations can participate, either directly or through a consortium, in a procurement proceeding initiated by the government. A consortium is a group of individuals or corporations, foreign or domestic, who join to participate in a procurement proceeding.

4. Can proposals be submitted after the submission deadline?

The principle of fairness which governs the bidding process means that the agency running the bidding process cannot grant privileges to some bidders and deny privileges to others. Therefore, it is inadmissible to receive an offer submitted after the deadline. If a winning bid is accepted under these circumstances, this situation will create fatal defects in the proceeding because the bid was not disqualified.

## CASE STUDY

The only way to reach the Cocos Island is via a nearly 50 year old one-lane bridge. Local inhabitants, service providers, and investors want a more efficient and safer bridge built, and in order to do so would be willing to pay a toll.

The state government wants to make Cocos Island a tourist destination and an anchor for the regional economy. In order to achieve this, the government wants to build an eight-lane bridge utilizing the most advanced construction techniques, but lacks the necessary resources to do so. Therefore, the government wants to grant a concession to a domestic or foreign company for the construction and operation of the bridge to Cocos Island.

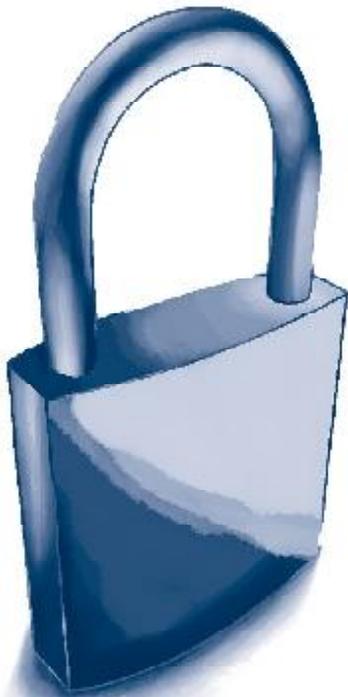
The government first issues an invitation to all interested companies to participate in the bid for the construction of the bridge to Cocos Island, and for the operation of the bridge for a term of 50 years.

Once the participating companies submit their proposals, the government will determine the winner and award the contract for the construction and operation of the bridge.

## Chapter 11

# Secured Transactions

## Introduction



When addressing certain issues, such as, mergers and acquisitions, restructurings, starting business operations in Mexico, and acquiring the essential assets for business, among others, two questions often arise:

Where and how does an individual or entity obtain the necessary capital to accomplish a project? How is payment of a credit transaction guaranteed?

The most important issue when entering into an agreement granting a security interest is selecting the correct choice of transaction for the parties to enter into in order to meet the needs of both parties – the lender and the borrower.

Therefore, it is necessary to analyze the range of possibilities offered by Mexican law, taking into account the most important elements and distinctive features of each project. These elements often include the economic capacity of the borrower, credit references (if applicable), the particular characteristics of each project, the payment structure, the repayment period for the amount due, and other characteristics.

## KEY POINTS

### A. Security Interests (linked to assets).

- Pledge or pawn. Personal property which is physically delivered to the lender in order to ensure the fulfillment of the obligation.
- Pledge without the transfer of possession. A security interest in personal property held by the lender without the physical delivery of the property in order to ensure the fulfillment of the obligation. This kind of interest can be granted over all of an individual's or entity's assets, and accounts receivable of a business.
- Mortgage. A security interest, generally in real property, held by the lender without the delivery of the asset in which the lender holds a passive right to retain the property until the obligation is discharged. If the obligation goes unmet and certain conditions apply, the property can be sold and the amount received on the sale applied to the original debt.
- There are also industrial, maritime, and aeronautic mortgages.

### B. Personal Guaranties (obligations which require an individual or company to personally pay debts).

- Promissory Note. A negotiable instrument which generates an unconditional promise in writing to pay a specified amount to the payee. This document is considered an executive title because it is enforceable through a summary proceeding that can be brought by the payee which allows for the seizure of goods in order to recover the amount due.
- Solidary Obligation or Guaranty. When a person besides the principle debtor assumes obligation for the same debt. This person is bound for the entire performance of the obligation, which may be enforced upon this additional debtor under the same terms and conditions as the principal debtor. Solidary obligation is analogous to joint and several liability in common law.
- Commercial Letter of Credit. Normally used in international transactions. It allows the vendor of merchandise to receive payment through a bank, who will only pay upon receipt of documentation evidencing the delivery or shipment of goods purchased.
- There also exist instruments such as a Standby Letter of Credit and Surety.

### C. Trust. A contract where the debtor conveys property or ownership rights to a trustee for the benefit of a creditor as a security interest for an obligation. The trustee holds legal title and manages the assets which have been provided as a security, and will retain title and management for the duration of the contract. The trustee manages the assets for the benefit of the creditor, and accordingly will be obliged to pay the creditor if the debtor fails to comply with its obligation towards the creditor.

### 1. Obtaining resources through financing:

- ↳ Economic capacity
- ↳ Credit references
- ↳ Amount of funding
- ↳ Payment schemes
- ↳ Terms, etc.

### 2. Assets which can be used to create a security interest

- ↳ Personal property
- ↳ Real estate

### 3. Types of secured transactions

- ↳ Collateral or security interests
- ↳ Personal
- ↳ Both

## QUESTIONS AND ANSWERS

### 1. What types of pledges exist, and what are the primary differences?

There are two types of pledges: The civil pledge which is governed by private civil law and the pledge without the transfer of possession which is regulated by commercial law. In both types, the creditor acquires a security interest.

a) The civil pledge has as a requirement that the property pledged must transfer possession, this is achieved by: (i) the delivery of the pledged asset to the creditor; (ii) the endorsement of the security agreement to the creditor; (iii) the delivery to the creditors of non-negotiable instruments and the corresponding registration; (iv) the deposit of the goods in a place where they are available to the creditor; or (v) the deposit of the goods in a depository designated by the creditor.

b) The pledge without transfer of possession allows the debtor to retain possession of the collateral. It is especially useful because the collateral can be intellectual property rights, accounts payable, inventory, or the entire assets of an individual.

The contract for a pledge without the transfer of possession must be notarized and registered with the Public Registry of Commerce.

Although the creditor has the right to seek a court order for the sale of the pledged assets, the creditor can become the owner of the property through the enforcement of the pledge only with the written authorization of the debtor. This authorization must be granted after the pledge is formed.

### 2. What are the requirements that a mortgage loan must meet in order to be enforceable against third parties?

The loan must be notarized before a notary public and registered in the Public Registry of Property in the locality where the property is located.

It is also important to note that registration fees vary from locality to locality, and are usually correlated to the property value, and thus should be considered an important expense.

3. Can any company enter into a security agreement with a third party?

Yes, as long as this type of activity is allowed for in the articles of incorporation or bylaws. Before entering into a security agreement, it is essential to review the articles and bylaws of the company in order to ensure that this type of activity is permitted.

4. What are the advantages of using a promissory note in credit transactions?

A promissory note is a document whose preparation involves minimal legal costs, the legal means for executing collection is accomplished through an executive commercial court, and the resolution is much faster than an ordinary trial.

## CASE STUDY

“Company X” is a Mexican company which was formed in 2000 as a Variable Capital Corporation (S.A. de C.V.), and which has never purchased real property. In 2009, the company seeks to purchase the machinery necessary to begin production in Mexico, and not focus solely on the import and sale of products.

In order to purchase the machinery, “Company X” has applied for financing with a foreign lender, who in order to grant credit requires the provision of sufficient collateral to assure the loan repayment within 10 years.

**a) Although the company does not own any real property, can “Company X” grant a security interest?**

If the foreign lender necessarily requires collateral in order to grant the requested funding, it is possible to enter into a contract for a “Fixed Asset Loan” which is a loan extended by a bank for the purpose of financing the purchase of machinery. The machinery becomes the security interest for the loan. Thus this type of transaction is considered a pledge without the transfer of possession, in favor of the debtor.

**b) If the lender requires additional collateral, what would be more convenient?**

Being that the company has no real property, the company should consider the possibility of making another pledge, be it a civil pledge or a pledge without transfer of possession over any other assets that the company holds.

Likewise, if necessary, the shareholders or the partners of the company can make a pledge against the shares or capital stock of the company.



## Chapter 12

# Bankruptcy

## Introduction

With the aim of regulating states of insolvency which commercial entities may face, a new bankruptcy law was adopted in 2000 which allows for the reorganization of a business through a process of conciliation with creditors, or allows for the commencement of a bankruptcy proceeding in the event that the continuation of the business is no longer possible. Individuals, businesses, and institutions engaged in commercial activities can be subject to a restructuring proceeding and/or bankruptcy.

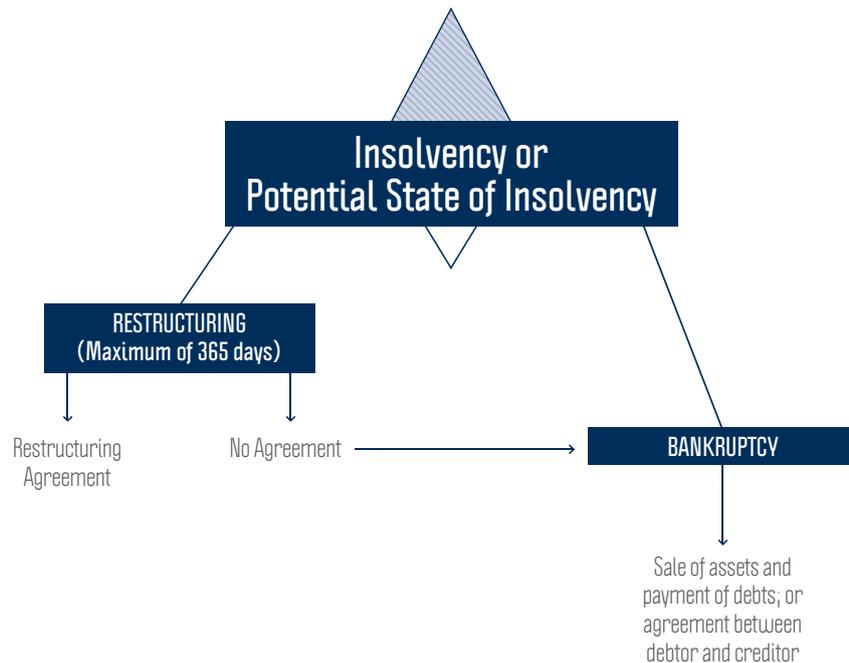
The UNCITRAL Model Law on Cross-Border Insolvency has been incorporated into Mexican law, allowing for the recognition of foreign insolvency proceedings.

The proceedings are divided into two categories: restructuring and bankruptcy. The duration of restructuring proceedings varies and depends upon the possibility of reaching an agreement which allows for the debt to be reorganized and for the debtor to continue conducting business, but cannot exceed 365 days. If the restructuring period expires without an agreement, then the bankruptcy proceeding begins. It is also possible to skip the restructuring proceeding and proceed directly to bankruptcy.



## KEY POINTS

- The objectives of the bankruptcy legislation are to: (i) create a system that encourages the restructuring of the debt of a business facing insolvency; (ii) provide greater certainty, a timetable, and help predict the results of bankruptcy proceedings; (iii) minimize the delays arising from litigation in the courts; (iv) separate the work of the court from administrative, commercial, and financial duties; and (v) establish rules for judicial cooperation in cross-border insolvency.
- There are three factors that are necessary in order to initiate a bankruptcy proceeding: (i) a commercial debtor, (ii) multiple creditors, and (iii) a general failure to pay obligations.
- There are 3 procedural bodies that handle commercial, administrative, and financial matters: (i) the investigator (before the proceeding); (ii) the mediator (during restructuring); (iii) the trustee (during bankruptcy). Legal matters are handled by the competent court. The Public Ministry also plays an important role in representing the interests of the Treasury, the workers, or other public institution that may be a creditor.
- In the case of bankruptcy and the sale of assets, the trustee will pay creditors in the following order: tax liabilities, labor liabilities, secured creditors, and then other creditors.



## QUESTIONS AND ANSWERS

1. When is a debtor considered to be in a general state of non-payment of obligations?

When: (i) the debtor has debts due to at least two creditors that are at least 30 days overdue, and that overdue amount represents 35% or more of the debtor's total debts; or (ii) the debtor does not have sufficient liquidity to meet 85% of its outstanding debts. The determination that a debtor is in a general state of non-payment of obligations is made at the time the bankruptcy proceeding is initiated.

2. In the case of a cross-border bankruptcy proceeding, can the trustees in the foreign proceeding participate in the Mexican proceeding?

Yes, principally when a request for provisional measures has been made over the assets of the debtor that are located in Mexico. Mexican trustees have the power to intervene in foreign proceedings, in accordance to the Model Law.

3. Which is the competent court for a bankruptcy proceeding?

The competent court is the federal court where the debtor's business is located. However, in the case of concurrent jurisdiction, a local court can also hear the proceeding.

4. What happens if the debtor and the creditors reach an agreement during the restructuring proceeding?

The agreement is formalized and must be approved by a judge of the competent court. The agreement then becomes mandatory for both the debtor and the creditors, and the bankruptcy proceeding terminates.

5. What happens if the restructuring period expires without an agreement being reached with the creditors?

The judge will declare the start of the formal bankruptcy proceeding, in which the trustee replaces the mediator. The trustee takes possession of the debtor's assets in order to manage them, and ultimately sell them and pay creditors. The primary goal is to sell the business as a unit, in case it is not possible to sell the assets separately.

## CASE STUDY

“Company A” is a Mexican company that makes auto parts and accessories. Its main clients are major automakers. As a result of the financial crisis in late 2008, “Company A” was involved in various credit transactions which increased their liabilities. This coupled with the external factors, such as a drop in the number of product purchase orders from clients, resulted in “Company A” being in a state of insolvency.

**Who can initiate a bankruptcy proceeding?**

“Company A” can initiate a proceeding, or a group of creditors with whom “Company A” already has past due debts can also initiate a proceeding.

“Company A” can request the initiation of an investigative stage in order to determine if the company can be restructured. The investigator can determine if the restructuring proceeding should begin, or if the company is in such a state that it should proceed directly to bankruptcy.

**In the case of bankruptcy and the sale of assets, can “Company B,” a company that also manufactures auto parts, acquire “Company A”?**

The acquisition proposal of “Company B” should be presented to a judge for approval. The primary goal is to purchase the business as a whole unit, although in doing so “Company B” also assumes all the liabilities of “Company A,” such as tax and labor liabilities.

## Chapter 13

# Litigation and Dispute Resolution

## Introduction

The Mexican legal system regulates various types of dispute resolution: legal proceedings, arbitration, and mediation.

The parties enter into agreements about the application of the law, methods of dispute resolution, and appropriate jurisdiction, all of which must meet the requirements established by Mexican law in order to prevent annulments or frauds against the law. In the case that no agreement has been entered into, the law also establishes rules for determining jurisdiction.

With the goal of implementing important reforms, Mexican rules for arbitration have been adopted from the UNCITRAL Model Law.

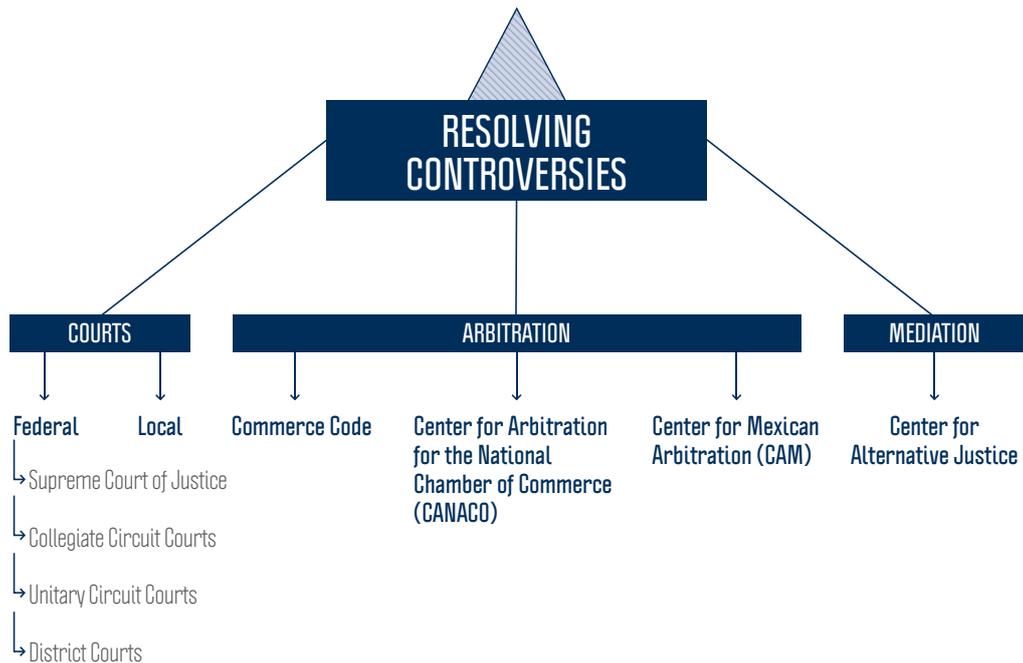
Likewise, with the goal of expanding access to justice and resolving conflicts through non-confrontational methods and alternatives to litigation, our system regulates mediation in various fields.

The Mexican legal system expressly regulates the application of foreign laws by Mexican judges, as well as the recognition, validity, and enforcement of foreign awards and judgments, which are intended to have effect in Mexico as long as they comply with the requirements established by law.



## KEY POINTS

- In order for the law to be enforced and for a court to exercise jurisdiction over a dispute, both parties should express a willingness to enter into litigation in the locality where one of the parties is located, where the obligation was supposed to take place, or where the object of litigation is located.
- Mexican laws on arbitration shall apply to domestic and international arbitration provided that they take place in Mexico.
- Mediation is used in family, civil, commercial, and criminal matters as a way to resolve disputes between individuals.
- The recognition and enforcement of court judgments issued abroad is subject to the compliance of that judgment with the formal requirements of Mexican law. With regard to the enforcement of foreign arbitral awards, Mexico is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (The “New York” Convention)



## QUESTIONS AND ANSWERS

1. How long can an ordinary trial in Mexico last?

Approximately two years, including an amparo proceeding, which is a procedural remedy which seeks to restore rights when a violation of rights guaranteed under the Federal Constitution has occurred. The length of a trial very much depends on the complexity of the matter and the workload of the courts.

2. Will a foreign judgment related to the performance of a mortgage loan for a property located in Mexico be recognized and enforced in Mexico?

No. In accordance with Mexican law, foreign judgments resulting from actions *in rem* (real property and certain types of personal property) cannot be enforced in Mexico.

3. In the event that parties have submitted to arbitration as a way of settling a dispute, can one of the parties request provisional measures for relief?

Yes. A party can ask the court to allow for the adoption of provisional measures for relief. For example, a party can (i) request prejudgment attachment of assets, when there is a risk that these assets will be hidden or lost; and (ii) request that a third party –such as a banking institution– freeze a bank account of the defendant, or seize payment from a company that owes money to the defendant with the intention of securing payment for an outstanding creditor, but in a way which avoids double payment by the third party if the defendant later does not comply with the judge's orders.

4. Can a Mexican judge apply foreign law when hearing and deciding a case?

Yes. Foreign law should be applied in the same way the law would be applied in its original forum, so that all the relevant laws and doctrines are taken together to ensure the proper application of the law.

5. According to Mexican law, what happens if a case is filed in Mexican court despite the fact that the parties have expressly submitted to the jurisdiction of a foreign court?

In principle, the Mexican court should not exercise jurisdiction in the case, and it should be dismissed. If no determination has been made over whether the Court can exercise jurisdiction in the case, it is the responsibility of the defendant to raise the issue of competence before the court. Otherwise, the defendant is said to have implicitly submitted to the jurisdiction of that court, the judge will continue with the trial, and the defendant will be barred from raising the issue of jurisdiction on appeal.

## CASE STUDY

An English company has initiated an arbitration proceeding against a Mexican company because of an alleged breach of contract. The parties had previously agreed that grievances would be resolved through arbitration and under English law. The parties proceed through all stages of the arbitration and an award is issued, faulting the Mexican company and requiring the company to pay damages. Following British procedure, the award issued from the arbitration conducted in the U.K. is forwarded to a Mexican judge for recognition and enforcement against the defendant residing in Mexico.

### Is possible to annul the arbitral award in a Mexican court?

No. The Mexican judge can refuse to recognize and enforce the award, but cannot nullify or suspend it. That power rests solely with the judge in the country where the award was issued.

### How long does it take for a court to recognize and enforce an arbitration award?

Approximately two months from the issuance of the award. In the event that the defendant challenges the award, the period of recognition and enforcement can last up to 6 months.

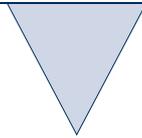




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