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MEXICAN LEGAL UPDATES

Alberto de la Peña

Haynes and Boone, LLP (Dallas)

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Midland, Texas



Overview

- 1. Political and Economic Situation**
- 2. Energy Sector**
- 3. Acquisition of Real Estate**
- 4. Financing and Security Interest**
- 5. Pending Legal Reforms**
- 6. Mexican Free Trade Agreements**

1. POLITICAL AND ECONOMIC SITUATION

POLITICAL SITUATION

- **President Vicente Fox, Mexico's first opposition party president in modern times, took office on December 1, 2000**
- **Divided Government for Mexico**
- **Congress:**
 - PRI 42.30% (Center)**
 - PRD 10.50% (Left)**
 - PAN 39.96% (Right)**

ECONOMIC SITUATION

- **Unemployment Rate 2004: 4.35%**
- **Inflation Rates**

1998: 18.6%	2002: 5.70%
1999: 12.3%	2003: 3.98%
2000: 9.0%	2004: 4.82%
2001: 4.4%	
- **Per Capita GDP 2004: US\$5,855.2 (20% more than 2003)**
- **Growth for 2003: 1.5%**
- **Forecasted Growth for 2004: 3.1%**



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2. ENERGY SECTOR



ENERGY INDUSTRY MACROECONOMICS

- **The energy sector plays an important role within the national economy:**
 - **Provides 3% of the Gross Domestic Product**
 - **Represents 8% of the total Mexican exports**
 - **Provides 37% of the Federal Income**
- **In the next 7 years, the energy sector needs US\$139 billion dollars of investment to meet the demand:**

USD 59 billion:
electricity

USD 40 billion:
oil exploration and production

USD 21 billion:
natural gas

USD 19 billion:
refining

ELECTRICITY SECTOR

- **Nationalized in 1960.**
- **Strategic activity**
 - **Strictly reserved to the state**
 - **No private participation is allowed, with few exceptions**
- **The Nation has the exclusive right of:**
 - **power generation**
 - **transmission, and**
 - **distribution of electricity as a public utility (public service)**

ELECTRICITY SECTOR (cont.)

- **The Nation carries out all activities related to the Electricity Industry through the state owned:**

CFE

Comisión Federal de Electricidad

- Generation
- Transportation
- Distribution

through out Mexico as a public utility

LFC

Luz y Fuerza del Centro

- Limited Generation
- Limited Distribution

in central part of Mexico

These companies have no subsidiaries.

Electricity Sector (cont.)

- **In 1992, the Electric Utility Law was amended to allow private parties to build, own and operate:**
 - **Power plants to sell generation capacity to CFE through Power Purchase Agreements,**
 - **Power plants to generate electricity for non public utility purposes (self supply),**
 - **Generation plants for exports, or**
 - **Facilities to import electricity for self supply purposes**

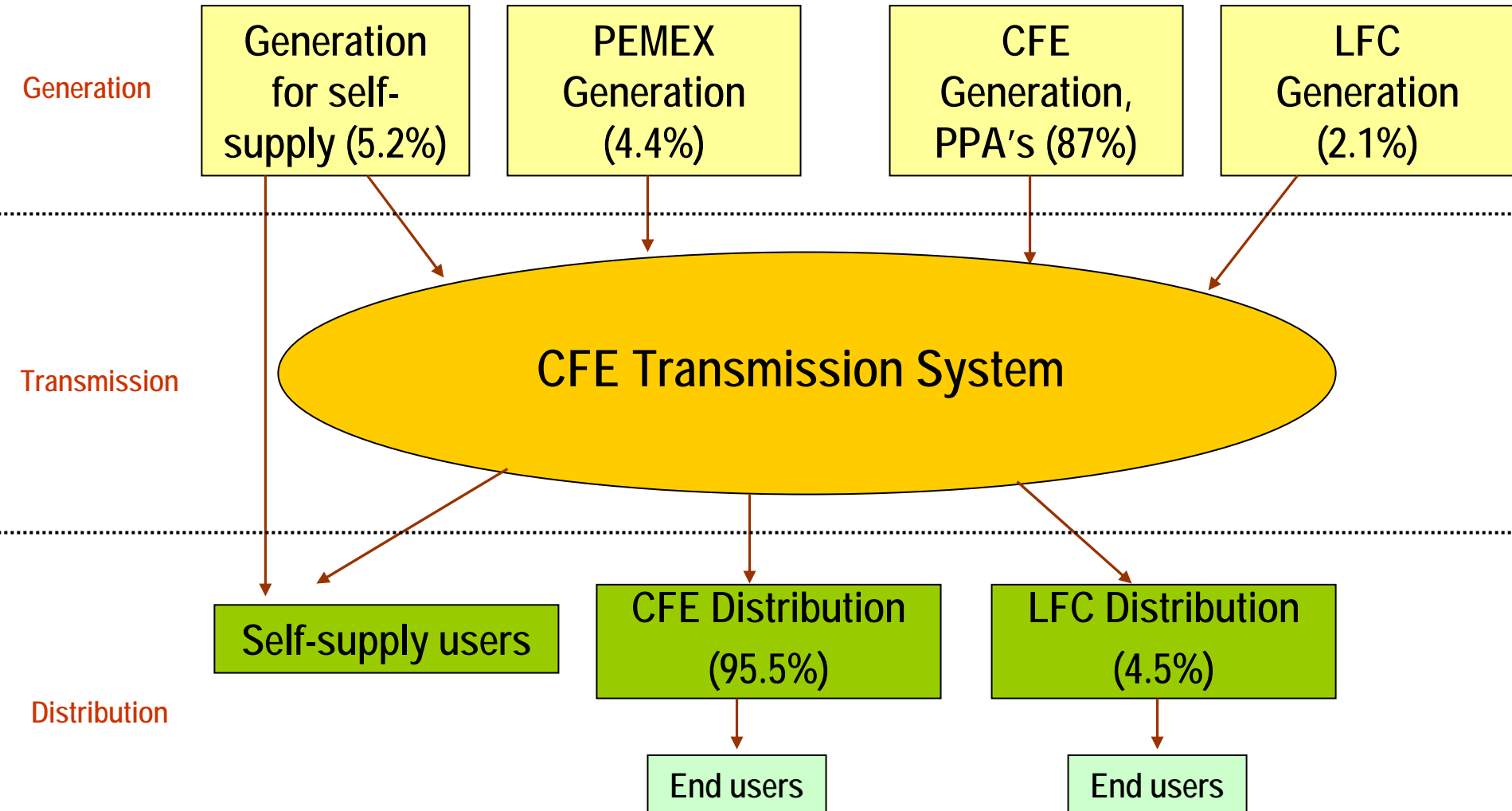
ELECTRICITY SECTOR (cont.)

- **Self-Supply Projects:**
 - **Cogeneration and gas fired plants**
 - **Generation permit from the CRE required**
 - **No foreign investment restrictions**
 - **Designed for a group of users to form a corporation which will own and operate the power plant**
 - **Users must be a stockholder of the generation company and be included in the permit title to receive electricity**
 - **CFE and LFC transmission and distribution systems may be used by entering into a wheeling agreement which is regulated by CRE**
 - **Numerous companies have already procured their own source:**
 - **Cemex**
 - **Vitro**
 - **Colgate**
 - **Kimberly Clark**
 - **Dupont**
 - **BASF**
 - **Uniroyal**

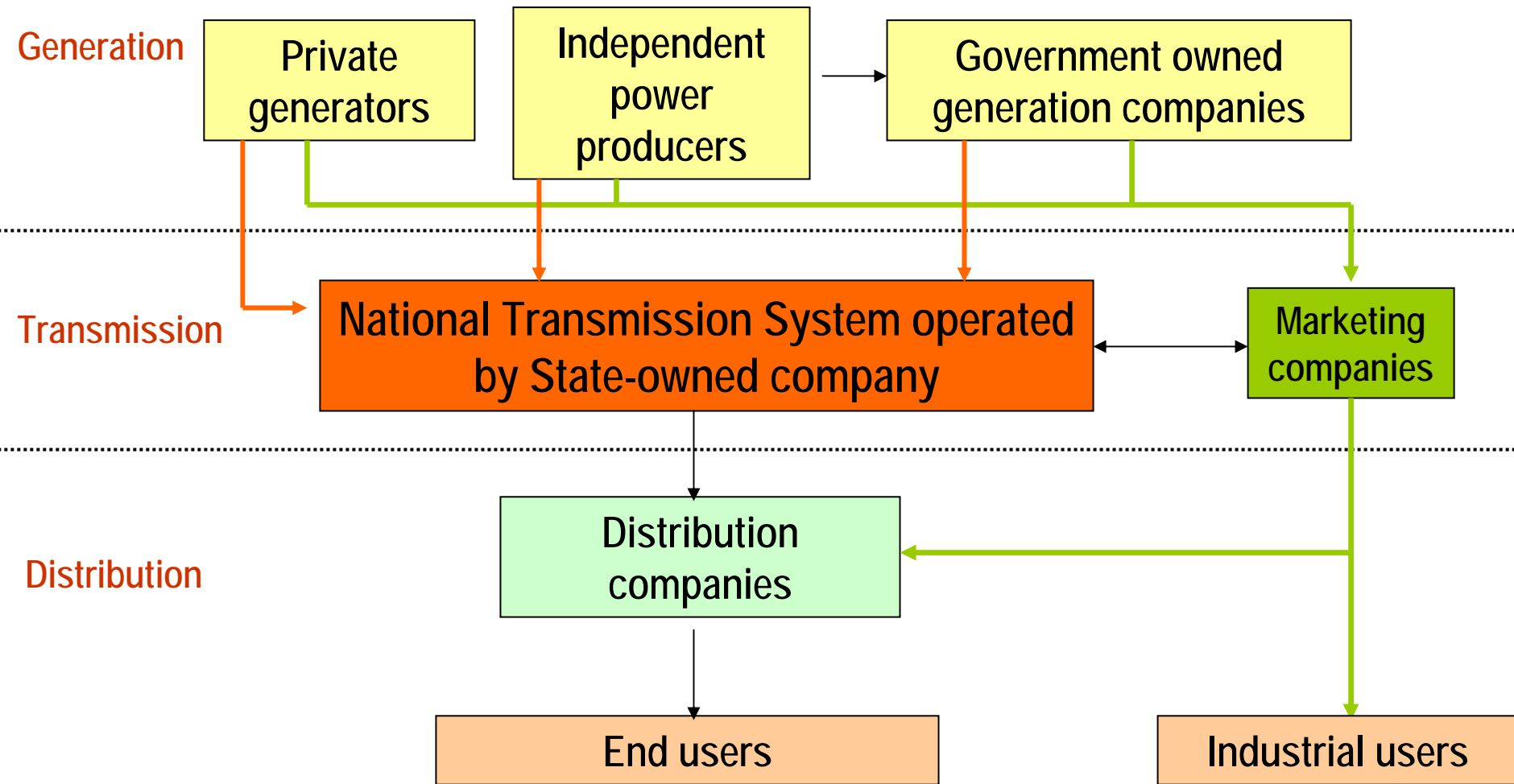
ELECTRICITY SECTOR (cont.)

- **Power Purchase Agreements (PPAs) with the CFE:**
 - **Awarded through public bid procedures**
 - **Long term (25 years)**
 - **IPP generation permit from the CRE required**
 - **granted only to Mexican entities who have entered into a PPA with CFE**
 - **no foreign investment restrictions**
 - **Financed through “PIDIREGAS,” a mechanism designed by the government to develop infrastructure projects**
 - **Payment is guaranteed by CFE and considered public debt.**

Current Organization of the Electricity Industry



Proposed Organization of the Electricity Industry by Fox



GAS INDUSTRY

- **Source of national pride**
 - **Nationalized in 1938**
- **Strategic activity by the Mexican Constitution**
 - **Strictly reserved to the state**
 - **No private participation is allowed, with few exceptions**
- **All hydrocarbons located in Mexican territories belong to the Nation**
- **The Constitution reserves to the Nation the exclusive right to:**
 - **Explore, exploit, refine and process crude oil and natural gas**
 - **Produce basic petrochemicals and artificial gas (LPG)**
 - **Make first hand sales of these energy products**

GAS INDUSTRY (cont.)

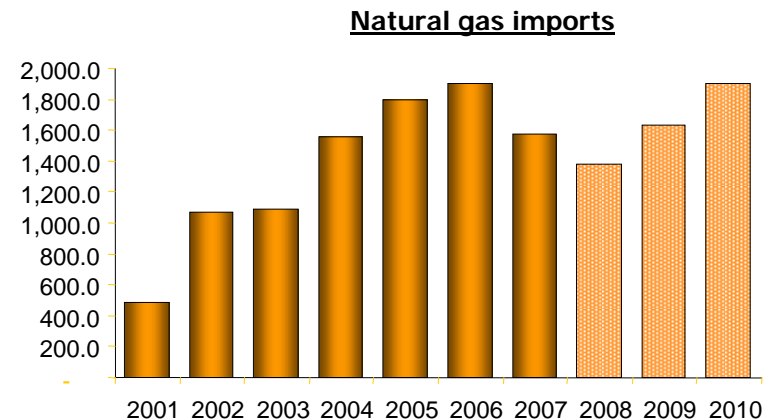
Downstream Gas

- **In 1995 legislation was passed to allow private investment in the downstream gas sector**
- **Private parties may own and operate gas transmission, storage and distribution systems through a permit granted by the CRE**
- **In order to sell or market the gas, permit holders may:**
 - **buy the gas from PEMEX**
 - **import it from the US**
- **Relationship between gas and power**

GAS INDUSTRY (cont.)

Increase Natural Gas Imports

- Imports have increased substantially in the past few years and could top 1.5 BCFD.
- There are no restrictions to import gas into Mexico by private parties using own infrastructure
- New pipeline infrastructure across the border is under development



GAS INDUSTRY (cont.)

LNG Storage Plant Development

Three or four LNG receiving terminals may be built by private parties:

- One or two terminals in Rosarito, Baja California (1 BCFD)
- One terminal in Lazaro Cardenas (250 MCFD)
- One terminal in Altamira (1 BCFD)



GAS INDUSTRY (cont.)

Lack of Investment in Natural Gas

- **Federal government relies on Pemex for approximately 1/3 of its revenue**
 - **Leaves Pemex with inadequate funds to reinvest in new exploration and production projects**
 - **Pemex invests more of its limited funds in crude oil activities**

ENERGY SECTOR (cont.)

- **Pemex has awarded multiple services contracts (MSC) for execution, development and maintenance of non-associated natural gas fields in the Burgos area**
- **Energy reforms are urgently needed to foster private investment in generation of electricity in Mexico**
- **Natural gas demand will continue to expand significantly**
- **Inadequate supplies and insufficient infrastructure will affect Mexico's economic development**

3. ACQUISITION OF REAL ESTATE

ACQUISITION OF REAL ESTATE

- **State Law**
- **No Foreign Investment Restrictions except in Restricted Zone**
- **Procedure:**
 - **Review Public Registry of Property (certificate of no liens)**
 - **Obtain certificate of no tax debts from local treasury**
 - **Review zoning**
 - **Review environmental issues (ground pollution)**
 - **Formalization before Notary Public (no escrow accounts. Payment usually made through wire – transfer / certified check)**
- **Acquisition subject to local transfer tax to be paid by buyer (Usually around 2% of value plus Notary fees)**

ACQUISITION OF REAL ESTATE IN RESTRICTED ZONE

- **Restricted Zone Definition**
 - 100 Kms from borders
 - 50 Kms from coastal shores
- **Residential purposes**
 - Key test: → Intent to permanently live on property
 - Trust is available

ACQUISITION OF REAL ESTATE IN RESTRICTED ZONE, *continued*

- **Non-residential purposes within restricted zone**
 - Foreign investors may own via Mexican entity
 - Trust is also available

ACQUISITION OF REAL ESTATE IN RESTRICTED ZONE, *continued*

- **“Non-residential purposes”
include:**
 - Time-sharing
 - Industrial, commercial, and touristic activities where one also lives at same time

4. FINANCING AND SECURITY INTEREST

A. Lending

- **Lending in Mexican territory may be subject to authorizations depending on each case:**
 - **Mexican Bank** – No foreign investment restrictions
 - **SOFOL (Bank-non-Bank)** – **51% Mexican**
 - **Mexican company in lending activities with private funds**
- **Lending in U.S. to Mexican companies is not subject to regulation in Mexico**
 - **Except for withholding tax on interest**

B. Security Interest

1) Mortgage (“hipoteca”)

- **Object:**
 - » **Real Estate**
 - » **Concessions**
 - » **Vessels**
 - » **Airplanes**
- **Formalities:**
 - **Formalized in Public Deed by Notary Public**
 - **Recorded in Public Registry**

2) Guaranty Trust (“fidecomiso de garantía”)

- **Object: Secures obligations with any type of personal or real property**
- **Formalities:**
 - **May be formalized in Public Deed by Notary Public, depending on the case**

3) Pledge Without Transfer of Possession ("Prenda Sin Transmisión de Posesión")

- **Object:** Secures obligations with any type of personal property of borrower, including inventory and future property. No transfer of possession is required
- **Formalities:**
 - Formalized before Notary Public and recorded in Public Registry



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5. PENDING LEGAL REFORMS



Pending Legal Reforms (cont.)

- **Energy** — To allow private investment (electricity)
- **Tax** — Increase tax collection by
 - simplifying tax regulations, and
 - increasing the number of tax payers

Pending Legal Reforms (cont.)

- **Labor** — Create more flexible rules for hiring and firing employees
- **Social** — Mexico has to substantially increase investments in education and social programs to reduce the levels of poverty

6. FREE TRADE AGREEMENTS

NORTH AMERICA - NAFTA (United States and Canada)

MIDDLE EAST - ISRAEL

LATIN AMERICA

URUGUAY



BOLIVIA



CHILE



COSTA RICA



COLOMBIA



VENEZUELA



NICARAGUA



SALVADOR

GUATEMALA

HONDURAS

NEGOTIATIONS WITH MERCOSUR



EUROPE

EUROPEAN UNION



EUROPEAN ASSOCIATION



OF FREE TRADE:

LIECHTENSTEIN

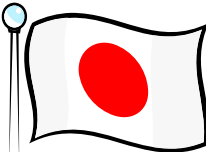
NORWAY



SWITZERLAND



JAPAN (01/01/05)



Thanks!

Alberto de la Peña

Haynes and Boone, LLP

901 Main Street Suite 3100

Dallas, Texas

Tel. 214-651-5618 Fax. 214-200-0580

delapena@haynesboone.com

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www.haynesboone.com