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Corporate M&A

Mexico: Law & Practice

José Víctor Torres, José Ignacio Rivero Andere,
Hernando Becerra and Jacinto Ávalos
González Calvillo, S.C.

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MEXICO

Law and Practice

Contributed by:
José Víctor Torres, José Ignacio Rivero Andere, Hernando Becerra and Jacinto Ávalos
González Calvillo, S.C. see p.13

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1. Trends

1.1 M&A Market

The second year of Mexico's new administration, under left-wing president Andrés Manuel López Obrador (AMLO), is now underway with continuing uncertainty in the Mexican economy, protectionist policies, austerity, and controversial reforms. Moreover, the overall landscape continues to be unclear. On one hand, the federal government continues to deliver blows to, and create uncertainty in, domestic and foreign investment – examples of these include the extremely reduced level of public spending that has halted the economy; the implementation of policies to revert the energy reform, which had been generating significant wealth in Mexico; the stubborn cancellation of infrastructure projects such as the partially built new Mexico City airport; the continued rhetoric used by the President against certain projects in particular (eg, renewable power); and the commencement of infrastructure projects, the viability and use of which have been questioned, such as the Santa Lucia Airport and the Tren Maya. On the other, there have been positive notes worth mentioning – these being significant action taken against corrupt figures in the prior administrations, such as Rosario Robles, Juan Collado, Genaro García Luna and Emilio Lozoya; a steady peso-dollar exchange rate; and the ratification by Mexico and the US of the USMCA.

In the M&A sector in Mexico, according to public sources, in 2019 there were 169 registered transactions with a consolidated value of approximately USD16 billion, which represents a 25% decrease with respect to 2018.

There are mixed opinions amongst expert analysts as to what to expect in the M&A sector in 2020. On the one side, there is an expectation that M&A activity will grow due to the markets having more clarity on the goals of the Mexican government and the effects of such goals on Mexico's economy after two years of AMLOs administration; the expectation of a significant increase in public spending as promised by the Mexican government; the implementation of the USMCA; the potential downgrade of Mexico's rating from investment grade, which could lead to certain funds being required to sell their positions in Mexico; and the buyers' market that currently exists due to the technical economic recession that is happening in the country. On the other hand, another group of analysts continue to forecast a decrease in M&A transactions, mainly due to the increased uncertainty that AMLO's administration has created; and the poor conditions of the Mexican economy that have generated a significant decrease in private spending and thus a reduction of investor appetite in the Mexican market.

1.2 Key Trends

In the first six months of 2019, M&A activity in Mexico mostly involved domestic transactions, showing less cross-border activity than in previous years. Most M&A transactions took place in the industrial, financial (including fintech), mining and real estate sectors, with a significant reduction in transactions in the energy sector, which was a driver of the Mexican economy in the last years of the Peña Nieto administration. In addition, new trends that are spearheading transaction growth in Mexico are centred in the start-up sector, as more and more buyers are looking into these companies to acquire IP, data, and engineering prowess – experts forecast that this will be key in years to come.

In addition, there was considerable expectation that cannabis and cannabis-related products would be legalised in Mexico in 2019, which would have implied strong investment opportunities paired with M&A deals. However, such legalisation is still ongoing and is now expected for late 2020.

1.3 Key Industries

According to public sources, the most relevant sectors that showed M&A activity in Mexico in 2019 were the industrial, financial, mining and real estate sectors, with consumer goods, retail, and IT following close behind. There were 24 transactions in the industrial sector, followed by 21 in the financial and mining sectors each, and 20 in real estate. Two large deals also involved infrastructure operators and developers. Additionally, no tender offers for publicly traded companies were launched during 2019.

2. Overview of Regulatory Field

2.1 Acquiring a Company

Company acquisitions in Mexico can be carried out through a wide array of structures or means. Acquisitions are usually implemented at either the shareholder level (equity purchases, mergers and public tender offers – the last one only in the case of publicly traded companies), or the asset level (through asset transfers paired with asset purchase agreements). As in most jurisdictions, the rationale for a buyer to choose one or the other mainly depends on the risk and liabilities the buyer is willing to assume, the tax implications that may arise therefrom and the nature of the target and the transaction itself.

An acquisition process generally entails:

- the negotiation and implementation of a "memorandum of understanding" or "letter of intent";
- the conduction of due diligence on the target;

- where applicable, obtaining merger clearance from the antitrust regulator – in Mexico this would be the Mexican Federal Antitrust Commission (*Comisión Federal de Competencia Económica*);
- the implementation of the relevant purchase agreement and other transaction documents; and
- additionally, where acquisitions are in regulated sectors, authorisation from the corresponding governmental body.

2.2 Primary Regulators

Generally, in Mexico there is no particular regulator overseeing M&A transactions. That said, depending on the characteristics of the deal – for example, the nature of the target, the sectors involved (non-regulated v regulated), deal size – the following agencies may be involved:

- the Federal Antitrust Commission (*Comisión Federal de Competencia Económica*, or COFECE), which authorises and issues merger control measures for transactions (other than those related to telecommunications and broadcasting) that meet the relevant thresholds (deal value, participant size, and concentration of assets) set forth in the Federal Antitrust Law (*Ley Federal de Competencia Económica*, or FECL);
- the Federal Telecommunications Institute (*Instituto Federal de Telecomunicaciones*, or IFT), which regulates transactions in the telecommunications and broadcasting sectors, and acts as the merger control agency in such sectors;
- the Mexican Banking and Securities Commission *(Comisión Nacional Bancaria y Valores*, or CNBV), which is the main financial and securities regulator in Mexico and, as such, it is in charge of overseeing transactions involving securities, financial institutions and publicly traded entities;
- the Mexican National Commission of Foreign Investment (*Comisión Nacional de Inversión Extranjera*, or CNIE), which authorises foreign participation in certain sectors that have foreign investment restrictions in terms of the Foreign Investments Law;
- the Mexican Social Security Institute (*Instituto Mexicano del Seguro Social*, or IMSS), which is the main authority regulating public health, social security and benefits, as well as pensions (in the M&A context the IMSS comes into play, in certain cases, when a transfer of employees takes place in the context of an asset deal);
- the Public Registry of Commerce (*Registro Público de Comercio*, or RPC), which records corporate acts that are generally implemented in M&A transactions; and
- the Public Registry of Property (*Registro Público de la Propiedad* or RPP), which records the transfer of real estate ownership titles in the context of asset deals.

Other authorities may come into play in an M&A transaction, depending on the industry of the target and the regulation of the relevant industry.

2.3 Restrictions on Foreign Investments

Mexico was, traditionally, protectionist with regard to foreign investment and several sectors were fully (or to some extent) reserved for Mexican investors. That said, for some time now, many of these protections have been cleared and most of the sectors comprising the Mexican economy have been fully liberalised.

Be that as it may, Mexico's Foreign Investment Law (*Ley de Inversión Extranjera*) still sets out certain restrictions applicable in a few strategic activities and sectors. Among these are the exploration of oil and other hydrocarbons, coin minting, the issuance of paper currency land passenger and freight transportation, and radio broadcasting.

2.4 Antitrust Regulations

Antitrust compliance, including concentrations and monopolies are regulated by Article 28 of the Mexican Constitution, international treaties, the FECL and its regulations.

The FECL sets out that certain concentrations are subject to pre-merger clearance review by COFECE, based on the value of the transaction and/or the size of the parties involved. The relevant amounts used to calculate the value of transactions and assets are expressed in units that are adjusted on an annual basis, known as the *Unidades de Medida y Actualización*, or UMAs. For 2020, one UMA is equivalent to MXN86.88, approximately USD4.57.

Pursuant to the FECL, the following transactions must obtain prior authorisation from COFECE before closing:

- transactions worth, directly or indirectly, more than 18 million UMAs (approximately USD82 million);
- transactions resulting in the accumulation of 35% or more of the assets or stock of an economic agent with annual sales originating in Mexico, or assets in Mexico, worth over 18 million UMAs (approximately USD82 million); and
- transactions resulting in the accumulation in Mexico of assets or capital stock worth over 8.4 million UMAs (approximately USD38 million) and involving two or more economic agents with annual sales originating in Mexico, or assets in Mexico, worth over 48 million UMAs (approximately USD219 million).

Merger clearance is almost always jointly requested by both parties and is typically structured as a condition to closing.

2.5 Labour Law Regulations

To the extent mergers or acquisitions are carried out at the stock-ownership level with the target entity remaining unaffected, then labour related issues are normally minimal. That said, if the transaction involves the actual transfer of assets (including employees) from one entity to another, then Mexico's Federal Labour Law (*Ley Federal del Trabajo*, or FLL) and its regulations set out the rules to be followed for such a transfer.

The most common way to acquire or transfer employees in Mexico is either to: (i) terminate the labour relationship of the targeted employees with their current employer (ie, the seller) and have them subsequently re-hired by a new employer (ie, the purchaser); or (ii) to carry out an employer substitution pursuant to the FLL, which entails an automatic transfer of employees.

In general, the first process will provide for the payment of accrued salaries and benefits to the terminated and re-hired employees.

The second process operates as a matter of law when a "transfer of business" is deemed to occur. The employment relationship of any transferred employees remains unaffected, in the sense that the purchaser would acquire the obligations and rights of seller (as the previous employer). Likewise, employment conditions and benefits cannot be modified, and seniority is recognised.

Finally, both processes must be assessed with the specifics of a deal in mind as joint-liability, severance, and liability (among other concerns) must be dealt with accordingly.

2.6 National Security Review

All transactions, including acquisitions, are subject to the applicable regulatory framework, including tax and anti-money laundering provisions. In that regard, Mexico has a well-established framework and a system for detecting illegal transactions. In particular, the Ministry of Tax and its specialised agency for preventing and detecting transactions carried out with illicit resources, or for money laundering purposes and the financing of terrorism, and the Financial Intelligence Unit (UIF), are the main governmental agencies continuously reviewing transactions in Mexico.

3. Recent Legal Developments

3.1 Significant Court Decisions or Legal Developments

As a civil law-based country, decisions by Mexican courts do not, in general, create precedents and their application and effects apply strictly to the parties involved. That being said, there is one exception to the foregoing: *jurisprudencia*, which creates general application precedents and results from five uninterrupted court resolutions by the Mexican Supreme Court or Federal Circuit Courts in the same sense, or from a resolution from the Supreme Court or from a Federal Circuit Court resolving two contradictory resolutions from such jurisdictional bodies.

In addition to the foregoing, and due in part to the reasons explained above, *jurisprudencia* decisions rarely take place specifically in the M&A sector in Mexico. However, decisions regarding other matters, such as those relating to the environment or tax, may influence M&A-related sectors.

The last high-profile judicial resolution pertaining to an M&A deal in Mexico was issued in 2015 and resulted in Grupo México being barred from increasing its position in Grupo Aeroportuario del Pacífico, as a consequence of breaching the latter's "poison pills". This case was finally resolved by the Mexico Supreme Court in favour of Grupo Aeroportuario del Pacífico and it was the first time the validity of a poison pill in a Mexican publicly traded company was subject to judicial scrutiny.

3.2 Significant Changes to Takeover Law

The rules regarding takeovers of Mexican publicly traded companies are set out within the Mexican Securities Market Law and its regulations. There have not been any recent significant changes to such takeover regulations in Mexico nor are any expected in the coming year.

4. Stakebuilding

4.1 Principal Stakebuilding Strategies

It is common for a bidder to build a stake in a target entity prior to launching an offer for a public company; however, such an accumulation of stock will be subject to:

- clauses used to prevent hostile takeovers, known as poison pills, in the by-laws of the potential target;
- disclosure provisions that require acquirers to disclose acquisitions of shares in the potential target upon reaching certain thresholds; and
- mandatory public tender offer requirements (which generally entail that a bidder who seeks to acquire 30% or more (including control) of a public company's capital stock must do so through a tender offer).

Regarding stakebuilding strategies in publicly traded companies, these will normally depend on business considerations, poison pills, and legal restrictions applicable to the target and thus they cannot be generally described.

4.2 Material Shareholding Disclosure Threshold

Shareholding disclosure and general filing obligations are applicable to public companies in Mexico. Regarding shareholding disclosure, the following requirements must be met:

- any person or group of persons who acquire shares in a publicly traded company, resulting in them holding an equity interest equal to or greater than 10% but lower than 30%, must inform the general investing public on the next working day;
- related persons, as per the Mexican Securities Market Law definition, of a publicly traded company who increase or decrease their equity interest in the company by 5% must inform the general investing public on the next working day; and
- any person or group of persons who holds 10% or more of the shares representing the capital stock of a publicly traded company must inform the CNBV of any acquisitions or sales of shares during any calendar quarter within five working days from the end of the relevant quarter.

This final point applies when the total trading amount performed by the person(s) in the applicable quarter is equal to or exceeds the equivalent in Mexican pesos of 1 million Investment Units (*Unidades de Inversión*). In addition, the person or group of persons shall inform the CNBV about the acquisitions and sales carried out within five working days, when the total amount traded in such term is equal to or exceeds the equivalent in Mexican Pesos of 1 million Investment Units, on the next working day after the day the amount is reached, calculating the value of the Investment Unit on the day of the last trade.

As to other filing obligations of publicly traded companies, they must generally and continuously disclose quarterly and yearly reports regarding the overall status of the company, as well as relevant events and material acts that are relevant to the issuer in its different areas and which might influence the stock value.

It is essential to note that the above-described reporting thresholds do not obviate the need to file an antitrust clearance petition if the underlying amounts paid or to-be-paid meet or exceed the thresholds mentioned in **2.4 Antitrust Regulations**. This is especially relevant given the intrinsically confidential nature of an accumulation build-up before a securities filing needs to be made because it may bring undesired attention. Hence, special focus needs to be put into ascertaining that the COFECE clearance is processed and obtained in the strictest of confidence.

Finally, as of the end of 2018, under the General Law of Commercial Companies (*Ley General de Sociedades Mercantiles*, or LGSM), private corporations must confidentially inform certain governmental authorities of their shareholders and of any stock transfers. This requirement was implemented to monitor and prevent money laundering and other fraudulent schemes from being implemented through the incorporation of companies.

4.3 Hurdles to Stakebuilding

It is possible for a company to introduce higher reporting thresholds to the extent that they benefit the general investing public. Lower thresholds would clearly violate the provisions of the Mexican Securities Market Law as they will be to the detriment of public investors.

Other common hurdles are poison pills in the by-laws of public companies, which can include:

- the authorisation by the board or shareholders of certain acquisitions;
- minimum acquisition pricing requirements; and
- the implementation of tender offers.

These poison pills generally apply in cases of acquisitions over certain percentages of the capital stock (ie, 10%, 20%, etc) or acquisitions that would result in a change of control.

4.4 Dealings in Derivatives

Dealings in derivatives are permitted in Mexico and the Mexican Securities Market sets out the specific requirements to be complied with in such cases.

4.5 Filing/Reporting Obligations

In general, the same reporting obligations for shareholding disclosure, tender offer and poison pill requirements are applicable to derivatives, whose underlying assets are shares of a public company, as to the shares themselves.

Additionally, public companies are required to disclose their positions in derivatives, including those in which the underlying assets are their own shares. Banks and other financial institutions are required to file reports before Mexico's Central Bank (*Banco de México*) with respect to the transactions they carry out connected to derivatives.

4.6 Transparency

In the case of a publicly traded company, shareholders have to make known the purpose of their acquisition and their intention regarding control of the company. Once a bidder seeks to reach a position of 30% or more, or to gain control of a publicly traded company, it must do so by launching a mandatory tender offer for the company's publicly traded stock. Special requirements may apply under poison pills. To that end, pursuant to the general provisions applicable to Issuers and Other Securities Market Participants (known as the *Circular Única de Emisoras*) any such bidder must disclose, in its prospectus:

- the intention and reasoning for the tender offer being executed;
- the bidder's purposes and plans once the offer has been made; and
- the capital structure of the target company before and after the offer.

5. Negotiation Phase

5.1 Requirement to Disclose a Deal

Generally, all agreements made prior to launching (written or verbal) that are:

- consummated;
- executed between potential buyers, shareholders, and/or directors of the public target company; and
- related to such public target company, its shares, or the tender offer for its shares,

must be disclosed at the moment in which the offer is launched.

Also, specific disclosure requirements (eg, relevant events – *eventos relevantes*) regarding the existence of the aforementioned agreements, may apply when the public target company is part of, or has knowledge of, prior agreements; although, generally, the disclosure can be postponed until the definitive agreements are signed and the acts provided have been consummated.

The tender offer filing may be treated as confidential until its authorisation and announcement. Regarding the target company, within ten days of the tender offer launch at the latest, its board of directors must issue a public opinion as to whether it considers the price offered by the bidder reasonable from a financial perspective. In issuing such an opinion, the board:

- must take into consideration the opinion of its corporate practices committee; and
- may engage an independent expert to issue a fairness opinion to serve as the basis for its corresponding opinion.

Other than a confidential filing to certain governmental authorities under the LGSM, there are no material disclosure obligations for private companies.

5.2 Market Practice on Timing

Generally, the timing of disclosure in typical market practice does not differ from legal requirements.

5.3 Scope of Due Diligence

Where a private target company is being acquired, due diligence is typically conducted under a broad scope with the purpose of weeding out potential contingencies and liabilities. Depending on the target entity itself, due diligence will cover anything from general corporate organisation and standing to tax matters, loans and other financial commitments, intellectual property, labour and workers' compensation, litigation, environmental issues and property.

In contrast, for the purchase of a public company, due to its nature and to material non-public information provisions, due diligence is generally limited to publicly available information. In addition, and as in private acquisitions, representations, warranties and indemnities can be agreed in favour of the purchaser.

5.4 Standstills or Exclusivity

Standstills and exclusivity arrangements are possible in the context of public acquisitions but are not necessarily common based on available Mexican precedents (there are a handful of precedents of tender offers in Mexico, out of which only two are related to a change of control).

As for private acquisitions, standstill and exclusivity provisions are often included in the transaction documents.

5.5 Definitive Agreements

It is permitted to document tender offer terms and conditions in a definitive agreement.

6. Structuring

6.1 Length of Process for Acquisition/Sale

The length of a process for acquiring or selling a business in Mexico will vary depending on several factors, including the type of the target and/or assets, the competitive dynamic (ie, whether an auction process is being run), the amount and scope of due diligence required, the closing conditions to which the transaction is subject, and the time needed to fulfil applicable regulatory requirements (including sector-specific requirements and merger clearance from the COFECE). Although timing will be highly specific to each transaction, generally speaking, the process will take a minimum of three to four months from the beginning of discussions to closing.

6.2 Mandatory Offer Threshold

Mexican law does not provide for any mandatory tender offer requirement in the case of the acquisition of shares of a privately owned company.

Regarding publicly traded companies and subject to certain exceptions, any person who intends to acquire (or to reach by any means) 30% or more (including control) of the company's shares, is required to conduct the acquisition through a mandatory tender offer for:

- if the acquirer does note gain control of the company, the higher of:
  (a) the percentage of the company's shares that the acquirer intends to acquire or
  (b) 10% of the company's shares; or
- 100% of the company's shares, if the acquirer intends to obtain control of the company.

Special requirements may apply under poison pills included in the target company's by-laws.

6.3 Consideration

Cash is predominantly used as consideration payable to target shareholders in the acquisitions of both private and public companies.

Stock (or some combination of cash and stock) is sometimes used when acquiring a private or public company, though only a few stock-for-stock acquisitions of publicly traded Mexican companies have taken place in Mexico, in each case by another public company through an exchange offer.

6.4 Common Conditions for a Takeover Offer

Tender offers for Mexican public companies are generally conditional on the bidder obtaining a certain percentage of the company's shares. In other words, a bidder will not be required to close on the acquisition if a certain number of public shareholders do not agree to the terms of the offer. Another common condition is the receipt of applicable regulatory approvals.

Mexican law affords the bidder full flexibility in defining the conditions of its offer, provided that such conditions are not contrary to the law, morality or public order. The regulator will require that any conditions be clearly set forth in the offering memorandum.

6.5 Minimum Acceptance Conditions

Common minimum acceptance conditions for tender offers in Mexico imply the acceptance by at least the number of shares that allows the bidder to obtain either control of the target, or the supermajority required by Mexican law to approve the delisting of the target (95% of all shares).

6.6 Requirement to Obtain Financing

Acquisition transactions or business combinations in Mexico may be conditional upon the bidder obtaining financing, but this is not common practice. Debt commitment letters are sometimes used to provide comfort to the seller that the buyer will indeed have the monetary resources to close on the deal.

6.7 Types of Deal Security Measures

A bidder may seek any type of deal protection measure, including break-up fees, matching rights, non-solicitation provisions and force-the-vote provisions.

In the context of a publicly traded company, the approval or opinion of the board of directors could be required regarding such measures, depending on their nature, whereas for a privately owned company, the role of the directors in a takeover situation is limited.

6.8 Additional Governance Rights

In a private company context, a bidder for a non-controlling interest would typically seek protections with respect to governance and information rights, and transferability of its shares.

Governance rights can include the right to designate members of the company's board of directors and supermajority voting or veto rights regarding relevant matters (for example, sale of assets, approval of annual budget, initiation of litigation, and others). Information rights can include the right to receive periodic financial information and operating reports, as well as a general right to make reasonable requests for additional information. Transferability provisions can include a right to cause the company to list the shares held by the bidder for trading in public markets, as well as tag-along and drag-along rights.

Regarding public companies, a minority shareholder would generally settle with the protections afforded by the target company's by-laws in line with the requirements set forth in the Mexican Securities Market Law.

6.9 Voting by Proxy

In Mexico, shareholders can vote by proxy on the decisions adopted at a shareholders' meeting. Shareholders of public companies typically vote by proxy. With regard to public companies, the proxy form must be prepared by the company and made available to shareholders at least 15 days in advance of the shareholders' meeting. The proxy form must comply with basic requirements of the Mexican Securities Market Law (ie, it must include the company's name, the meeting agenda and enough space for shareholder instructions). Proxy solicitation is not common in Mexico.

6.10 Squeeze-Out Mechanisms

For private companies, Mexican law permits the redemption of shares as a squeeze-out mechanism, whenever it is expressly contemplated in the company's by-laws.

In principle, squeeze outs are not permitted for public companies under Mexican law. However, shareholders of public companies may agree to call options (to be provided for in the company's by-laws or a shareholders' agreement) that could be employed as a squeeze-out mechanism. Also, the participation of minority shareholders could be diluted as a result of a capital increase approved in a shareholders' meeting, although all shareholders have a pre-emptive right to acquire new shares issued as a result of the capital increase in proportion to their shareholding percentage.

6.11 Irrevocable Commitments

There has been limited experience of takeover offers in Mexico. Whether a buyer seeks to obtain irrevocable commitments from the principal shareholders of a target company to tender and/or vote in favour of a transaction is highly transaction-specific.

As most Mexican companies have a defined controlling shareholding, including those that are publicly held, such an attempt would seem unlikely to achieve a successful takeover offer without some sort of agreement with the principal shareholders. It would make sense for such an agreement to be negotiated during the early stages of the transaction, but timing also depends on the specific circumstances.

7. Disclosure

7.1 Making a Bid Public

If the target company is privately owned, there is no requirement for a bid to be made public, and a bid would not generally be announced.

In principle, publicly traded companies must disclose a bid to the public through the publicising of a relevant event as soon as it gains knowledge of negotiations that could result in a change of control. This includes all relevant information regarding the proposed transaction (ie, the acquirer and the seller, the number/percentage of shares to be acquired and the purpose of the acquisition). The target company may choose to delay disclosure of the bid until the bidder launches a public tender offer for the shares of the company (see below), as long as no information on the proposed transaction is leaked to the public.

Since the acquisition of 30% (special requirements may apply under poison pills included in a target company's by-laws) or more (including control) of a public company is required to be conducted through a public tender offer (with the previous authorisation of the CNBV), any acquisition bid (negotiated or hostile) would be made public by the bidder during the process of launching the required offer, through the publication of the respective offering materials as required by Mexican regulations.

7.2 Type of Disclosure Required

In connection with a merger or other business combination involving a public target where the shares of the bidder would be issued as consideration payable to target shareholders, the bidder (assuming it is also a public company) would need to disclose, prior to the transaction, an information statement containing details of the transaction (including the share exchange ratio, the business combination rationale and the pro-forma shareholding structure following the transaction), general information of the entities involved in the transaction (ie, bidder and target), and financial information (including pro-forma financial statements) of the bidder.

In the case described above, where the bidder is not a public entity, it is also required to register its shares with the Mexican Securities Registry, which would entail a full authorisation process with the CNBV.

None of these requirements would apply in a business combination between private companies.

7.3 Producing Financial Statements

Only in cases of merger, or any other business combination where shares of the bidder would be issued as consideration, would the bidder need to disclose financial information (including pro-forma financial statements), as stated in **7.2 Type of Disclosure Required**. Financial statements of the bidder (assuming it is publicly listed in Mexico) would be required to be presented in accordance with International Financial Reporting Standards (IFRS).

7.4 Transaction Documents

Transaction documents are subject to disclosure to the extent they constitute prior agreements or offering documents, as required by the applicable regulators, in the case of publicly traded companies.

Privately owned companies are not subject to disclosure requirements in connection with business combinations.

8. Duties of Directors

8.1 Principal Directors' Duties

Directors of public companies are expressly required by law to act in good faith and in the best interest of the company; to avoid conflicts of interest; and to keep confidential all non-public information, within what the law addresses as a duty of care (*deber de diligencia*) and a duty of loyalty (*deber de lealtad*). Lack of fulfilment of these duties carries liabilities, including criminal ones, which can be pursued through specific actions. Directors owe a duty to the company, not to a particular shareholder.

Board members are statutorily required to refrain from taking advantage of business opportunities available to the company.

Under the special action afforded by the law against board members based on a breach of their duty of care or their duty of loyalty, liability for damages can be claimed by the company itself or shareholders holding 5% or more of the company's stock. The Ministry of Tax, with the prior agreement of the CNBV, is the only body that may initiate an action arising from criminal liability.

Except for an action arising from wilful misconduct or certain illegal actions, including those related to a conflict of interest, directors' liabilities may be limited by the company's by-laws. Indemnity and directors' and officers' insurance is also allowed, subject to the same exceptions.

Board members are expressly required to keep confidential all non-public information they hold as a consequence of their role, generally and in relation to business combinations.

A business combination often results in the replacement of board members. New board members are required to disclose to the audit committee and external auditor any irregularities they know of arising from the performance of the duties of their predecessors. otherwise they will be held jointly liable.

For private companies, specific duties regarding confidentiality and conflicts of interest apply to directors in terms of the General Law of Business Organisations.

8.2 Special or Ad Hoc Committees

Members of the board with a conflict of interest in a business combination are statutorily required to refrain from voting on the conflicted business combinations and from attending related board meetings.

Public companies are mandated to have committees in charge of corporate practices and auditing functions; it is precisely these committees that will be in charge of analysing and assessing the merits of potential business combinations. Such committees must be composed of independent directors, subject to exceptions. It is not common for a board of directors to establish an ad hoc committee as such bodies are usually created by law (such as the corporate practices committee and the audit committee) or through the company's by-laws.

8.3 Business Judgement Rule

Board members are required to act in good faith and to exercise their duties by aiming at value creation for the benefit of the company, without benefiting specific shareholders. In that sense they must act with due diligence, making reasonable decisions and fulfilling all duties imposed on them under the law and the company's by-laws.

Directors of public companies, hearing the opinion of the corporate practices committee, are required to disclose their own opinion in connection with the price offered in a takeover situation and any conflicts of interest. This opinion can be supported by that of independent experts.

While the fact that directors fulfil their duties, including rendering an opinion in connection with a business combination, would be central in a court's decision on whether a business combination is supported legally and in business, that court could still review any aspect of a business combination in the context of legal actions exercised under the law.

8.4 Independent Outside Advice

For business combinations of both private and public companies, investment bankers commonly provide outside advice to directors.

As previously stated, with respect to public companies, directors are required to render an opinion on the reasonableness of the price offered from a financial perspective and any conflicts of interest. The law also provides that the directors' opinions may be added to those of independent experts. Note that many business combinations are completed without independent outside advice.

Likewise, auditors' positions are of relevance in business combinations, in the form of reports directly related to the combination and through background (historical) information.

8.5 Conflicts of Interest

The requirement of not participating in deliberations in connection with business combinations, disclosure obligations, committees' authority in connection with a conflict of interest, and limitations the law provides in defensive measures, have all helped avoid conflicts of interest in business combinations. However, competent authorities always carefully review these and, as a result, further judicial or other scrutiny is unusual.

9. Defensive Measures

9.1 Hostile Tender Offers

Hostile tender offers are permitted in Mexico. The law, and the by-laws of a potential target entity, may contain special provisions, including in connection with:

- rules based on minimum percentages to be acquired and acquisition of control;

- percentages subject to compulsory acquisition through public offering;
- protecting the target's shareholders through proper disclosure; and
- the offer, the acceptance and the process.

That said, hostile tender offers are rare in Mexico and there have only been a very small number in recent years.

9.2 Directors' Use of Defensive Measures

Mexican law allows directors to use defensive measures. These must be set out in the company's by-laws. The law expressly allows the by-laws to contain provisions aiming to prevent shareholders or third parties from directly or indirectly acquiring control of the company, subject to the following conditions:

- being approved by 95% of the shareholders present in a meeting;
- non-exclusion of non-tendering shareholders from any economic benefits resulting from the application of the defensive measure provisions;
- not entirely restricting the acquisition of control of the company;
- when implying board approval for the acquisition of a certain percentage of the company's shares, the provisions must include the criteria the board is required to observe in approving or disapproving the defensive measure, including the fact that this must not take longer than three months; and
- allowing for the proper exercise of economic rights of the acquirer.

9.3 Common Defensive Measures

In some private companies, the need for direct approval from the board to acquire controlling or even less-than-controlling percentages is a common defensive measure. In public companies, some are based on board approval subject to the limitations discussed. In this sense, super-majority voting, requiring higher than ordinary percentages to approve a merger, rather than simple majorities, may also be in place. Staggered boards are also a relatively common defensive measure. Voting-rights plans, which separate certain shareholders from their full voting powers at a predetermined point, may also be used under limitations provided in the law.

9.4 Directors' Duties

Directors are required to act under a duty of care and the duty of loyalty, as already mentioned in **8.1 Principal Directors' Duties**. As discussed in **8.3 Business Judgement Rule**, directors, hearing the opinion of the corporate practices committee, are required to disclose their own opinion regarding the reasonableness of the price offered and any conflicts of interest. Their opinion can be put together with that of independent experts.

9.5 Directors' Ability to "Just Say No"

For private companies, directors can indeed "just say no" and take action that prevents a business combination, if provided for in the by-laws of the target company.

In the case of public companies, directors cannot just say no and take action that prevents a business combination. Note that poison pills can only be implemented by a board of directors in the form and subject to the limitations listed previously, the law and the company's by-laws. This reduces the level of liability of directors when they do act under these limitations.

10. Litigation

10.1 Frequency of Litigation

As mentioned before, litigation is uncommon in connection with M&A deals in Mexico, particularly with respect to public companies. That said, the law has moved forward in recent years in expressly allowing freedom of parties in different types of Mexican entities to agree on drag-along, tag-along, puts, calls and other special rights.

10.2 Stage of Deal

As mentioned before litigation resulting from M&A deals in Mexico is not common. That said, if litigation were to be brought it would necessarily be after the negotiation and work-out stages are unsuccessful. The action of securities authorities in public companies will often prevent litigation, including a thorough preventive review. The fact that rights and obligations related to business combinations are clear enough under the law also helps to prevent litigation.

11. Activism

11.1 Shareholder Activism

Shareholder activism has not been a particularly significant opposing force in Mexico given the protectionist nature of the applicable statutes which imply strong regulation and disclosure.

Private equity, venture capital and strategic investment activity is considerable and generally occurs in the form of an approach to controlling shareholders and management. Negotiation with groups of minority shareholders is also frequently sought.

Minority rights are afforded to shareholders in private and public companies. In the case of the latter, such rights have a broader scope and lower thresholds for further protection.

11.2 Aims of Activists

There has not been significant activism on the part of hedge funds or other parties in Mexico. The activity of private equity, venture capital and strategic investors usually takes place through an approach to shareholders and management and negotiation with groups of minorities.

11.3 Interference with Completion

Activists do not usually interfere with the completion of announced transactions in Mexico. The disclosure, tender offer and offer acceptance process is carefully regulated by law. Activity by parties increasing their participation in public companies is progressive and subject to the disclosure, notice or authorisation requirements mentioned in this chapter.

González Calvillo, S.C. is a solution-centred Mexican firm with international reach whose M&A practice group has country-leading experience providing legal and business advice to foreign and domestic clients in all corporate, transactional and regulatory aspects of buying, selling or combining companies and businesses across regulated and unregulated industries, as well as working with entities of the Mexican government in strategic projects. The team participates in all types and sizes of domestic and cross-border transactions involving corporate matters, joint ventures, strategic alliances, planning and implementation of partnerships, negotiated acquisitions, public tender offers for acquisitions, spin-offs, split-offs, LBOs, privatisations, corporate restructurings, private equity, sales and purchases of all kinds of assets, stock, equity interests, and equity-type securities, minority stakes and assets, and capitalisations. The firm's M&A lawyers are knowledgeable in connected practice areas such as competition and antitrust, project finance, capital markets and general commercial legal issues, allowing them to offer broad support appropriate to complex and cross-border transactions.

Authors

José Víctor Torres is a partner at González Calvillo and a member of its steering committee. He is a seasoned transactional lawyer with ample experience as lead counsel in complex domestic and cross-border transactions, involving global mergers and acquisitions, acquisition financings, being continuously retained as local counsel by foreign firms for multi-jurisdictional transactions involving Mexico. Over the years, he has represented companies from both highly regulated and non-regulated sectors, including private equity firms, investment funds and companies in the telecommunications industry. Representative clients include Nissan and KIO Networks.

Hernando Becerra is a partner at González Calvillo and a member of its steering committee and its professional development committee. He has over 15 years of professional experience and has oriented his legal practice towards cross-border M&A (including the corporate and regulatory components thereof), and financing transactions. His practice includes advising local or foreign investors in the development of renewable energy projects in Mexico. He worked for three years as an international associate in the New York office of Milbank. Representative clients include IFM Investors, Cemex and Pattern Energy Group.

José Ignacio Rivero Andere is managing partner of González Calvillo and a member of its business development committee. He has over 15 years of experience providing legal and business advice to Mexican and foreign clients, in multimillion dollar domestic and cross-border transactions. He sits and actively serves on the board of directors of several leading Mexican companies, including Aleatica, Grupo Crédito Maestro and Resuelve tu Deuda. Representative clients include IFM Investors, BP, WSP Parsons, DICSA, Aleatica, Proeza, Rappi, Grupo Crédito Maestro, Cellpay, and Resuelve Tu Deuda.

Jacinto Ávalos is senior associate at González Calvillo and is actively involved in domestic and cross-border transactions related to mergers and acquisitions, banking and finance, capital markets and private equity. He is an active member of the Mexican Bar Association (BMA) and the National Association of Business Lawyers (ANADE). His experience includes working as an international associate at Latham & Watkins LLP in New York City. He obtained an LLM from the University of Pennsylvania Law School, and a Business and Law Certificate from The Wharton School, University of Pennsylvania.

González Calvillo, S.C.

Montes Urales 632
Lomas de Chapultepec
11000, Mexico City
Mexico

Tel: +52 55 5202 7622
Email: info@gcsc.com.mx
Web: www.gcsc.com.mx

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