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Trends & Developments

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practiceguides.chambers.com

2021

Trends and Developments

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Cannabis Legalisation in Mexico – Investment Opportunities in Agrarian Land

Mexico is on track to become a large marijuana market for a variety of reasons. On 9 March 2021, the Mexican Chamber of Deputies passed a Bill approving the Federal Law for the Regulation of Cannabis (FLRC), as well as the amendment to several provisions of the General Health Law and the Federal Penal Code. The FLRC regulates, among others, the recreational use of cannabis by adults (18 and over), as well as its cultivation and commercialisation (subject to obtaining appropriate licences). At the time of writing this article, final approvals from the senate and the president, who has expressed support for legalisation and making this a new area of economic opportunity in the country, are still pending. Mexico will join Canada and Uruguay in a small, yet growing, list of countries in the American continent that have legalised marijuana. According to specialists, Mexico's geographic location and climate make the country a particularly good place to invest in this market.

With a population of over 125 million people, Mexico is set to become one of the world's largest legal consumer markets of cannabis and its derivatives, and various opportunities in the real estate sector will come with this, including the acquisition and exploitation of land for cultivation and production of cannabis. The legalisation of marijuana in other countries has already started to impact their real estate industry. In the US, those states (15 at present) where medicinal and recreational use of marijuana has been legalised for more than three years, have seen an increase in the demand for commercial properties – specifically, 21% of such states have seen

an increase in the demand for land, 42% for storage space, and 27% have seen an increase in the demand for retail space, according to a report issued by the (US) National Association of Realtors.

Accordingly, Mexico will possibly have an increase in the demand for land suitable for the legal cultivation and production of cannabis, and hence, an increase in the demand for agrarian land, such as *ejidos*. The Centre of Studies for Sustainable Rural Development (Mexico) revealed that *ejidos* and communal property (both subject to the agrarian system) currently represents 52% of the total national surface, and the Bill of the FLRC explained that, during a period of no less than five years following its implementation, at least 25% of the cultivation licences should preferably be granted to farmers or *ejidos* in the municipalities in which the federal, state and municipal governments have previously carried out tasks to eradicate plantations of cannabis. Consequently, land subject to the agrarian system, such as *ejidos*, will most definitely play an important role in the real estate shift resulting from the new regulations.

National and foreign investors will be able to participate in the production and commercialisation of cannabis through different legal strategies, including the use and exploitation or acquisition of agrarian land.

A Brief Overview of Ejidos

To further outline the potential opportunities and strategies of investment to arise from these new regulations, it is important to explain briefly what

an *ejido* is and the special treatment of agrarian land in Mexico's legal framework.

An *ejido* is a legal entity mainly composed of Mexican agrarian workers with an initial estate of land granted by the government for its communal use and exploitation, subject, of course, to the provisions of the law. It is composed of a Meeting (*Asamblea*) of the people that have ownership rights in the land of the *ejido*, known as *ejidatarios*; an *Ejido* Representatives Board (*Comisariado Ejidal*); and a Surveillance Board (*Consejo de Vigilancia*).

Ejido land is not considered private property; it is subject to a unique system regulated by the Agrarian Law and there are special restrictions and procedures for the transfer of property, its use and exploitation. The land of *ejidos* is classified into three different types:

- common use lands (*tierras de uso común*), an area of the *ejido* co-owned by all the *ejidatarios*;
- human settlement lands (*tierras de asentamiento humano*), the residential area of the *ejidatarios*; and
- parcelled land (*tierra parcelada*), portions of land individually assigned to an *ejidatario* for its exclusive use and exploitation.

Each type has different restrictions and procedures for its acquisition or granting of use and exploitation.

Investing in cannabis through agrarian land

Even when the Agrarian Law allows for the transfer of *ejido* property, such land may only be purchased once a long, complex and time-consuming process of privatisation of said agrarian land has been completed; however, the law also provides for other mechanisms which would allow contribution of the land for investment purposes without transferring actual domain and thus,

going through the time-consuming process of converting the land to private property, or else allowing the project to commence and be developed while at the same time completing the process to privatise said *ejido* lands.

Subject to the special aspects of each transaction, such arrangements may involve, among others, merchandise purchase agreements, granting of use and exploitation rights, or the contribution of the use and enjoyment rights associated with the land to a company created for such purposes, depending on the cannabis-related activities investors choose to participate in, and the licence they seek to obtain.

The FLRC provides four available licences for commercial purposes:

- cultivation;
- transformation (preparation and production);
- sale; and
- export and import.

However, only one type of licence may be obtained by an individual or entity, so for instance, the holder of a cultivation licence may not obtain a sale licence. Such restriction extends to their partners, shareholders, subsidiaries, relatives, and spouses. Consequently, investors must first decide which activity they will invest in, seek to obtain the corresponding licence, and choose their investment strategy or commercial structure.

Any corporate framework will have to be carefully crafted so as to comply with applicable elements of the agrarian and civil codes, as well as the FLRC.

The following are general descriptions of some of the alternatives that may be used to participate in the cannabis market through the use of *ejido* property.

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Transfer of common use lands to a special purpose vehicle

The Agrarian Law allows the ownership of common use lands to be transferred by the *ejido* to companies where the *ejido* is a shareholder or partner for the development of a specific commercial enterprise. To that end, investors generally create a special purpose vehicle (SPV), a Mexican company in which the investors and the *ejido* are partners or shareholders, the sole purpose of which is to participate in those activities authorised by the FLRC, subject to previously obtaining the corresponding cannabis licence.

The transfer of ownership of common use lands entails a complex process similar to privatisation, including approval of transfer by the Meeting, and the requirement that the *ejido*'s equity participation in the company must be at least equal to the reference price of the land set by an appraisal.

Foreign investors should be aware that, pursuant to the FLRC, the participation of foreign capital in entities that hold a cannabis licence for commercial purposes is limited to 20% and that the use of an SPV or existing entity is mandatory for foreigners, as individuals applying for a licence must be Mexican nationals. However, there are sophisticated and serious traders in Mexico with whom foreign investors may establish joint ventures.

Granting of use and exploitation rights (usufructo) of parcelled land

The Agrarian Law also allows *ejidatarios* to enter into commercial relationships with investors. In this case, the use and exploitation rights over parcelled land can be transferred directly to said investors or companies where the *ejidatario* is a shareholder or partner, also for the development of a specific commercial enterprise. Under this scenario, the *ejidatario* does not need any government approval, or that of the *ejido*'s Meeting,

to the extent that the contribution mechanism is legal.

Investors may also enter into contracts with the *ejido* or the *ejidatario* to obtain the use and exploitation rights of agrarian land for the cultivation of cannabis. One way would be through a sharecropping agreement, whereby the SPV would receive from the *ejido* or the *ejidatario* the right to use and exploit the land during a specific term, and the parties would distribute the products of the harvest according to the terms and conditions of the agreement, providing the SPV does not receive less than 40% of the product, pursuant to the provisions of the Federal Civil Code, which will need to be revised against local civil codes to verify any possible percentage variations. Another approach would be through a lease, where the *ejido* or *ejidatario* grants the outright use of the land to the SPV, without the need to distribute the harvest among the parties. Once again, the corresponding cultivation licence would need to be obtained in advance.

Foreign investment limitations and O&M agreements

Foreign investment in legal entities that own agrarian land is initially limited to 49%. Such percentage may be increased when there is specific approval by the Ministry of Economy, but the excess capital must be represented by "neutral stock". The Foreign Investment Law (FIL) stipulates that it will be regarded as "neutral" when the investments are represented by shares without voting rights or with limited corporate rights, provided that prior approval has been obtained from the Ministry and when "it is applicable".

The language in the FIL is vague and allows corporate structures to be implemented making it possible for there to be negative control by foreign investors, but the spirit of the FIL is that Mexican investors must participate in the capital of legal entities that acquire agrarian land and

must have a majority of the voting stock. The actual day-to-day management is not restricted to being carried out by the foreign investor or by someone appointed by the foreign investor.

Operation and management agreements (O&M) are not regulated, so this allows for an appropriate operating structure to be implemented.

Merchandise agreements

Investors may also seek to exclusively obtain from the *ejido* or *ejidatario* the cannabis products for their subsequent transformation, or to obtain them from the transformation licensee for later sale or export and import. For such purpose, the structure commonly used implies that the *ejido* or *ejidatario* will receive a loan from the investors for the development of the project and will commit to repay the loan with the price to be paid for the product (cannabis) sold to such investors. The *ejido* or *ejidatario* are only authorised, however, to constitute use rights (*usufructo*) as collateral for the loan, which is a structure now commonly used for the exploitation of other agrarian products. The referred merchandise agreement would further grant the investor exclusivity rights over the products obtained by the *ejido* and/or the *ejidatario*, as the case may be.

Direct purchase of agrarian land (parcels)

Finally, investors may choose to purchase parcelled land for cannabis cultivation and production. As previously mentioned, this may involve a long and complex process of converting the land from agrarian property to private property. Parcels within the *ejido* are initially owned by the *ejido*, so through the privatisation process, the land is first assigned and transferred to particular *ejidatarios* who would then become full owners of their parcels and, at such time, would be legally entitled to commence the privatisation process to convert the land from the social regime of the *ejido* to a full ordinary private prop-

erty, and thus thereafter, be able to sell the same to the investors. Such process involves specific steps, including demarcation and assignment of parcels within the *ejido*, the *ejido* Meeting's assistance and specific approval, and administrative procedures before the National Agrarian Registry, among others.

The majority of parcelled land must first be properly marked and assigned to *ejidatarios*. Such requirement may be critical for a transaction if it has not been completed prior to the time of the desired acquisition; the participation of advisers and experts is therefore recommended to expedite time processes.

A call for the meeting of *ejidatarios* must be sent to all *ejidatarios*, and the Agrarian Attorney (*Procuraduría Agraria*) must be notified in order for the latter to render its opinion regarding demarcation and assignment of parcels, and to verify compliance with all relevant provisions. In the first call, at least 75% of the *ejidatarios* must be present to consider the meeting legally installed, and in the second or subsequent calls, 50% plus one *ejidatario* are required to be present. If not properly conducted and prepared, such requirement may present a hindrance, as *ejidos* are generally composed of a great number of *ejidatarios*.

In the meeting, if legally installed, two thirds of the present *ejidatarios* must vote in favour to approve the transfer. These are only some of the steps to legally purchase parcelled land – the agrarian law provides several other requirements, including recording procedures in both the National Agrarian Registry and the Public Registry of Property, in addition to the right of first refusal of family members, other *ejidatarios* and other prior users of the land, to acquire said parcels in the event of the first sale thereof, even if the parcel had long since been privatised. The minimum purchase price is determined by the

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National Assets Appraisal Commission or by a licensed bank. Overall, investors should be aware that the process for outright acquisition is usually slow, and consider alternative ways to enter the cannabis market.

Once they have chosen their investment path in this new and regulated sector, investors will need to seek experienced and specialised real estate-corporate legal counsel that can provide an effective and tested legal framework to mitigate risks and deliver prompt solutions in the challenges to come with the emerging cannabis market. An established counsel will be able to use thoroughly verified legal documents and strategies to give investors certainty and cost-effective results based on known market standards in the United States and Canada. Even if

the actual functioning of the cannabis market is yet to be determined, investors should be completely covered in all other legal aspects, from extensive due diligence to post-closing matters, whether they are investing in either agrarian or private property.

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